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An overview of privatisation in Nigeria and options for efficient implementation

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AN OVERVIEW OF PRIVATISATION IN NIGERIA AND OPTIONS FOR ITS EFFICIENT IMPLEMENTATION

by

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Privatisation has been recognised as a key element in the process of structural economic adjustment and seen as one of the panacea for economic malaise in the face of recent deterioration in the global economic environment. This is because, generally, public sector enterprises have been fingered as avenues for substantial losses and potent source of budget deficits. Privatisation on the other hand is known to promote efficiency, reduce fiscal burden, attract new investment and help in developing and deepening domestic financial market. Nigeria's privatisation experience had recorded some successes anchored basically on political will and use of appropriate option mix with emphasis on public offer of shares. However, the need to further encourage foreign investors, adopt optimal tariffs and increasingly apply the performance contract system for the state owned enterprises (SOEs) can not be over emphasised.

INTRODUCTION

Privatisation, which now occupies the center stage in global economic liberalisation is regarded as an avenue for raising productivity and enhancing overall economic growth. This is achieved through increased involvement of the private sector in productive economic activities through the sale of public enterprises to the private sector, with a view to improving economic efficiency. With privatisation, the role of government in direct productive activities diminishes as the private sector takes over such responsibilities. Under such a setting, government is expected to provide essential infrastructure and an enabling environment for private enterprise to thrive. Privatisation is predicated on the assumption of state inefficiency and "absolute" efficiency of the market.

Over the years, many countries, especially developing ones, have witnessed increasing costs and poor performance of state-owned enterprises (SOEs), resulting in heavy financial losses. Since the 1970s, in particular, SOEs have become an unsustainable burden in some countries, absorbing large share of budgets of governments in form of subsidies and capital infusion. For instance, SOEs are adjudged to have contributed substantially to public sector deficits and have financed less than one fifth of their investments through internally generated resources

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(Nair and Filippines, 1988). As some governments ran into severe fiscal problems such that loans became increasingly difficult to raise at home and abroad, they were forced to consider some radical methods for reviving the SOEs. Such reforms embarked upon by developing countries included privatization. Kikeri et al (1994) noted that the high costs and poor performance of SOEs and the modest and fleeting results of reform efforts have turned many government towards privatization. Other reasons include the collapse of communism in Eastern Europe and the Soviet Union, and some successes of privatisation undertaken earlier in countries such as the United Kingdom. Fiscal crises have also led some governments to privatize as a way of raising revenues and stemming losses, especially in the face of increasing public debt. Also, many governments are believed to have opted for privatisation because of their inability to finance investment in their SOEs than expectations of efficiency gains. However, the objectives of governments for embarking on privatisation vary from country to country. They include the expansion of the role of the private sector to improve mobilisation of savings for new investments, modernising the economy through increased private investment, new technology and efficient management to stimulate growth. Others are to facilitate the development of the competitive environment, provide greater employment opportunities over time and reduce the cost of goods and services to consumers. The need to improve government's cash flow, enhance the efficiency of the SOEs, promote 'popular capitalism' and curb the power of labour unions in the public sector, redistribute incomes and rents within society and satisfy foreign donors who would like to see the government's role in the economy reduced are generally fingered as rationale for privatisation. Privatisation which connotes a reversal of state ownership of enterprises has many different forms. For example, government might sell some shares in SOEs through public offerings to passive investors without losing control over the enterprise. Another variant of privatisation is leases and management contracts which entail no transfer of ownership. Partial privatisation mixes private and state ownership. Management contracts and leases combine private management with state ownership and control. Other privatisation arrangements mix private ownership with state regulation. However, the motivation that drives government to privatise and the political will to see it through would determine, to a large extent, the success or failure of the programme.

