Philanthropication *thru* Privatization

Building permanent endowments for the common good

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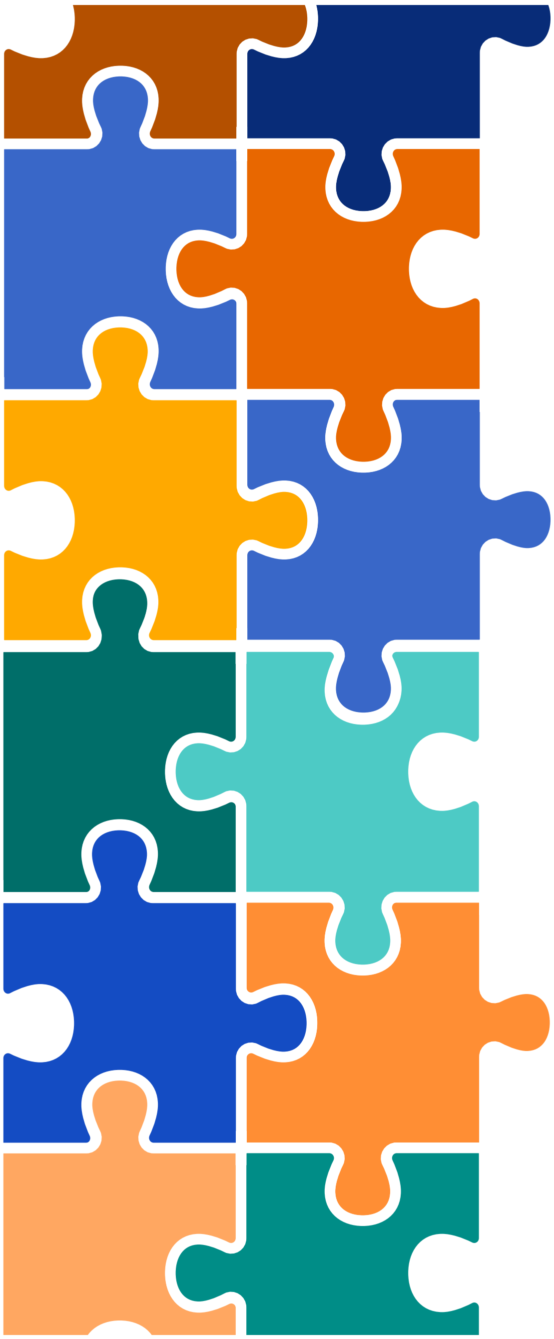

PtP How-To Booklet no. 2

How to Apply **PtP** to STATE-OWNED ENTERPRISES

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None of these organizations or individuals is responsible for any errors of fact or interpretation in the material presented here, however. That responsibility rests with us alone.

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Introduction

What is Philanthropication through Privatization?

This is one in a series of "How-To Booklets" intended to explain a new route to the formation of charitable foundations around the world. This route involves a range of transactions in which the ownership or proceeds of the sale of essentially public, or quasi-public, assets are transferred in whole or in part to charitable endowments. We have called this mechanism Philanthropication thru Privatization, or PtP for short.

EIGHT TYPES OF ASSETS AVAILABLE FOR PtP TRANSACTIONS

i. State-owned enterprises
ii. Other state property
iii. Royalties from state-controlled businesses
iv. Debt swaps
v. De-mutualization
vi. Stolen assets
vii. Penalty-based assets
viii. Stranded assets

The objective of PtP is to use a portion of the proceeds from privatizations to create, endow, and/or support new or existing charitable foundations, allowing these foundations to better pursue socially beneficial missions. This process thus transforms assets from public or quasi-public ownership or control to private charitable ownership or control, while still preserving something of the general public nature of the asset's function.

Recent research undertaken through the Philanthropication thru Privatization Project directed by one of the present authors has identified well over 550 foundations resulting from such transactions. Included here are some of the world's largest charitable institutions—such as the Volkswagen Foundation in Germany, the huge foundations of banking origin in Italy and Spain, the Nippon Foundation in Japan, and many more.[1]

The PtP Project has so far identified six different classes of assets that have been involved in such PtP transactions:(i) government-owned enterprises; (ii) other transfers of government property; (iii) enterprises required to pay royalties or fees to governments in return for access to government-regulated activities (e.g., running lotteries or extracting minerals); (iv) debt swaps in which creditors relieve debtor nations of financial obligations in return for debtor governments' paying an equivalent amount in local currency into charitable endowments; (v) the sale or conversion of quasi-public, nonprofit, or mutual institutions to private owners; (vi) stolen assets resulting from bribes or corruption; (vii) legal penalties levied by governments for corporate malfeasance; and (viii) assets stranded in accounts without legitimate claimants.

Having identified this new route to the creation of charitable endowments, the PtP Project is seeking to encourage its more widespread use, particularly in regions where charitable institutions and charitable resources are in short supply. It does so in the belief that the assets involved in such transactions are ultimately not the government's assets, but the people's assets—often their only such assets—created by the sweat and toil of a country's workers or belonging to the people as part of their birth right of resources. While the proceeds of such transactions can be used for a variety of purposes, the creation of charitable endowments has surfaced in numerous cases as a highly valuable one, creating permanent assets dedicated to the common good and establishing an alternative private channel for addressing priority issues that may not yet have attracted governmental attention.

This booklet, like the others in the series of such documents produced by the PtP Project, is designed to acquaint citizens with how the PtP approach to foundation development can be applied to one particular asset class—in this case the ***privatization of state-owned enterprises***. To do so, the booklet first explains what privatization of state-owned assets is, why it has been pursued by governments, what the scale of such transactions has been and will likely be in the future, and what downsides accompany privatizations. It then looks at how PtP can overcome these issues and yield win-win outcomes for governments, investors, affected communities, and citizens more generally.

Endnotes

[1] For further detail on these PtP foundations, see: Lester M. Salamon, (2014), *Philanthropication thru Privatization: Building Permanent Assets for the Common Good*, (Bologna: il Mulino). Also available at: bit.ly/PtP_FinalReport.

PART I

What is Privatization?

State-owned enterprises (SOEs) are government-owned companies that provide goods and/or services, on a commercial basis.

What Are SOEs and Why Were They Created?

As the name implies, state-owned enterprises (SOEs) are government-owned companies that provide goods and/or services on a commercial basis, to large segments of a nation's population. While some countries, such as the United States, have rarely employed SOEs—relying instead on privately owned businesses to provide virtually all commercial goods and services—most other developed and developing countries of the world have relied on them intensively. The most important, and pervasive, SOEs were those providing telecommunications, electricity, and other public utility services such as water, sewerage, and natural gas distribution. These fields seemed natural choices for state ownership since they were fields where natural monopolies existed, meaning that the normal mechanisms of market competition could not be relied upon to keep prices low and service widely available. Most societies created SOEs in these fields, or nationalized existing privately-owned companies, in order to ensure delivery of these vital services to broad cross-sections of the citizenry, often subsidizing these services to ensure that disadvantaged populations or residents of out-of-the-way locations could access them at affordable prices. In some cases, these services grew organically out of other government functions; the most important example of this is telecommunications, which evolved in almost every country (besides the U.S.) from the Army Signal Corps' technology and its need to provide secure military communications over long distances. In other cases, SOEs were created explicitly because private capital was considered insufficient, or insufficiently daring, to make the massive investments required to build out, for example, a modern electricity generation, transmission, and distribution grid, or to extend such systems into inaccessible regions with few paying customers.

SOEs dominate the "commanding heights" of many economies.

Over the four decades after World War II, state-owned enterprises rose to dominate the "commanding heights" of many economies—i.e., the key companies providing basic utility services, heavy manufacturing (e.g., steel), and banking services. This occurred in many western countries—especially in Europe, as well as in what are now called "emerging market" nations. In the newly de-colonized countries of Africa and Asia, governments often nationalized critical infrastructure companies owned by former colonial masters, and SOEs dominated the economies of the Soviet Union and communist China. National oil companies (NOCs) were founded the world over to ensure national access to vital energy resources or to displace foreign-owned companies, and these NOCs now control over 90% of the world's proven oil reserves. Similarly, almost all countries (again except the U.S.) launched international airline service through state-owned national carriers. State-owned enterprises reached their zenith in the late 1970s, when they accounted for over 20% of the gross domestic pro-duct (GDP) of Great Britain and other European nations, and often even higher GDP shares in developing countries.

SOEs remain enormously important components of national economies in many parts of the world.

And despite the rise of free-market economic systems, such SOEs remain enormously important components of national economies in many parts of the world. This is obviously the case in countries like China, where the World Bank estimates that about 30% of the economy is in majority state-owned enterprises.[1] Elsewhere in the developing world SOEs are also quite plentiful. India Coal, for example, is that country's largest enterprise with tentacles reaching into banking and other non-energy sectors. Similarly, Petrobras, Brazil's state-owned energy company dominates the Brazilian economic scene. Even in Western Europe, however, companies such as France's EDF (Électricité de France) and Germany's Deutsche Bahn (German Federal Railway) still dominate entire industrial sectors.

Privatization involves the sale or transfer of state-owned assets or enterprises to private investors.

What Is Privatization of SOEs and Why Do Governments Do It?

Privatization involves the sale or transfer of state-owned assets or enterprises to private investors. This policy of privatizing, or selling off, SOEs has been actively pursued by almost all national governments since Margaret Thatcher's Conservative government launched it in Britain during the 1980s. At work in the movement to privatize such enterprises has been popular reaction against the perceived low quality of service provided by many SOEs, especially in telecommunications and other utilities, and the lack of consumer choice inherent in state monopoly provision of goods and services. Ideology also played a role, as free market sentiments surfaced with the elections of Margaret Thatcher in the U.K. and Ronald Reagan in the U.S. and found strong support in Western economic circles and in key international organizations such as the World Bank and the International Monetary Fund (IMF). Margaret Thatcher, first elected in 1979, launched the first modern privatization program by selling shares of stock held by the state in SOEs to private investors, largely through public share offerings known as share-issue privatizations. When Ms. Thatcher left office in 1990, the role of SOEs in the British economy had been cut in half to about 10%, and the privatization program her government had developed was fast becoming a model adopted by governments around the world.

The largest and most important privatizations have involved the sale of government-held stock in SOEs to private investors through large share offerings, but many other types of transactions can be classified as privatizations of state-owned enterprises—including the direct sale of an SOE to a private company or investor group or the auctioning off of real estate or airwave spectrum—and all of these transactions offer possibilities for PtP.

