Issue N. 1
July 2004

The Privatization Barometer – PB
is a joint project of

FONDAZIONE IRI

Fondazione Eni Enrico Mattei

The PB Newsletter

A Quarterly Publication of the Privatization Barometer
www.privatizationbarometer.net

privatizationbarometer

Reporting on privatization in enlarged Europe

A fresh start ahead?

privatizationbarometer

THE WEBSITE ON PRIVATIZATION IN EUROPE

Contents

Reporting on privatization in the enlarged Europe

Please see important certifications and subscription information at the end of this issue.

The PB Newsletter
A Quarterly Publication of
Privatization Barometer
www.privatizationbarometer.net

Editor:
B. Bortolotti

Scientific Advisor:
W.L. Megginson

Researchers:
L. Farinola
V. Milella
E. Panetti

c/o Fondazione Eni Enrico Mattei - FEEM
Corso Magenta 63 20123 Milano - Italy
tel +39 | 02 | 5203.6931
fax +39 | 02 | 5203.6946
e-mail: info@privatizationbarometer.net

What is the PB Newsletter?

The PB Newsletter is a quarterly report on privatization activity in the enlarged European Union. It aims at monitoring the most recent trends, at analyzing aggregate data on revenues and transactions, and at providing updated statistics at the country and sector level.

The PB Newsletter highlights the most important deals, which are regularly commented on by privatization guru William L. Megginson. It also hosts contributed articles by top international scholars, who will make accessible to the reader the most recent results of professional research.

The Newsletter will also report on the PB indexes, a series of indicators which will follow the performance of equity investment in privatized companies in the EU.

Rigorous, updated, easily accessible and freely distributed on the web, the PB Newsletter is an authoritative source of information and a vehicle for a more informed discussion on the choices and consequences of privatization.

Privatization Trends in Europe

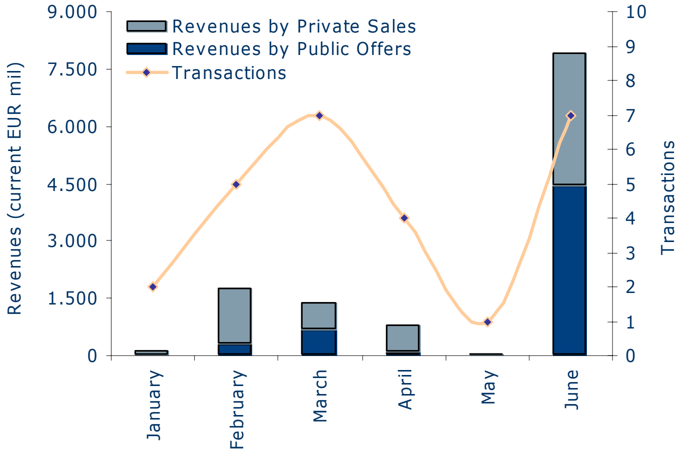
The process resumes after a global dip…

Privatization activity during the first semester 2004 involves 24 companies and is worth €12.07bn. Deals and revenues are approximately a half of the total reported in 2003, suggesting a consolidation of the slightly rising trend after the turn-of-the-century plunge. Privatization had a promising start in Q1 with numerous sales in the New Europe, especially in Poland and Hungary.

…thanks to a new wave of IPOs

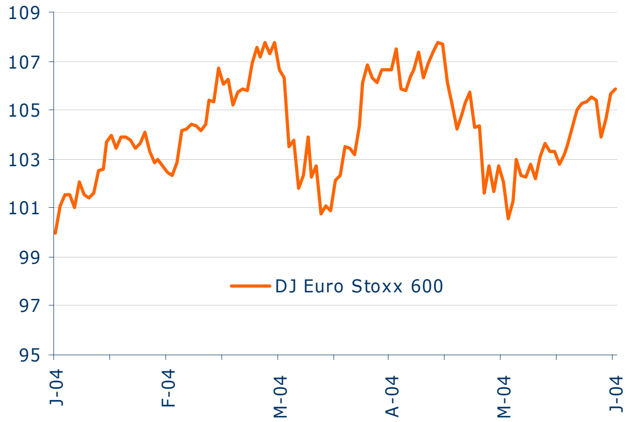
However, the bulk of revenues were raised during the month of June, when IPO fever revamped in the equity markets of the Old Europe (Figure 1). The resort to stock markets to float state-owned enterprises or their subsidiaries is an important recent phenomenon. Given that larger and usually more appealing companies are privatized in public equity markets, we forecast a slight end-of-year growth in privatization activity with respect to 2003, especially if the positive outlook of equity markets observed in late Q2 continues in the second semester (Figure 2).

Figure 1. Revenues and Transactions in Europe, 1H2004



Source: *Privatization Barometer*

Figure 2. Equity Markets in Europe, 1H2004



Source: *Datastream*

Almost all revenues are raised in Old Europe

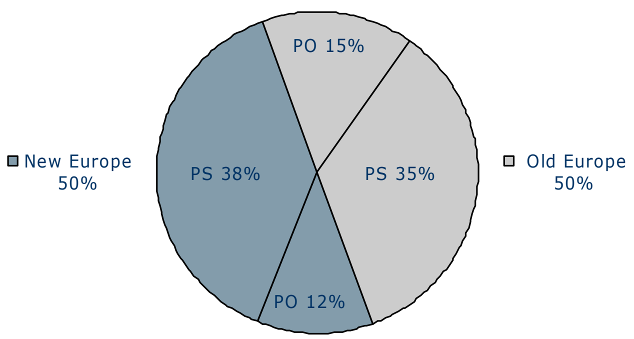
The number of privatization deals is evenly split between countries of Old and New Europe [(1)], with a similar distribution of transactions in public and private equity markets (Figure 3). As usual, stark differences emerge in the breakdown by revenues. The overwhelming bulk of proceeds are raised by government operating in EU15 countries (Figure 4). As to the choice of the privatization method in Old Europe, asset sales are still predominant in terms of revenue, despite the recent surge in share issue privatization.

Core EU15 countries get the lion's share but some accession countries are catching up

We report privatization activity in twelve nations of the enlarged European Union. Three countries of Old Europe-- France, Germany, and Italy--lead the country ranking thanks to operations yielding more than two thirds of total revenues in Europe. Interestingly, three accession countries, namely the Czech Republic, Hungary and Poland occupy prominent positions and overcome countries historically involved in large scale divestiture such as the United Kingdom. The Czech Republic ranks first among the countries of the New Europe thanks to the sale of a majority stake in the national oil group, which attracted international bidders. Major Polish sales are concentrated in the utility and telecommunications sectors. The Slovak Republic, the United Kingdom, and Lithuania occupy the last positions in the country ranking, each reporting one small scale transaction worth less than €0.5bn.

