BALANCE OF PRIVATISATION POLICIES RELATED TO FOREIGN DIRECT INVESTMENT IN THE TRANSITION COUNTRIES OF CENTRAL AND EASTERN EUROPE

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ABSTRACT:

Foreign privatization is a special form of acquisition in which strategic investors assume control of part or all of the equity of a State-owned company in the host country. As a result of the mass privatization taking place in the Central and Eastern European countries (CEECs), foreign privatization accounted for a substantial share of the foreign direct investment (FDI) flowing into these countries. As a general rule, early privatization policies favoured domestic investors, but as the attainment of the most profitable sales price and the implementation of business restructuring gradually took over as the chief goals of privatization, foreign investors were allowed to compete on equal terms. The privatization experience in the CEECs provides evidence of the beneficial role played by Eastern country firms in post-privatization restructuring and in their own self-promotion.

KEY WORDS: foreign direct investment, privatisation, transition, Central and Eastern Europe.

JEL: F15, F21.

RESUMEN:

La privatización extranjera es una forma especial de adquisición que implica que los inversores extranjeros estratégicos asuman el control de parte o todo el patrimonio neto de una compañía de titularidad pública en el país huésped. Después de que los países de europa central y oriental (PECO) se sometieran a la privatización masiva, una parte considerable de la inversión extranjera directa (IED) se realizó en forma de privatización extranjera. Las políticas de privatización en su fase inicial ofrecían, por regla general, un trato preferencial a los inversores nacionales, pero más tarde, cuando el precio más rentable de venta y la reestructuración de compañías se convirtieron en las metas principales de privatización, se situó a los inversores foráneos en igualdad de condiciones. Las experiencias de privatización en los PECO ponen en evidencia el positivo papel desempeñado por las compañías de los países del Este en la reestructuración post-privatización y en la promoción de las mismas.

PALABRAS CLAVE: inversión extranjera directa, privatizaciones, transición económica, Europa central y Oriental, UE.

JEL: F15, F21.

1. INTRODUCTION

Foreign (cross-border) acquisition (or merger) and greenfield investment are two modes in which a firm can undertake foreign direct investment (FDI) in a host country. Foreign privatisation is a special form of foreign acquisition[1], involving strategic foreign investor taking over a part or the whole of the equity of state-owned company in a host country (for more, see UNCTAD, 2000, pp. 99-105). More precisely, FDI implies privatisation everywhere where acquisition or partnership involves a host country company (directly or indirectly) in state ownership, i.e.: (i) partial or full acquisition of a state-owned company, (ii) additional investment in a state-owned company, and (c) joint venture with a state-owned company (Rojec et al, 1995). For a considerable part of the previous decade, former socialist countries of Central and Eastern Europe (CEECs) have been going through overwhelming privatisation processes, which largely determined the type of foreign investors' involvement. FDI was closely linked to privatisation all until the privatisation processes have substantially changed the ownership structure of the transition economies.

The basic aim of privatisation in CEECs was to eliminate the inherent inefficiencies of state ownership and planning (Mihaly, 2001). This puts foreign privatisation in a specific perspective. The capital stock gap, the technology gap and the lack of entrepreneurship have usually been mentioned as the most outstanding advantages of foreign privatisation for CEEC economies (see, for instance, Mihaly, 2001). One can also add corporate governance. On the other hand, foreign privatisation in CEECs has often been accompanied by a clear political and public discomfort and opposition, argumented by the need to prevent the sales of national wealth to foreigners and to put residents in preferential position in the privatisation process.

The objective of this paper is to analyse the balance of foreign privatisation policies of CEECs, which went through the transition process and which recently became EU member states; the host country and not the foreign investor perspective is in the focus of our interest. The paper makes an overview of the existing knowledge on the subject and focus on three topics. Section 2 overview trends in foreign privatisation in CEECs, their relevance for FDI and for privatisation. Section 3 deals with the role of foreign privatisation in privatisation concepts of CEECs and with policies to foreign privatisation, while section 4 analyses experiences of CEECs with foreign privatisation. Section 5 concludes.

2. TRENDS IN FOREIGN PRIVATISATION: THEIR RELEVANCE FOR FDI AND FOR PRIVATISATION

For a considerable part of the previous decade, CEECs were going through overwhelming privatisation processes, which largely determined the type of foreign investors' involvement. Privatisation has been an important means of attracting FDI, but the majority of privatised assets was acquired by or distributed to domestic stakeholders, depending on the prevailing privatisation methods. Although a number of countries sold state-owned enterprises to foreign firms, foreign privatisation, on a value basis, was concentrated in a handful of countries (UNCTAD, 2000) with large and medium-sized companies as the main targets. FDI was closely linked to privatisation all until the privatisation processes have substantially changed the ownership structure of CEECs.

[1] In the literature, the term cross-border mergers and acquisitions (M&As) is usually used. In practice, acquisitions far prevail. This is especially so in foreign privatisations in CEECs. Further on, we use the term acquisition(s).

2.1 Foreign privatisation in overall FDI inflows.

Table 1 shows that privatisation process was a substantial conduit for FDI in CEECs in the 1990s (Hunya and Kalotay, 2000). One can notice considerable fluctuations in foreign privatisation in value terms, as well as a share of foreign privatisation in total FDI inflows in individual countries. This reflects the dynamics and changes in the privatisation policies, i.e. in attitude towards foreign privatisation in individual countries. In smaller countries, fluctuations may also reflect realisation of some big privatisation deals in individual years. The data on foreign privatisation in CEECs for the period since 1999 are not available. Since FDI inflows in CEECs were constantly increasing in 1998-02[2], and since privatisation policies in most CEECs have become more friendly to FDI in the late 1990s one can assume that part of these increases were absorbed by foreign privatisation.

Hungary, which has treated foreign and domestic investors in the privatisation equally basically from the beginning, seems to be the first country, which has more or less exhausted its foreign privatisation potential by mid 1990s. Other CEECs began to change their privatisation policies in the second half of 1990s. In number of CEECs, late 1990s and early 2000s were characterised by the end of nation-wide privatisation schemes with preferential treatment of residents and by the shift of privatisation process towards more targeted direct sales of state-owned companies with basically equal treatment of foreign investors. Hunya and Kalotay (2000, p. 6) quote the cases of Czech Republic, Slovakia and Romania as countries in which "with the growing recognition of the benefits of FDI-related privatisation this became the main method of privatisation" in 1996 and 1997. This opened the room for more foreign privatisation. CEECs, which saw the highest increases in FDI inflows since 1998 are Poland, Czech Republic, Slovakia, Bulgaria, Croatia, Romania, Slovenia. These increases can be partially explained by the changes in privatisation policies, but also by the increased availability of already privatised companies for foreign acquisitions. This was the period of privatisation of the financial sector (banks, in particular) and some public utilities (especially telecommunication industry) where foreign investors played the dominant role (Hunya and Kalotay, 2000).