When first launched by Ms. Thatcher's government, privatization was an extremely controversial policy that generated determined opposition from Britain's Labour Party, which promised to re-nationalize the companies that the Thatcher government had sold off. But the policy proved very successful, especially for government, and quickly spread elsewhere in Europe and eventually around the world. There are at least three principal reasons for this, though the reasons are far from non-controversial.

The most important reason is that privatization holds out the promise of significantly improving the financial and operating performance of state-owned enterprises, and the quality and responsiveness of services provided to the public. Over the past three decades, it has become clear that the actual performance of many SOEs lags far behind what was expected—or what is acceptable to consumers. Privatization brings in private owners and managers and fundamentally changes the incentives these new agents face—from satisfying the political wishes of government officials to maximizing firm value for shareholders. A large body of empirical research generated over the past quarter century clearly indicates that privatized firms typically become more efficient, more profitable, less heavily indebted, and make more capital investments than these companies did as SOEs, though each of these advantages also comes with costs. The evidence regarding employment change at former SOEs is thus more mixed, as is the empirical evidence regarding price changes for goods and services provided by the newly-privatized companies. Most studies show that the number of workers employed by privatized companies declines from the levels prevailing when these were SOEs—a byproduct of the push to become more efficient and productive—but the employment effect is muted by the fact that privatized companies also tend to experience accelerated growth after being divested, though this often takes considerable time. With regard to pricing, the mass of empirical evidence indicates that privatization generally results in stable or even declining prices after government divestiture, as productivity gains flow through to consumer prices, but there have indeed been several highly-publicized examples of

THE PROS & CONS OF PRIVATIZATION

The Pros

☺ Improves efficiency of SOEs
☺ Provides income gains for government
☺ Serves ideological goal of reducing government's role

The Cons

☹ Reduces SOE employment
☹ Boosts costs for formerly subsidized users
☹ Cuts service for hard-to-reach areas
☹ Prone to corruption

price increases—such as occurred for water and sewerage services in Britain during the 1990s—and this remains a very sensitive issue for policy-makers and citizens alike.

The second major reason why governments have adopted privatization is that selling state-owned assets or enterprises allows states to raise very large amounts of money without having to either raise taxes or cut government spending. Empirical studies suggest that governments generally, but far from universally, save most of the proceeds from privatizations by retiring outstanding debt or reducing the amount of new debt issued—rather than spending the sale proceeds on new or expanded government programs. Thus, privatization yields a significant fiscal bonus for most countries adopting the program, though considerable corruption has attended the privatization process in many locales, most notably in Russia and parts of the developing world.

Finally, many governments have adopted privatization as a policy for ideological reasons—to reduce the role of the state in the nation's business affairs or to reduce the power of public sector unions, or both. This rationale is, naturally, put forth as an explicit justification more often by right-wing and center-right political parties than by left-wing parties, but governments of all stripes have justified adopting privatization as a means to reduce state intervention in their economies. Experience has also shown that it is virtually impossible to inject competition into an industry when the dominant incumbent firm is state-owned, so governments wishing to liberalize and/or de-regulate an industry will often choose to simultaneously privatize the dominant SOE provider.

Does Privatization Have a Future?

Reflecting these concerns, according to the Privatization Barometer governments around the world have raised around US$3.5 trillion since 1977 by selling state-owned enterprises to private investors and corporations, with over US$2 trillion of that being raised since 2004. Roughly two-thirds of this total has been raised by governments selling stock they owned to private investors through share issue privatizations, with the remaining one-third being accounted for through various types of direct government asset sales. The privatization wave has also accelerated recently: the 48-month period between January 2013 and December 2016 saw governments around the world raise almost one trillion dollars (US$998.8 billion) through privatizations—dwarfing the total for any comparable previous period.[2]

While European governments once accounted for the lion's share of privatization sales and proceeds, leadership has shifted over the past fifteen years to emerging market countries—particularly China—and, surprisingly, the United States. The U.S. federal government was the world's leading privatizer in 2009, 2010, and 2012, as American banks repurchased the preferred stock that the federal government had issued to rescue these institutions during the 2008-09 global financial crisis. China is easily the country with the largest overall privatization program, measured by aggregate proceeds, since Chinese SOEs have raised over US$500 billion by selling newly issued stock to private investors, mostly since 2000.

Privatization has dramatically reduced overall levels of state ownership of business enterprises in most western nations—particularly in Europe—and has less drastically reduced the role of SOEs in many emerging markets. It should be noted that, while the importance of SOEs has declined in most countries, the state's overall economic role has not—in fact government spending as a share of national income has increased significantly worldwide over the past 40 years. Perhaps most importantly, even after all the recent privatization waves, the Economist estimates that governments still have up to US$9 trillion worth of assets and interests that could be sold to private investors in the years ahead, so privatization has a potentially very bright future.

Indeed, privatization may be accelerating worldwide. The annual pace of global privatizations has exceeded US$200 billion almost every year since the 2008-09 global financial crisis, and governments continue to have pressing needs for revenues to support rising demand for services. This pressure will doubtless be greatest in the rich, but aging, societies of Europe and developed Asia, especially Japan. And as the Economist data mentioned above noted, the supply of saleable assets remains large.

Perhaps the most important long-term trend that is emerging is that entire industries that were once off-limits for privatization will soon be put up for sale, beginning with state-owned national oil companies. Saudi Arabia will soon partially privatize Aramco in what will doubtless become history's largest ever share offering, and this could pave the way for many future national oil company privatizations. Similarly, huge privatizations are under way of institutions like Japan's Postal Bank and India Coal. PtP advocates could usefully focus very clearly on becoming involved in these divestments, as well as in the more traditional sales of state enterprises and assets.

PRIVATIZATION: FAR FROM OVER

→ US$3.5 trillion in privatization sales since 1977
→ US$2 trillion since 2004
→ Nearly US$1 trillion in sales in 4 years between
→ January 2013 and December 2016
→ China now the world's largest privatizer of SOEs
→ Governments retain up to US$9 trillion of SOEs
→ potentially eligible for privatization
→ Pace of privatization accelerating
→ Massive privatizations (e.g., Japan's Postal
→ Bank, Coal India, Saudi Aramco) in prospect

Sources: Privatization Barometer, Economist

Endnotes

[1] See: Gao Xu, (January 19, 2010),"State-owned enterprises in China: How big are they?", World Bank East Asia & Pacific on the rise blog.

[2] Privatization totals worldwide are tracked and discussed each year in a "Privatization Trends and Major Deals" article by the first author of this paper in the *Privatization Barometer Report*.

PART II

Why Does PtP Make Sense for the Privatization of SOEs?

SOEs dominate the "commanding heights" of many economies.

The Push-Back to Privatization

For all its popularity among governments and investors, privatization in its various forms has recently encountered more than a little push-back among citizens, and this certainly applies to the sale of state-owned enterprises. For, while privatization of SOEs brings numerous economic benefits, these benefits accrue mostly to investors and governments —while many citizens often experience its downsides, and these downsides have provoked increasing resistance to the privatization juggernaut. As one observer has put it: "After 2000, some of the bloom came off the privatization rose…[p]rivatization everywhere remains a very hard political sell."[1] One recent survey in Central and Eastern Europe, for example, revealed that 80% of respondents opposed the status quo achieved through privatization and wanted to change it in some way. Interestingly, only 29% favored returning the assets to government control, suggesting that respondents favor private ownership if they can see some more tangible benefit from the transactions that lead to it.[2] Surveys carried out by Latinobarometer covering 19,000 people in 18 Latin American countries found that the percentage of respondents who disagree or disagree strongly with the statement that "privatization of state enterprise has been beneficial for the country" rose from 54% in 1998 to 78% in 2003, and stayed close to 65% in four surveys taken since then.[3]

But scientific research is not needed to demonstrate the push-back on privatization of SOEs. Citizens have increasingly taken to the streets to oppose it. The original deal for the privatization of Ukraine's state-owned Kryvorizhstal steel plant, for example, helped generate Ukraine's Orange Revolution. Such protests have even penetrated China, as one Chinese provincial government was forced to halt the privatization of a state-owned steel mill in mid-2010 after thousands of workers took to the streets—this on the heels of another protest three weeks earlier in another Chinese province that led to the beating death of an executive overseeing the sale of another state-owned company.[4]

These protests and negative sentiments have made privatization politically treacherous. The fall-out is not only political, however. The consequences can also be economic. Thus, there were a significant number of failed, withdrawn, or cancelled privatization sales over the past six years, following a truly dismal record in 2010. Two prominent failures occurred in 2014 and 2015, respectively, when the Pakistani government was forced in November 2014 to cancel a planned sale of a stake in Oil and Gas Development, Ltd, its state-owned energy conglomerate, and when, the following year, the Chinese government backed away from selling up to 30% of the service stations of Sinopec, its own state-owned oil and gas company, losing a deal that might have raised $20 billion. Such events can be highly disruptive to the affected investors and highly damaging to country reputations, discouraging future investors from committing and lowering prospective prices on tendered assets.

Privatization of state-owned enterprises has "upside-down effects."

A major reason for this push-back against the privatization of SOEs is what one of the present authors has termed the "upside-down effects" of privatization.[5] Essentially, while it is widely believed that privatization brings overall positive economic results, these results take considerable time to become manifest and are very widely dispersed so that the benefits are hardly discernible to most people. By contrast, privatization often produces negative results for the workers and communities in close proximity to the privatized companies through layoffs, narrowing of health and pension benefits, and other cost-reduction strategies, and these negative results occur quickly and are highly concentrated on particular populations. Other consumers, too, can feel negative effects. As noted, one of the reasons that state-owned companies are found to be "inefficient" is that they were often deliberately created to ensure that disadvantaged populations can get access to critical services—even if this requires artificially low prices, special subsidies, or extensions of service to out-of-the-way locations whose residents are too sparse or too disadvantaged to cover the real costs. Privatization often achieves its efficiencies by ending these subsidies and halting the service, leaving vulnerable populations worse off. Add to this the fact that the private owners of formerly state-owned enterprises have been known to strip these enterprises of what assets they possess and sell-out quickly to reduce their risks, and it is easy to see why privatization's reputation has suffered in many places. On top of this, privatization has been prone to corruption and cronyism as insiders make off with enormous public assets at bargain-basement prices, a pattern that manifested itself especially dramatically in the privatization of Russia's state-owned enterprises in the 1990s, creating a powerful cadre of oligarchs and making large segments of the public, both inside Russia and without, highly suspicious of the process.

PtP offers a way to reverse the upside-down effects of privatization by creating "win-win" outcomes for all parties.