In Nigeria, there had been a cumulative dismal performance of SOEs which resulted in a "crisis of confidence". This was due to various problems which can be attributed to internal and external factors. The internal factors relate to inadequate and inappropriate investment decisions, adverse business environment characterized by weak capital base and control mechanism, poor system of accountability and the absence of any remarkable reward system. The external factors relate to unfavourable export/import prices, restricted access to external markets and funds; high rates of interest on foreign loans, etc.

Given the prevailing socio-economic and political conditions of the Nigerian economy, the justification for institutional reform of the SOEs derives from three main concerns which are macroeconomic in nature. The first, centers on the need for the restoration of fiscal balance in the highly indebted Nigerian economy in the light of excessive budget deficits, (which SOEs have been a major cause, through excessive loans) and their inflationary impact. The second relates to the need to improve efficiency in the public sector, especially the SOEs' sub-sector. The third factor, which is international in dimension, centers on the need to reduce the size of government involvement in economic activities in order to free some resources which could be deployed to alleviate international debt burden. The reform of SOEs in Nigeria has, thus, focused on such critical aspects as financial and physical restructuring via divestiture with a market-oriented approach under the Structural Adjustment Programme (SAP) adopted in 1986.

The objective of this paper is to review the major issues influencing the choice of privatisation strategies and options for their implementation in Nigeria, as well as, benefits derivable from the various options. For ease of presentation, the rest of the paper is divided into four parts. Part II reviews the relevant literature on the subject including policy framework while the status of privatisation/ commercialisation policy in Nigeria is treated in Part III. Part IV examines privatisation strategies and the Nigerian experience including prerequisites for successful privatization initiatives. Part V concludes the paper with some policy recommendations.

PART II

REVIEW OF RELEVANT LITERATURE AND POLICY FRAMEWORK

The expansion of state-owned enterprises (SOEs) in both developed and developing nations in the 1960s and 1970s was predicated on the assumption that these SOEs would provide opportunities for optimal and efficient resource allocation for national development. They were also expected to make greater contributions to national output, investment and employment. In this regard, many developing countries relied on SOEs than industrial economies did in the hope of substituting for a weak or non-existent private sector.

In developing countries, large public resources were deployed to the creation and development of SOEs, especially in the 1970s. This contributed to the accelerated growth of the SOEs in number, size and complexity. For instance, increased establishment of SOEs in Nigeria at the time was based mainly on the reasons that they were going to be leading edge of modernisation, generate resources for further investment, constitute the commanding heights of the economy, guarantee control away from foreign interests and lead the country towards self-sufficiency in the production of essential goods and services. Policy makers also believed that would increase employment.

In terms of size, available evidence shows that by the early 1980s, SOEs accounted, on average, for 17.0 per cent of gross domestic product (GDP) in sub-Saharan Africa in a thirteen-country sample (Nellis, 1986), 12.0 per cent for Latin America and a modest 3.0 per cent for Asia (excluding China, India and Myanmar), compared with 10.0 per cent of GDP in mixed economies world-wide (Short, 1984). SOEs in Nigeria are estimated to account for 16.3 per cent of GDP[1]. SOEs also accounted for as high as 90.0 per cent of all productive activities in Eastern Europe and Central Asia. It has, however, been observed in many countries, especially developing ones, that SOEs have been economically inefficient and have incurred heavy financial losses over the years. For example, World Bank estimates show SOE losses between 1989 and 1991 reaching 9.0 per cent of GDP in Yugoslavia, and more than 5.0 per cent on average, in a sample of sub-Saharan African countries. Similarly, about 30.0 per cent of all SOEs in China incurred losses, and the consolidated government and enterprise deficit was in the range of 8.0 per cent of GDP in 1991 (Mckinon, 1994; Yusuf and Hua, 1992). Notably, SOEs have contributed substantially to public sector deficits and typically financed less than one-fifth of their investments through internally generated resources (Nair and Filippines, 1988). According to World Bank (1993) estimates, government transfers and subsidies to SOEs amounted to 3.0 per cent of GNP in Turkey and 9.0 per cent in Poland in 1990. Also the financial performance of nine key SOEs (telecommunications, postal services, airlines, railways, transport, power, cement, iron and steel, and textiles) in five West African countries (Benin, Ghana, Guinea, Nigeria, and Senegal) has been persistently poor, with annual government transfers and overdrafts to these sectors ranging from 8 to 14 per cent of GDP. As governments ran into severe fiscal problems in the 1980s and loans became increasingly difficult to raise at home and abroad, they were forced to consider relatively radical methods for reviving the SOEs. The factors which influenced the choice of method of privatisation have included the objectives of government, current structure, size and financial performance and condition of the SOEs. Others have been the sector of operation of the SOEs, the relative degree of economic advancement within the country as well as the political arrangement.