[2] FDI inflows in CEECs in 1998 were USD 22.5 billion, in 1999 USD 25.1 billion, in 2000 USD 26.4 billion, in 2001 USD 25.0 billion and in 2002 USD 28.7 billion (UNCTAD, 2003, p. 252).

TABLE 1: Privatisation related FDI inflows in selected CEECs, 1993-1998 (million USD and %)

	1993	1994	1995	1996	1997	1998
Bulgaria						
Total FDI[1]	40	105	90	109	505	..
Privatisation related FDI	3	28	63	36	340	..
Privatisation related as % of total	8	26	70	33	67	..
Croatia						
Total FDI[1]	105	113	101	540	342	576
Privatisation related FDI	53	92	79	4	8	1
Privatisation related as % of total	51	81	78	1	2	0
Czech Republic						
Total FDI[1]	653	868	2,561	1,429	1,038	..
Privatisation related FDI	568	862	2,559	1,317	1,038	..
Privatisation related as % of total	87	99	100	92	100	..
Hungary						
Total FDI[1]	2,339	1,146	4,453	1,788	1,811	1,410
Privatisation related FDI	..	..	3,025	578	272	178
Privatisation related as % of total	..	..	68	32	15	13
Romania						
Total FDI[1]	37	188	207	151	669	1,378
Privatisation related FDI	6	33	82	16	335	1,163
Privatisation related as % of total	17	17	40	11	50	84

Source: Hunya and Kalotay, 2000; based on UNCTAD, FDI/TNC database; *Note:* The data presented in this table are not strictly comparable because the definition of "privatisation related" inflows varies from country to country.
1/ FDI equity inflows paid in cash only.
(..) Data not available.

2.2. Foreign privatisation in overall privatisation.

Foreign privatisation represents an important part of overall privatisation processes in CEECs but, with the exception of Hungary, FDI was not the dominant form of privatisation (Hunya and Kalotay, 2000). At the end of 1997, the shares of foreign privatisation in overall privatisation in selected CEECs range from 1% in Slovenia to 45% in Hungary (see Table 2). The shares of foreign privatisation in the subsequent years undoubtedly increased, since the privatisation policies shifted to direct sales of large companies, where foreign investors are in clear advantage.

In spite of relatively high foreign involvement in large-scale privatisation in CEECs, foreign privatisation obviously did not play a major role in the mass privatisation schemes of CEECs. The importance of strategic foreign acquisitions of state-owned companies ass much more a qualitative one; i.e. immediate entrance of strategic foreign investor, with the wish and the ability to restructure and improve a target company. Foreign privatisation as a privatisation method was important mostly in the privatisation of medium and especially large companies needing fast and thorough restructuring. Here, free distribution and buy-outs of state ownership with discounts for residents were not able to compensate for the lack of domestic savings (Jašovič, 1993; Korže and Simoneti, 1992). But even in large-scale privatisation, foreign investors have restricted their acquisitions to a narrow range of industries, namely, fast-moving consumer goods, especially tobacco products, automobile production, the paper industry, cement industry, and power generating and telecommunications equipment (UN/ECE, 1993, p. 9).

TABLE 2: Distribution of enterprise assets between privatisation methods in selected CEECs, up to end-1997 (%)

	Sales to foreign investors[1]	Sales to domestic investors[1]	Equal access voucher	Insider[2]	Other[3]	Still State property
Czech Republic[4]	10	10	40	5	5	30
Hungary	45	12	-	3	20	20
Lithuania[5]	12	2	43	9[6]	-	43
Poland[5]	10[7]	..	6	..	44	40
Romania[4]	5	5	20	10	-	60
Slovakia[4]	7	3	25	30	5	30
Slovenia[5]	1	8	18	27	21	25

Source: Hunya and Kalotay, 2000; based on UNCTAD; DJANKOV, S. (1998) "Ownership structure and enterprise restructuring in six newly independent states". Washington, D.C.: World Bank; mimeo, adjusted by data drawn from EBRD (1998) *Transition Report 1998*. London: European Bank for Reconstruction and Development; and estimates adopted from HUNYA, G. (1999) "The relationship between FDI, privatization and structural change in Central and Eastern European countries", in E. Rosenbaum, F. Boenker and H.J. Wagener (eds.) *Privatization, Corporate Governance and the Emergence of Markets*. Basingstoke and London: Macmillan; *Notes*: 1/ Includes both direct and portfolio sales; 2/ Management buy-out and employee share ownership programme; 3/ Leasing, debt-equity swaps, restitution, transfer to social security funds and local organisations, and liquidation; 4/ Estimates; 5/ Data available from the privatisation agencies, up to end-1998; 6/ This share of employee participation is also included under the voucher data as employees acquired voucher shares in their companies; 7/ Includes sales both to foreign and domestic investors.

The role of FDI in CEEC privatisation varies from country to country, the main reason being different privatisation concepts. In countries like Slovenia, Czech Republic or Poland, with preferential treatment of residents in the privatisation, foreign investors were much less important privatisation agents than in countries without such schemes, Hungary being the most typical example. Additionally, the variations can be explained by inter-country differences in FDI policies and by varying attractiveness of countries for foreign investors in general; here Hungary, Czech Republic, Poland and lately also Slovakia have been in the forefront. With the shift of privatisation concepts and policies from nation-wide distribution/discount schemes to case by case direct sales of companies, the relevance of foreign privatisation for the privatisation processes in CEECs has increased. Also, there have been an increasing number of foreign acquisitions of companies privatised under mass privatisation schemes.

