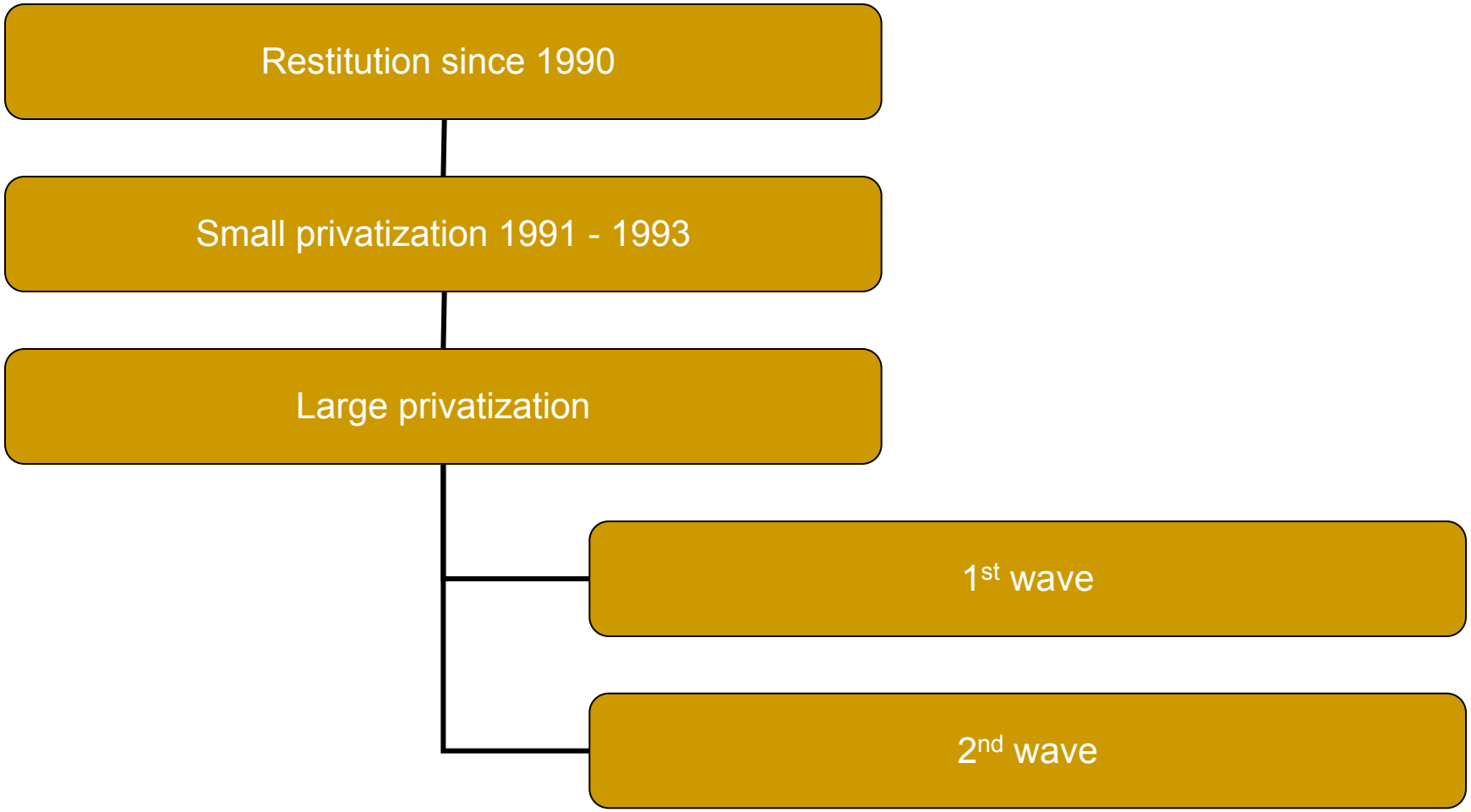
HISTORY DEVELOPMENT

PRIVATIZATION PROCESS

Introduction

- At the beginning of the 1990's the Czechoslovak economic structure was unitary
  - Almost all property existed in the form of state ownership
    - Suitable for central planners
    - Unsuitable for market oriented economy
  - Till the end of 1994 80 % of the state property was transferred in private ownership