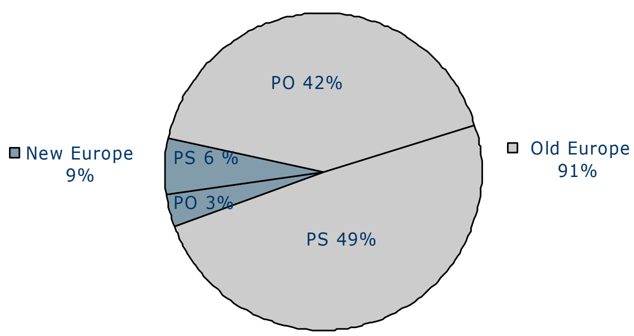
[(1)] The Old Europe includes: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom. The New Europe includes: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia

Figure 3. Transactions in Old & New Europe, 1H2004



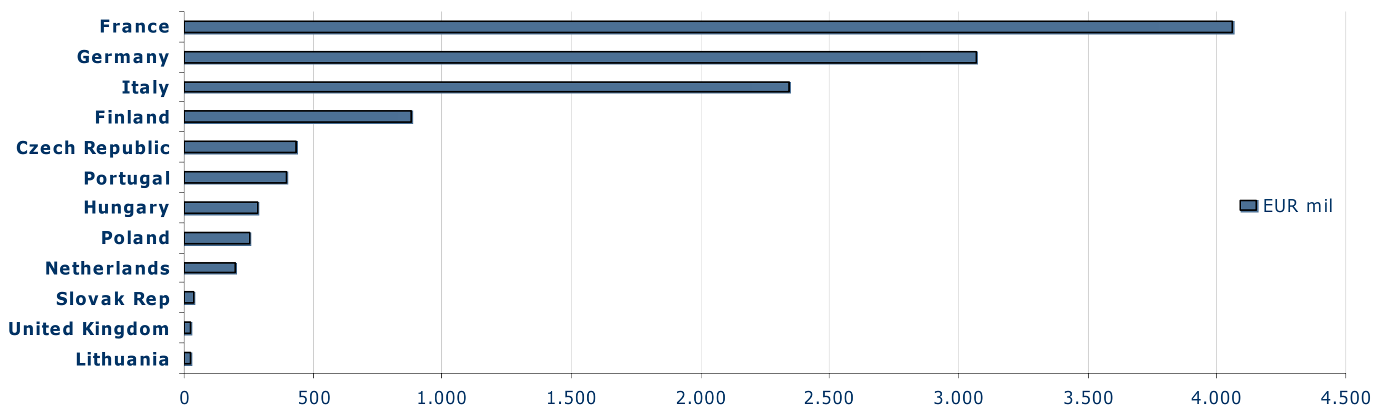
Source: *Privatization Barometer*

Figure 4. Revenues in Old & New Europe, 1H2004



Source: *Privatization Barometer*

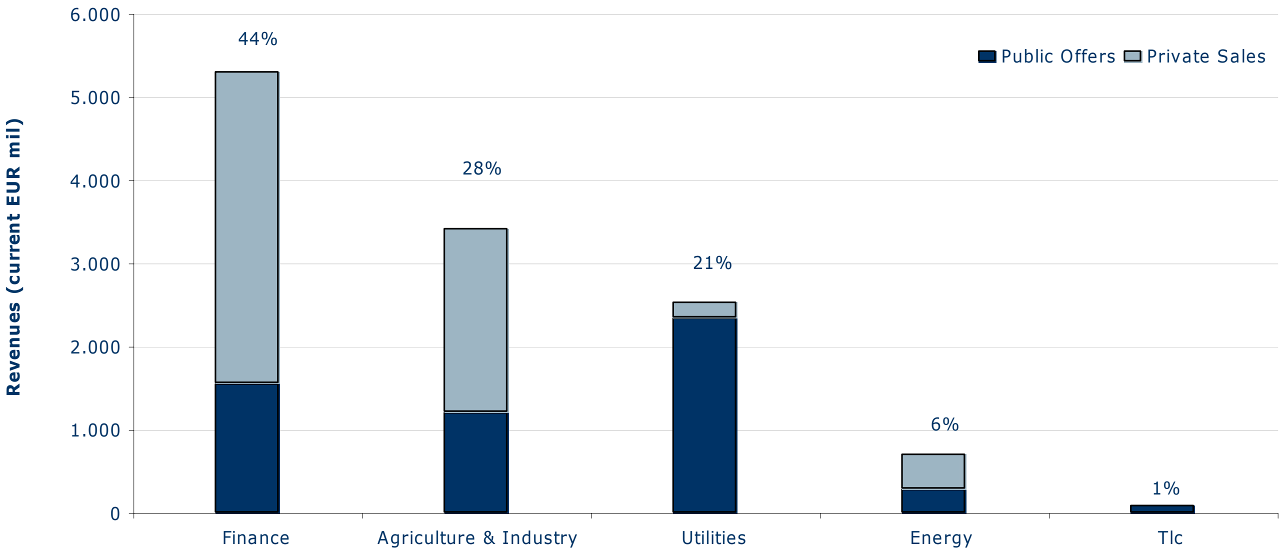
Figure 5. Country Ranking by Revenues, 1H2004



Source: *Privatization Barometer*

The resumption of the privatization process occurring in the semester can be ascribed to important operations in the financial sector. Indeed, four out of the top 10 deals reported in the period involve financial institutions: the direct sale of the banking business of Caisse des Dépôts (CDC), Eulia, the spin off of Deutsche Post banking assets Postbank, and the two equity placements of Sampo, the Finnish bank holding company. Taken together, these operations account for 44 percent of total revenues (Figure 6). Sales in manufacturing industries and utilities stand out being worth 28 and 21 percent of proceeds, respectively. Interestingly, with the exception of Italian sales of Snam Rete Gas and Terna, respectively the gas and electricity distribution systems, privatization in the utilities and energy sector appears concentrated in the countries of New Europe.

Figure 6. Distribution of Revenues by Sector, 1H2004



Source: *Privatization Barometer*

William L. Megginson

University of Oklahoma

A Hot June!

June IPO fever, but the largest deal is (still) a private sale

Although the first five and one-half months of 2004 saw relatively little privatization activity in Europe, the last two weeks of June more than made up for this early lull. Four major deals were launched between June 18 and June 30, accounting for over €7.3 billion in total revenues. Three of these were IPOs, but the single largest deal was a complex private sale. All four sales were executed by Old Europe governments. These four sales, plus the other major deals of 1H2004, are described below.

French Caisse des Dépôts and Consignations reorganizes its investment banking holdings

After several years of discussion, the French mutual bank Caisse d'Epargne acquired full control of the investment banking activities of Caisse des Dépôts et Consignations (CDC), the state-owned bank, in a complex deal worth more than €4 billion. Of this, €2.9 billion was paid by Caisse d'Epargne for the CDC's 50.1 percent stake in **Eulia**. Caisse d'Epargne financed this deal by a bond issue worth €3.3 billion ($4.01 billion). As a result of this complex deal - allowing the government to comply with EU requirements to end state guarantees for public sector banks - CDC now owns 35 percent of the central management company of Caisse d'Epargne.

The Italian electricity grid floated in the domestic market

The Italian electric utility ENEL sold 50 percent of its wholly owned electricity grid network **Terna** in a successful IPO that netted ENEL €1.7 billion ($2.0 billion). Though the final offering price of €1.70/share was set at the low end of the indicated price range for this offering, the issue itself was several times over-subscribed, and Terna's shares closed the first day of trading up 3.6 percent, to €1.761/share. ENEL's shares traded up 2 percent on the offering's success, closing at €6.636/share. Interestingly, ENEL plans to payout the Terna offering proceeds as a special dividend later this year, so the Italian government (which still owns 61 percent of ENEL) will receive a cash dividend of over $1.2 billion.

Deutsche Post spins-off Postbank, at last…

In Germany's largest IPO for four years, Deutsche Post (DP) sold off a 33 percent stake in **Postbank** in an IPO that raised almost €1.6 billion ($1.9 billion). DP raised an additional €1 billion ($1.2 billion) from a simultaneous bond issue exchangeable into Postbank shares in three years. Though ultimately successful, the development of Postbank's IPO was extremely contentious, with DP insisting on a much higher valuation for Postbank than the market believed appropriate almost until the final date for pricing the issue. The offering's lead managers, Deutsche Bank and Morgan Stanley, finally prevailed upon DP to accept an offering price of €28.50/share ($33.84/share), rather than the €31.50-36.50/share price originally planned. Even at the lower offering price, institutional investors largely shunned the Postbank issue (offered to them at a price of €29/share), and more than 20 percent of the 56 million shares on offer were allocated to retail investors (with an offering price of €28.50/share), rather than less than 15 percent as planned. In spite of the controversy, the Postbank offering succeeded, and the stock closed its first day of trading up slightly at €28.84/share. DP purchased Postbank from the German government five years ago, and had unsuccessfully attempted to sell off a large stake several times before. The German government remains the majority shareholder in DP.