3. FOREIGN PRIVATISATION CONCEPTS AND POLICIES

In dealing with the issue of foreign privatisation in privatisation concepts and policies of CEECs one should distinguish two phases; the phase of nation-wide mass-privatisation schemes and the phase of post-privatisation ownership consolidation and of targeted sales of the remaining state property, mostly in manufacturing, financial sector and public utilities. Increased economic efficiency has been the main reason for privatisation, but in the early phase of transition, privatisation was motivated by other factors (creation of domestic capitalist class, justness, special treatment of residents etc.) as well, the accent was on speed and preferential treatment of residents (see, for instance, CEEPN, various issues of Annual Privatisation Reports). Requests that residents should be treated in a preferential way were logical and obvious, and no political option was able to ignore that. Claims that the main companies should remain in local hands also had considerable weight. Besides, the interest of foreign investors was focused on a relatively close circle of countries and enterprises. In the second phase, increased economic efficiency has remained the main motivation for privatisation, but the factors of speed and justness have given the way to establishing of corporate governance and restructuring of the privatised companies, and to selling of

companies for the best price possible. If in the first phase, foreign investors were usually put into a specific (discriminatory) position, in the second phase, foreign investors have been, in principle, put on equal terms with domestic investors. In fact, in the second phase the situation for foreign investors has not differed any more from that in the case of foreign privatisations/acquisitions in developed market economies. Further, we explain the role of foreign privatisation in privatisation concepts and policies of Czech Republic, Hungary, Poland and Slovenia.

3.1. Czech Republic

Czech privatisation has been divided into "small-scale" and "large-scale" privatisation. Privatisation combined standard privatisation methods with voucher privatisation. About one third of national assets have been distributed through voucher privatisation[3]. Foreign participation in the Czech privatisation process was confined to the large-scale privatisation, embracing the privatisation of the largest state-owned enterprises. In the large-scale privatisation, various methods were used to transfer ownership to the new owners. Public tenders were often applied, especially if the project indicated a direct sale. Direct sales had to be approved by the government. In the approval process, the government for a long time preferred the so-called "Czech way of privatisation". Projects with foreign participation were subject to particular scrutiny, in particular since they generally concerned the best enterprises in the economy. Out of about 5,000 enterprises undergoing Czech large-scale privatisation, only 144 were privatised partially or fully to foreign investors. Still, USD 4.6 billion from direct sales to foreign investors represented more than half of all proceeds from large-scale privatisation[4] (Zemplinerova, 2001; Zemplinerova and Jarolim, 2001).

The result of such a policy was that potential of FDI has long been under-utilised in the Czech privatisation. Voucher privatisation led to a very dispersed ownership structure without establishing the corporate governance and with a lack of necessary capital investment. The latter was also true for direct sales of state-owned companies to domestic owners (Zemplinerova and Jarolim, 2001). This and the financial strain of debt servicing and budget deficits pressed Czech government to change privatisation policy and to increase revenues from privatisation. Thus, in the second half of the 1990s the attitude of the Czech government towards foreign privatisations has become much more friendly and FDI inflows via foreign privatisation strongly increased (Hunya and Kalotay, 2000). In this period, another venue opened to foreign investors, i.e. the option of acquiring the newly privatised companies, i.e. to negotiate with the new owners instead of with the National Property Fund.

3.2 Hungary

Foreign privatisation in Hungary has been supported by the privatisation policy, which preferred the sales of state property to free distribution or give-away methods. In large deals, usually bids offering the highest (cash) values were selected. This practice obviously favoured foreign (especially large) investors (Szanyi, 2001). In Hungary, an attempt to introduce a mass scheme for major preferential treatment of residents and domestic investors in the privatisation has never been made. Company's purchasing price has been the

[3] Several hundred privatisation investment funds were established to collect and invest voucher investment points on behalf of individuals. 72% per cent of investment points were invested by the funds.

[4] Book value of companies included in the large-scale-privatisation was around USD 35 billion.

dominating factor in deciding to whom to sell. These are the main reasons that foreign privatisation has been so important in the Hungarian privatisation[5].

Sales to foreign investors has become especially important avenue of privatisation since 1995, when Hungarian officials realised that of the remaining 1,500 firms to be privatised, the interest of foreign investors was limited to 30-50 of them. The privatisation agency decided to devote special attention to these core firms, because they could attract foreign investors, generate significant privatisation revenues in hard currency, were important as export producers and were source of positive externalities on the domestic market. As a result, the inflow of FDI via foreign privatisation considerably increased. This could not have been done without the centralised nature of the Hungarian privatisation process, "personalised" in the State Privatisation Agency (Mihalyi, 2001).

The reasons why Hungarian privatisation favoured foreign investors have been the high level of foreign debt, budget deficits, the existence of joint ventures and above all the consensus that the improvement of Hungarian export performance, which was seen as the main structural prerequisite for the improvement of country's economic performance, is not possible unless the country was fully integrated into the international networks of multinational enterprises (MNEs). According to Mihalyi (2001, p. 62), "selling virtually each and every 'crown jewel' of the Hungarian economy to MNEs was a blessing in disguise".

3.3. Poland

Foreign investors in Poland were allowed to participate in capital privatisation and privatisation through liquidation. Capital privatisation, also called indirect privatisation, began with the transformation of a state-owned enterprise into a sole-shareholder company owned by the State Treasury ("commercialisation"), followed by the sale of shares of this company via public tender. Most of the large state-owned companies were privatised through this method, which has been the best suited and by far the most often used by foreign investors (Jermakowicz, 1993). In 1990-98, foreign investors were responsible for about 45% of the proceeds and 75% of the investment commitments from capital privatisation (Uminski, 2001).

In privatisation through liquidation, an enterprise was liquidated and its assets were sold by auction, leased out or contributed in kind into another company. Contribution in kind was the only privatisation through liquidation method, which allowed for FDI. Foreign investors were allowed to participate only if there were no domestic buyers. A new company, jointly owned by the State Treasury and the private (foreign) investor, was set up, and assets of the liquidated enterprise were transferred to it as the Treasury's share (Jermakowicz, 2001). Privatisation through liquidation was mostly applied to smaller enterprises. As a result, this path was dominated by employee buy-outs. By the end of 1999, there were 1,572 completed cases of privatisation through liquidation, of what only about 80 with foreign participation (Uminski, 2001).

Foreign investors also had a role in the Mass Privatisation Programme. Polish government distributed mass privatisation certificates among citizens. The certificates were converted into shares of National Investment Funds, which managed the shares of 512 enterprises included in the Programme. Ministry of Privatisation hired management groups to manage the Funds. Foreign participation in the Programme was, firstly, in the form of foreign management groups hired to manage the Funds and, secondly, as foreign acquirers of the companies included into Funds' portfolios (Jermakowicz, 1993). Until mid 1999, 47

[5] The shares of foreign currency in total Hungarian privatisation revenues in 1990-99 were as follows: in 1990 79.1%, in 1991 80.9%, in 1992 61.2%, in 1993 67.3%, in 1994 7.4%, in 1995 87.2%, in 1996 57%, in 1997 61.1%, in 1998 37.0% and in 1999 71.5% (State Privatisation Agency data; quoted from Mihalyi, 2001).

foreign investors were engaged in the acquisition of enterprises from Funds' portfolios. Detailed data, available for June 1996-June 1998, show that foreign investors were responsible for 69% (USD 587 million) of all Funds' transactions in that period. Foreign investors bought large companies in selected attractive industries (cement, automobile and chemical industries) (Uminski, 2001)[6].

