THE OPERATING AND FINANCIAL PERFORMANCE OF NEWLY PRIVATIZED STATE-OWNED ENTERPRISES IN MALAYSIA

ISNURHADI BANALUDDIN

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By

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Thesis submitted in fulfilment of the requirements for the degree of Doctor of Philosophy

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PRESTASI OPERASI DAN KEWANGAN SYARIKAT MILIK KERAJAAN YANG BARU DISWASTAKAN DI MALAYSIA

ABSTRAK

Pengswastaan syarikat milik kerajaan adalah bertujuan untuk mengatasi prestasi yang tidak memuaskan daripada syarikat tersebut. Kajian ini ditumpukan kepada penilaian prestasi operasi dan kewangan syarikat yang diswastakan yang menerbitkan saham di pasaran modal Malaysia. Penyelidikan dibuat dengan menyiasat prestasi syarikat selepas pengswastaan, and menilai prestasi tawaran awam permulaan (IPOs) untuk jangka masa pendek dan jangka masa panjang. Analisis statistik dibuat dalam menilai prestasi syarikat dalam hal ini diwakili dengan prestasi proksi iaitu i.e. pulangan jual (ROS)**,** pulangan harta_(ROA), pulangan stok (ROE), penjualan sebenar dan keuntungan bersih pada beberapa faktor yang dijangkakan mempengaruhi prestasi tersebut iaitu sekatan belanjawan yang lemah, peratusan saham yang diterbitkan, saham yang diagihkan kepada pegawai, dan perubahan pasukan pengurusan di atasan. Beberapa perkara iaitu peratusan saham yang diterbitkan, ketidakpastian tentang nilai syarikat di masa hadapan, nilai pasaran satu bulan sebelum penerbitan saham, ukuran syarikat, dan nilai saham yang diterbitkan pada hari pertama perdagangan dan pulangan permulaan dianalisis secara statistik untuk menilai prestasi tawaran awam permulaan pada jangka masa pendek dan jangka masa panjang. Hasil kajian menunjukkan bahawa prestasi proksi ROS, ROA and ROE berkurangan, dan penjualan sebenar dan keuntungan bersih syarikat menjadi lebih baik selepas pengswastaan. Faktor-faktor yang menyebabkan perubahan indeks prestasi ini tidak sama, bergantung kepada proksi yang dinilai. Faktor yang menyebabkan perubahan dalam ROS adalah hutang jangka pendek terhadap jumlah asset and saham yang diagihkan kepada pegawai. Peratusan saham yang diterbitkan dan saham yang diagihkan kepada pegawai merupakan perkara yang memberi kesan terhadap ROA, sedangkan ROE dipengaruhi oleh perubahan pasukan pengurusan di tingkat atas sahaja. Penjualan sebenar dipengaruhi oleh peratusan saham yang dijual dan saham yang diagihkan kepada pegawai, sedangkan keuntungan bersih tidak dipengaruhi oleh apa apa faktor yang dikaji. Kajian menunjukkan bahawa pada amnya IPOs terkurang harga sedangkan prestasi jangka panjang tidak terkurang mahupun terlebih harga. Hanya besarnya pulangan permulaan mempengaruhi prestasi tawaran awam permulaan untuk tempoh satu, tiga dan lima tahun. Kajian ini mengesan satu pola terlebih harga (pulangan negatif) tempoh jangka panjang yang tidak bermakna.