[1] *Estimated from Accounts of SOEs with Central Bank of Nigeria*

PART III

PRIVATIZATION/COMMERCIALISATION POLICY IN NIGERIA

The promulgation of Privatisation/Commercialisation Decree No. 25 of 1988 gave legal backing to SOEs reform measures proposed in the Structural Adjustment Programme (SAP) document (Federal Republic of Nigeria, 1986, 1988). According to the Decree, the policy is aimed at the following objectives:

(i) restructuring and rationalisation of the SOEs to lessen the dominance of unproductive investments in the sector;
(ii) re-orientation of SOEs towards a new horizon of performance, improvements, viability and overall efficiency;
(iii) ensuring positive returns on public sector investments in SOEs,
(iv) checking of the absolute dependence on the Treasury for funding SOEs and encouraging them to patronize the capital market; and
(v) initiation of the process of gradual cession to the private sector of such SOEs, which by their nature and type of operations, are best performed by the private sector.

The Decree also provided for the establishment of a Technical Committee on Privatisation/Commercialisation (TCPC) to oversee the implementation of the programme.

Towards these ends, the TCPC, now Bureau for Public Enterprises (BPEs) classified the existing SOEs for partial/full commercialization, and partial/full privatisation on the basis of their respective commercial orientation. Within this classification, commercialisation is defined as "the reorganisation of enterprises wholly/partially owned by government in which such enterprises shall operate as profit-making ventures and without subvention from government". Under this definition, enterprises designated as fully commercialised ventures would be expected to operate profitably on commercial basis, adopt private sector procedures and be able to raise funds from the capital market without government guarantee. Partially commercialised SOEs were expected to generate enough revenue to cover operating expenses, with government providing capital grants for the financing of their capital intensive projects. Privatisation is conceptualised as the "the transfer of government owned share holding in designated enterprises to private shareholders, comprising individuals and corporate bodies" in addition to management control.

It is therefore apparent from these operational concepts that privatisation of SOEs is deemed to imply their commercialisation while a different consideration is given to ownership structure.

In the process of programme implementation, out of the 600 SOEs identified at the Federal level by the TCPC, 133 of them were earmarked for reform. Of this number, 111 enterprises were classified for privatisation and the rest for commercialisation (Table 1).

PART IV

PRIVATISATION STRATEGIES AND THE NIGERIAN EXPERIENCE

An optimal policy of privatisation must consider several issues, including which types of SOEs should be privatised. The question of when and how the privatisation programme should be carried out and to whom should the SOEs be sold and at what price are other issues that should be addressed. Also, the privatisation option to adopt would depend on the objectives of the divestiture. The options available include public offer of shares or initial public offering (IPO), Trade sale, New equity investment by the private sector and sale of public assets (asset disposal) as well as reorganisation or breakup leading to any of the earlier mentioned options. Others are employee or management buy outs and management contracts and leases. Any option considered appropriate or feasible would depend on a variety of factors, some of which are discussed below.