3.4 Slovenia

Slovenian mass privatisation scheme was launched in 1992 by the adoption of the Ownership Transformation Act (OTA). Public utilities and financial institutions were not part of the scheme and most of them still wait for privatisation. Slovenian privatisation concept has been characterised by a mixture of free distribution, internal buy-outs with discount for insiders (employees, management) and commercial privatisation, and by autonomous preparation of privatisation programs by the enterprises. Each citizen was granted an ownership certificate, which he/she could exchange for the shares of a company or of an authorised investment ("privatisation") fund. OTA has given insiders of the companies the possibility to freely select the combination of available privatisation methods. Favouring of internal buy-outs has been the main characteristic of Slovenian privatisation. There were no limitations on foreign investor participation in the privatisation programs. Initial contact of the interested foreign investor had to be established with the target company directly; the company then had to prepare a privatisation program in such a way to include a foreign investor.

The fact that Slovenian mass privatisation concept favoured internal buy-outs, free distribution of shares and company-led privatisation in practice excluded foreign investors from mass privatisation in Slovenia. On the other hand, a considerable part of the existing FDI stock in Slovenia has been realised as foreign acquisitions in the same period, in most cases of companies that were not directly subject of OTA. This was effectuated through various modalities: (i) foreign privatisations of companies before the adoption of OTA; (ii) sales of subsidiary companies of non-privatised parent companies to foreign investors; (iii) foreign acquisitions of companies in the process of courts-led rehabilitation or liquidation; (iv) joint venture in which strategic foreign investor formed a joint company with a part of non-privatised company (Rojec et al, 2001).

In the early phase of privatisation, Czech Republic, Hungary, Poland and Slovenia had quite different concepts and policies to foreign privatisation. On the one side, it was Hungary with the most liberal policy to foreign privatisation and no preferential treatment of residents; the privatisation of its main enterprises in fact was based on foreign privatisation. Then there was Poland, which had a certain restraint to foreign privatisation, but allowed all the main companies to be privatised via FDI and had a relatively moderate mass privatisation programme. The third was the Czech Republic with a comprehensive voucher privatisation scheme and a preference for the "Czech way" in privatisation by direct sales, but still with a number of foreign privatisations during its first phase of privatisation. On the other side of the span was Slovenia, which allowed foreign privatisation in its mass privatisation programme, but in practice excluded foreign investors by a comprehensive free distribution of shares, by a preferential treatment of internal buy-outs and by giving the initiative for privatisation in the hands of enterprises themselves.

Changes of privatisation policies, which made foreign privatisation an increasingly important method of privatisation, happened in Hungary in 1995-96, in Romania in 1996,

[6] Ministry of Privatisation did not include those enterprises in the Mass Privatisation Programme, in which foreign investors had expressed a continuing interest. Sommer and Choroszucha (1993) reported that - due to legal reasons and due to the dispersion of shares in the enterprises - it was very difficult to acquire the controlling share in the enterprises included in the Mass Privatisation Programme.

and in the Czech Republic and Slovakia in 1997. The Czech government introduced an FDI friendly policy in 1998 and privatisation of companies and banks was re-launched by inviting foreign investors (Hunya and Kalotay, 2000). In Slovenia, after the privatisation under the mass privatisation scheme was finished, the new owners began to sell the privatised companies, while the state initiated the privatisation of some state owned banks and public utilities. This resulted in some big foreign acquisitions in Slovenia in the beginning of 2000s. Still, Slovenia has not basically changed its attitude to foreign privatisation. As a result, a large part of financial institutions and public utilities is still not privatised, while the role of para-statal funds in the manufacturing sector is still high.

4. EXPERIENCES WITH FOREIGN PRIVATISATION

At the end of the day, it is the impact of privatisation on company restructuring, efficiency and development, which really counts when one looks at different modes of privatisation. There is an ample evidence that foreign investment enterprises (FIEs), in principle, perform better than domestic enterprises (DEs) in CEECs; acquired companies/greenfields have significantly higher productivity than domestic companies, they have deeper foreign trade linkages by having disproportionately high shares in exports and imports, FIEs are the main profit generators in CEECs with higher relative shares of investments and R&D than domestic firms etc. (Hunya, 2000; Resmini, 2000; Rojec, 2000; Konings, 2001; Meyer, 1998; Damijan et al, 2003). Underlying reasons for superior performance of FIEs as compared to DEs are ownership specific advantages brought in by foreign investors (technology, production programmes, marketing channels, management and organisational knowledge etc.), economies of scale and advantages of subsidiaries' integration into their foreign parent companies.

Apart from that, there are also important privatisation specific arguments, which suggest that foreign privatisation will be relatively more efficient in privatised companies restructuring and development. The nation-wide mass privatisation schemes with preferential treatment of insiders and residents in general, brought about a dispersed ownership structure (corporate governance problem) and owners with a lack of entrepreneurship determined motivation, resources and knowledge for enterprise restructuring. The lack of real and efficient ownership led to delays in restructuring especially as voucher privatisation was accompanied by an acute lack of new financial resources for investment: In the case of insider privatisation, shares were usually paid from anticipated future profits of the privatised company, which prevented investments (Hunya and Kalotay, 2000). On the other hand, FDI as a privatisation method immediately provides strategic foreign investor as "responsible" owner who can quickly contribute to the improvement of the efficiency of the acquired company, its internationalisation and integration into the global economy. In other words, FDI brings in the privatised companies strategic foreign investors with entrepreneurship-determined motivation, interested in the profitability, efficiency and long-term development of a company and with a capability of realising these goals (Rojec et al, 1995).

