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Mass Privatization in Poland: Differences and Similarities with Other Privatization Programs

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I would like to talk today about Polish privatization and especially about the mass privatization projects, and I plan to touch upon seven issues. The first one, very briefly, is where the Polish economy is after three years of reforms. The second one will be Polish privatization policy and its accomplishments. The third one, why do we need mass privatization? The fourth one, how is it to work? Fifth, I will try to compare Polish privatization schemes with other privatization projects. Sixth, how and when is the Polish mass privatization program to be implemented? And lastly, what are the major challenges to the implementation of the programs?

Let me start with the first topic, the Polish economy in 1992. There are very positive signs: industrial production grew by 3-1/2 percent; inflation is down (it was about 600 percent in 1990, and about 43 percent in 1992); there is a substantial positive trade balance of about $US 800 million; and, most of all, we are pleased with the growth of the private sector. There are about 200,000 private businesses registered; some 45 percent of GDP comes from the private sector right now; and the private sector employs between 56 and 60 percent of the work force in the country. All this is very positive. Many advisers encouraged our country to start with greenfield operations—small operations in the private sector—and it's really taken off. There are also some negative symptoms, however. Unemployment is about 12 percent, and it could go up to 15 percent or even higher. The budget deficit will be about 5 percent and can go considerably higher. And, because of the budget deficit, fiscal policies require an increase in taxes and this is something which could be a problem for businesses.

The second issue is privatization. Some three years ago when the country decided to privatize its companies it was a kind of dogma that everything should be privatized. At that time about 2,800 companies were owned by the founding bodies, namely, central ministries, and about 4,000 were owned by regional or municipal authorities. Polish privatization practically started in the summer of 1990 with the Privatization Bill and in the beginning there was considerable interest in classical privatization (which means British-style privatization). What have been the accomplishments of our privatization program? They are quite substantial, I would say. At this moment approximately 1,000 companies have been privatized in some way, and the current policy of the government is a multi-track approach to privatization. All ways of privatization are applied and encouraged. Let me start with the first means of privatization, which is floatation on the Warsaw Stock Exchange. Today 16 companies are floated on the Warsaw Stock Exchange. Initially, the advice was to identify the best companies—advisers suggested taking those with huge export potential—but that turned out to be not such good advice. The best companies on the Warsaw Stock Exchange are those that can sell both to the domestic market and to the foreign market. Since the foreign markets are extremely volatile, the combination of good products for the domestic market and for export seems to be an optimal mix. Those companies that are able to provide this combination are the best on the Warsaw Stock Exchange. As a result of so-called capital privatization, 54 companies were sold to strategic buyers. The most spectacular recent transaction was the sale of the paper pulp company to International Paper for $100 million in cash, with the promise by International Paper to invest another $175 million in the next three years. At this point, it is worth mentioning that Pepsi-Cola is in Poland, as are other big companies such as Phillips, McDonald's, Burger King, and Coca-Cola. What is also important is that all the big six accounting firms are in Poland, as are three American public relations firms: BBDO, DMB&B, and Leo-Barnett from Chicago. All of them are very active on the Polish market. You can also find executive search firms in Warsaw, both Western and Polish.

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Secondly, approximately 400 companies were leased to the joint stock companies created by employees and management. These leases are to be completed soon or have already been completed, and they work. Five hundred other companies are to be liquidated and their assets will be auctioned. All together we are talking about 1,000 companies being involved in some way in privatization. Five hundred other companies, mostly in the industrial-manufacturing-construction sector, were transformed from state-owned companies into joint stock companies, which means it's relatively easier to privatize them, provided they are attractive to buyers.

What about financial services? This goes a bit slowly. There are 12 big state-owned banks, two of which are to be privatized this year. Another process which goes quite slowly is the privatization of our big state-owned farms. They are heavily indebted and attract no buyers, and it will be a difficult and very long process to privatize them. Fortunately, private farming has always been a dominant feature of Polish agriculture.