After more than ten years of trying, the French government finally sold off a 35 percent stake in jet engine manufacturer **Snecma**, raising €1.2 billion ($1.45 billion) in a successful IPO. The offering price was fixed near the bottom of its indicated price range, at €15.60/share ($18.53/share) for individuals and €15.70/share ($18.64/share) for institutions, and 50 percent of the offer was allocated to individuals. By law, 10 percent of the issue had to be offered to employees, and the French government retained a golden share in the company. The offering was a modest success, in that it raised the funds hoped for by the government and the shares closed slightly higher on the day at €15.70/share ($18.64/share).

Six other noteworthy transactions…

Besides the flurry of deals in June, six other noteworthy privatization deals were executed during the first half of 2004. Three of these were sales by "Old Europe" governments or state-owned enterprises and three involved sales of companies in "New Europe."

in Old Europe…

The largest single transaction of the January-May 2004 period was the sale of **Brenntag**, a chemicals logistics business, by Germany's state-owned railway, Deutsche Bahn, to the American private equity group Bain Capital for €1.37 billion ($1.71 billion). Deutsche Bahn had acquired Brenntag in 2002 as a part of a larger acquisition, and since this company did not fit into the railway's strategic plans DB put Brenntag up for sale shortly thereafter. In April 2003 Deutsche Bahn received no fewer than ten bids for Brenntag, and Bain Capital was announced as the winner in November. The deal was finalized in February 2004.

The second largest privatization deal of the first five months of 2004 was the sale by Italy's Eni of a 9.05 percent stake in **SNAM Rete Gas** on the Milan Stock Exchange on March 31. This share offering raised €650 million ($793 million) for Eni, and left the company with a 50.07 percent shareholding in SNAM Rete. By Italian law, Eni must reduce its stake in any subsidiaries operating in regulated sectors to 20 percent by 2007.

The final major deal from Old Europe during this period was the private sale by the Portuguese government of a 30 percent stake in **Portucel SA** for €303.7 million ($360 million) to the Portuguese investment company Semapa SGPS in April 2004. This was a controversial deal because an international investment group had actually offered a (marginally) higher per-share price for Portucel than did the winning (Portuguese) bidder, but the government intervened to favor Semapa. The government quickly moved to defuse this cricticism by announcing that Semapa would not be allowed to bid for the sale of its holdings in Galp, the country's dominant oil company, planned for the summer of 2004.

…and in New Europe

The three New Europe deals were all smaller in absolute size than the sales described above, but the sales were relatively more important to the accession country governments. In March 2004, the Polish government sold by auction a 70 percent stake in **Polskie Huty Stali (PHS)**, the nation's largest steel-maker, to the Anglo-Dutch group LNM Holdings for €207 million ($252 million). LNM also assumed $860 million in PHS's debt and committed to an additional $606 million capital investment program.

New Europe’s second major deal was the trade sale of the Czech Republic’s 63 percent stake in the national oil group **Unipetrol** to Poland’s PKN Orlen for €418 million ($498 million) in April 2004. Several international oil companies had expressed an interest in Unipetrol, and two of these—Royal Dutch Shell and Hungary’s MOL, had been shortlisted by the Czech government. In the end, however, neither firm chose to formally bid, leaving PKN Orlen as the sole qualified bidder. Although the amount offered was slightly less than the Czech government had been offered in a failed privatization two years previously, the price was substantially above Unipetrol’s weighted-average stock price over the preceding six months.

The final major deal was the Polish government’s trade sale of an 85 percent stake in the **Zespol Elektrocieplowni Poznanskich (ZEP)** thermal-electric power station for ZL350 million ($74.3 million) to France’s Dalkia Termika in March 2004. Dalkia Termika already owned significant portions of the Polish power grid before this sale was completed, and ZEP’s sale only took place after Dalkia had signed a social package with ZEP’s workers specifying the terms of employment and investment the company promised to make in ZEP after it gained control.

Table 1. Deals, 1H2004

Date	Company	Nation	Sector	Percent for Sale	Method of Sale	Value of Transaction (EUR mil)
30/06/04	Eulia	France	Finance	50,10	Private Sale	2.860,06
23/06/04	Terna	Italy	Utilities	50,00	Public Offer	1.699,35
23/06/04	Deutsche Postbank AG	Germany	Finance	33,00	Public Offer	1.554,56
27/02/04	Brenntag AG	Germany	Agriculture & Industry	100,00	Private Sale	1.377,06
17/06/04	Snecma	France	Agriculture & Industry	35,00	Public Offer	1.203,82
30/03/04	SNAM Rete Gas SpA	Italy	Utilities	9,50	Public Offer	650,86
16/06/04	Sampo plc	Finland	Finance	11,00	Private Sale	474,54
28/04/04	Unipetrol	Czech Republic	Energy	63,00	Private Sale	418,32
24/03/04	Sampo plc	Finland	Finance	8,00	Private Sale	411,48
26/04/04	Portucel SA	Portugal	Agriculture & Industry	30,00	Private Sale	303,77
17/02/04	MOL Rt	Hungary	Energy	10,50	Public Offer	279,83
05/03/04	Polskie Huty Stali SA	Netherlands	Agriculture & Industry	75,00	Private Sale	207,07
26/01/04	Medizinische Zentrum Schwerin	Germany	Agriculture & Industry	100,00	Private Sale	142,84
20/02/04	Mineiro de Neves Corvo (SOMINCOR)	Portugal	Agriculture & Industry	51,00	Private Sale	101,08
02/04/04	TPSA	Poland	Tlc	/	Public Offer	87,92
14/06/04	Zespol Elektrocieplowni	Poland	Utilities	85,00	Private Sale	74,25
22/06/04	Elektrocieplowy Brzeze	Poland	Utilities	36,30	Private Sale	56,31
15/03/04	Bratislava's Steam-Gas Cycle (PPC)	Slovak Rep	Agriculture & Industry	90,00	Private Sale	40,72
07/05/04	Optex Opoczno	Poland	Agriculture & Industry	39,80	Private Sale	35,62
06/03/04	Norwich Airport	United Kingdom	Transport	80,10	Private Sale	30,27
25/03/04	AB Lietuvos Dujos	Lithuania	Utilities	34,00	Private Sale	29,18
03/02/04	Cesky Mobil AS	Czech Republic	Utilities	3,62	Private Sale	18,76
01/03/04	MOL Rt	Hungary	Energy	11,80	Public Offer	12,50
14/04/04	Cefarm Lodz	Poland	Agriculture & Industry	81,50	Private Sale	4,64
05/02/04	Dunaferr	Hungary	Utilities	80,00	Private Sale	1,59
05/01/04	EDB-Ster Polska	Poland	Services	51,00	Private Sale	0,40