The main conclusion of the literature on foreign privatisation in CEECs is that, from the point of view of corporate governance, company restructuring and development, FDI is probably the best performing mode of privatisation. In elaborating this point, we provide an overview of the existing studies on the subject. In the overview we amply use four surveys of foreign privatisations prepared by Artisien-Maksimenko and Rojec (2001), Estrin et al (2000), Wes and Lankes (2000), and Hunya and Kalotay (2000). The latter is in fact analysis of UNCTAD's survey. Artisien-Maksimenko and Rojec based their findings on the survey among the sample of 75 foreign privatisations in the Czech Republic, Hungary, Poland and Slovenia, the findings of Estrin et al are based on 12 case studies of foreign privatisations in

Bulgaria, Czech Republic and Slovenia, the findings of Wes and Lankes on the survey of 134 FDI projects in 16 CEECs, while UNCTAD surveyed 23 foreign privatisations from 7 CEECs. The four sources combined, plus a number of other analyses, which we use, enable a relatively robust assessment of the results of foreign privatisation. We concentrate on three specific aspects, which crucially determine the restructuring/development impact for a privatised company. The first relates to the objectives of target company's management and of privatisation agency in privatising a company via FDI, the second relates to post-acquisition changes and the third to post-acquisition performance of the privatised companies.

4.1. Objectives of host country actors in privatisation of companies with strategic foreign investor

On a host country side, there were two relevant actors in foreign privatisation in the mass privatisation era, i.e. privatisation agency and target company’s management. The objectives of these two actors for bringing a strategic foreign investor in a company have had a crucial influence on the restructuring of a company. Objectives and position of the two actors in mass privatisation were pretty much different than in the case of usual non-privatisation acquisitions. A seller in a usual, non-privatisation take-over is concerned mostly by the purchasing price, while considerations of a privatisation agency as the seller were much broader and concerned with a number of macroeconomic, social and "national" issues. Also, privatisation agency was responsible for privatisation of thousands of companies and was not able to go in depth with every single company. Because of that, the role of target company's management tended to be relatively stronger than in usual non-privatisation acquisitions. The issue here is what were the main interests and objectives of target companies' management and of privatisation agencies in foreign privatisations, were they going in the same direction, or were they in conflict with each other. We tackle this issue by looking in the objectives of both actors, in factors, which were decisive in selecting the foreign acquirer, and in guarantees and promises given by foreign acquirers.

The survey of Artisien-Maksimenko and Rojec (2001) put forward two objectives, which dominated considerations of target company’s management on why to attract strategic foreign investor; they are to save a target company and/or to secure its further development. Target company's management decided to attract strategic foreign investor when and if this would save and/or decisively improve the situation in a company. All the other objectives quoted by target company's management were a kind of derived objectives of the two primary ones; they related to additional financial resources, new technology/knowledge, access to (new) markets, integration into foreign parent company's network (see Table 3). Firms from the sample of Estrin et al (2000, p. xx) also believed that "they could not survive by themselves in the open, competitive, market environment and that they needed to have access to the factors that they lacked, such as technology, cash, managerial know-how, and marketing ... The need to search for a foreign partner had been accepted in the early stage of the transformation policy, even if it did not fit with national privatisation policy".

TABLE 3: Objectives of host country actors in foreign privatisation, factors leading to a winning bid, guarantees and promises of foreign investor - survey of 75 foreign privatisations in the Czech Republic, Hungary, Poland and Slovenia

	Level of importance (max: 3, min: 1)[1]
Objectives of target company's management	
(1) To save the firm from bankruptcy	1.7
(2) To access new sources of finance	2.3
(3) To acquire new technology	2.2
(4) To preserve employment	1.5
(5) To enter foreign markets	2.1
(6) To get management/marketing skills	2.2
(7) To access raw materials, components, inputs	1.3
(8) To secure the firm's long-term development	2.7
Objectives of host country's privatisation agency	
(1) To speed up privatisation	1.9
(2) To maximise the firm's price	1.8
(3) To save the firm from bankruptcy	1.6
(4) To secure the firm's long-term development	2.3
(5) To speed up integration into the world economy	2.1
Factors leading to a winning bid	
(1) Higher firm's price offered	1.9
(2) Employment commitments	1.6
(3) Investment commitments	1.9
(4) Employment commitments to the management of the target company	1.8
	% of all sample firms
Guarantees and promises given by foreign investor	
(1) Employment guarantee	28.4
(2) Best effort employment promise	29.7
(3) Future investment guarantee	56.8
(4) Best effort investment promise	40.5
(5) Employment promise to the existing management of the target company	50.0

Source: Artisien-Maksimenko and Rojec, 2001; *Notes*: 1/ Average scores were derived as follows: (3) very important, (2) important, (1) unimportant.

In bringing a strategic foreign investor in a non-privatised company, CEEC privatisation agencies attached most importance to target company's long-term development and speeding-up of local economy's integration into international economy. Only then come the operational objectives such as collecting high purchase price, speeding up privatisation and saving a target company from bankruptcy (see Table 3). Comparison of management and government objectives shows that both actors were crucially motivated by target company's restructuring and further development. The comparison, however, also shows differences. Management stressed the increase of management skills and access to new resources; the government agency, in turn, stressed benefits of local economy's integration in international market, speeding up privatisation process and collecting high purchase price. Government agency, apparently, takes a more macro-economic and social approach.

Factors leading to a winning bid and guarantees and promises given by a foreign buyer are complementary indicators of host country objectives in foreign privatisations. Table 3 puts forward higher purchase price and investment commitments as the two main factors, which made potential foreign investor the winner of the bid. While the privatisation agency was interested in increasing budget revenues by higher purchasing price, the management was interested in investment commitments, which would bring additional capital in the company. In the third place was employment promise to existing management, while employment commitments to employees in general appears to be the least important factor. Frequency and structure of foreign investor's guarantees and promises give pretty much the

same picture. Future investment guarantees and best effort investment promises were much more frequent than employment guarantees and best effort employment promises. Employment promises to the existing management were also much more frequent than employment guarantees and promises. Concern for target company's restructuring and development, plus that of target company's management employment was obviously in the forefront. Management tended to eliminate potential acquirers, which offered only higher purchase prices and selected those, which offered future investment commitments and employment commitments to the management.

Target companies' management was the most important host country actor in foreign privatisations in CEECs, especially in the case of smaller target companies. Privatisation agencies were not in a position to really actively involve in the privatisation of thousands of companies. That is why they tended to concentrate on controlling and active involvement in larger privatisations, while privatisations of smaller companies were left to be realised by their management. Roughly speaking, privatisation of larger companies was, in principle, privatisation agency driven, while privatisation of smaller companies was usually management driven (Rojec and Jermakowicz (1995).