(i) Offer of shares to the Public

Privatisation of a SOE through initial public offering (IPO) or public offer of shares involves listing of the SOE on the stock exchange and extending invitation to individuals and corporate bodies to purchase the shares offered for sale at a given price. The entire SOE equity or part of it could be offered for sale depending on the privatisation objective as well as the depth of the domestic capital market. For instance in Latin America, where many countries had relatively well-developed capital markets, governments commonly sold a part of the equity to the public (Ramamurti, 1991). This method promotes wider share ownership and the transaction is perceived as open and transparent. It elicits wide publicity through the media to attract a wide range of participants. However, it is costly and may involve a small discount to maximize impact. By contrast, in Africa, where capital markets were underdeveloped or non existent, governments used management contracts and leases to privatise SOEs that were large or dominated their markets. However, the option could be politically damaging if it failed.

(ii) Trade Sale

The trade sale suits disposal of well-established SOEs which are sufficiently small and specialised not to merit IPO. It may be the only option in countries with vestigial capital markets. However, it is difficult to justify the sale price of the SOE as objective, as it could be challenged with the benefit of hindsight. The SOE which is performing poorly or technically insolvent may require write-offs before sale.

(iii) Sale of Assets

This may be the only option for SOEs that have been making losses over the years. It is the simplest and fastest method of sale, and may make an unattractive SOE business more attractive for sale. The state would have to retain all residual liabilities and may require big write-offs of remaining unsold assets. Employees may also have to be laid off by government.

(iv) New Equity Investment By The Private Sector

In addition to, or in lieu of the sale by own stockholding in the SOE, the government's share or all of its newly-issued stock of the SOE can be sold to private sector purchasers. This option may require conversion of the state enterprise into a public company where the management discipline of the private sector is introduced. This arrangement produces some revenues for the state when compared to outright privatisation.

(v) Reorganisation or Breakup

The government may embark on reorganising a SOE before deciding on any of the options in (i-iv) above. This approach, which is useful for dismantling monopolies prior to privatisation, allows a series of partial disposals to take place. However, the parts may be worth less than the whole. Competition may lower enterprise values, while smaller units may be less viable.

(vi) Employee or Management Buy-outs

Some or all of the stock in a SOE may be sold to the management and/or employees of the SOE. Such an arrangement may be one of necessity where no other interested purchasers can be found or it may be a matter of government labour policy to encourage employee ownership and participation in the enterprises being privatised. This option may allow privatisation to take place when all other methods are impracticable. It may lead to substantial improvements in performance owing to change of attitude to work and improved motivation. This approach, however, requires strong underlying cash flow in order to finance leverage requirement. It may also require state guarantees to achieve the buy-out deal.

(vii) Management Contracts and Leases

Assets are leased for a predetermined period to an outside group that assumes full commercial responsibility for operating them, while the state retains ownership and responsibility subject to agreed contract. The management provides skills and technology for an agreed fee. The benefits of this option include the introduction of private sector management as well as allowing the state to retain significant control. However, liabilities and ultimate responsibility remain with the government. The option may work when other methods are politically unacceptable, but poor performance could not be ruled out.

The Nigerian Experience:

In the course of privatising the affected enterprises in Nigeria, the TCPC evolved five methods.

(i) Public offer of shares through the Nigerian stock Exchange (NSE). To qualify for listing on the NSE, an enterprise must have a good record of profitability for 5 years and history of dividend payment of not less than 5 per cent for at least 3 years;

(ii) Private placement of shares, principally to institutional investors, core groups with demonstrated management and/or technical skills. This was done in enterprises where government holding was small, and the majority shareholders could not be persuaded to make public offer of shares, even when the conditions for listing were fulfilled; it was also used where the full potentials of the enterprises were yet to be realised and there is need for it to be nurtured for a few years. A total of seven enterprises were privatised through this method.

(iii) Sale of Assets: Where the above two methods could be applied because of poor track records, liquidation of assets was done via sale of assets on piece-meal basis to public through public tender. A total of twenty-six enterprises were privatised this way. Many small and micro enterprises owned by River Basin Authorities were affected.