The Failure of Previous Efforts to Mute Popular Hostility to Privatization

This substantial resistance to privatization has given rise to a variety of efforts to mute this conflict by building broad public incentives into the privatization process. In the opinion of long-time World Bank privatization advisor John Nellis (2017), however, "these efforts have either produced very modest positive outcomes, or, more commonly, have failed outright." Two such incentives in particular have been most widely tried, and have almost universally failed.

Prior efforts to overcome popular hostility to privatization through subsidized public share sales or distribution of vouchers transferable into shares in privatized companies have either produced very modest positive outcomes, or, more commonnly, have failed outright.

The first of these was the offer, either to workers in firms slated for privatization or to entire populations, of heavily discounted ownership shares in companies slated to be privatized. This concept was widely promoted in the early years of postwar privatization in Germany by the popular postwar Minister of Economy, Ludwig Erhard, widely considered the father of Germany's postwar "economic miracle."[6] Erhard was an early partisan of privatization, and the Nazi-owned Volkswagenwerk Company provided a convenient early target. But Erhard's support for privatizing the Volkswagen Company was not motivated alone by his conviction that the state had no business being directly involved in industrial production. Also at work was his passionate philosophical commitment to what he termed Wohlstand für Alle, or "wealth for all," which he saw as a new era in the development of a social market economy to be achieved through the distribution of shares in the country's wealth to all people. The vehicle for this massive sharing of ownership was to be the issuance of people's shares (Volksaktien), and the privatization of the Volkswagen Company became the ideal instrument for putting this scheme into operation.

From the evidence at hand, it is hard to determine whether this plan materially improved the prospects for the privatization of the Volkswagen Company. It certainly did not convince the plant's workers, who remained staunchly opposed to privatizing the company despite Ehrhard's proposals. Nor was the federal Social Democratic Party of Germany impressed. To the contrary, despite the visibility given to Erhard's ideas during a political campaign in which he loudly trumpeted them, the SDP's representatives in the parliament voted solidly against every one of the legal provisions paving the way to the privatization.

More influential in the ultimate outcome, it appears, was the idea of creating a foundation out of the proceeds of the sale. This was certainly true of the management team of the Volkswagen Company, which was not at all amused by the idea of Mr. Ehrhard to spread ownership and control of this company among millions of citizen-stockholders. They therefore backed an alternative concept promoted by the then-Minister of Finance Georg Strickrodt of the State of Lower-Saxony, where the Volkswagen plants were located. Strickrodt advanced the idea of a charitable foundation as the inheritor of the Volkswagen Company, but a foundation that would function "as a new form of incorporated enterprise" (Die Stiftung als neue Unternehmensform), as he put it in a 1951 publication.

In the end, what emerged from the drawn-out battle over the privatization of the Volkswagen Company was a conglomerate proposal that married a version of Ehrhard's *volksaktien* idea with the creation of a foundation, but one divorced from ownership of or by the company and more responsive to popular concerns about the health of Germany's scientific capabilities in the aftermath of the 1958 Sputnik launch than to Strickrodt's notion of a "new form of incorporated enterprise."

As to the *volksaktien* element in the privatization plan, it did not work out anywhere close to the way Mr. Ehrhard had hoped, or that the PtP foundation idea achieved. Ultimately, 60 percent of the shares of the company—some 360 million shares—were set aside for purchase by citizens, but through a complicated system of rebates and privileges.[7] Far from creating a community of citizen-owners of prized enterprises as Ehrhard had imagined, however, the purchase price of the shares was so far below the actual market value that, despite a stipulation that purchasers must hold their shares a minimum of two years or have to refund the rebate, within 6 months of the date of issuance 20% of the purchasers had sold their shares at a price that by then stood at 1110% of the purchase price, and most others took the same route subsequently.

Nor was this early negative German experience with such discounted share sales to citizens an isolated case. Rather, the practice was used widely in other privatization cases, with similarly disappointing results. As the Senior Manager of the World Bank's Privatization and State-Owned Enterprise reform practice summarized the experience:

> *"Since such shares were often transferred at highly discounted prices, the new share-holders could, and very often did, quickly sell the shares in the secondary market and pocket a profit. While the political gain to the selling state was not nil, it was ephemeral. And if workers were laid off by new owners, a frequent occurrence, the small gain from the stock sale was outweighed by the loss of job.*[8]

Similar disappointments surround a second widely used effort to suppress or avoid political opposition to privatization: namely, the use of *vouchers*. Vouchers are certificates distributed to citizens or workers in firms targeted for privatization to enable them to acquire ownership stakes in companies being privatized without having to come up with actual cash. The avowed object is to avoid letting only wealthy locals or foreigners take ownership of privatized firms.

In actual practice, however, voucher schemes backfired terribly. In the Czech Republic, for example, all state-owned firms were transformed into joint stock companies and vouchers entitling recipients to acquire shares in the resulting companies were distributed to all citizens over the age of 18 for a fee roughly equivalent to one week's average wage. Private investment funds quickly came into existence, however, and attracted most of the vouchers, thus leaving citizens with shares in the investment funds rather than in specific firms. With little or no regulation, corruption became rampant in many of the funds, while others came under the control of state banks more concerned with their own profits than the success of the privatized companies. This produced, according to an OECD country report, ownership structures that "impeded efficient corporate governance and restructuring"[9] and that benefited "a small group of people …while the mass of citizens received, directly at least, little or nothing from the transfer of former state property."[10]

And this was one of the more successful applications of the voucher approach. In Russia, the approach reached its true nadir, with a dominant two-thirds of the shares in about two-thirds of all privatized firms in the hands of firm managers and "insiders" while stakes in 13 high-potential, natural resource-based firms were essentially handed over to Russian commercial banks, all apparently owned by a group of financial ''oligarchs'' connected to the presidency. Far from engendering citizen support, the voucher scheme thus ended up provoking serious citizen complaints that the shares they had acquired for their vouchers were worth little or nothing.[11] The overall result of Russian privatization, as one group of analysts summed things up, was that:

> *"…a new kleptocracy emerged. A small number of individuals, who mostly achieved initial wealth through favorable deals with, or outright theft from, the government, ended up controlling most of Russia's major firms and, to a nontrivial extent, the government itself."*[12]

More generally, as Senior Manager John Nellis of the World Bank's Privatization and State-Owned Enterprise reform practice has concluded, in most places where the voucher method was used:

> *"…the mass of citizens came fairly quickly to believe that vouchers were a sham that provided few if any benefits. They were a facade, behind which insiders, oligarchs, and the politically well-connected obtained controlling interests in the best assets, leaving only a few crumbs for the average voucher holder."*

PtP offers a way to reverse the upside-down effects of privatization by creating permanent pools of resources that can be used to offset the negative effects that privatization often produces, but not ephemerally, like these prior approaches.

PtP As a Win-Win Option

Compared to these prior attempts to overcome popular hostility to the sale of public enterprises, PtP offers a number of crucial advantages. In a sense, PtP offers a way to reverse the upside-down effects of privatization by creating permanent pools of resources that can be used to offset the negative effects that privatization often produces, but not ephemerally, like these prior approaches, but rather in an on-going way. PtP does so by creating significant charitable institutions endowed with permanent assets that can deliver benefits to citizens over the long run. What is more, PtP does this without interfering with the establishment of suitable institutional structures in the privatized industries, a risk that the prior mechanisms encountered prior to leading to the eventual emasculation of citizen control as various politically connected interests took advantage of the situation to secure effective control of the subsidized shares, leaving citizens feeling that privatization was nothing more than a huge rip-off of the citizenry. The PtP concept, by contrast, calls for the creation of independent foundations, separated from the managerial structures of the privatized companies, carefully insulated from political control, and equipped with transparency and accountability provisions that in many places exceed those exhibited by state organs.

By placing all or a significant portion of the assets resulting from privatization transactions into private charitable institutions dedicated to improving the quality of life of citizens—particularly citizens most negatively affected by privatization—PtP can reduce citizen opposition to legitimate privatization transactions by ensuring citizens that they will share in the benefits that can flow from the sale of assets that are their birthright or the product of their sweat and toil, and will do so on a long-term basis. As such, PtP offers special benefits that create “win-win” outcomes for all parties involved in privatization programs—investors, governments, communities, and civil society.

Even 10% of the resources secured by the government of Ukraine from the sale of the state-owned Kryvorizhstal steel would have created a US$480 million national community foundation in this country.

PtP's benefits to communities

Most obvious are the benefits to communities resulting from PtP's contribution to building endowed charitable institutions dedicated to improving the quality of life for citizens and fostering effective nonprofit organizations that can provide important health, education, and related benefits over the long term. The need for such social support programs provided by charitable institutions is pervasive, and is most acute in poorer or transitional countries; but private funding for the foundations that could support these services—alone or as a partner with governments—is desperately lacking. Given the scale of privatization transactions, moreover, the scale of such resources can be substantial. Even 10% of the resources secured by the government of Ukraine from the sale of the state-owned Kryvorizhstal steel, for example, would have created a US$480 million national community foundation in this country. Such institutions are also in a position to mobilize additional resources of time and money through charitable donations and volunteer activity, and thus to add further to the contribution they can make to improving the quality of life and strengthening the economic fortunes of citizens. Thus, for example, the King Baudouin Foundation, a PtP foundation that generates a sizable share of its endowed revenue from a concession arrangement with the Belgian lottery, has attracted over 600 new donor advised funds created by individuals and companies. In the process, PtP can ensure that the benefits of privatization do not flow exclusively to outside investors or local elites but are shared more broadly with a country's citizens in a transparent, focused, and enduring way.

But PtP also brings important benefits to governments and investors.

PtP's benefits to governments

Transferring ownership of important national assets from governments to private companies or individuals is always troubling for many people, but this queasiness can be at least partly reduced by ensuring that privatization also creates or expands socially beneficial charitable institutions and endowments. By accomplishing this, PtP can deliver important benefits to governments, including:

- Improved ability to attract investors.
- Avoidance of failed privatization sales and consequent access to the revenue that might otherwise have been lost.
- Guaranteed support for priority programs requiring committed resources over an extended period—such as fostering scientific advances, extending internet access, encouraging high-tech development, improving the environment, providing worker training, or investing in education.
- The creation of new institutions capable of mobilizing new charitable and volunteer resources and serving as partners with governments in addressing priority public problems.
- Improved international reputation leading to greater access to foreign direct investment.