Source: *Privatization Barometer* , and *Securities Data Corporation*

Bernardo Bortolotti

University of Turin and FEEM

Privatization in EU: a Brief Historical Sketch

A global phenomenon

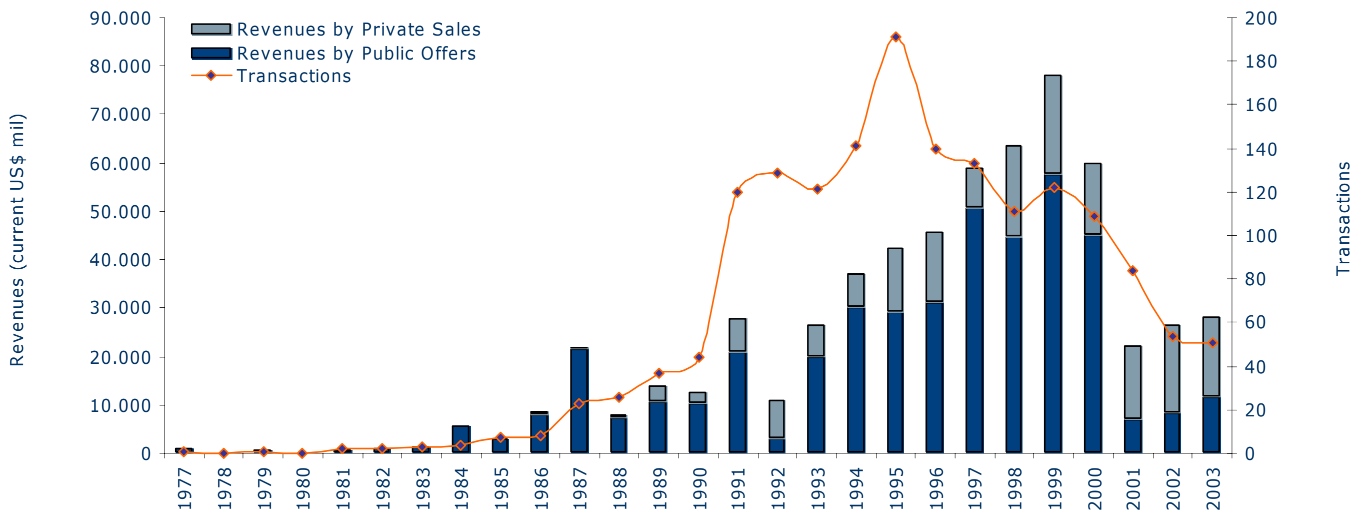
Privatization is a truly global phenomenon in recent economic and financial history and countries belonging to the (enlarged) Europe have had a major impact on this process. A glance at the aggregate data clearly confirms this fact. Overall, from 1977 to 2003, the countries belonging to the European Union have implemented 43 percent of the 3,836 global transactions and raised 49.6 percent of total US$1,220bn privatization revenues. In the ranking by regions, the EU ranks first both in terms of total transactions and proceeds, followed by Central and Eastern Europe and the former Soviet Union, Asia and Latin America.

The major involvement of Europe in this process can be ascribed to three main factors: a larger size of the State-owned enterprise sector; an earlier start with respect to the other areas of the world; finally, the exceptional weight of the British privatization program, a rather unique experience not only in terms of the number of deals, but also in terms of methods and results.

Exponential growth during the 1990s and plunge at the turn of the century

A preliminary analysis of privatization trends in Europe based on revenues shows that the process experienced an exponential growth until the end of the 1990s, and then started to decline sharply from 1999 onwards, mainly due to the global economic downturn and negative stock market conditions (Figure 7). The number of transactions followed a similar pattern, even if the dip in activity started earlier in the mid 1990s. Privatization methods have also been shaped by the underlying market conditions. Overall, we find public offers – share issue privatizations in public equity markets – largely predominate throughout the 1990s, being driven by the Great Bull Market. Starting from the turn of the century onwards, private sales – equity placements to strategic investors – account for a larger fraction of revenues (an almost unprecedented fact in European privatization history). Indeed, governments of all political stripes have been reluctant to sell their stakes in depressed markets.

Figure 7. Privatization in Europe, 1977 - 2003



Source: *Privatization Barometer*

Not surprisingly, western European countries accounted for the lion's share of privatization activity, representing more than 90 percent of revenues. However, the contribution of the ten new accession countries on the number of transactions is far from negligible, accounting for 38 percent of the total.

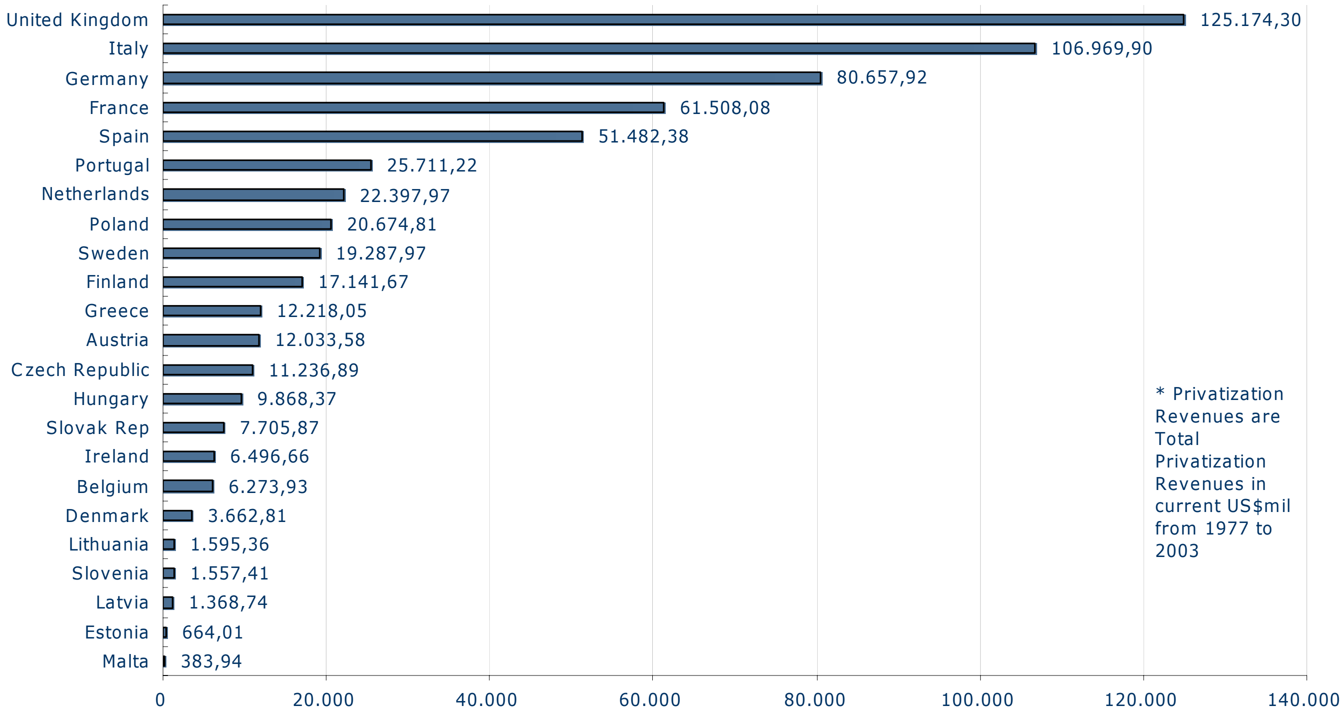
The choice of privatization methods in Old vs New Europe

Privatization methods in Old and New Europe have been markedly different. While at the initial stage of the process governments in the majority of western European countries could rely on fledgling stock markets to implement sales, in New Europe stock markets had to be created from scratch. Innovative methods (such as mass or voucher privatization) have therefore been devised by market-oriented governments to entice the population to equity investment and jumpstart domestic stock markets. The experience yielded mixed results. Mass privatization often led to insider ownership. Direct sales to strategic (often foreign) investors implemented on a case-by-case basis proved more effective due to their impact on corporate governance.

The United Kingdom starts…

Not surprisingly the United Kingdom leads the ranking by total revenues (Figure 8). Privatization was one of the key features of the Thatcherite revolution, which dramatically shrank the size of SOE sector during the 1990s. The 1977 public offer of British Petroleum (BP) is usually considered the first large-scale privatization in modern times, after the failed attempts in the 1950s by the Adenauer government in Germany.