(iv) Management Buy Out (MBO): where the entire enterprise or a substantial part was sold to workers who would organise and manage it in their own way.

(v) Deferred Public Offer: This method was applied where less revenue would be generated than the real value of the enterprises. Thus, a willing buyer/seller price was negotiated based on the re-evaluation of the enterprises' assets. The number of enterprises which have been privatised through these method are shown in Table 2.

The privatisation of SOEs in Nigeria had recorded some initial achievements. Some of the achievements include:

(i) Reduction in the size of the SOEs. Thus far, 88 enterprises have been privatised and about 27 others were commercialised successfully as shown in Table 2. A sum of ₦ 3.3 billion was realised from the sale of SOEs assets. The money raised the level of fiscal receipts and relieved the Treasury of undue pressure;

(ii) The capitalisation of the capital market rose from ₦ 12.0 billion in 1989 to ₦22.6 billion and ₦ 65.5 billion in 1991 and 1994, respectively. The exercise also expanded the frontiers of the Nigerian capital market in terms of resource mobilization and allocation; and

(iii) Privatisation has massively expanded personal share ownership in the country. About 1.5 billion equity share holders, forming two major share holders' associations in the country have "revolutionised" the entire system.

These relative success not withstanding, the programme implementation faced some problems. These include regional imbalances in shareholder distribution and bottlenecks in the system especially in processing application resulting in frustration for most of the applicants. Other problems were, inadequate access to credit which tended to dampen enthusiasm especially amongst the poorly paid working class, excessive intervention by institutional investors with the aim of broadening their portfolio as well as antagonism by labour on the ground of retrenchment and others with opposing ideological perceptions.

Various efforts were made to resolve these problems including improved access to finance through Central Bank of Nigeria's advise to banks to provide credit to prospective shareholders.

Prerequisites for Successful Privatisation Initiatives

Inspite of the recognition of the benefits of privatisation, there are records of unsuccessful attempts in some countries. This is because certain conditions precedent to its success are missing. A major prerequisite for successful privatisation is a firm commitment by government to enact broad measures to liberalise markets and the economy. This is because privatisation works best if it is carried out in a competitive environment. The ensuing competition would improve products and services quality, and with free entry and exit, only the efficient firms will survive. The markets that surround SOEs on the output and input sides must be liberalised at the same time. That means deregulating banks so that the SOEs would have opportunity to compete for capital at the market. It also means freeing up labour so that SOEs compete for appropriate labour without sacrificing quality for political expediency. However, reform fatigue owing to extensive debate, with little action, could adversely affect the privatisation programme. Governments should strive to maximise proceeds from privatisation by taking decisive actions on loss making SOEs, especially in the context of the globalising world economy. The lack of political will on the part of government and deference to special interest groups may delay the benefit of privatisation to the detriment of public interest. In addition, privatisation may lose its appeal if incentives and discounts are required to achieve successful privatisation of SOEs, thus reducing the revenue derivable from the exercise. This situation could arise when SOEs are bunched for privatisation resulting in a glut of investment opportunities.

PART V
SUMMARY AND POLICY RECOMMENDATIONS

(a) Summary

The paper reviewed the relevant literature and policy framework for effective privatisation. The objectives of governments for embarking on privatisation were noted to include the expansion of the role of the private sector in order to improve savings mobilisation for new investments and facilitate the development of the competitive environment. Others include redefining the role of Government in order to allow it concentrate on the essential task of governing; reduction of the fiscal burden of loss making SOEs and spreading and democratising share ownership for enhanced productivity and accountability. The justification for institutional reform of the SOEs in Nigeria was examined. This was based largely on the cumulative dismal performance of these enterprises. A major motive of the Nigerian Federal government in privatising SOEs appears to be the desire to improve government's cash flow as well as satisfy foreign donors who would favour a reduction in government's role in the economy. The major issues which influence the mode of privatisation and benefits derivable from the various options were also discussed. Moreover, conditions that would facilitate successful privatisation were highlighted. Among others, it was opined that Government should focus more on the critical motives and benefits of privatisation which include redistributing incomes and enhancing the efficiency of the SOEs through effective handling of the privatisation initiative. For example, government should exhibit deep commitment to market liberalisation upon which successful privatisation depends. It should also resolve the common conflict between quick and extensive privatisation and the desire to maximise proceeds from privatisation.