PtP's benefits for investors

Investors in privatization transactions also stand to benefit from PtP. The advantages to them include the following:

- Greater likelihood of community support and consequent avoidance of failed or delayed sales.
- Resulting advantages in the bidding process from governments eager to demonstrate to citizens that privatization will yield benefits for them as well.
- Clearer license to invest and operate resulting from early good will with employees, potential customers, and suppliers.
- Positive reputation among international customers and suppliers. Already, the *Economist* magazine has taken notice of the PtP idea and endorsed it in a recent article.[13]

More than 550 endowed, independent, charitable foundations have already been created or enriched through one or another type of privatization transaction over the past 65 years.

Evidence That PtP Works

Perhaps the best evidence of the advantages that PtP can bring is the fact that more than 550 endowed, independent, charitable foundations have already been created or enriched through one or another type of privatization transaction over the past 65 years—most of them since 1990. These foundations currently control assets worth about US$156 billion, and operate in 23 countries scattered broadly across the globe. The most common type of PtP transactions are those involving the privatization of quasi-public institutions, such as nonprofits or mutuals, but sizable numbers of PtP transactions have involved SOEs as well.[14] These institutions were not created in response to pressure from some international organization. Most were not even aware that other similar institutions were in existence since no "philanthropication thru privatization," or "PtP" concept existed to call attention to their common origins. Rather, each arose as a win-win solution to a problem impeding a privatization transaction. In short, this concept has already been road-tested over 550 times and been found to work.

The first large PtP organization created—the Volkswagen Foundation (*Volkswagen Stiftung*)—was formed in 1962 to resolve a stand-off between Germany's national government and the German state of Lower Saxony over ownership of the Nazi Party's Volkswagen Company following the postwar occupation of Germany. As a result, no settlement could be reached about which government could privatize it and claim the proceeds. When the need for resources to support German science became especially urgent following the successful launch of Sputnik by Russia, German policy-makers turned to what we would term a “PtP solution:” they agreed to privatize the company and place 60% of the proceeds in a newly created, independent “Volkswagen Foundation” dedicated to improving German science, splitting the remaining 40% between the Federal Republic and the state of Lower Saxony. Starting with an endowment of under US$1 billion, this foundation has built an endowment of €2.9 billion (US$3.2 billion) while distributing more than €4.2 billion (US$4.6 billion) to over 30,000 projects in support of German science over the past five decades. This pattern has been repeated with other German privatization sales, including the huge German National Environmental Foundation (*Deutsche Bundesstiflung Umwelt*), which was formed in 1990 from the sale of a state-owned chemical company and has become perhaps the world’s largest environmental foundation.

Indeed, PtP foundations have taken their place among the largest foundations in the world. Included are Spain’s US$20 billion “la Caixa” Banking Foundation, created in 2013 through the privatization of a huge Spanish cooperative bank; Italy’s Cariplo Foundation, which, prior to the recent financial crisis, controlled assets larger than the Ford Foundation, the second largest foundation in the U.S.; Japan’s Nippon Foundation supported by the proceeds from the heavily regulated motor boat racing betting; and many more.

Endnotes

[1] John Nellis, (2012), "The International Experience with Privatization: Its Rapid Rise, Partial Fall, and Uncertain Future," *SPP Research Paper*, 5(3), pp. 11, 24.

[2] Timothy Frye and Ekaterina Zhuravskaya, (2007), "Support for Revising Privatization in the Post-Communist World," *The PB Report 2007.* (Milan: Fondazione Eni Enrico Mattei), pp. 49-50.

[3] Corporación Latinobarometer, 2010 Report, cited in Nellis (2012) p. 20. See also: Carol Graham and Sandip Sukhtankar, (2004), "Does Economic Crisis Reduce Support for Markets and Democracy in Latin America?" *Journal of Latin American Studies*, 36(2), pp. 349-377.

[4] Keith Bradsher, (August 17, 2009), "Bowing to Protests, China Halts Sale of Steel Mill," *New York Times*.

[5] Salamon (2014).

[6] The discussion of the genesis of the Volkswagen Foundation and the role of people's shares in it draws on a Field Guide on this PtP case prepared for the PtP Project under the supervision of Rupert Strachwitz of the Mecenata Foundation in Berlin.

[7] Thus, a rebate of 20% was given for a maximum of five shares to people with an annual income lower than 6,000 German Marks (12,000 marks for married people), a rebate of 10% for those with an annual income lower than 8,000 German Marks (double for married people), an additional rebate of 5% for families with more than two children, and a special privilege for Volkswagen Company employees to purchase up to 10 shares with the company paying for the first one completely.

[8] John Nellis, personal email communication to the authors, September 9, 2017.

[9] OECD (1998, p. 49), cited in John Nellis, (2008), "Leaps of Faith: Launching Privatization in Transition," in Ira W. Lieberman and Daniel J. Kopf, *Privatization in Transition Economies: The Ongoing Story* (Contemporary Studies in Economic and Financial Analysis, 90), Emerald Group Publishing Limited, p. 102.

[10] Nellis (2008), 102.

[11] Nellis (2008), 112.

[12] Bernard S. Black, Reinier Kraakman, and Anna Tarassova, (2000), "Russian privatization and corporate governance: What went wrong," *Stanford Law Review*, 52, 1746–1747.

[13] Matthew Bishop, (September 21, 2013), "A Spoonful of Sugar: Endowing charities can make privatisation more palatable," *The Economist*.

14 Salamon (2014). See the PtP website at p-t-p.org for the latest tally of PtP foundations.

PART III

How Does Privatization Work?
The Basic Steps

The privatization of state-owned enterprises can seem dauntingly complicated. It may be useful, therefore to break it down into its component steps. In particular, the following steps must usually be followed for all privatizations: (1) Establishing the legal authority to privatize—either to authorize a pro-gram of multiple sales or to authorize divesting a single company or industry; (2) Selecting companies for privatization, and establishing a calendar for sales; (3) Preparing the firm for privatization; (4) Choosing the appropriate privatization method; (5) Setting the price for the sale; (6) Implementing the sale process; (7) Executing the transfer of ownership and re-arrangement of responsibilities; and (8) Allocating the proceeds. Each of these steps is described in more detail below. For the more complex share issue privatization method of divestment there are additional steps required between points 5 and 6 above, and these will be discussed to conclude this section.

Of central concern to PtP advocates should be the provisions for transparency and for fair and impartial access to the process.

PRIVATIZATION STEP 1: Establishing authority to privatize

A first step in any privatization process is for a government to establish: (a) the authority to sell one or more of its SOEs; (b) the criteria for choosing which SOEs to privatize; (c) the procedures through which such transactions can take place; and (d) the organizational entity to which the responsibility for managing the privatization is assigned. This is usually done in a formal law or decree of the governing body. The resulting laws and identity of the implementing agency should be available online.

PtP TIP #1: *Of central concern to advocates of PtP should be the transparency provisions built into the process and the provisions for fair and impartial access to the privatization process. Also of concern should be any provisions that prohibit the transfer of any proceeds of privatization sales to private entities such as charitable foundations.*

The choice of the body responsible for privatization can be very important and have far-reaching implications. Some governments simply hive off a body within a government ministry—usually the Ministry of Finance (MOF)—to handle some or all aspects of privatization, and staff this with mid-level bureaucrats. Other governments establish an entirely new agency, headed by a senior appointee but still under the MOF, with the sole mission of developing and managing the privatization process.

Finally, the most unambiguous signal of determination to privatize rigorously is shown by those governments that establish an entirely new Privatization Ministry, with its own staff, a director of ministerial rank, and the clear mandate to divest speedily and well. This last option is only rational when a country has a large number of important companies it wishes to privatize, since this is the most expensive option—but also the most transparent and empowering.

Having PtP on the table at an early stage can reduce concerns about possible negative effects of privatization.

PRIVATIZATION STEP 2: Selecting companies for privatization and establishing a calendar for sales

Once a privatization authority has been established, the entity with responsibility for privatization activity must establish a program identifying the enterprises that will be candidates for privatization; the schedule for the transactions; and the procedure through which the transactions will be handled. Selecting SOEs to privatize is usually a complicated process involving equal parts political negotiation and economic analysis. Governments often find that, for reasons lost to political history, they own numerous relatively small- to mid-sized businesses providing non-core products and services. These are often in reasonably competitive condition and thus require little rehabilitation before being offered for sale, and are thus usually sold at the start of a privatization program. Rational governments generally choose to "sell the easiest ones first."

Deciding which large SOEs providing vital goods and services to sell is a much trickier task. Since governments historically created or nationalized SOEs to provide such services nationwide, the key companies that are candidates for privatization tend to be among a nation's largest and most important—including utilities such as telecommunications, electricity production and distribution, water and sewage, and airlines and banks. Unless executed properly, privatization of such critical companies (or entire industries) can be very problematic. And since these companies are invariably large employers, and often heavily over-staffed, the difficult question of redundancy always raises its head at this early stage, and remains a concern throughout the process. Having the PtP option on the table at this early stage can frequently offer a way to mitigate, if not remove, these concerns.

In the early years of privatization, selecting which SOEs should be privatized first involved a major leap of faith on the divesting government's part, since no one really knew which companies could transition to private ownership most successfully. However, the passage of time, and accumulating experience, have helped policy-makers develop a set of "best privatization practices," which allow them to address the industrial, financial, and political challenges posed by privatizing SOEs. One of the most important such insights was that governments should adopt the aforementioned "sell the easiest companies first" policy—meaning those which are already relatively efficient and not loss-making—and defer privatizing the weakest companies perhaps for several years. Further actual post-sales operating performance soon showed that most companies improved performance after privatization, and that industries such as telecommunications and banking could best flourish under private ownership.

Some industries—such as nuclear power generation, water and sewage services, and subsidized passenger rail transport—are especially difficult to privatize effectively.

However, experience also showed that some industries—such as nuclear power generation, water and sewage services, and subsidized passenger rail transport—were especially difficult to privatize effectively, either because of the compelling need to provide strong oversight to ensure safe operation (nuclear power) or because the high capital costs required to provide quality service imply monthly charges that many consumers cannot afford (water and sewerage). More generally, it is very difficult to privatize any service that requires a subsidy to operate affordably, which is why very few subway, light rail, or intercity train services have yet been fully privatized. A final important insight gained was that if a state enterprise truly needed financial or operational restructuring before it could prosper as a private company, it was usually best to leave this restructuring effort to the new private buyers of the SOE, rather than for the government to attempt to "reform" the SOE itself before sale.

PtP advocates would be wise to establish contact with privatization officials early and to monitor the process regularly.