Now let me discuss, Why mass privatization in Poland? Mass privatization seems to be a solution for companies that are good but not good enough to find direct investors or buyers, either domestic or foreign, in the near future. Those are companies with potential—companies which are not in the red—but most of them need a lot of capital and a lot of restructuring. Our goal is to privatize between 400 and 600 of them through the mass privatization scheme. Those companies are bigger-than-average Polish companies; we do not want to have in our program companies with a turnover of less than $10 million, which in Poland makes them bigger than average. To privatize these companies through the mass privatization process is to accelerate considerably the whole privatization program. But one can also say that the program has two legs and two goals. We want to restructure the companies; to provide managerial skills in the short term and capital in the longer term. We believe that there are many opportunities for long-term restructuring in Poland, for which you need financial skills, marketing skills, and management information skills; then, when these problems are solved, the capital will come in to restructure those companies. Therefore, this program is heavily based on capital markets. Capital markets will be the ones to value the companies. We will not hire any consultants or experts to do the valuations; the valuations we know from East European regions, and from Germany, are most of the time incorrect or far off the actual price anybody would like to pay. We believe that our process of valuation will reduce the cost of privatization. And what is very important, we believe that some skills which are scarce in Poland (for example, financial management or marketing) will be introduced.

Presider, Steven Davis, partner, LeBoeuf, Lamb, Leiby, & MacRae, introduces Dr. Thieme at dinner.

Now I want to go to the hand-out which all of you should have, and I will try very briefly to describe the program on the basis of this hand-out (see chart on page 4). Basically there are three levels of the program. At the bottom level are the companies, this is where you can see the 33 percent numbers. It is to be decided by the Parliament soon whether this program will include 400 or 600 companies. Those 400 or 600 companies are to be allocated in the portfolios of about 20 National Investment Funds, which are the NIFs. Those funds are to be venture capital funds, as active as they can be, not passive. The companies are to be allocated to the funds, and the shares of the funds are to be distributed to all adult citizens of the country in the form of share certificates. There are three material levels of the program: the citizens, the funds, and the companies. The citizens are to get a security called a "share certificate" and the lion value of the share certificate are the shares of all 20 NIFs. Share certificates are to be on the market for a few years in a bearer form, an unregistered form, and then they are to be converted. They can be converted immediately, or, if somebody is a passive investor, he or she can hold them for a longer time and convert them before maturity. The maturity is not yet fixed. It will be announced about one year earlier so that people have one year to convert them into the shares of the funds. Shares of the funds, the mezzanine level, are to be dematerialized and traded on the Warsaw Stock Exchange. We are also thinking

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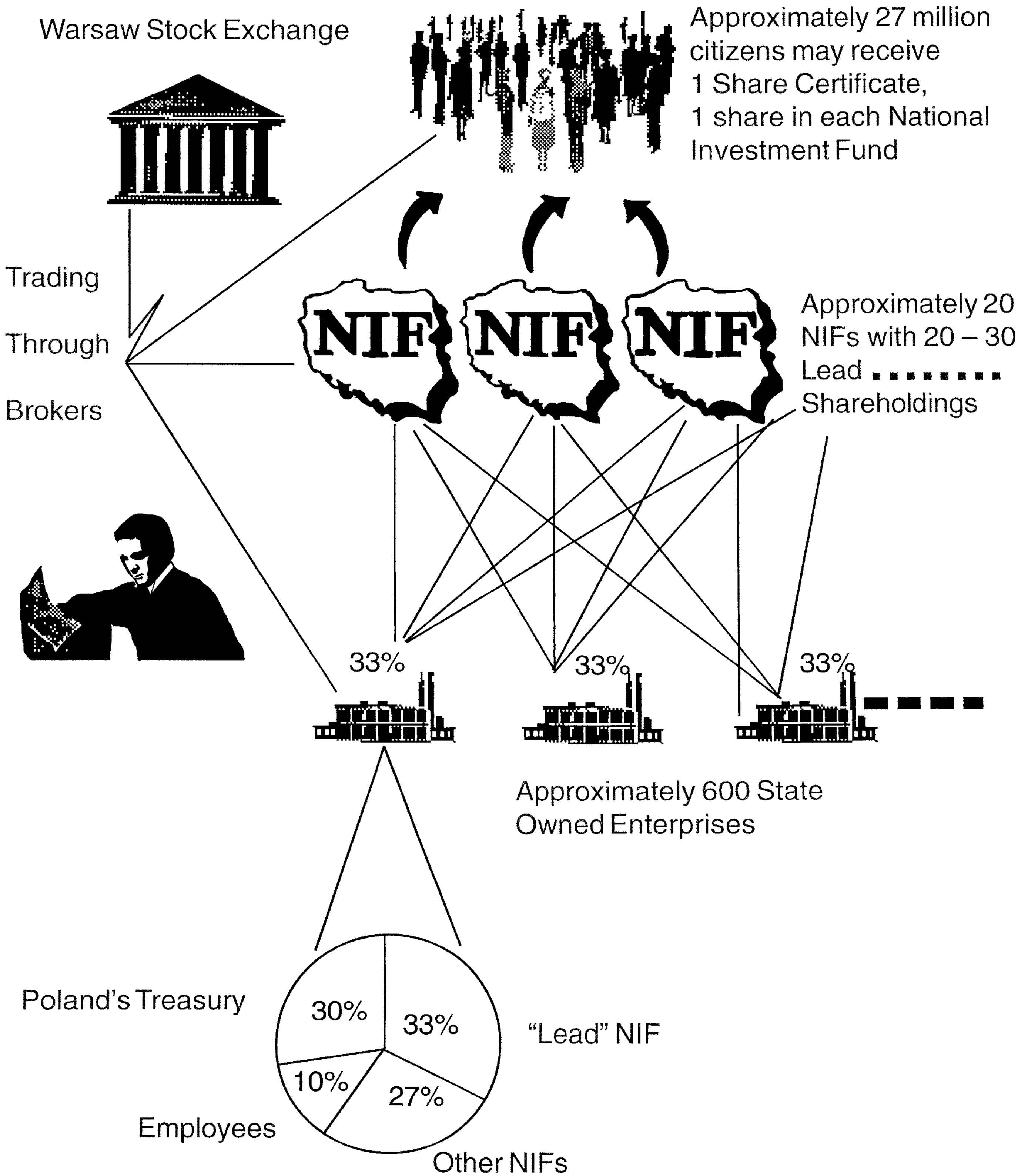
Mass Privatization Program