THE OPERATING AND FINANCIAL PERFORMANCE OF NEWLY PRIVATIZED STATE-OWNED ENTERPRISES IN MALAYSIA

ABSTRACT

Privatization is the transferring of ownership from state to private ownership expecting that the lackluster and unsatisfactory performance of state-owned enterprises can be improved. This study was focuses on the evaluation of operating and financial performances of the privatized firms which issued shares in capital market. The research was carried out by investigating the performance of the firms after privatization, and evaluating the performance of initial public offerings (IPOs) on the short-run and the long-run. The performance were studied through statistical analysis of the dependency of several independent variables namely performance proxies i.e. soft budget constraint, fraction of share sold, share allocated to employee and top management team change on dependent variables i.e. return on sales (ROS)**,** return on assets_(ROA) and return on equity (ROE), real sale and net income. Several factors associated with the variation in initial returns such as percentage of share sold, uncertainty about the future firm value, market index fluctuation prior to the issue, size of firm and the value of issue on the first day of trading were analyzed statistically to evaluate the short-run and the long-run performances. The results showed that the performance proxies ROS, ROA and ROE deteriorated and real sales and net profit of the firms improved upon privatization. The factors that are responsible to the performance changes differ depending on the performance proxies. The factors responsible for ROS are the short-term debt to total asset and the share allocated to employee, the fraction of share sold and the share allocated to employee are responsible for ROA, while the ROE is affected by the top management team change only. The real sale is influenced by the fraction of share sold and the share allocated to employee, while net profit is not affected by any factor considered in this study. The study also indicated that, on average, the IPOs are underpriced while the long-run performances of IPOs are neither underpriced nor overpriced. The factors that influence the initial returns are percentage of share sold, uncertainty about the future value of the firm, market index fluctuation, size of firm and the value of issue on the first day of trading. Only the magnitude of the initial returns significantly affects the one-, three- and five-year long-run IPOs. The study observed a pattern of underperformance (negative returns) of the long-run IPOs but statistically insignificant.

CHAPTER 1

INTRODUCTION

1.1 Background

Privatization as a policy of transferring ownership from state to private or public assets has been one of the most popular economic policy for the last twenty five years. Margaret Thatcher's conservative government which came to rule United Kingdom in 1979 is regarded as the pioneer of the modern privatization programs. The policy has been adopted by many countries in which governments from various political backgrounds enthusiastically sold state-owned enterprises (SOEs, hereafter) to private investors expecting a significant improvement of the companies. This privatization policy has transformed the role of the state in the economy in almost every country in every continent from industrialized nations such as the United Kingdom, France, United States, and Japan to emerging countries such as Malaysia, Thailand, Indonesia, and Philippine in Asia, as well as Chile, Brazil, and Mexico in Latin America.

The first countries to adopt privatization programs are the former Soviet-Union and countries in the Central and Eastern European (CEE) regions. The Soviet Union took up the privatization of SOEs as part of an integrated effort to transform their economies from a command-based economy to global market economy. The policy was then adopted by many other countries such as Poland, Czech Republic, Hungary, Bulgaria (Megginson, Nash & van Randenborgh, 1994). Thus, the political change around the world and the budget deficit, as well as the unsatisfactory and lackluster performance of most SOEs has shifted the government economic policy.

Malaysia as one of the leading economy from emerging market has embrace privatization since early 1980. The generally lackluster performance and unsatisfactory of state-owned enterprises together with economic crisis in the form of recession required the change in the policy. The then Malaysia Prime Minister Mahathir Mohamad first announced his government's privatization policy in 1983. Issuing shares in capital market is one popular mode of privatization in Malaysia which usually involves very large companies. To date, there have been 41 companies privatized through issuing shares in Bursa Malaysia (EPU, 2002). Some large and well-known companies amongst others are Malaysia Airlines, Telekom Malaysia, TV3, and Proton. These companies play very important role in Bursa Malaysia after privatization (Jomo, 1995b).

Now after more than two decades of privatization policy in many countries in the world, the impacts of the policy have been studied using various methodologies. For example, Galal, Jones, Tandon and Vogelsang (1994) using case study approach reported an average net welfare gains in 11 of 12 privatized companies considered in their study which equal on average 26 percent as compared to the sales of the firm before privatized. Using large sample from many countries and many industries and applying the same methodology, Megginson, Nash and van Randenborgh (1994), Boubakri and Cosset (1998), and D'Sousa and Megginson (1999) report that on average the performance of SOEs is improving upon privatization. On the other hand, Harper (2001), using a sample of Czech firms, reports that the efficiency and the profitability of the firms decrease immediately following privatization.

Eckel, Eckel and Singal (1997) report that the performance of the British Airlines improves upon privatization. Ramamurti (1997) and La Porta and Lopez-de-Silanes (1999), using a single industry sample, also report a favorable performance upon privatization. On the other hand, Martin and Parker (1995) find that only less than half British firms they studied perform better after being privatized. Newberry and Pollit (1997) conclude that British Electricity Company's (CEGB) restructuring and privatization was in fact worthwhile, however, it could have been better implemented taking into account of public's welfare. Privatization program in some transition countries, primarily Russia is considered failed (Nellis, 1999). Privatization through mass and rapid schemes as in these transition economies of former Soviet Union and Central Easter European countries turned over assets to people who are lacking incentives, skills, and resources to manage the firm. In this institutional vacuum, privatization can and has led to stagnation rather than to better financial results and increased efficiency.