Figure 8. Country Ranking by Revenues *



Source: *Privatization Barometer*

...followed by Continental Europe

Privatization started to spread out in Continental Europe in the mid-1980s in France with the highly politicized (re)privatization of financial institutions by the conservative government elected in 1986, and in Italy with the start of the long lasting process of de-nationalization of IRI, the State holding company. Privatizations brought more than $100bn of revenues to state coffers, and Italy boasts the second position in the ranking by revenues, followed by Germany, France, and Spain.

Portugal and Turkey reported their first truly large-scale sales in 1993. Through the 1990s privatization also spread to Belgium, Greece and Ireland. In 1999, the process peaked in terms of revenues, largely due to the privatization of Enel in October (the largest IPO in history), and a subsequent private placement of the first Italian electric generation company (Genco) in November. By the end of 1999, the trend started declining: three years later the number of privatizations more than halved and 2002 showed a decrease in revenues of about 63 percent with respect to 1999.

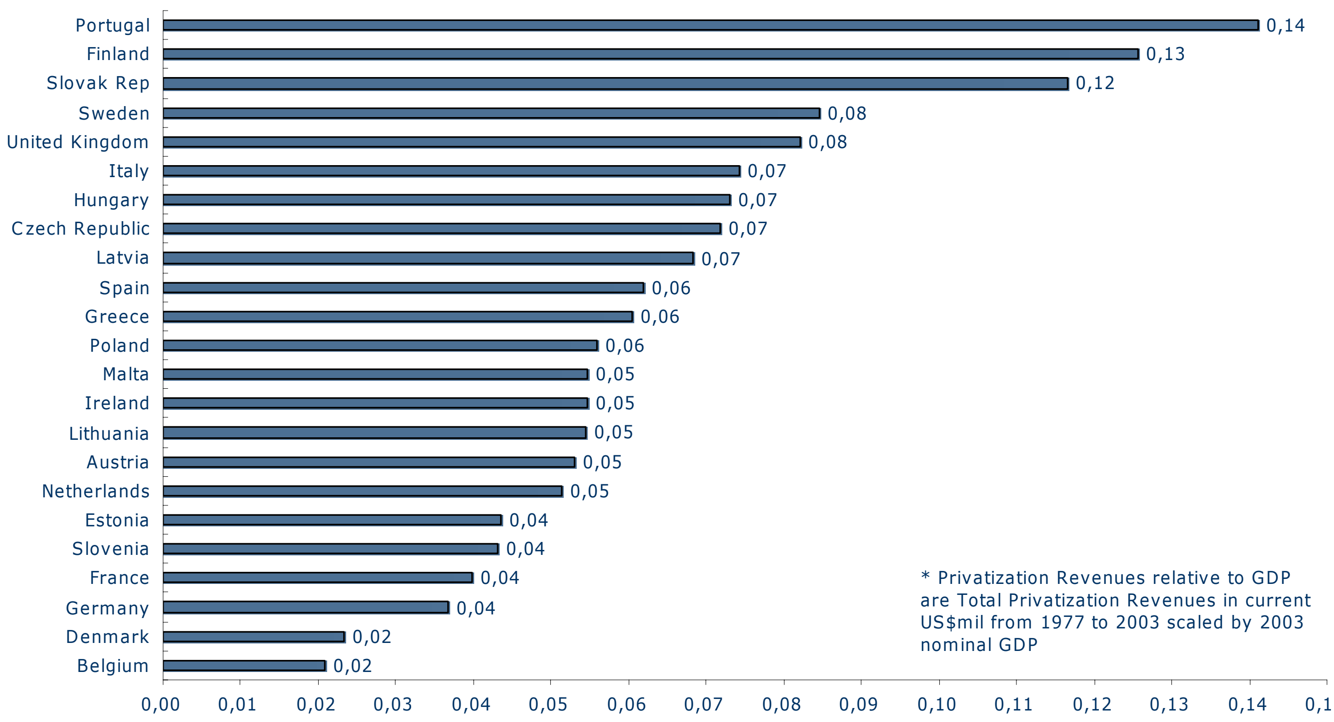
Privatization booms in transition economies in early 1990s

Hungary and Slovenia kicked off privatization in New Europe in 1989, followed by Poland in 1990, Czechoslovakia in 1991, and Estonia in 1994. Interestingly, Poland raised the largest total proceeds in the area (36 percent of the total), surpassing several countries of Old Europe such as Sweden, Greece, Austria, and Belgium.

The picture changes by taking into account the size of the country

The size of the country matters in explaining the extent of privatization, since this also affects the size of the SOE sector. Indeed, the final ranking is considerably reshuffled when total revenues are scaled by GDP (Figure 9). Now Portugal, Finland and the Slovak Republic lead the ranking, with proceeds higher than 10 percent of GDP. The UK and Italy remain in prominent positions, while France and Germany fall dramatically, reporting a tiny 4 percent. Belgium and Denmark remain in the bottom positions, both in absolute and relative terms.

Figure 9. Country Ranking by Revenues relative to GDP *



Source: *Privatization Barometer, and World Bank*

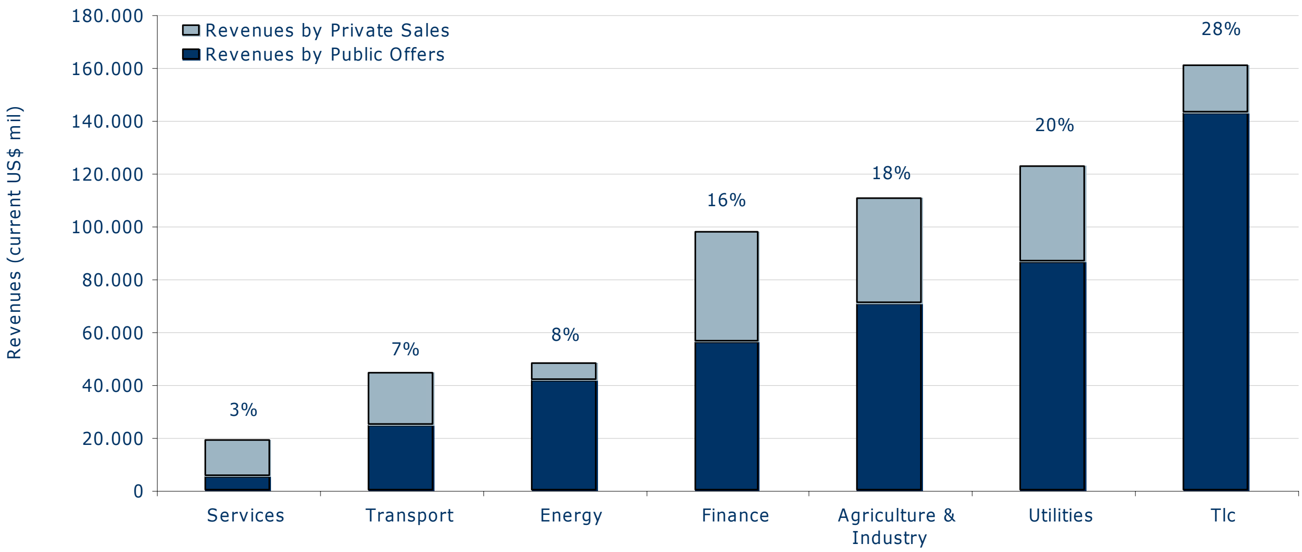
All sectors are involved…

The breakdown by industry (see Figure 10) shows that almost every sector witnesses at least some privatizations. At the beginning of the process sales are concentrated in (reasonably) competitive sectors such as agriculture and industry, and in finance. Indeed, the divestiture of state banks was fundamental for successful privatization of the non-financial sector. Starting from the second half of the 1990s onwards, privatization also spreads to network industries, especially telecommunications and utilities, accounting for an overwhelming bulk of the proceeds (48 percent).