Once the privatization program has been established, the privatization agency should be expected to publicize it through various channels including their websites. Experience has shown that a firm deadline is vital to motivate managers and workers in a SOE slated for privatization to complete any necessary preparatory work on time. The actual planned sale details—date, time, location, sale method, minimum price (if any), and duration of sale—should be clearly and repeatedly announced, far enough in advance to maximize participation at the sale itself.

PtP TIP #2: *Failure to publicize the plans is an early indication that the process is not being handled in a fully transparent manner. PtP advocates would be wise to remain in contact with privatization authorities during this early stage and monitor privatization agency websites.*

PRIVATIZATION STEP 3: Preparing the firm for privatization

A crucial early step is preparing a company for sale. If the SOE is already a joint stock company operating in a competitive industry, the preparatory phase may be both short and nearly painless. In other cases, complicated questions of governance, sharing of proprietary knowledge, and eventual legal structure must be addressed.

PtP TIP #3: *If PtP backers have the opportunity to give input to governments at this stage they should concentrate on imparting (or ensuring the endurance of) a public service ethos to the company being privatized. Emphasizing this will provide a partial counter-weight to the normal and over-riding goals of most officials charged with preparing a company for privatization, which is to maximize efficiency and reduce operating costs. PtP proponents can also, at this stage, embed the idea of allocating a significant portion of sale proceeds to philanthropic organizations as a way to ensure the public ethos goal will be achieved.*

There are two principal methods for privatizing SOEs.

PRIVATIZATION STEP 4: Choosing the right privatization method

Governments have two principal methods for privatizing SOEs—direct asset sales and share issue privatizations, or SIPs. Both sale methods have been used thousands of times by most of the world's 196 national governments. Direct asset sales are numerically the most common privatization method, but SIPs have raised over twice as much money, approximately US$2.5 trillion in aggregate proceeds since 1977.

Direct asset sales. Direct asset sales are the principal method for privatizing smaller state-owned enterprises, which are typically far more numerous than large-scale SOEs. In this form of privatization, the government sells the enterprise directly to private companies or investors. Such sales can be implemented through private negotiations between the government and an interested buyer, through open auctions, or through closed bids. The characteristic of the specific asset itself usually suggests which method is optimal. Direct asset sales are a preferred method for selling smaller state-owned enterprises because this divestment method is much cheaper to execute than are public share offerings. On the other hand, direct asset sales are far less transparent than are SIPs and all of the (painfully frequent) cases of corruption and self-dealing reported for privatization deals over the years have involved direct asset sales.

PtP TIP #4: *Advocates of PtP could usefully monitor such direct asset sales, and take steps to ensure access by a wide variety of potential purchasers. They can also make known their interest in having the PtP option considered seriously in such transactions.*

China developed a particular form of asset sale for smaller enterprises when it began its privatization activity 10 or 15 years ago; this so-called "Management Buy-out Route" gave preferential treatment to the existing managers of the state-owned enterprises. As will be noted below, this route has created a particularly interesting option for achieving a PtP result—but it also produced some considerable wind-fall gains for the managers that acquired these assets.

The share issue privatization approach is the preferred method when privatizing larger SOEs.

Share issue privatization. When it comes to the privatization of larger SOEs, the share issue privatization (SIP) approach is the method of choice.

This is so because much larger sums—and therefore far more investors—are typically involved. SIPs are therefore much more complicated. In an SIP transaction the government issues shares of stock in an SOE and sells them to private investors using an Initial Public Offering (IPO), thereby bringing private investors in as partial owners of the former SOE. Subsequent sales of stock in partially privatized companies, known as seasoned equity offerings (SEOs), can then be used to sell down the state's residual holdings, perhaps all the way to zero. Share offerings are often massive, with the largest raising over US$20 billion for relatively small stakes of 15-25% in large telecommunications, energy, or utility companies. *Privatization Barometer* documents over 300 SIPs worldwide raising at least US$1 billion each just since 2004, and one of the present authors documented almost 200 such sales during the 25 years preceding 2004.

Voucher privatization. For completeness, we should note that the newly democratic countries of central and eastern Europe created by the disintegration of the Soviet Union in 1991 used a form of asset sale called "voucher privatization" to rapidly transfer ownership of business enterprises from state to private hands. This usually involved the state giving—or selling for nominal prices—vouchers to all citizens. These vouchers could then be converted directly into shares of SOEs being privatized and listed for trading on the nation's newly created stock exchanges. While these programs succeeded in rapidly transferring ownership to private investors, they were widely criticized because company insiders often ended up owning a majority of shares in valuable companies, while ordinary citizens were allocated shares in less valuable firms. Additionally, since voucher privatizations did not raise any new money for the government or the company—and brought the firm no new managerial expertise or contacts—the performance of privatized companies rarely improved much, and sometimes even deteriorated. For these reasons, voucher privatization programs have virtually disappeared from governments' policy tool kits.

Broadly speaking, three basic methods are available for valuing a non-traded company for sale.

PRIVATIZATION STEP 5: Setting the price for the sale

At first blush, it may seem that setting a sale price for a company being privatized would be highly complicated, especially since SOEs operate outside the price-setting pressures of the competitive market system and often benefit from a great variety of often-invisible subsidies. In fact, however, corporate finance experts have developed a number of basic valuation techniques that can greatly simplify this process. The dilemma in the case of the privatization of SOEs is not that the underlying valuation process is so complicated, but that governments often have a variety of extraneous policy objectives beyond securing the fairest price that complicate the calculus involved. Governments also face conflicting political pressures in many aspects of pricing companies for privatization—most critically whether to set a high price to maximize proceeds raised or to set a low price and allocate shares very widely to maximize the political benefit for the divesting government. In this section, we first briefly introduce these valuation techniques and show how they apply to direct-asset and share price sales, respectively.

Basic valuation methods. Broadly speaking, three basic methods are available for valuing a non-traded company for sale: (1) the earnings capitalization approach, which is also known as the P/E ratio method; (2) the discounted cash flow method; and (3) the comparable firm approach. The *capitalization approach* involves determining the sustainable level of total profits that a privatized company will likely generate and then applying a multiple (e.g., ten times profits) to determine total firm value by applying a price-earnings ratio. Such ratios are computed for all types of private companies, but, of course, this method only works for companies with positive earnings. And there is also the issue of subsidies that complicates the picture. The second method, the *discounted cash flow or DCF technique*, is the fundamental valuation methodology of modern finance. This involves predicting the future stream of earnings that a company will generate, and then determining the present value of such cash flow by discounting it back to today using an appropriate discount rate, reflecting the fact that money in the future is not as valuable as money in the present. The discount rate is determined based on the industry the firm is operating in, plus perhaps an adjustment for country and political risk. Finally, the *comparable firm approach* involves determining the value of a publicly traded firm in the same industry as the firm being valued, and making adjustments as necessary for financial and operating differences between the traded and the non-traded companies.

PtP can help avoid the creation of crony capitalists.

Valuation of direct asset sales. The comparable firm approach is the most commonly used approach in the privatization of small and medium size businesses because, by definition, they typically have many comparable firms that can be referenced for valuation, both domestically and in neighboring countries. Larger companies being sold via direct asset sale can be more challenging to price, but even here many comparable companies already trade actively on stock exchanges in neighboring countries. and the assets slated for divestment are actively traded. This is particularly true for telecoms, electric utilities, banks, and airlines—all of which have well established valuation metrics based on comparable firms that are traded globally.

Governments often “tilt” the terms of auctions and asset sales to favor certain groups, especially local companies and/or domestic managers or investors groups.

PtP TIP #5: *The Management Buy-out Route to PtP discussed above in the context of recent MBOs in China may provide a way to legitimize such preferential prices to domestic managers or investors by connecting them to a contractual obligation to sell the acquired companies after a set time period and put all or a significant share of the net gain in value of the privatized company into a charitable foundation. That way, government officials will not be accused of creating a set of crony capitalist oligarchs, and the public will get some solid benefit out of their success in turning struggling SOEs into profitable businesses.*

Valuation of share issue privatizations. Establishing the offering price to be charged to initial purchasers of the stock of privatized companies in the case of share-issue privatizations is somewhat more convoluted, but the basic corporate finance metrics applied are identical. What is different, as noted more fully below, is that the process is more attenuated, and involves a more elaborate process of consultation with potential investors to "test the market." As a result, the number and purchase price of shares is often not settled until quite late in the process, and often only days or weeks before the shares go on sale. What is more, the process is often complicated by the fact that governments are almost always pursuing two conflicting goals in such large SIPs: maximizing proceeds on the one hand, but also maximizing political objectives such as spreading share ownership widely among the population and ensuring that new investors will not lose money on their share purchases, on the other. As a result, SIP offer prices are often set far lower than the maximum that could be charged. Governments often choose to deliberately discount prices in SIPs to favor domestic investors and employees over foreign and institutional investors. One important, early (1999) empirical study found that governments deliberately underpriced privatization IPOs sold to domestic retail investors by an average of 35%, even as these same shares were sold to foreign and institutional investors at much higher prices. Recent evidence suggests that governments still deliberately underprice SIPs to domestic retail investors—though to a much lesser degree than 35%—and continue to preferentially allocate shares to domestic investors over foreign ones.

Governments that give special consideration to bids that include a PtP option can mitigate citizen opposition.

PRIVATIZATION STEP 6: Implementing the sale process

If a proposed privatization has progressed to this point, the hard work is largely done; largely, but not fully. The company has been identified, prepared, and valued, and the method of sale has been selected. In addition, the sale has been advertised and potential bidders, in the case of direct asset sales, have been asked to indicate expressions of potential interest. Furthermore, materials providing basic financial data on the company or companies being sold will have been prepared and made available to potential purchasers so that they can conduct their own due-diligence reviews.

The next step is to actually conduct the sale. The first, and arguably most important step here—especially in the case of direct asset sales—is for the selling government to pre-qualify companies and/or investor groups to participate in the sale or auction. This may be a simple case of establishing the financial capability and ethical operations of bidding firms and investors, or may require detailed due diligence analysis of potential bidders—especially foreign ones, if they are allowed to participate.

Once potential bidders are pre-qualified and the sale announced, the next step is to conduct the asset sale or auction. Although there are many ways to structure auctions—such as sealed bid, first price, Dutch auction, as examples—there are really just two basic rules for conducting these in a proceeds-maximizing way: (1) ensure the maximum number of qualified bidders participate, and (2) ensure the bidders cannot collude to set unfairly low prices. This can be done by taking a pro-active approach to advertising and by setting a minimum bid price that will be accepted. Governments also frequently impose financial and operating mandates on companies being divested through asset sales, and these can limit the scope for multiple bidders to participate. Such mandates include requiring the purchaser of a company to maintain employment and/or geographic service coverage levels after privatization, or requiring the buyer to commit to specific investment policies and levels. In such cases, asset sales are often negotiated directly between the government and one or a very limited number of potential buyers.