Furthermore, the necessity for hard budgets which would ensure that state subsidies and policy loans are eliminated, are noted. Similarly, the need for SOE monopoly prices to be regulated with a clear pricing formula that would keep pressure on management to improve efficiency were also discussed.

In a similar manner, the objectives, operational conceptualization and scope of the privatisation/ commercialization programme should be reexamined in order to correct some drawbacks due to omissions in the process of policy implementation.

(b) Recommendations

(i) the implementation of the requirements of the 1990 Company Allied Matters Decree under which commercialised SOEs would be incorporated for competition with others in the same business.

(ii) the need to operate optimal tariffs on the basis of marginal cost (MC) pricing rather than sub-regional tariff comparison. This is to preclude cost-push inflation which could arise as a result of arbitrary fixing of prices of goods and services.

(iii) the need to apply the performance contract system for evaluation purpose in the spirit of the Decree. The performance of SOEs that were reorganised for eventual privatisation should be monitored to ensure they live up to expectation.

Finally, foreign investors should also be further encouraged by government, although local investors are expected to take advantage of the bulk of the investment opportunities made available by the privatisation programme. Foreign participation should be considered where expertise is needed to upgrade efficiency and such expertise is not available locally. Foreign participation could open up the export market and provide global linkages and international exposure for privatised businesses. However, for projects of strategic and national importance, foreign ownership should be limited and widespread to ensure that no one foreign party would have undue influence on the enterprise. Foreign participation could take the form of equity financing, debt financing and management expertise.

TABLE 1

SECTORAL DISTRIBUTION OF PRIVATISED ENTERPRISES

SECTORS	NUMBER OF ENTERPRISES	REFORM TYPE
1. Manufacturing and Processing	**38**	
Textile companies	3	Full privatisation
Food and Beverage	6	"
Salt company	2	"
Wood & Furniture	2	"
Flour milling	1	"
Dairy companies	2	"
Steel rolling	3	Partial Privatisation
Fertilizer companies	2	"
Motor vehicle assembly	6	"
Paper mills	3	"
Sugar company	3	"
Cement company	5	"
2. Agriculture, Forestry & Fisheries	**20**	
Agric. & Livestock production	18	"
Cattle ranches	2	"
3. Transport & Communications	**6**	
Transportation	4	Full privatisation
Air & Sea travels	2	Partial privatisation
4. Building & Construction	**4**	
Construction & Engineering	4	"
5. Trading & Business Services	**39**	
Development banks	4	Partial Privatisation
Commercial & Merchant banks	12	"
Oil Marketing	3	"
Hotel & Tourism	4	Full privatisation
Insurance companies	14	"
Film production & Distribution	2	"
	111	

Source: TCPC Final Report Vol. 1, 1993.

TABLE 2

ENTERPRISES PRIVATISATION METHOD IN NIGERIA (1986 - 1989)

	METHOD	NUMBER OF ENTERPRISES
1.	Public offer of shares	53*
2.	Sales of Assets by public offer	8
3.	Private placement	7
4.	Management buy out	1
5.	Deferred public offer	4
6.	Stepped down to commercialization	5
7.	No further privatisation action necessary	11
		89
	Enterprises yet to be privatised	22

* Include 8 enterprises privatised by FMOA & FMOT before TCPC.

Source: TCPC Final Report Vol. 1, 1993.

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