…but partial privatization is dominant in strategic industries

Only few countries, notably the UK and Spain, have fully privatized strategic sectors such as energy, telecommunications, or transport. In the majority of countries, both in Old and in New Europe, governments have transferred ownership rights, but retained direct or indirect control rights in SOEs. As a consequence, the privatization process in several industries has been partial and incomplete. The challenges that European governments will face in the future are either to accomplish such a process, or to prove that even in a globalized economy large shareholdings by the State represent an efficient pattern of governance.

Figure 10. Distribution of Revenues by Sector, 1977 - 2003



Source: *Privatization Barometer*

Saul Estrin

London Business School, United Kingdom

Privatization in Transition Economies: Methods and Consequences

Introduction

Privatization as a momentous change in the countries of the former communist bloc

Improved company performance was at the heart of the transition from a command to a market-oriented economy in central and Eastern Europe. The main way that this was achieved was through a huge, radical and very rapid privatization process. By 2004, tens of thousand of firms had been privatized and privately owned firms supplied the bulk of output in all the transition economies. In this article, we explore some of the issues thrown up by these momentous changes.

Poor performance of SOEs is the key driver

Most observers regard state ownership, with its weak managerial motivation and perverse incentives, as one of the main factors behind the poor economic performances of the communist bloc. State owned firms suffer from the classic problems arising from the separation of company ownership and control in an especially virulent way, and it is hard for the state to replicate the corporate governance mechanisms – capital market disciplines, statutes preventing certain behaviors, transparent accounting procedures, effective monitoring systems – available to private owners.

Privatization is transition

The problem was especially serious in communist countries where the monitoring of management and the incentives for efficiency were already weak. The collapse of central planning and the lack of any other external constraints meant that managers and insiders gained almost total discretion to follow their own objectives, leading to "asset stripping" by managers, job and wage guarantees for workers, and rent absorption by all parties. Privatization, as a way to focus company objectives on profits and sharpen managerial incentives, was therefore an essential element of reform. As the Czech privatization minister, Dusan Triska said in 1992, "Privatization is not just one of many items on the economic program. It is the transformation itself."

Privatization Methods

The practical problems of implementing privatization

The sheer scale of privatization in the transition economies posed considerable practical problems. At the aggregate level, the stock of domestic private savings in these countries was too small to purchase the assets being offered. For a few firms, auction or public tender methods were used. Such sales could in principle be to domestic or foreign purchasers but, in practice, only Hungary and Estonia were willing to sell an appreciable share of former state-owned assets to foreigners. Elsewhere, sales of state-owned enterprises have mainly been to a country's own citizens.

Some countries also experimented with restitution to former owners; e.g. in the former East Germany, Hungary, the former Czechoslovakia and Bulgaria. Restitution immediately creates a property-owning middle class and re-establishes "real ownership" but entails legal complexities. For example, suppose that a factory has been built on a plot of land formerly owned by a farmer. Does the farmer receive the land, and therefore rental for the factory? Should the farmer be compensated for the value of the property at the time of its seizure, and if so how is such an evaluation to be made some?

Mass privatization as a pragmatic solution

Problems in implementing these methods and the urgency of the problem led a number of transition countries to introduce "mass privatization" – distribution of shares in the privatized company for free (or at a nominal price). There are a number of forms of mass privatization. A crucial policy decision is whether the vouchers are distributed equally to the population as a whole or whether, as in Russia and many CIS states, to management and employees. The offer of free shareholdings to insiders was used to diffuse potential opposition to privatization from managers and workers. Policymakers also had to decide whether the vouchers could be exchanged directly for shares in companies, or whether the vouchers were to be invested in funds that own a number of different companies. In the Czech and Slovak republics and in Russia, vouchers could be exchanged directly for shares, but in Poland, citizens' vouchers were exchanged for shares in government-created funds that jointly owned former state-owned enterprises.

Mass privatization proved to be the predominant form of privatization in the transition countries. Nineteen of the 25 transition economies used it as either a primary or secondary method. Nine countries used management-employee buyouts as their primary methods, with six more using them as their secondary method. Only five countries used direct sales as the primary privatization method.

Privatization Outcomes

Mass privatization made possible a sheer transfer of ownership…

Mass privatization facilitated an extremely speedy ownership change in most transition economies. Few countries had contained a private sector of any significance in 1990, with the private sector share of GDP usually less than 20 percent. The transformation has been extraordinary. As early as 1994, the private sector share was above 50 percent in nine countries: Hungary and Poland, along with Russia, Estonia, Latvia, Lithuania, Armenia, Czech Republic and Slovak Republic. By 2000, the private sector in five additional nations had reached at least 50 percent of GDP -- Armenia, Bulgaria, Croatia, Georgia, and Kazakhstan -- and only two laggards, Belarus and Turkmenistan, still had private sector activity below 25 percent of GDP.

…but often lead to dispersed structures and to insider ownership

But there remain real concerns about the quality of privatization, because it did not always lead to the establishment of effective corporate governance mechanisms. The long "agency chains" implicit in mass privatization led to ownership structures that were highly dispersed. Mass privatization also often led to ownership by insiders. For example, insiders held a majority shareholding in 75 percent of firms in Russia immediately post-privatization (1994) and outsiders only 9 percent. Insider ownership was predominantly in the hands of workers but this created little problem for management because worker ownership was highly dispersed so control was effectively in the hands of management. The situation appears to have been more mixed in central Europe. Insider and foreign ownership were predominant in Hungary, while insider and de novo ownership pre-dominated in Poland. The Czech Republic is an alternative case where investment fund ownership predominated.

The Consequences of Privatization

A stronger positive impact in Central Europe then in CIS countries

The impact of privatization on the performance of firms in transition economies has for the most part been positive. However, the privatization effect is significantly stronger in central Europe than in the Russia and the CIS (Community of Independent States) countries; in most cases, the impact is around twice the size. For example, in Poland the difference in sales growth rate between private and state-owned firms is estimated to be between 5.4 and 8.7 percent; and in central Europe the difference in productivity is estimated to be 4.3 percent. In contrast, the findings for Russia and CIS states are more mixed, with some studies indicating positive performance effects from privatization and others zero or even a negative effect.

The owner makes the difference

The identity of the eventual owner has affected the outcome of privatization. Djankov and Murrell (1) conclude that differences in enterprise performance between different owners are very important: "Privatization to workers is detrimental, privatization to diffuse individual owners has no effect and privatization to Funds or foreigners has a large positive effect". They find that privatization to investment funds is five times as productive as privatization to insiders, and privatization to foreigners or blockholders is three times as productive as privatization to insiders.

Corporate governance failures as the main cause of poor performance

Banks and blockholders on average improve company performance about as much as foreign owners. One interpretation is that the crucial issue is ownership concentration, since blockholders, funds, foreigners and banks all have concentrated holdings.

The relatively poor performance of Russia and the CIS countries in the impact of privatization can be explained by two factors. The first factor is the preponderance of a relatively less effective form of private ownership -- specifically dispersed worker ownership. The second factor is the relatively worse functioning of corporate governance mechanisms cited above, which has meant that worker owners have been less effective in improving performance than they might have been in countries with a stronger institutional framework, such as Poland.

Conclusions

Privatization in central and Eastern Europe has been an important element in the transformation of these economies, and has laid the foundations for the emergence of a market economy. However the scale of privatization required, and the paucity of domestic resources, led to the adoption of privatization methods which, though effective in the transfer of ownership rights, did not tackle many of the crucial corporate governance issues central to productivity enhancement. In many countries, especially those now entering the European Union, these issues are now being addressed.