PtP TIP #6: *Suggestions that governments will give special consideration to bids that stipulate a willingness to dedicate a share of the proceeds of a sale to the creation of a charitable foundation can bring a PtP outcome into the transaction and thereby also help mitigate any citizen opposition*.

As noted previously, compared to direct asset sales, divesting a company via the share issue privatization (SIP) method is much more complicated and extended. This process begins with the issuance of a public request for proposals to the investment banking industry for selection of a firm to assess the feasibility of the share price approach, and formulate a strategy for rolling out the shares. The investment bank, or consortium of such banks, that win this often highly lucrative "underwriting mandate" will then perform a series of tasks more or less simultaneously—estimating an appropriate valuation for the firm and hence a target minimum proceeds for the stock issuance; devising a strategy for the issuance, including identification of the exchanges on which the shares will be offered; preparing all the necessary financial regulatory documents for filing in all the national jurisdictions where the shares will be offered; arranging the share listings; conducting a "road show" for prospective institutional investors; negotiating with the selling government over the underwriting spread (the portion of the per share sale price that the underwriter keeps as a fee); assembling a selling "syndicate;" setting the number and types of shares to be issued and hence the degree of ownership and control being surrendered by the government; and establishing the target price for the shares.

PtP TIP #7: *As part of this process, investment bankers may usefully raise with investors whether it would be helpful to integrate the PtP option into this process as a way to allay investor fears of hostile local opposition to the sale or to the new management of the company.*

PRIVATIZATION STEP 7: Executing the transfer of ownership and re-arrangement of responsibilities

Great, the sale has executed and the winner or winders have been announced; now what? While rather anti-climactic, the legal and regulatory procedures required to transfer title to a new operator and to begin conducting lawful business are nonetheless vital. For asset sales and auctions of firms operating in competitive industries, these steps could be as simple as signing and filing the required legal documents and then obtaining a business license.

For utilities and other firms that operate in non-competitive industries, the legal process of transferring ownership is much more complex. Any natural monopoly—defined as an industry in which only one firm can operate efficiently—must be regulated to prevent the newly-private operator from charging consumers monopoly (i.e., exorbitant) prices after privatization. Since the service in question (e.g., telecoms, electric power generation) has heretofore been provided by the government itself, presumably under restrictions to protect consumers, it is often necessary to set up new regulatory systems and agencies immediately before, or even simultaneous with, the privatization event. Privatizing what will become a regulated company therefore involves multiple legal and political steps before title can be transferred to the new owner, and clarification of the likely regulatory regime will likely figure prominently in investor decisions about whether to bid and how much to pay. Complexities also attend the allocation of responsibilities in share issue privatizations. Sales of shares involve the reallocation of ownership rights from governments to private investors.

Depending on the scale and concentration of the resulting ownership rights, changes may be required in the governance structures of the private firms. Outside owners will demand seats on the board, even when the government retains majority control. This, in turn, can lead to changes in management. How and when this might occur also depends on how the sale was structured. As noted in a previously cited article, large SIPs are both vehicles for governments to raise vast sums of money and tools of political statecraft where governments seek favor with future voters. In addition to deliberately underpricing privatization IPOs, governments very frequently also allocate these underpriced shares to favor key groups. Governments often tend to spread shares as widely as possible among the voting public, with some SIPs creating several million brand new shareholders. Employees of the company being privatized are almost always allocated shares, often at highly discounted prices, and favored domestic retail investors are allocated more shares (and at lower prices) than are domestic institutional investors—who in turn are allocated more shares than are foreign buyers. These latter investors are also usually charged the full market price for any shares they buy. All of this can also create opportunities for corruption and favoritism. Beyond that, it can deny the privatization process of one of its more important potential advantages: bringing in outside owners and managers to who achieve operational efficiencies in the privatized firms.

Care must be taken to avoid the seepage of benefits to well-placed political or other figures.

PRIVATIZATION STEP 8: Allocation of the proceeds

This is the fun part—splitting up the proceeds. Since governments generally launch privatization programs at least partly because they "need the money," it is unsurprising that the bulk of the proceeds from most real privatizations are claimed directly by the selling government. Claimed, that is, after all contractually required payments are made to auditors, lawyers, consultants, and investment bankers who assisted in the sale process itself, and these can amount to a sizeable figure—especially for investment banks in SIPs, as described below.

Particular care has to be taken at this stage as well to avoid the seepage of benefits to well-placed political figures who may have overseen the privatization process or otherwise been instrumental in its promotion. This can best be done through rigorous and timely disclosure of what the sale proceeds are, what amounts are paid to the investment bankers and others who were legitimately involved in the process, and what is becoming of the remaining proceeds.

PtP TIP #8: *PtP proponents need to be vigilant at this stage of the process to ensure that the proceeds supposed to be set aside for a valid, independent PtP foundation are actually made available. As detailed more fully below, this will only be possible, however, where two conditions have been met: first, that such advocates will have been fully and effectively involved in the prior steps of the process, mobilizing public attention to the privatization process and the public stakes in its outcome, and clarifying for all stakeholders the win-win possibilities that the PtP option presents; and second, that a compelling concept will have been developed of what a PtP foundation created or significantly enhanced as a result of receipt of the privatization proceeds would look like in terms of governance structure, purpose, and operating procedures.*

In share-issue privatizations, the proceeds to philanthropic organizations can take the form of both cash and shares of stock. With regard to the former, the same concerns about transparency in the allocations of the resulting proceeds as apply to direct sale privatizations should hold. In these cases, a prime incentive for privatizing is likely to be generating investment capital for the privatized firm or retiring corporate debt as opposed to bolstering government budgets or reducing government debt. Since these are still public assets, however, citizens deserve clear, concise, and timely accountings of how the firms allocate these resources.

PtP TIP #9: *Even in these cases, firms might usefully see the advantages of dedicating some substantial portion of the proceeds of the privatization transaction to charitable endowments as suggested by the PtP approach as a way to relieve citizen concerns about what companies might do with the assets built up by the sweat and toil of the country's people.*

As noted more fully below, past experience has suggested that such proceeds can usefully take the form of a portion of the newly issued shares in the privatized company rather than a portion of the cash proceeds of the share sales. Such shares can be non-voting shares to avoid further diluting ownership and can be accompanied by phased, multi-year diversification plans requiring the PtP foundations to divest themselves of these shares over a period of years. But the foundations should be made the beneficiaries of whatever economic success the privatized companies achieve, which ownership shares, however temporary, can provide.

With regard to the other resulting owners of shares, privatized companies will also have to come to terms with the payment of dividends—the other form of allocation of resources that the privatization will entail. This, will require new patterns of thinking on the part of company managers.

Endnotes

[1] One of the authors participated (as a government advisor) in the development and execution of a large closed bid auction for the last remaining state-owned tobacco distribution monopoly in Europe. Though many investors evaluated the restructuring and sale package—which involved developing an industrial plan for the post-divestment company—only three bidders stayed throughout the process. The auction itself raised a surprisingly large €2.3 billion.

[2] Privatization Barometer maintains a database of large privatizations since 1977, which is especially comprehensive for EU share issue privatizations. The annual Privatization Barometer Report has an opening section, written by this paper's first author, describing annual privatization trends and major deals around the world. Finally, this same author lists all large pre-2004 share issue privatizations in an appendix to William L. Megginson, (2005), *The Financial Economics of Privatization*, (New York: Oxford University Press).

[3] Voucher privatization programs are described and assessed in Maxim Boycko, Andrei Shleifer, and Robert W. Vishny, (1994), "Voucher Privatization," *Journal of Financial Economics*, 35(2), pp. 249-266; Stijn Claessens, (1997), "Corporate Governance and Equity Prices: Evidence from the Czech and Slovak Republics," *Journal of Finance* 52(4), pp. 1641-1658; and John Nellis, (2002), "External Advisors and Privatization in Transition Economies," *Center for Global Development Working Paper #3*. Chapter 3 of the book cited above (*The Financial Economics of Privatization*) also presents a detailed description and assessment of voucher programs.

[4] See Morris Bornstein, (1999), "Framework Issues in the Privatization Strategies of the Czech Republic, Hungary and Poland," *Post-Communist Economies* 11(1), pp. 47-77.

[5] See Steven L. Jones, William L. Megginson, Robert C. Nash, and Jeffry M. Netter, (1999), "Share Issue Privatizations as Financial Means to Political and Economic Ends," *Journal of Financial Economics* 53(2), pp. 217-253.

[6] Austria's Erste Bank helped its bids for several Central European government-owned banks by taking the initiative itself to incorporate offers to create such foundations into its bids for these banks (Salamon [2014], pp. 59-60).

PART IV

How Can PtP Be Applied To the Privatization of SOEs?

All of the privatization methods described above can be adapted for PtP purposes.

Identifying the Right Option

As suggested above, all of the privatization methods described can be adapted for PtP purposes. Either a *portion of the SIP share offering* or a *portion of the proceeds raised through an asset sale* can be used to endow a PtP foundation.

The first approach was used in the case of the Italian foundations of banking origin, which received 100% of the shares of the newly spun-off for-profit banks.

In the case of the privatization of the Czech economy, a particularly inventive PtP approach was developed.

In the case of the privatization of the Czech economy in the aftermath of the dissolution of the Soviet empire in the early 1990's, a particularly inventive approach was developed to take account of the fact that a significant number of enterprises were being privatized and there was a strong conviction among political leaders that some of the resulting proceeds should go into charitable endowments to spur the re-creation of what before World War II was a vibrant network of nonprofit organizations that were nationalized by the post-war Communist government. The privatization law therefore stipulated that 1% of the proceeds of all major privatization transactions were to be devoted to building charitable endowments. Since the pace of privatization was uneven, however, and time was needed to transform the assets into cash and the existing array of charitable institutions into legitimate foundations, Czech authorities created a Foundation Investment Fund to manage the assets dedicated to charitable purposes until two processes were completed: *first*, the privatization of the SOEs and the recovery of the assets resulting from their sale; and *second*, the passage of a new foundation law that created reasonable regulatory and other provisions to ensure that the assets would be protected once they were transferred into the foundations. Once these two processes were completed, an application process was initiated among the relative handful of approved foundations and the privatization resources allocated to some 25 of them. The vibrancy of the Czech civil society sector today can reasonably be attributed in no small part to this carefully designed PtP process.