Structure of privatization process



Restitution

- It is process of confiscate property reversion to former owners.
- Discussion about size of restitution
  - Several strong pressure groups against restitutions
    - Advocate of former political regime
    - Managers of companies that were a subject of restitution process
    - Economists
      - Slow down and postpone of privatization process
      - Doubts about social acceptability of property reversion
  - Very strong public support of restitution process

Problems with restitution

- Date of setting restitution claims
- If restitution in the forms
  - Money compensation
  - Physical compensation
- How evaluate the property
- Identification of former owners with claims for restitution

- In Czechoslovakia was decided that i the restitution process there
  - will be returned the property confiscated after communist coup in Feb 1948
  - Will be returned the property only of Czechoslovakia citizens and
  - In specific cases will be returned the property of the Church

- Whole restitution process started at the end of 1990
- Date about total value of restituted property are different
  - According to Official Report of the Czech government total value of restituted property was from 70 to 130 billion CZK.
  - In first phase
    - Restitution of confiscated property from 1955-1959
    - 70 000 civil buildings and office buildings
    - Later extended in farmlands, woods, etc. Returned 50 % of state ownership of farmlands and woods
- Czechoslovakia had the second largest re-privatization program of any of the former socialist European countries, with the exception of the former East Germany

- Beside the physical restitution there existed also financial compensation if the physical restitution was impossible
- Main financial resources came from Restitution Privatization Fund
  - In this fund there was concentrated financial resources from privatization process
    - 3 % stocks from companies that were submitted in voucher privatization
    - Owners of confiscated property got stocks from this fund in the case if they could not get back property physically and in advance they got 30.000 CSK in cash.

PRIVATIZATION PROCESS

- Privatization process had 3 principal elements:
  - Wide-ranging restitution process
  - A small-scale privatization programme
  - A large-scale privatization programme

HISTORY DEVELOPMENT

OVERVIEW OF PRIVATIZATION PROGRAMS

OVERVIEW OF PRIVATIZATION PROGRAMS SMALL PRIVATIZATION

- Small privatization process was launched in January 1991
- It began with an amount of 120 thousand restaurants, shops, and small business, designated for selling
- It was base on selling of small retail business units by public auctions.
- Public auctions were directed by local privatization committee
  - A committee announced 30 days before auction detailed information about business that come into auction
  - If there was no interest about privatized business was applied so called Holland auction
    - Decreasing in initial price from the extreme high price to lower
      - Decreasing about 50% in 1st and about 20% in 2nd auction round

OVERVIEW OF PRIVATIZATION PROGRAMS SMALL PRIVATIZATION

- Unsold firms from the first round were re-auctioned later in the second round, in which foreign participation was allowed to participate
- The first auction took place in 1991 and last in 1993
  - The most auctions took place in 1991 and 1992
- By the end of the year over 22.000 enterprises had been sold for 30 billion CSK
- The total value of call price was 21 billion CSK
- It means that total value of earnings were about 50% higher than total value of initial call price.
- Those enterprises that remained unsold had to be moved into the large privatization program
- Earnings from the auctions were deposited in the National Property Fund

National Property Fund (NPF)

- One of the important transformational institution
- It was established in 1991 and its initial function was execution of privatization decision of the government.
- All state owned companies designed in privatization were transferred under control of National Property Fund.
- It executed privatization and got in earnings.
- Fund did not take care of transferred property.
  - It was criticized because company in control of NPF was paralyzed and not able to decide about long-term investment or restructuralization.
  - On the other hand NPF did not hampered cost wasting of state owned company management and forbidden dividing of companies.

National Property Fund

- Earnings from privatization of state property did not pass in state budget but became property of NPF and was used as settlements for several actions
  - Ecological accident costs
  - Discharge from debts of privatized companies
  - Capital support of companies designed for privatization
  - Transformation and stabilization of banking sectors
  - As a resources for the support of social, health and retain insurance funds.

Problems of small privatization

- 75 % buildings were auctioned without property right to building it means that the subject of privatization was only occupational lease for 2 and later for 5 years
- If the subject of privatization was some public utility business this business had to be provided for 10 years
- With the most problems were related financing of small privatization
  - The most of households disposed only by limited number of savings and all privatization was financing by debts
  - There were established conditions for the future problems in banking sector.
    - In 1990 total value of property designed for privatization was 1400 billion CSK but total value of households savings and cash was only 323 billion CSK.