The PB Index

Presentation

Overview

Several studies in finance have proved that idiosyncratic factors affect the behavior of privatized firms. These firms tend on average to over perform benchmarks in the medium and long run, and share issue privatizations are often more strongly under-priced than public offerings by private companies. Furthermore, it has been recently documented that ownership and control structures of privatized and private companies do not converge, and that privatizing governments have often transferred ownership rights but retained control. This typically occurs by exerting their rights as large shareholders, or by wielding power via additional control devices such as golden shares. Importantly, in strategic sectors such as energy, utilities, telecommunications, aerospace and defence, where the largest and most valuable firms operate, company performance is affected by the outcome of a regulatory game where governments, regulators, politicians, and various stakeholders are involved.

Privatized companies are thus likely to be different animals from private listed companies. For this reason, their financial performance warrants systematic attention.

The PB Index

The PB Index is designed as a benchmark for tracking the performance of privatized companies. It serves primarily as:

- Benchmark for portfolio managers and investors who invest in privatized companies.
- Performance yardstick for governments and investment banks floating shares of state-owned companies.
- Vehicle for attracting attention to privatization in European equity markets.

The PB Index tracks the performance of shares of privatized companies that are listed for trading in domestic stock markets of the enlarged European Union. It is subject to periodic review by the PB Index Administrator, who ensures the overall consistency with the purposes of the Index.

The PB Index is capitalization weighted, and denominated in Euros.

The Index is restricted to ordinary shares of privatized companies trading in the stock exchanges of the European Union, including the ten new accession countries.

The constituents of the indexes are the shares of companies privatized from January 1977 to date. A privatization is defined as a transfer of ownership or voting rights from the central or local government, or from bodies of the public administration, to private investors. Eligible securities are also traded shares of equity carve-outs from state-owned enterprises or privatized companies. Transactions involving the transfer of shares to private companies or financial institutions fully owned by public shareholders are not considered privatizations. Privatization transactions are identified from the Global New Issues Database of Securities Data Corporation.

Index maintenance implements the adjustment for company additions and deletions and stock price adjustments due to corporate actions and merger and acquisitions (M&A) activity.

If the privatized company merges or is acquired, its share price is replaced by the one of the resulting company in case of merger, and by the one of the acquiror in case of a tender offer or an acquisition, if these companies are listed in the same stock market where the privatized company was initially traded. If the privatized company is acquired by a foreign company and then de-listed from the domestic exchange, it is deleted from the Index.

Adjustments are made on a quarterly basis.

The index is capitalization-weighted, and calculated with the Laspeyres formula, which measures price changes against a fixed base quantity weight. The index is calculated on a price only basis excluding the dividend yield, and uses daily data and closing prices of the stocks at the base date and at each date. The source of price and quantity data is Datastream.

In addition to the Composite, two regional (one including EU15 and one the ten new accession countries) sub-indexes are constructed, together with two sub-indexes including companies with and without any direct ownership stake by the government or public entities (partially versus fully privatized).

The PB Index Composite includes 203 stocks. The two regional indexes include 153 companies of EU15 countries and 50 companies of the ten new accession countries of Eastern Europe. The two sub indexes Partially and Fully Privatized include 101 and 100 stocks, respectively.

Analysis

In this section, we briefly describe the return characteristics of privatized companies over the past year, starting from July 1, 2003.

Figure 11 refers to the PB Composite Index, which includes the whole set of privatized companies for which we track performance. The figure shows that, had one invested € 100 million in this index, the investment would now be worth € 123.12 million.

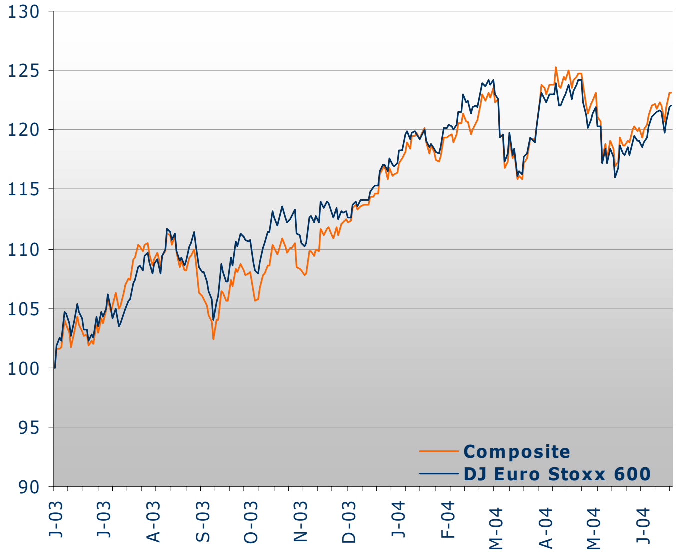
The overall performance of the composite index is quite in line with the one of Eurostoxx 600, which we use as benchmark. The PB Composite Index underperformed substantially the benchmark during Q4 2003, rapidly catching up in the first semester 2004.

The similar behavior of the PB Composite Index and of the benchmark is not particularly surprising, given that both indexes are capitalization-weighted and that several privatized companies are the largest listed companies. It is therefore likely that more weight is given in the benchmark to the constituents of our PB Composite Index.

Stark differences in performance appear when we analyze the PB regional Indexes. Higher performance is found for stocks of privatized companies of New Europe, which yielded a 13.72 percent abnormal return relative to the Eurostoxx 600 (Figure 13). On average, higher returns were in general accompanied by overall higher volatility. However, the high relative performance reported in the first semester of 2004 is associated with a substantial decrease in volatility (Figure 14). This suggests that privatized companies of New Europe have likely yielded a positive (risk-adjusted) abnormal return over that period.

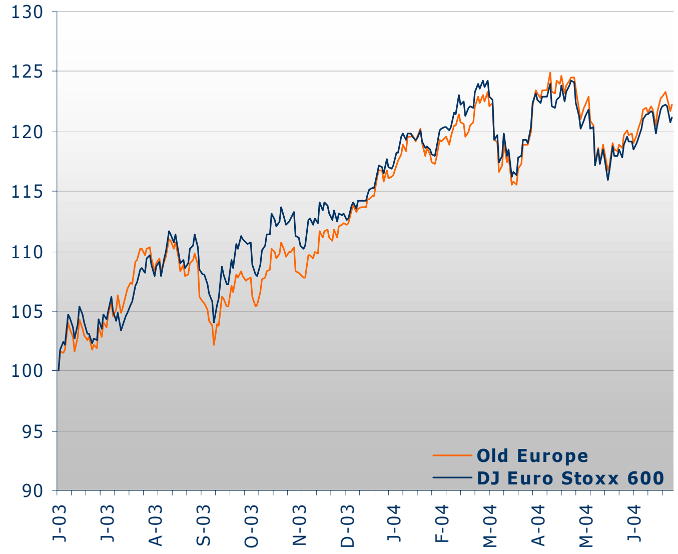
The other regional PB Index referred to privatized companies of the Old Europe (Figure 12) basically overlaps with the composite, again due to the higher weight given to EU10 bellwether stocks.