Rob Wyder (left), Volvo North America Corporation, and Martin Blumenthal, Techint, Inc.

about dematerializing share certificates. Then it will be possible to have a parallel market for dematerialized share certificates and bearer paper securities. On the ground floor, there are companies and their shares which will be traded on the private market. The program is initiated by the government, as are most of the reforms. This is not a spontaneous program, and the funds are not spontaneously created as they are in the Czech Republic. They are created by the state administration, but as soon as they get created, they are to become private companies. The umbilical cord is to be cut and they are to lead their own lives as soon as possible.

Participation in the program is totally voluntary. The citizens can participate or not. This of course creates a technical problem concerning the expected value per shareholder or share certificate holder, since we don't know how many people will come. We know what the assets assigned for the program are, but we don't know by how many participants they are to be divided. On the other hand, this can be attractive for the public relations people; they can advertise by saying, "Come, because if you don't come, the others will get more."

How will companies be attracted to the program? They will not be forced to participate. We will go through very complicated and sophisticated negotiations with the workers' councils, the management, founding bodies, other ministries, and sometimes the anti-monopoly office. We don't want to drag anybody to this program; we want them to appreciate its values and merits and join voluntarily. About 200 companies already have been converted into joint stock companies, and another 200 are to be converted, and the shares are to be transferred to NIFs, as shown in the pie chart on the bottom of the page. Sixty percent are to be transferred to the NIFs, 10 percent is a "sweetener" for the employees of the companies, and 30 percent goes to the State Treasury for some time. As I said, the criteria to select the companies for the program is their size. We don't think that the cost of running NIFs will be high; we expect it to be quite moderate, but in order to support the cost, the companies are to be bigger than average, which means more than $10 million in annual turnover. Depending on whether 400 or 600 companies participate in the plan, they will constitute between, say, 10 and 15 percent of Polish industry. We are working very closely with the anti-monopoly office. Monopolies are to be retained by the state, which means that the anti-monopoly office will work on the composition of the portfolios. They will put limits on branch concentration, which means that those funds will be like conglomerates; they will have a few companies from each branch but they will not be allowed to monopolize any branch of the industry.

The Polish privatization bill stipulates that the employees get 20 percent of shares of privatized companies at a discount of 50 percent. However, if we don't know what the values of the shares are, then we don't know how to calculate this 20 percent. Thus we say that it seems to us that 20 percent at 50 percent discount is equal to 10 percent for free. So we simply say that the employees will get 10 percent without any contribution, which should be an attractive offer. This solution is to be an amendment to the privatization bill, and we will apply this solution to all participating companies.