Advantages of small privatization

- Established small business sector
- At the end of 1991 small private companies provided 41 % of all retail sales.
- But small privatization was financed with debts and thus determined future development in companies
- A lot of companies had problems with debt settlements
  - Were not able to get next credits and had to used supplier credit that were not able to settle.

Large privatization

- The transformation of significant number of state-owned companies in private hands.
- Because of new economic clime direct control of state owned companies was unexecutable.
- Government decided about quick privatization because a lot of companies needed restructure that became the task for new private holders.
- Large privatization took place from 1991 to 1994 in two waves
- Main aims
  - Intensify effectiveness of the Czech economy as a whole
  - Brake up monopoly structures in the market

Dispute about pace of privatization

- Reasons for quick privatization
  - Negative experience in Hungary – privatization of state-ownership in hands of former management
  - Afraid of “pre-privatization”
    - Company existed without management till finishing of privatization process and was getting worthless
    - tunneling of company by management
      - Cheap selling of company assets in the hands of management
  - This occurred in every transformation economies because state failed as the owner and supervisor.

Privatization projects

- Specific of the Czechoslovakia privatization was
  - Competition between submitter of privatization projects
  - In Czechoslovakia anybody had a right to submit privatization project for property designed for privatization programme
    - 5 projects for one company in average, some companies 20-30 competitive project, maximum Lacrum Brno – 126 projects
  - Submitter could use several privatization methods or combination of methods

- In July 1991 was introduced list of companies designed for the first wave of privatization
- Management of companies submitted privatization project till Nov 1991
- Competition projects could be submitted till February 1992
- Management project had to introduces project for company as a whole
  - Competitive projects introduced plans only for specific part of company

- Then particular Ministry was decided about projects and suggested the best one
- Final decision was done by Ministry of National Property
  - Only in specific cases by government (only 5 % of all privatization projects)
- After approval of privatization project company property was transferred in NPF that
  - Carried out privatization
  - Control un-sold property
  - Get in earnings

- In reality almost all projects were submitted by former company managers or its employees

Privatization methods

- Voucher privatization
- Public auctions
  - Won the highest offer
- Public tender
  - Multi-criterion decision
  - Not only price
- Direct selling without public tender
  - Approved by government
  - Higher probability of corruption
- Transformation of company in joint-stock company and then sale of company stocks
  - In stock exchange, voucher privatization or OTC
- Free transfer of state property in municipial units, funds of social insurance, etc.
  - Buildings, kindergartens, etc
- Temporary transfer in NPF

- The most of companies transferred from state-ownership to joint stock company
- Then was applied combination of privatization methods
  - Part of stock was sold in voucher privatization
  - Rest was sold by auction or by other method
- Method of direct selling was used in the case of large state companies
  - E.g. car company - Skoda

- In all privatization methods were obvious one government effort
  - Privatization into the arms of Czech citizens – known as a “the Czech way”
  - Foreign capital was disadvantaged by several barriers
    - Small privatization was open for foreign investors only for property that was not asked by Czech investors
    - Foreign investors get property for market value (Czech for lower book value if market value was lower then could apply market value as well)
    - On the other hand foreign investors did not interested in a company as a whole but only for profitable part

Voucher Privatization

- Dominant privatization method was voucher privatization
  - About 50 % of all joint stock companies were offered for vouchers
- The aim of voucher privatization was quick transfer of property rights into private hands
- Other aims
  - Establishment of positive relation of Czech citizens to market economy
  - Quick transfer of property and limitation of pre-privatization tunneling
  - Equitably of private property

Mechanism of voucher privatization

- Voucher privatization was proceeding in several phases
  - First phase
    - Registration of Investment Privatization Funds
  - Second phase
    - Registration of privatization participants
    - Voucher privatization was open for all Czechoslovak citizens 18 years old
    - In price of 1035 CSK got voucher booklets with 1000 points that were divided in 10 lots with 100 points
  - Third phase
    - List of companies designed for voucher privatization with basic information about a company (revenues, number of employees, number of share, value of basic capital, etc.)
  - Fourth phase
    - Zero round
      - Voucher participants could invest voucher points via Investment Privatization Fund
    - Voucher participants invested their voucher points on their own
  - Fifth phase
    - Several rounds of voucher privatization