4.2. Post-acquisition restructuring introduced by strategic foreign investors

Decision for a foreign privatisation is closely related to the expectation that foreign investor will launch a process of company's restructuring and adaptation to market conditions. The available analyses mostly speak in favour of intensive and positive post-privatisation restructuring in companies privatised by FDI. New owners usually introduced new production programmes, reorganised marketing activities, transferred technology, undertook training and reorganisation of management, financially consolidated acquired companies, but in the framework of streamlining the product line they also frequently downgraded the subsidiary to a sub-delivery base or to an assembly unit and reduced its decision-making competencies. Reduction of overstaffing is also a frequent post-privatisation measure, which, however, is not foreign privatisation specific.

There is a growing consensus that foreign investors, in principle, transform privatised companies deeper and faster than local investors, what is due to clear corporate governance, technological, managerial etc. advantages. Experiences of companies being privatised by FDI (see Illes, 1995; Jermakowicz et al, 1995; Rojec et al, 1995; Zemplinerova, 1995; Hunya and Kalotay, 2000; Estrin et al, 2001 etc.) show that restructuring of the acquired companies mostly took place as quick as possible through a speedy implementation of a variety of measures, such as upgrading product quality, reducing the range of products, introduction of new products, transfer of technology, giving market access, re-organising different functions in the companies, training the management and workforce, developing sales departments etc. Most, but not all case studies report (significant) investments in restructuring. In almost all cases, investments were combined with technology transfer and rapid improvements in quality.

In some cases, strategic foreign investors did not bring big overnight changes but only speeded up the existing restructuring efforts in the companies. In the course of restructuring, foreign firms preferred upgrading and expanding existing capacities over introducing totally new activities (Hunya and Kalotay, 2000). The pace of restructuring depended on a number of factors, mainly the nature of a product and the market structure; the more specific the assets, the longer it takes to adjust and to solve problems (Estrin et al, 2000). Results came faster if restructuring efforts had already been under before the acquisition. Previous co-operation between foreign investor and a target company was also important.

Sales of companies privatised by FDI often decreased after privatisation and so did employment, but less than on average in companies privatised other way (Hunya and Kalotay, 2000). In general, companies privatised via FDI passed through the process of defensive restructuring (reduction of non-viable activities and employment) in a shorter period of time than companies privatised other way. They also launched the process of offensive restructuring via new investments and employment faster (Simoneti et al, 2001; Szanyi, 2001). The role that companies privatised by FDI play in the new corporation networks is sometimes very different from what it was before the privatisation. This applies especially to companies that have become large-scale and highly specialised sub-assemblers within international corporate networks, losing their former full scope product range. Overall, restructuring and streamlining characterised the processes in companies privatised by FDI, which was motivated by efficiency-seeking considerations[7]. Investors maintained and developed only those activities that were relevant to them. The situation in market-seeking investments was different; new owners sometimes changed little in the acquired facilities and amply used established local marketing networks (Szanyi, 2001).

Table 4 summarises the changes and restructuring operations that have been undertaken by foreign parent companies in the privatised companies analysed by Artisien-Maksimenko and Rojec (2001). After the acquisition, the new owners most frequently introduced new production programmes, reorganised marketing activities, undertook training and reorganisation of management, and financially consolidated acquired companies. Further on we look in restructuring activities in more detail.

TABLE 4: Post-acquisition changes and restructuring operations in companies privatised by foreign investors - survey of 75 foreign privatisations in the Czech Republic, Hungary, Poland and Slovenia

	% of all sample firms
(1) Financial consolidation	40.5
(2) Selling of non-business or non-core- business assets/parts of the company	14.9
(3) Reduction of overstaffing	28.4
(4) Reorganisation of management	48.6
(5) Replacing members of the management	21.6
(6) Training of management	63.5
(7) Introduction of new programs	70.3
(8) Reorganisation of marketing activities	70.3
(9) Reorganisation of supply activities	31.3

Source: Artisien-Maksimenko and Rojec, 2001.

4.2.1. Production programme and market orientation

In 70.3% of the companies surveyed, new production programmes were introduced and marketing activities were reorganised. After the acquisition, most of the acquired companies from the sample (65.8%) produce the same goods as their foreign parent companies. This, in the first place, indicates the main intention of their foreign parents, which is to supply the local market by local production. In spite of the domination of local market-seeking motivation, exports to sales ratio has been quite high in the acquired companies, i.e. 48.5% on average.

[7] It is less clear, however, whether this streamlining is a natural consequence of a transition from over-sized state-owned firms to smaller, more specialised firms better adapted to a market economy, or it is typical for foreign-owned companies only (Hunya and Kalotay, 2000).

4.2.2. Transfer of technology

In 79.9% of the surveyed companies, new owners brought new technology/know-how/products. In 54% of companies, transfer was in the form of machinery and equipment and in 53% in the form of industrial property rights, manufacturing, marketing, organisational and managerial know-how and skills, computerisation of production, training of management and employees, etc. In 33.8% of cases, production processes in the surveyed companies are more or less identical to that in their foreign parent companies, while in 55.4% of cases they are more labour intensive. Obviously, the technology in the privatised companies is mostly different than in their foreign parent companies.

4.2.3. Training and reorganisation of management

Training (63.5% of the companies) and reorganisation of management (48.6% of companies) were among the most frequent post-acquisition measures of foreign investors. Frequent management training and reorganisation was necessary because there was not much replacing of existing management (only in 21.6% of the sample cases). The reasons for the latter were employment promises given to the management, no better local management available and limited rationale for bringing management from abroad.

4.2.4. Reduction of overstaffing

Knowing the chronic overstaffing in CEEC companies and in view of the fact that employment guarantees were given in only 28.4% of the surveyed companies, it is surprising that after the acquisition employment was reduced in no more than 28.4% of cases. This, as well, might be linked to pre-acquisition reduction of overstaffing, which was done in 36.5% of the companies. Methods of overstaffing reduction were in most cases "soft", i.e. financial support to early retirement, sales of non-(core)-business assets to redundant workers under favourable conditions and then buying their services, retraining of workers etc. This is very much in line with other findings on the subject, which report on the excess of labour force, on soft methods used for the resolution of this problem, and of emphasis given to the (re)training of the workforce (Illes, 1995; Jermakowicz *et al*, 1995; Rojec, 1995; Zemplinerova, 1995). Finally, Estrin et al (2000) claim that restructuring that followed the acquisition handled the excess labour problem smoothly.