Gloria Gilbert Stoga, Carnegie Council Privatization Project, with Dr. Thieme at a private dinner held in his honor.

International competition to hire fund managers has started; a year ago we went through the pre-selection phase. However, since the legislation regulating the mass privatization program will be slightly changed in relation to the one suggested by us a year ago, most probably we will invite new bidders when we start the tender procedure right after the Parliament approves the mass privatization law.

The only goal is that NIFs own the companies and maximize the value of the shares for the shareholders. NIFs will focus their attention on restructuring the companies, especially those companies in which they will have a 33 percent stake in their portfolio. They are to do this through supervisory boards; by helping to appoint directors, consultants, and advisors; by helping to get credit and new equity finance; by helping to float the companies; by helping to fund joint ventures; by helping to build business plans; and by helping them become modern companies in the Western sense.

Who is eligible to participate in the program? Every adult citizen of the country, but they have to pay about 10 percent of the average monthly salary (which nowadays is about $200 per month) to register, which means that whoever wants to register will have to pay about $20. How much she or he is to get for that $20 is very difficult to say. We estimate the total assets of those 400–600 companies to be between $2–3 billion. It will depend on how many people enroll in the program. For example, if all of the 27 million adult citizens enroll, then the market value of equity assets per one share certificate can be three to four times higher than the registration fee. However, if, for example, only ten million people enroll, then the market value can be ten times higher than the registration fee. But I would be extremely cautious about those estimates; who knows what is to be the real market price? The bottom line is the registration fee, which is one of the reasons we want to have it. If there was no registration fee, which was the original proposal, there would be no bottom for the market value. The general idea was to hire professional management to help restructure the companies and give a stake in those companies to the citizens for them to learn about the capital market. For the population, the most important thing is to participate in a capitalist economy; to learn by making simple decisions about whether to sell or buy more, to learn what a dividend is or what it means if there is no dividend. All these concepts are new for people who have not had any experience with the capitalist market for the last 50–60 years.

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I would say there are three components for successful privatization. The first one is you cannot work with state-owned companies; you have to transform them. You have to corporatize; you have to create a company. That is the first step and it's very formal. There is a lot of experience in Poland, Hungary, and Czechoslovakia on how to do this, and there is legislation to make it possible. We believe in Poland that the next step is to provide professional management to those transformed companies, and this is extremely important in order to attract the future interest of the investment community, whether domestic or foreign. In order to extend credit to those companies, the banks have to know that they are dealing with professional managers, and professionally managed companies. Equity investors have to know that those companies are run in a professional way. The last thing, extremely important, of course, but the most difficult, is to attract capital to those companies. We do not believe that this capital will come very soon. It will come, but it will take years, probably, rather than months, to attract foreign capital. The difference between Poland and what they are doing in Russia is that in Russia they are just doing the first step. What is going on in the Czech Republic is a variant of the first step. At this moment we see mutual funds mushrooming, but there is a very slight chance that these mutual funds will involve themselves in the restructuring of the companies. What we want to do in Poland is to change the legal framework, to provide professional management, hoping that in some time this will be an efficient system to attract capital from both domestic and foreign markets.

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What about the implementation of our program? As I mentioned, the size of the program is the value of the companies, which is between $2 and $3 billion. Estimated participation is between 5 and 15 million citizens. The cost to prepare the program is in the range of $50 to $70 million, which is about 3 percent of the value of the assets to be privatized. Because there is a participation fee, the State Treasury will get revenues estimated at US $150–450 million.

In order to implement this program, we have created a department which the Ministry of Privatization will run and we will contract out most of the activities to external agents. The program is very, very complex; there are extremely complicated legal issues. We have to prepare capital markets. The Polish capital market system is currently very cute and small; it works perfectly. There are about 70,000 investors and 16 securities and there are about 200 brokerage windows all around the country, but only in the major cities. If this program is to work, the access to trading has to be easy, but not costly; so we have to prepare the infrastructure of the capital markets to deal with volumes which will be several times higher than the current ones.

Other extremely important issues are marketing, public relations, and education. We have to educate almost everybody about the concepts of funds, corporations, dividends, shares; those are the concepts which have been unknown for the last 40 years. We have to hire hoards of accountants to prepare the companies for this scheme. And, most probably, in order to organize a nationwide distribution system, we'll have to contract out this activity to the post office or a consortium of banks. We already have a lot of support from the international community, and especially from multinational agencies.