The second approach, involving the allocation to charitable foundations of the proceeds of the sale of a state-owned business rather than a share of ownership of the privatized company, was used in the case of the Volkswagen Foundation when the Federal Republic of Germany and the State of Lower Saxony agreed to allocate 60% of the proceeds from the sale of shares in the Volkswagen Company to create the Volkswagen Foundation, with the remaining proceeds split between the two governmental entities.

A third possible route to the formation of charitable endowments out of the privatization of a state-owned enterprise is for the state to transfer ownership of the affected business directly to a charitable foundation, which can either operate the enterprise or sell it and use the proceeds as its endowment. Though unusual, such transactions have occurred—most famously in the case of the well-known Italian opera company, la Scala, which was transformed into a foundation and endowed with the capital resources of the former government-owned opera company along with a 99-year rent-free lease of the beautiful la Scala opera house.

A fourth route to a PtP outcome, which we might term "delayed philanthropication thru privatization," is currently emerging in China.

Yet a fourth route to a PtP outcome, which we might term "delayed philanthropication through privatization," is currently emerging in China. As noted, the government there initiated its privatization process more than a decade ago with a practice of allowing the managers of selected smaller, state-owned enterprises to purchase their companies and operate them as private entities. In at least one case, the managers of one of these companies took a pledge that if they succeeded in making their company profitable, they would transfer ownership in it to a charitable foundation at the end of 15 years. The resulting Rong Chang Foundation was established in 2016, though tax complications have delayed the actual transfer of the company to the foundation. The creators of this foundation are hoping that other management groups that gained ownership of their companies through this "Management Buy-out Route" to privatization will follow their example and transfer ownership of the resulting private companies to foundations when the original managers retire.

Is There a "Best" Method of Privatization for PtP?

Clearly, the most favorable method of divesting a state-owned asset or enterprise would be simply to transfer ownership to a PtP foundation, but that is rarely a viable option—particularly for very large privatizations. Governments generally need to raise money from privatizations and so demand a significant share of the proceeds.

It is usually a fairly straightforward process to support PtP foundations through both share issueprivatizations and assets sales.

Nonetheless, it is usually a fairly straightforward process to support PtP foundations through both SIPs and assets sales. In a SIP, the government can allocate some of the shares offered to private investors to PtP foundations instead, and these organizations can then either hold the shares received for an extended period—and collect a stream of dividend payments —sell the shares and create an endowment with the proceeds, or use a combination of these options to provide immediate revenues with which to initiate activities while holding the balance of the shares in the hopes of their rising in value.

PtP TIP #10: *In terms of the payoff from privatization, research carried out by the Philanthropication thru Privatization Project found that this latter, two-step combined route to the creation of PtP foundations—in which foundations initially secure shares in the privatized companies, hold them for various periods, and then sell them—has been the most advantageous for the resulting foundations.*

One reason for this is that the companies that are privatized are frequently not in the best condition at the time of privatization. Therefore, the funding secured from their sale is far less than the value they often enjoy following several years as private companies. The Volkswagen Foundation, for instance, was severely disadvantaged by not getting actual shares of the Volkswagen Company. Within a month of the public offering of these shares, the price had jumped by multiples of their initial sale price so that what the Volkswagen Foundation received in cash as 60% of the proceeds of the initial sale was a fraction of what it could have gotten if it owned the shares and sold them even a month or two later. Contrast that with the outcome for the New Zealand and Italian savings bank privatizations: in both of these cases, the PtP foundations received shares in the resulting privatized banks, which doubled or tripled in value several times over as consolidations occurred and the former small savings banks were acquired by larger for-profit institutions. What started out as small charitable arms of quasi-public savings banks thus quickly found themselves transformed into some of the largest charitable foundations in the world.

Supporting PtP foundations is usually even easier in the case of direct asset sales.

Supporting PtP foundations is usually even easier in the case of direct asset sales. In that case, the government can simply transfer all or a portion of the cash proceeds received to a new or established charitable foundation, which would set up an endowment with the funds received. As the Czech example discussed above showed, however, this latter can have its own complications when multiple small SOEs are involved and sales are executed over an extended period. In such cases it can be sensible to have the resulting proceeds or shares managed by a professional investment company until such time as they are transferred to one or more foundations in the form of endowments.

PART V

What Steps Can PtP Advocates Take to Pursue a PtP Outcome to the Sale of SOEs?

As noted above, governments wishing to privatize one or more state enterprises must follow a fairly standardized process of first developing a privatization program, then preparing the target companies for sale, deciding on the optimal method of sale, fixing the price of the enterprise or the shares to be offered for sale, advertising its intentions, and executing the sale. Advocates of PtP can access this process at a number of different steps—though the earlier they begin to access the process the better. More specifically, citizen groups interested in promoting the PtP option in the context of the privatization of SOEs can usefully pursue the following steps.

10 STEPS FOR PROMOTING PtP IN YOUR COUNTRY

STEP 1 **Determine who is in charge.**
Identify and become familiar with privatization authorities and pending transactions.

STEP 2 **Identify the best targets for PtP.**

STEP 3 **Learn the applicable laws.**
Review privatization and foundation laws.

STEP 4 **Decide where the proceeds will go.**
Determine if the proceeds could go to an existing foundation, or whether you will need to create a new one.

STEP 5 **Develop a case statement for PtP.**

STEP 6 **Identify stakeholders and allies.**
Get in touch with potential stakeholders and allies in government, civil society, and the media.

STEP 7 **Plan your PtP foundation.**
Design your recipient foundation carefully to ensure compliance with best foundation practices of transparency, accountability, and independence.

STEP 8 **Develop a PtP strategy.**
Develop a comprehensive strategy for making your PtP transaction a reality.

STEP 9 **Monitor the process carefully.**

STEP 10 **Contact the PtP Project at PtP@p-t-p.org**

STEP 1 | Identify the privatization agency or agencies in the jurisdiction; visit its website to identify what SOEs are pending privatization.

PtP can obviously be pushed most effectively when a government has already announced plans for a significant SOE privatization program. Privatization creates the opportunity for PtP, but PtP rarely provides the impetus for privatization.

STEP 2 | Identify the best targets for PtP.

Things to look for in deciding how to focus the PtP campaign are:

- Companies the privatization of which is likely to provoke citizen resistance or concern (e.g., companies with wide consumer usage, significant government subsidization of consumers or other social-purpose activity, or sizable workforces concentrated in particular geographic regions that may be in danger of being downsized);

- Companies whose ownership is somehow disputed or that have received significant government subsidization that creates a case for the preservation of the kind of significant public or social-purpose link that the PtP option can help to sustain; or

- Situations in which broad privatization agendas are being pursued that could open the possibility for application of the "Czech model" (i.e., channeling a percentage of the proceeds of multiple privatizations into a foundation investment fund over a period of years for ultimate channeling into a new or existing foundation or foundations). This could be applied to the proceeds either of issue-share privatizations or direct sales.

STEP 3 | Review privatization and foundation laws.

Privatization laws sometimes establish barriers to the transfer of the proceeds of privatization transactions to private organizations. In such situations, PtP advocates may need to push for exemptions for charitable foundations equipped with strong transparency provisions and independent governance structures. Some scrutiny should also be made of basic foundation laws to ensure that reasonable protections exist to ensure the openness and conflict-free governance of such institutions. If such provisions are not in place, special laws may be needed to establish the PtP foundation or foundations.

STEP 4 | Determine if there are any existing foundations that could serve as suitable recipients of PtP proceeds or whether a new entity would be more appropriate.

The type of enterprises being privatized can often provide clues to the uses that will make sense of any PtP proceeds that are generated and hence what existing foundations might be appropriate beneficiaries of the privatization assets. (*See Step 9 below for the criteria to look for in eligible foundations.*)

STEP 5 | Develop a case statement for promoting the PtP option.

Draft a short, 2-page Concept Note indicating how PtP can be fruitfully applied in your country and how it can produce win-win outcomes both for communities, privatization authorities, governments, and potential investors. A variety of materials are available on the PtP Project website (**p-t-p.org**) that can be of help with this. You can also contact the project via email at **PtP@p-t-p.org** to secure the Project's help in developing a strong case statement.

STEP 6 | Initiate contact with key stakeholders in civil society, the media, and within government.

It is important that efforts be made to forge a common approach to handling reactions to privatization on the part of civil society leaders. Inevitably, some civil society and citizen groups will be opposed to privatization either in general or in relation to particular SOEs. Advocates of PtP must walk a careful line by making clear that they are not particularly for or against privatization—but rather are committed to making sure that if privatizations go forward some of the benefits should be reserved directly for affected citizens rather than being deposited into government budgets or taken as bribes by affected government leaders, and that this can most usefully be done by depositing them into private, independent foundations with strong transparency and conflict of interest provisions and detailed legal commitments to serving the public interest. PtP advocates are most likely to gain traction with governments and investors when proposed sales face real or potential political opposition, as mentioned in Step 1 above. At the same time, opponents of privatization must also be convinced that PtP offers a useful compromise solution since PtP will usually be adopted only if advocates are able to muster the support needed to push for including this in some or all privatization sales.
PtP TIP #11: *Civil society groups would be wise to establish a "lead agency" to pursue the PtP option, but that organization would be wise to establish a "contact group" or advisory structure to maintain communications with interested parties. If necessary, limited seed funding might be available from the PtP Project for initial fact-finding and leads can be provided to other potential funding sources.*

Government leaders with strong policy interests that align with the interests of communities (e.g. in supporting education, social welfare provision, scientific research, or environmental improvement) can also be very helpful in advocating for PtP since this approach provides a way to shelter the resulting resources and preserve them for these priority purposes. The creation of the Volkswagen Foundation out of the proceeds of the sale of the Volkswagen Company in Germany, for example, was motivated by the interest of policymakers to put aside long-term resources for the promotion of science in Germany to counteract fears of the Soviet scientific advances reflected in the launch of Sputnik, the world's first orbiting satellite.

Contact should also be initiated with the privatization agency and with key government officials involved in privatization (e.g. finance or economics ministries). The key goals for this step are two-fold: first, to learn as much as possible about the privatization plans and the agency's perspective on which ones are likely to be the hardest to pull off; and second, to persuade the privatization authorities of the win-win possibilities that PtP can provide to them. The second of these goals is every bit as important as the first since the success of PtP will often depend on the support it receives from the privatization authorities. Also important will be to establish some process for communication and liaison between the community representatives and the privatization authority to enable community groups to monitor the privatization process.