4.3. POST-ACQUISITION PERFORMANCE OF THE ACQUIRED COMPANIES

Post-acquisition performance of CEEC companies privatised by FDI has been monitored and measured in a number of ways. The existing analyses offer the following evidence: (i) restructuring and performance trends in FIEs compared to DEs, (ii) performance and efficiency of foreign privatisation as compared to other privatisation methods, and (iii) trends in performance of companies privatised by FDI in the post-privatisation period. The overall assessment does not leave much doubt that foreign privatisation has been a successful privatisation method. FIEs have made higher contribution to the restructuring of CEEC economies than DEs and they also perform much better; companies privatised by FDI are among those which show the best post-privatisation performance and much above average export orientation; restructuring and performance trends in companies privatised via FDI intensified and improved after the privatisation. Apart from post-acquisition layoffs, which, however, were not foreign privatisation but overall transition specific, maybe the main problem has been that foreign

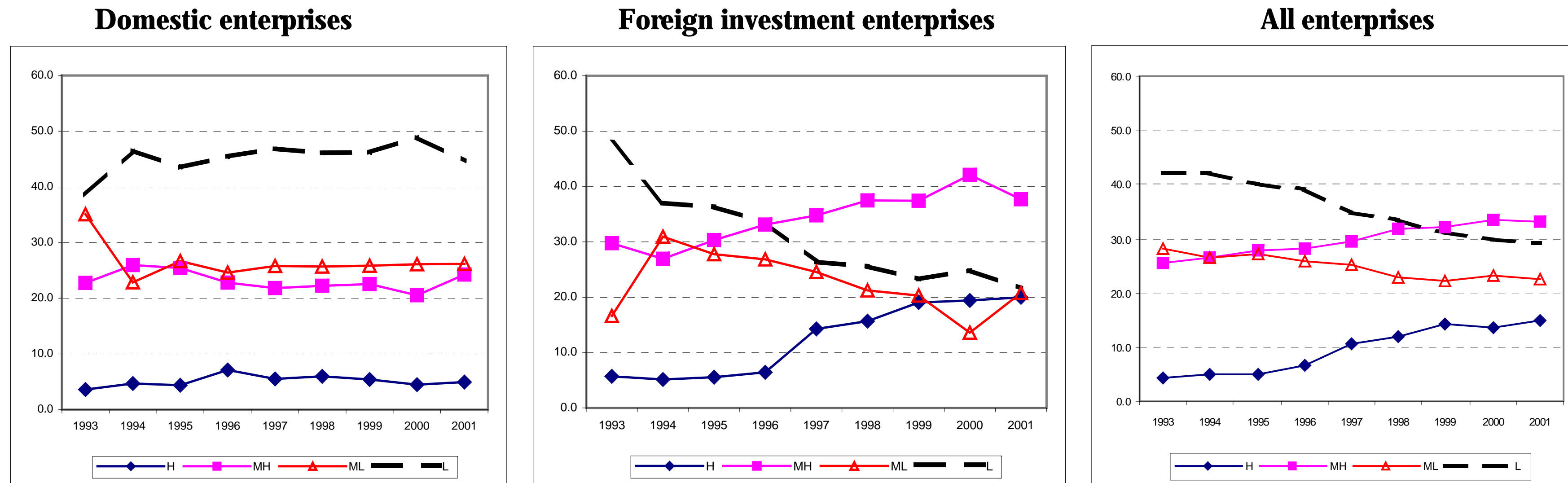
investors sometimes downgraded the acquired companies to a sub-delivery base or to an assembly unit and reduce their decision making competencies.

4.3.1. Restructuring and performance trends in foreign investment as compared to domestic enterprises

The most obvious indicator of the superiority of foreign privatisation as a privatisation method and of the post-acquisition performance of companies privatised via FDI is the contribution of FIEs to the restructuring of CEECs economies and their superior performance compared to DEs. Considerable part of the positive restructuring trends in CEEC manufacturing are due to FIEs, while the restructuring processes in DEs are much slower. In 1993-2001, FIEs in 6 new EU member states from Central and Eastern Europe strongly increased the shares of high technology (from 5.7% to 20.0%) and medium-high technology (from 29.7% to 37.7%) industries in total manufacturing value added, predominantly by reducing the share of low technology industries (from 48.0% to only 21.6%). Restructuring in DEs has been much slower and not really positive; we see the stagnation of the shares of high and medium-high technology industries and the increase/stagnation of the share of low technology industries (see Figure 1).

Table 5 reveals that productivity growth (in terms of value added per employee) in the CEEC manufacturing during 1990s was much higher in FIEs than in DEs. FIEs outperformed DEs in all the technology defined industry groups. FIEs recorded the largest productivity growth in high technology industries, which grew on average by some 40% faster than in medium-low and low technology industries, while productivity growth in medium-high technology industries has been lower.

FIGURE 1: Distribution of value added in the manufacturing sector by technology defined groups of industries[1]: For FIEs and DEs[2] in 6 CEECs[3] in 1993-2001; in %



Source: Damijan and Rojec, 2004, based on WIIW database; *Notes*: 1/ H = High technology, L = Low technology, MH = Medium-High technology, ML = Medium-Low technology industries. They sum up to 100%; 2/ FIEs = Foreign Investment Enterprises, i.e. enterprises with 10% or higher foreign equity share; DEs = Domestic Enterprises; 3/ Czech Republic, Hungary, Poland and Slovakia for 1993-2001, Estonia for 1995-2001, and Slovenia for 1994-2001.

TABLE 5: Cumulative changes in labour productivity[1] by technology defined groups of industries in FIEs and DEs[2] in 6 CEECs[3] in 1995-2001; in %

	FIEs	DEs
High technology industries	238	128
Medium-high technology industries	131	117
Medium-low technology industries	186	100
Low technology industries	191	124

Source: Damijan and Rojec, 2004, based on WIIW database; *Notes*: 1/ Average cumulative growth rates of value added per employee in individual industries within respective technology sectors; 2/ FIEs = Foreign Investment Enterprises, i.e. enterprises with 10% or higher foreign equity share; DEs = Domestic Enterprises; 3/ Czech Republic, Hungary, Poland and Slovakia for 1993-2001 Estonia for 1995-2001 and Slovenia for 1994-2001.

Another outstanding feature of FIEs is their superior export propensity compared to DEs. In all technology-defined groups of industries, except medium-low technology industries, FIEs show much higher exports to sales ratio and much higher increase of the ratio than DEs. There is no doubt that increased export capacity of CEECs has been one of the most outstanding features of foreign privatisation and FDI in CEECs in general.