Figure 11. The Performance of the PB Index Composite



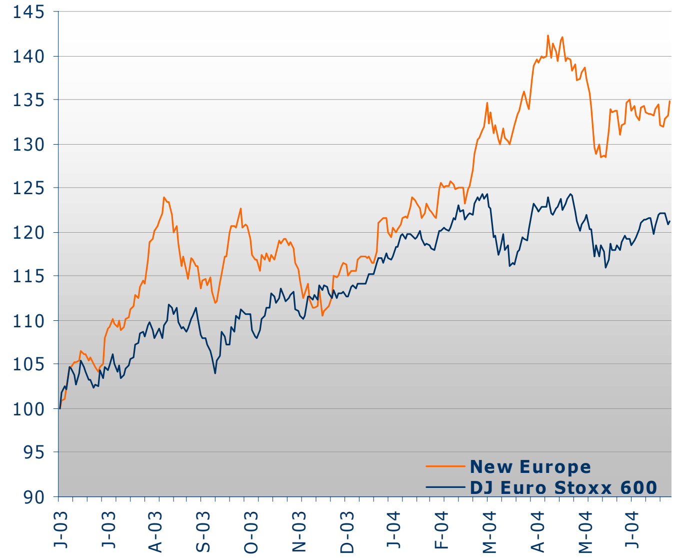
Source: *Datastream*

Figure 12. The Performance of the PB Index Old Europe



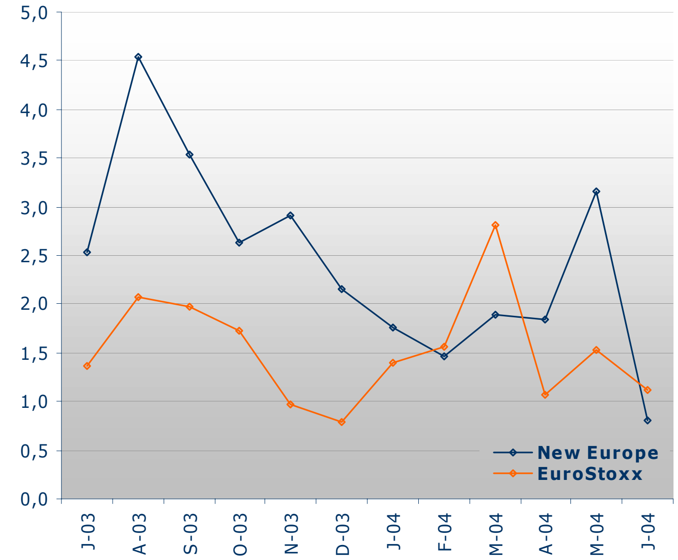
Source: *Datastream*

Figure 13. The Performance of the PB Index New Europe



Source: *Datastream*

Figure 14. The Volatility of the PB Index New Europe



Source: *Datastream*

Selected News

All news are available in PB News section – News are provided by Dow Jones News, all rights are reserved.

NETHERLANDS
02 July 2004 - **Dutch State OKs IPO Plans For Dutch Schiphol Airport**

AMSTERDAM (Dow Jones) - The Dutch government Friday said it has agreed to the initial public offering plans of **Schiphol Group**, the Dutch airport operator in which it holds a majority stake.
The state has agreed to list a minority stake of the company in due course, the ministry of traffic and transportation said Friday. Besides the Dutch state, the cities of Amsterdam and Rotterdam hold 21.8% and 2.4% stakes in Schiphol respectively. Schiphol operates three airports in the Netherlands and services some terminals at Brisbane Airport in Australia and John F. Kennedy Airport in New York.
The approval of the Dutch government was long awaited. Some politicians from the ruling coalition have been reluctant to privatize Schiphol, seeking safeguards for public-interest areas such as the effects on employment and the environment. Schiphol Chief Executive Gerlach Cerfontaine has repeatedly called for the government's go-ahead for a listing, as a key to its international expansion. Schiphol, which posted a 2003 net profit of EUR137 million, has recently shown an interest in buying a majority stake in Brussels-Zaventem airport, valued at around EUR500 million. The Dutch government hasn't decided the timing of the IPO, noting it will do so at "the right time from a financial, economic perspective."

HUNGARY
28 June 2004 - **State Railway MAV Mulls Freight Unit Sale**

BUDAPEST (Dow Jones) - Hungarian state-owned railway company **Magyar Allamvasutak Rt**. is considering selling its freight operations, Nepszabadsag reports, citing unnamed Ministry of Transport and Economy sources.
The freight division is MAV's only unit which generates profits. It's expected to make 19 billion forints ($1=HUF207.60) in pretax profit this year on revenues of HUF92 billion.
MAV's freight operations are worth between HUF60 billion and HUF100 billion. Possible suitors include Germany's state-owned Deutsche Bahn AG, Nepszabadsag says.

GERMANY

22 June 2004 - **Germany To Sell Deutsche Telekom, Deutsche Post Stakes By 2006**

BERLIN (Dow Jones) - The German government plans to fully sell its remaining stakes in **Deutsche Telekom AG** and **Deutsche Post AG** by 2006, with the largest tranche being sold in 2005, a German government source said Tuesday. The comments come as the German government prepares to present its 2005 budget Wednesday, which foresees EUR15.45 billion in privatization revenues. The government's stake in Deutsche Telekom stands at 26.1%, while it holds a 20% stake in Deutsche Post.

The source said the privatization could involve parking additional shares in state-owned development bank KfW as it has done in the past. KfW in the past has bought shares in the two companies from the government. It then holds on to these shares until market conditions improve. KfW currently holds a 16.7% stake in Deutsche Telekom and a 48.3% stake in Deutsche Post. According to leaks of the 2005 budget plan, the government is banking on record privatization volume in order to only moderately increase net new borrowing next year to EUR22 billion.

FRANCE

15 June 2004 - **French Govt and Motorola Want To Sell Stakes in Bull**

PARIS (Dow Jones) - Motorola and the French government, two key shareholders **in Bull SA**, want to sell their stakes after they are diluted in a capital increase, managing director Gervais Pellissier said Tuesday at a press conference. Motorola owns 16.9% of Bull and the French government owns 16.3%. Thursday, Bull will kick off a capital increase of EUR44 million, part of a comprehensive rescue package unveiled last November. France Telecom and NEC which currently own 16.9% each, are participating in the rights' issue and will control 12% after the operation is finalized.

They will be joined by new shareholders that have committed to join the rights' issue. They include Axa Private Equity, part of French insurance firm AXA, whih will get 8.8% of the new shareholding structure; the company's management which intends to buy a 6% stake; Debeka of Germany, with 3%; and Artemis, with 2.5%.

Convertible bond holders will get between 23% and 37.5% of the company, as part of a separate conversion offer.

Pellissier also said the company targets a revenue of between EUR1.2 billion and EUR1.5 billion in 2005.

AUSTRIA

10 May 2004 - **OIAG To Sell 17% Of Telekom Austria in 2004**

VIENNA (Dow Jones) - Austria's state privatization agency Friday said it will sell up to 85 million shares, or 17%, of **Telekom Austria AG** through a stock market placement this year to institutional investors. "The supervisory board has empowered OIAG to sell up to 85 million share by Dec. 31, 2004, to domestic and international institutional investors in a stock market transaction," OIAG said in a statement.

The time of the sale depends on market conditions, OIAG spokeswoman Anita Bauer said. However, she added, no sale could take place until at least June because of lockup agreement related to Telekom Austria's other former major shareholder, Telecom Italia SpA, which sold its 15% stake in January. She said the agency was still considering whether to include a retail offer as part of the 17% stake sale.

The sale of the 85 million shares would be worth about EUR995 million at Friday's share price of EUR11.73. OIAG currently holds 47.2% of Telekom Austria. Taking into account a convertible bond issue, the sale of the stake would reduce OIAG's holding to about 25%.

FRANCE

05 May 2004 - **French Govt Publishes France Telecom Privatization Decree**

PARIS (Dow Jones) - The French government Tuesday published a decree in its official gazette authorizing it to reduce its stake in France's national telecommunications operator **France Telecom SA** to under 50%. The state owns 53.1% of France Telecom.

On Jan. 1, the government published a decree putting into force a law that opens the way for it to give up its majority stake in the company. But a last legal decision was necessary to make any loss of control of the operator compliant with the law.

Last week, France Telecom Chief Executive Thierry Breton said he hasn't been officially informed of any privatization plan. But government sources have said the government's stake could fall under 50% this year.

The electronic version of the PB NEWSLETTER is available at www.privatizationbarometer.net/newsletter