There are actually two timetables for the program's implementation, one in the immediate future and one for the entire scheme. The bill for mass privatization, the National Investment Fund bill, is to be voted on by Parliament between the eighteenth and twentieth of February. There is opposition from the left and from the right. The far left is against privatization. What they suggest is creating National Investment Funds modeled after Italian holdings, like IRI or INRI. They want to create holdings and not privatize them for a few years and then let the Parliament decide whether to privatize them or not. We reply that the Italian system was created by Mussolini some 60 years ago, and it proved to be rotten and is to be privatized now. The far right is a little uneasy about the possibility of foreign investors taking over control of NIFs. But if everything goes well, three months after the Parliament approves the bill, we expect the proposals of the fund managers to be submitted, and two months later the firms are to be selected. This brings us to sometime in the summer or fall of this year. Then, two months later, National Investment Funds are to be created and, two or three months after that, share certificates are to be distributed. The horizon for the entire scheme is ten years. The share certificates are to be on the market probably for three to four years, then the holders would be asked to convert them into shares of the funds and the funds are to exist for some ten years. At that point the general assembly of shareholders is to decide what to do with them. There are three possibilities: to divest, to turn them into mutual funds, or to turn them into some kind of industrial conglomerates.

I would like to say a few words about the major challenges of this program. There are political challenges, such as the opposition in Parliament, and there is the trade-off between the speed of implementation and the quality of the papers issued to the market. If we go very fast, then the public will not have enough information about the markets. We have to make the program attractive to the public, to the companies, and to the fund managers. We have to use marketing skills, which are quite rare in Poland. Just one week ago, we contracted a marketing consulting firm, the biggest contract in Eastern Europe, for $4.5 million over two years. We hope it will go very well.

There are logistical challenges, and there are also external challenges, such as the availability of foreign capital for restructuring worldwide. Who knows whether this capital will be available for Poland or for this region? The last challenge is a systemic challenge. The solution, as I told you, is based on capital market costs; specifically, on Anglo-Saxon capital markets. Who knows at this moment whether this is the best system for Poland? There are many people who say that the German system of banks being involved in running the industry can be better for Poland. We'll find out, but not soon, probably a few years from now. ■

Questions and Answers

Q You mentioned restructuring several times and, in my experience, one of the major problems in Poland is the amount of debt that a lot of the enterprises carry. In the United States when there is a restructuring, the creditors either reduce their debt or they convert it into equity. That seems to be something that doesn't happen in Poland. Do you think that's going to change?

A The Parliament has just approved a bill on restructuring the debts of banks and companies. About 1,200 companies are heavily indebted, one to the other or to the banks, and in order to restructure the debt of those companies, all the methods you mentioned are to be used. But those companies are not our companies. Our companies are not indebted heavily. They are not on this list. As I told you, they are better-than-average Polish companies.

Q In your talk there seems to be a tension between the desire to educate people about capitalism and the need to make the program successful, in the sense that the more people that subscribe, the smaller is your margin of safety in terms of the ultimate value of what they purchase. I wonder if you have made a policy decision about just how aggressively you are going to seek to involve the maximum number of people.

A Of course, the political goal is to involve as many people as possible. However, with the system of capital markets, with the banking sector, with the number of dealers, with the systems of the Warsaw Stock Exchange, it would be extremely difficult to have a society of 27 million shareholders trying to buy or sell. From the logistical point of view—let us say my narrow point of view—I would prefer fewer rather than more participants, but I guess the politically acceptable number would be about one third to one half of the population.

Q Of all of the problems facing the fund managers as well as all businesses in Poland, the biggest is the legal infrastructure and I'm specifically referring to things such as being able to pledge security, attach liens on property, and institute bankruptcy procedures. In order for fund managers to accomplish their goals they will need to have this infrastructure in place. Could you please give your thoughts on when Parliament will get around to passing an acceptable infrastructure that will support a capital market?

A Your statement is, in general, correct, but those things change. Last Saturday the Parliament voted an adjustment of the Polish legal system to the system recommended by the EEC (especially in the sphere of economy). Besides, one can do many things within the Polish legal system if one knows it thoroughly. ■

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