TABLE 6: Export propensity[1] by technology defined groups of industries: For FIEs and DEs[2] in 6 CEECs[3] in 1993 and 2001; in %, Change in percentage points

	FIEs			DEs		
	1993	2001	Change	1993	2001	Change
High technology industries	31.5	89.2	57.7	17.3	34.9	17.6
Medium-high technology industries	44.4	81.0	36.6	27.8	52.3	24.5
Medium-low technology industries	30.0	36.0	5.9	20.0	39.4	19.3
Low technology industries	19.7	37.4	17.7	14.2	24.3	10.1

Source: Damijan and Rojec, 2004, based on WIIW database; *Notes:* 1/ Exports to sales ration; 2/ FIEs = Foreign Investment Enterprises, i.e. enterprises with 10% or higher foreign equity share; DEs = Domestic Enterprises; 3/ Czech Republic, Hungary, Poland and Slovakia for 1993-2001, Estonia for 1995-2001 and Slovenia for 1994-2001.

4.3.2. Results of foreign privatisation as compared to other methods of privatisation

Djankov and Murrell analysed 23 studies on the effects of different types of owners on post-privatisation company performance in CEECs. Among eleven types of owners, they found privatisation to foreigners to be the most effective, i.e. foreign privatisation has been ten times as productive (partial correlation coefficient between company performance and foreign owners was 0.052) as the least effective privatisation, which was diffuse individual ownership (partial correlation coefficient was 0.005). Still, foreigners as owners did not have statistically significant different effects on company performance than managers (0.047), concentrated individual ownership (0.048) and investment funds (0.051), which all belong to the group of the most efficient owners[8] (Djankov and Murrell, 2000, p. 29).

4.3.3. Post-privatisation restructuring and performance trends in companies privatised by FDI

UNCTAD survey conducted among 23 major companies in 7 CEECs, which compares pre- and post-privatisation performance of companies privatised by FDI, claims that

[8] Djankov and Murrell claim that the most inefficient types of owners are traditional state ownership and diffuse individual ownership, while insiders, outsiders, workers, banks and commercialised state ownership are in the middle group.

surveyed companies had shown improvements already in the pre-privatisation period[9], but in most cases, companies improved their performance considerably after privatisation. The performance of sales is the key to most of the improvements occuring in the companies surveyed. The rate of increase in sales accelerated from 11% in the pre-privatisation to more than 40% in the period after privatisation. All the performance indicators from Table 7 were much better in the post- than in the pre-privatisation period. It seems that cost saving, financial restructuring and output growth are the first post-privatisation targets of the foreign investor. Only after profitable operation was established, can new capacities and new products be introduced. Improved performance is to major extent the consequence of capital investment activities, whose average growth in the post-privatisation period was 36.6% (Hunya and Kalotay, 2000).

TABLE 7: Results of the UNCTAD survey on FDI and privatisation, 1999, in %

	Average growth	
	Pre-privatisation	**Post-privatisation**
Total output	7.1	30.2
Capital investment	27.9	36.6
Personnel cost	14.1	34.6
Revenue from sales	11.1	42.8
Total exports	39.5	33.8
Total imports	14.2	39.9
Productivity indicators		
Sales/assets	4.9	38.2
Sales/employee	16.4	47.6
Sales/Personnel cost	-2.6	6.1
Sales/Output (capacity utilisation)	3.7	9.7
Number of companies surveyed	23	

Source: UNCTAD survey on FDI and privatisation, 1999; quoted from Hunya and Kalotay 2000, p. 36.

In general, companies from UNCTAD survey have higher export propensity than local firms and the difference increases in time. The growth of exports after privatisation remains high. The survey results confirm import surplus as a general feature of local market oriented FDI in CEECs. The main reasons for a growing import propensity are: the increasing use of local affiliates as a distribution channel for imports, the substitution of earlier local sourcing by suppliers from MNEs own network, and an increase in capital investment, particularly in imported capital goods (Hunya and Kalotay, 2000).

5. CONCLUSIONS

Privatisation policies of CEECs have gone through the phase of nation-wide mass-privatisation schemes and the phase of post-privatisation ownership consolidation and of targeted sales of the remaining state property, mostly in manufacturing, financial sector and public utilities. In the first phase economic efficiency as motivation for privatisation was very much complemented by political considerations, like to enable people to participate in privatisation, to retain companies in endogenous hands, and the accent was on speedy privatisation of thousands of companies. In the second phase, the issues of corporate governance, enterprise restructuring and the acquisition price have come in the forefront. In the first phase, residents were, as a rule, given a preferential treatment in privatisation, while

[9] This was a result of pre-privatisation restructuring activities in the companies. Artisien-Maksimenko and Rojec (2001) report that pre-privatisation restructuring in foreign privatisations from their survey included reduction of overstaffing (36.5% of cases), sale of non business assets (27%), debt restructuring (23.0%) and operational restructuring (16.2%).

in the second phase, foreign investors have been, in principle, put on equal terms with domestic investors.

The available evidence on experiences with foreign privatisation in CEECs suggests that it has played a positive role in the post-privatisation restructuring and development of CEEC companies. Companies privatised by FDI, as a rule, made deeper and faster restructuring, and show better performance indicators and export propensity than other companies. The issue, which is often raised in relation to superior performance of companies privatised by FDI, is to what extent is this due to sample selection bias. In other words, do FIEs perform better than DEs because foreign investors tend to buy the best companies in CEECs? There is no doubt that to a certain extent this may be the case. However, claiming that superior performance of FIEs is mostly due to the acquisition of only the best companies would mean that one denies the importance of ownership specific advantages, of integration into international corporate networks (advantages of multinationality), of economies of scale, and in the case of foreign privatisation, in particular the advantage of bringing in a strategic type of owner. The fact that, contrary to most other methods of privatisation, foreign privatisation immediately establishes corporate governance and bring in a strategic foreign investor, with clear strategy and available resources to realise it is of major importance. Various analyses show that acquiring of better companies has not been the main reason for superior performance of FIEs. It is above all the fact that strategic foreign investors immediately and thoroughly restructure the acquired companies, introduce new production programmes, integrate them into their international corporate networks, what make them more successful.

The times of nation-wide mass privatisation schemes in CEECs are over. The issue now is acquisitions of the privatised companies and the privatisation of the remaining state-owned companies. As far as the former is concerned, the rules of the game in the EU are clear and policy wise there is not much to say. As far as the latter is concerned, the government may only have the following objectives: to maximise the positive impact of privatisation on the development of company concerned, on the host economy in general, on the budget revenues and on the employees. In this framework, the techniques on how to make a successful privatisation do not differ in any sense from techniques of foreign acquisitions, as presented in any textbook and amply practised in every day business life.

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