- Fifth phase
  - Announcement of number of shares designed for particular voucher round sale
    - Announcement of price of this shares
      - How many cost one share:
      - In first round all shares had same price 3 shares cost 100 voucher points
    - Voucher participants and investment privatization funds ordered shares. Investment funds could hold at most 20 % of company
    - This orders was collected and processed in Center for voucher privatization
    - It led to several situations
      - Supply and demand were same or supply was higher then demand
        - All orders were executed
      - Demand was higher than supply but not more than about 25 %
        - Demand of privatization funds were limited to balance demand and supply
      - Demand was significantly higher than supply
        - Investments were cancelled and investors got back their voucher points
  - All companies that were not sold moved in next privatization round with new price of shares.
    - In next round price was determined by level of demand and supply in previous round
- Next privatization round started

1st wave

- Started in Nov 1991 finished in Jan 1993
- Participate 5,95 million of Czech citizens (from 7,4 million available)
- There were offered 1491 joint stock companies
- 72 % voucher booklets were investment via investment funds
- Total revenues 6 billion CSK

2nd Wave

- Started in September 1993
- Participate 6,169 million of Czech citizens
- 63,5 % voucher booklets were investment via investment funds
  - Bad experiences with Investment Funds from 1st wave
    - Delay of shares transfer from Investment Funds
  - Total revenues 4,4 billion CSK

OVERVIEW OF PRIVATIZATION PROGRAMS VAUCHER PRIVATIZATION

- The advertising campaign and promises to economize 1,000 crowns attracted many citizens to take part in the privatization process
- There were more people involved than had been expected
- The turning point in voucher privatization came with the aggressive campaign of the Harvard Investment and Consulting Funds

OVERVIEW OF PRIVATIZATION PROGRAMS VAUCHER PRIVATIZATION

- Their founder Viktor Kozeny was the first to take a bet on a general assumption that privatization vouchers identified with cash profit
- He was the first to guarantee buying the coupons back within one year for a value ten times higher than the initial investment of one thousand crowns
- Ordinary participants were attracted more by an expectation of making a quick profit than the idea of ownership or responsibility

OVERVIEW OF PRIVATIZATION PROGRAMS VAUCHER PRIVATIZATION

- Unfortunately, until establishing and implementing of the Law on Fund Regulation, there were very limited codes
- The only rules were for fund establishments such as joint-stock corporations
- From time to time there were implemented ad hoc governmental decrees, which provided only weak regulation and the problem was criticized

OVERVIEW OF PRIVATIZATION PROGRAMS VAUCHER PRIVATIZATION

- The principles in the Law on Regulation were not applied in time
- Some principles were: diversification requirements and prevention of the conflict of interests
- In fact, many funds nominated governmental officials to their director boards, so that politicians sometimes played very important roles in the voucher privatization procedure

OVERVIEW OF PRIVATIZATION PROGRAMS VOUCHER PRIVATIZATION – THE SECOND WAVE

- Voucher privatization helped to establish a capital market and the RM-System as well
- That was a special system of securities trading with the great advantage of a simple shareholder approach
- In the 1st wave only Czech and Slovak Federal Republic citizens were eligible, in the 2nd wave, after the separation of the two republics, only Czech citizens were allowed to participate in the Czech Voucher Privatization process

Privatization after 1995

- Privatization process was continuing after 1995
- But the pace of privatization was decreasing because a lot of property was transferred in private sector
- The most usage privatization method was direct sale.
- Revival of privatization with left oriented government of Milos Zeman
  - Privatization of banks

Total value of property

- Book value of property designed for privatization and transferred
  - 780 billion CSK
    - Small privatization – 45 billion CSK
    - Free transfer in voucher privatization – 333 billion CSK
    - Free transfer in municipal units – 121 billion CSK
    - Restitution – 25 billion CSK
    - Privatized by standard privatization method– 121 billion CSK

Thank you for your attention!