IPP | Policy Brief 25/2016

Privatization or Fire Sale

Nadeem ul Haque
Shahid Kardar

Institute of Public Policy
Beaconhouse National University

Happy days have returned. Privatization has been resumed in earnest. So goes Islamabad's self congratulatory declaration on the Rs. 38 billion raised from the sale of its 20% stake in UBL. The authors of this article, who probably have been the strongest proponents of the free market in recent decades and have generally pushed for a more market-based open economy, should then be equally happy. We, however, feel that privatization done wrongly can have perverse results. To this end we refer to this deal to illustrate the several questions that should be widely debated so as to inform the government's privatization policy.

As mentioned above, we have long advocated the adoption of a more deregulated, open, market-based economy. Privatization is but one tool in that direction.

Most public policy analysts would agree with the following principles of privatization.

a) The divestment should improve the efficiency and profitability of the operations of the enterprises being sold.
b) The transaction should be conducted in an open and transparent manner with adequate preparation and time so as to get the best price for a public asset-i.e. adequate price discovery efforts are made. Moreover, the mode of sale should not result in a wealth transfer to the buyer.
c) Improve market competitiveness in general and in the sector in particular.
d) The receipts from privatization should not be used to fund current fiscal needs, since that is likely to slow down much needed fiscal reforms.

With these principles in mind we find it very hard to understand the reasons for the fire sale of UBL. It does not satisfy the first objective of improving market efficiency. UBL is already being managed privately and just the sale of an additional 20% stake will not ipso facto lead to an improvement in the efficiency of the bank and thereby induce any difference in UBL's bottom line.

The sale of these shares has obviously augmented the government's coffers (including that received in the form of foreign exchange of US$ 310 million). Yet the government does not seem to have any plans to retire debt so that it can be verified that the exchequer will recoup the lost dividend stream on these share through savings on debt servicing. Nor is it apparently going to invest the proceeds in projects that will generate income which will be more than the loss of the above referred dividend earnings. Objective (d) has been enshrined in our law, which requires that privatization receipts should not be utilized for financing current expenditure. Yet available evidence suggests that there is every reason to fear that the proceeds will be used to finance the current fiscal position, resulting in the transgression of the law as well as that of objective (d).

The government could well argue that the sale proceeds will be used for funding its many mega projects. All this clever accounting will do is to facilitate a higher level of unproductive current spending. Given that many of these grandiose projects will generate low returns, and some may even require a continuing government subsidy to meet their costs of operations and maintenance, will such use of the funds not add to our future fiscal problems?

The government has been announcing that it will respect objective (b) requiring transparent transactions that will facilitate price discovery. Unfortunately, the process has raised a host of questions that need clarification.

a) Why was the pricing done at a discount? The market price was Rs.170 per share and the price demanded for this large block was Rs.158. The fact that the shares were sold at a lower price raises doubts about the intentions underlying this divestment.
b) The triumphant reports coming out of Islamabad are citing over subscriptions. In such cases, normally, price is bid up. But not here.
c) About 8 buyers including a government entity NIT have acquired the shares. That some brokers who have bought shares suggest that they were buying for someone else. It would be interesting to find out the identity of the final buyer and how long these shares are held. The street gossip is already hinting at where these shares have gone.
d) The market's perception is that the transaction was rushed. It did not give bidders enough time. Time to an auctioneer's hammer is important for bringing out the true value of a share.
e) The government was adamant to sell the block as a block. Since eight buyers emerged for a block, why did the government insist for the shares to be sold as a block? Could not a different auctioning system (the one used favoured only those with deep pockets) been employed to fetch a higher price?
f) When a stock markets exists and existing shareholders have determined a price, why would the government conduct an off floor transaction? The reason given to us is that the market was not big enough to handle such a large transaction. This claim needs to be researched and debated. In our view, there are marketing strategies that would allow such a transaction to be done on the floor to maximize value-the shares could have been divested bit by bit in the market over the course of a month.

Finally, if this divestment results in the consolidation of the holding of the group that already has a major/majority stake would that be in the public interest, especially if these shares sold at a discounted price end up with the current owners? If privatization increases concentration of bank ownership a mere handful of individuals could be in a position to control the money market and the pricing of loans and financial services. There is, therefore, reason to worry about the wisdom of such a privatization policy.

Nadeem-ul Haque is former Deputy Chairman Planning Commission and Shahid Kardar former Governor State Bank of Pakistan