STEP 7 | Design the recipient foundation.

For the PtP option to gain real traction, PtP proponents must have some concrete ideas about the structure and operation of the foundation or foundations targeted to receive the PtP proceeds, as well as some specific and well-articulated objectives for the programmatic thrust to be advanced with the resources made available.

A useful starting point for developing such design features can be found in the "Principles of Good Practice" for foundations formulated by the European Foundation Centre, as discussed earlier.[1] While acknowledging the diversity of foundations and of foundation laws, the EFC nevertheless recommended adherence by all foundations to four major principles:

a) **Independent governance.** PtP foundations must be structured in a way that guarantees an arm's length relationship between them and both the privatized company and governmental authorities. This can be achieved by forbidding, or significantly limiting, board involvement of both government and company officials and guaranteeing, through nomination procedures and by-laws, that board members, however chosen, understand that their primary orientation must be to the care and protection of the foundations and not to the care or support of any organization that may have nominated them. Several examples of how existing PtP foundations have striven to achieve such autonomy can be found in the recent PtP report cited earlier.

b) **Professional management.** PtP foundations must develop the systems and personnel to operate in a professional fashion. This will require the articulation of clear strategic objectives and the development of programs and operations in line with these objectives; recruitment of personnel with relevant expertise and experience both for the programmatic and investment components of the foundation's operations; and clear engagement of the Board in setting strategic directions and monitoring progress toward achieving them.

c) **Transparency.** To retain public trust, PtP foundations must operate with complete transparency, making their statutes, by-laws, guidelines for funding activities, information on grant programs, application procedures, as well as board and staff lists, annual reports, grant lists, and finances publicly and readily available and accessible. “Sunlight,” it has been said, “is the ultimate disinfectant,” and PtP foundations need to be seen as “squeaky clean.” Also required will be strict conflict-of-interest provisions written into foundation by-laws and operating rules to ensure that members of governing boards and staffs do not use these positions to further their personal interests.

d) **Accountability.** As a corollary to their commitment to transparency, PtP foundations are wise to be proactive in assessing what they are accomplishing on a regular basis and reporting on this to their various stakeholders. Regular review of activities and reassessment of strategies should be an ongoing function to offer regular feedback to those who stand to benefit from foundation activities.

In addition to these principles articulated by the European Foundation Center for foundations in general, two additional principles can usefully be applied to PtP foundations given their particular origins:

e) **Representativeness.** The governance structures of PtP foundations not only need to be meaningfully autonomous vis-à-vis government and privatized firms; they also need to be meaningfully representative of the constituencies they are designed to serve. As the case studies examined in the PtP report cited earlier showed, this can be achieved by giving particular constituencies, including civil society bodies, the privilege of nominating candidate representatives to the boards or simply by establishing by-law provisions requiring the inclusion of representatives of key constituencies or competencies on governing bodies. Also important will be strict terms of office for governing body members and regular turnover. These steps will help protect these foundations from being perceived as closed shops controlled by narrow bands of insiders.

f) **Grantmaking.** Finally, one rationale for channeling all or part of the resources from privatization transactions into charitable foundations instead of into government budgets is the impact this can potentially have on strengthening the civil society sector by providing indigenous sources of support for local not-for-profit organizations. Such organizations have been found to contribute to democratic governance and, because of their contribution to “social capital,” to building the climate of trust that successful market systems require. The experience of several PtP foundations suggests that such foundations can play an important role in fostering effective civil society organizations and sectors—which in turn can boost charitable giving, promote volunteering, and strengthen bonds of trust among people. For this to be possible, however, PtP foundations must operate at least in substantial part through grant programs and other similar support activities open to nonprofit organizations.

Given these overarching guidelines, designers of PtP foundations created out of the proceeds of the privatization of state-owned businesses need to address how the foundations they are creating will address the following topics:

- ***Governance arrangements*** that promote meaningful autonomy from government authorities and privatized companies and ensure meaningful community engagement after the privatization transaction is completed.
- ***Mission statements and programmatic objectives*** that are coherent and responsive to citizen needs.
- ***Transparent reporting and grant-making requirements and strict conflict-of-interest provisions*** to provide reassurance that the assets will be protected from corruption and used for valid charitable purposes.
- ***Recruitment of professional staff and establishment of effective procedures*** for grant management and evaluation.
- ***Establishment of reliable methods for handling foundation assets and investments.*** In certain circumstances where corruption is rife the assets can be housed in one or more investment management firms outside the country that is home to the foundation and called down in tranches as needed for valid program purposes. This was the procedure established in the case of the BOTA Foundation in Kazakhstan, for example.[2]

The PtP Project has secured the cooperation of a number of existing PtP foundations to provide the pro-bono assistance of professional foundation managers to help set up the procedures for various facet of foundation operations.

STEP 8 | Develop a PtP strategy.

Based on the information gathered in the preceding steps, PtP advocates should formulate a PtP strategy. Key elements of this strategy should include:

a) **Identification of the privatization sales on which to focus.** This will obviously depend on which sales the privatization authority is contemplating, and which of these pose the most attractive targets for PtP due to the controversial nature of the sale, the existence of community opposition, the complicated or contested ownership of the asset, the privatization method being planned, the interest of key government officials, or other considerations.

b) **Identification of the optimum privatization method to promote** (direct asset sale; share issue privatization; direct transfer of an asset).

c) **Identification of potential partners both outside government and, if possible, inside it.** This should include civil society organizations, professional associations, the media, local businesses.

d) **Initial identification of the programmatic thrust and structure of the charitable institution to be proposed** to receive the proceeds of the PtP deal and initial determination of whether a new institution would need to be developed or whether an existing institution or institutions could be advanced as potential candidate trustees of the resulting resources.

STEP 9 | Monitor the privatization process.

Once decisions are made about the privatization transaction or transactions on which to focus, PtP advocates will need to monitor the privatization process carefully and diligently. Key issues to watch for are the following:

a) **The pricing of the asset.** Occasionally, authorities price an asset well below its reasonable value in order to benefit existing managers or friends of the government.

b) **The openness and transparency of the process.** Existing laws should set formal rules for bidding on SOEs up for privatization, including whether bids are to be open or closed, what kind of announcements must be made of potential sales, the basis for accepting bids, restrictions on such things as asset stripping, elimination of jobs and benefits for workers, relaxation of safety or environmental protections.

Similarly, in cases of SIP, formal rules should exist for underwriting the share issue to ensure fair pricing and access to the shares. Only sales that adhere to reasonable transparency and openness should be considered candidates for PtP so as to avoid tarnishing the reputation of the resulting foundations.

c) **The privatization method being used.** As noted, direct asset sales are most prone to corruption and are therefore most in need of careful outside monitoring and PtP foundations that have received ownership stakes in privatized companies rather than cash have generally fared better than those that have received cash proceeds from a sale. Advocates should therefore push for methods that yield the PtP benefits in this form.

d) **Inclusion of the PtP option or other social-purpose requirement in the initial request for bids or IPO prospectus. All governments are concerned with maximizing proceeds fro**m, minimizing political opposition to, and maximizing political support for, privatization sales. Advocates should emphasize how PtP can serve these goals and also bring win-win rewards to communities. Proponents can advance this idea privately, if invited in by officials to consult on sales, or they can push the goals in the court of public opinion. The less politically secure is a government in any specific privatization deal, the more leverage PtP proponents will have to push for a meaningful share of the assets being generated. Several cases discussed above resulted in all of the shares of a privatized company being allocated to one or more NGOs, but much more typical is allocating a portion of the shares or proceeds on offer. While this may seem trivial, one percent of a multi-billion-dollar share offering is a significant sum of money. PtP proponents can also point out to government planners that investors may be more likely to accept a higher share offer price if some of the proceeds are dedicated to supporting philanthropic organizations that will allow new owners to arrive on the scene as partners of communities rather than opponents.

STEP 10 | Learn more about the potential for PtP, and how to become involved in advocacy for it.

The PtP Initiative, founded and directed by Johns Hopkins University Professor Dr. Lester Salamon, provides a great deal of information on PtP—including 22 detailed case studies—a report summarizing the results of its initial inquiry into the scale and character of well over 500 PtP foundations,[3] and actionable advice online at **p-t-p.org**. The PtP initiative is housed administratively in the East-West Management Institute, an independent nonprofit organization that has played an instrumental role in building sustainable civil society institutions worldwide.

Also highly useful are the regular editions of the Privatization Barometer, which chronicles the extent of privatization under way country-by-country, including lengthy lists of press accounts of completed or announced privatizations as well as analytical articles on the process.[4]

For further information, contact the PtP Initiative team via email at: **PtP@p-t-p.org**.

Endnotes

[1] Another useful set of principles to guide PtP foundations can be found in Volkswagen Foundation, (2008), "20 Principles of Good Practice." See also: "Best Practices in PtP Foundation Design and Operation" by Nigel Seiderer at p-t-p.org (forthcoming, 2018).

[2] See: Aaron Bornstein with Lester M. Salamon, (2016), "The BOTA Foundation: A Model for the Safe Return of Stolen Assets?" (New York: East-West Management Institute).

[3] Salamon (2014).

[4] Available at: privatizationbarometer.net.

"...an admirably clear...balanced and accurate account of the raison d'être for SOEs, their all-too-often deficient performance, and the application of 'philanthropication' as a solution to SOE problems."

~ John Nellis, Principal, International Analytics, (formerly Senior Manager, World Bank Privatization and State-Owned Enterprise reform practice)

"...an extremely well-written and clear booklet introducing an intriguing idea that could easily have avoided failed privatization sales in several countries where I was offering privatization advice to governments on behalf of the World Bank."

~Ira Lieberman, former Chief of Mission on several World Bank privatization advisory missions

PtP How-To Booklet no. 2

How to Apply **PtP** to

STATE-OWNED ENTERPRISES

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About the PtP Project

The Philanthropication thru Privatization (PtP) Project seeks to promote an option for the creation of independent charitable foundations around the world by capturing all or a portion of an assortment of "privatization" transactions involving the transformation of publicly-owned or -controlled assets into private wealth. The Project has thus far identified over 550 foundations with assets over US$155 billion that have emerged from such transactions, including some of the largest foundations in the world, such as the Volkswagen Foundation, the King Baudouin Foundation, the Nippon Foundation, the 200 U.S. health conversion foundations, and the enormous Italian foundations of banking origin. The PtP Project is directed by Dr. Lester M. Salamon. Administrative and technical support for the Project is provided by the East-West Management Institute (EWMI). For more information about the PtP Project, visit **p-t-p.org**.