In short, study on the impact of privatization on the firm performance seems inconclusive with majority reporting favorable changes but there are some studies reporting the opposite.

Criticism of the existence of state-owned enterprises (SOEs) is not a common sense but is based on theories. Most prominent theories that support privatization are notably property right, public choice and principal-agent theory. From point of view of property rights literatures, when a company has no clear residual claimant, no individual or group with a clearly specified right to claim any residual benefits or surplus left after other claims are met, the company will be less efficient (Alchian & Demsetz, 1972; Demsetz, 1988 and Grossman &

Hart, 1986). Since no one clearly benefit from SOE's efficient operation, no one will be strongly motivated to hold management accountable for performance, hence agency problems will not be reduced. Thus, the property right analysis of public ownership leads to the conclusion that public enterprises are less economically efficient than private enterprises.

Other school of thought that shares a view of weaknesses of public ownership and hence providing the rational for privatization is public choice theory. Public choice theory suggests that public managers, bureaucrats and politicians will use their control of SOEs to pursue their own interest, rather than the state firm's efficiency (Niskanen, 1971). Privatization allows profit-maximizing entrepreneurs to take the place of size-maximizing-bureaucrats and vote-maximizing politicians. From the vantage point of the management of public enterprise, privatization alters the firm's criteria of success. Under public ownership which leads to large subsidies and other concessions, it is more worthwhile to lobby minister and key public official for fund than the diligent search for ways of reducing costs. On the other hand, privatization, by freeing enterprises from the burden of political inference and non-market criteria, limits politicians' ability to redirect the enterprise's activities in a way that promote their personal agenda or yield to a short-term political pressure at the expense of market efficiency, clarifies the objectives of the enterprise, and lead to enhanced economic performance.

Within the agency view, there are two perspectives on the causes of the existence of poor incentives for efficiency. The first one termed managerial perspective, states that monitoring is poor in publicly owned firms and therefore the incentives for efficiency are low powered (Vickers & Yarrow, 1989). The second one, the political perspective, claims that political interference is what distorts the objectives and the constraints facing the public managers (Shleifer & Vishny, 1996). The reason that the public managers are poorly monitored because the firms are not traded in capital market, as is the case of any private firms. This fact eliminates the threat of take-over when the firms perform poorly. Additionally, shareholders cannot observe and influence the performance of the enterprises (Yarrow, 1986).

The political perspective argues that distortions in both the objective function that managers seek to maximize (Shapiro and Willig, 1990) and the constraints they face, through the so-called soft budget constraints problem (Kornai, 1980), result in lower efficiency under public ownership. Public managers, who tend to report to a politician and pursue their political careers, incorporate to the objective function aspects related to maximization of employment at the cost of efficiency, and political prestige (the empire building hypothesis). The reason why managers are able to do that without facing the threat of bankruptcy is related to the second distortion, the soft budget constraint. In any situation in which the firms have engaged in unwise investments, it will be in the interest of the government to bail the firm out using the public budget. The rational for this relies on the fact that the bankruptcy of the firm would have a high political cost, whose burden would be distributed within a well-defined political group, like unions. On the other hand, the cost of the bailout can be spread over the taxpayers, a less organized, larger group in society, with diversified interests and preferences. The threat of bankruptcy is non-credible under public ownership because the political loss involved in closing a publicly owned company is larger than the political cost of using

Taxpayer money to bail it out.

Similar with privatization in other countries, many scholars as well as general folks have questioned the merits of privatization in Malaysia because despite of the privatization program, the government still retains a “golden share” of the company. This reflects the intention of the government to interfere on corporate matters if considered important at any time. Due to the policy, the privatization in Malaysia is sometimes referred as partial privatization. With this policy, it is questionable that the privatization program can achieve its objectives including those officially identified by the government (Rugayah, 1995). While the partial privatization indeed changes the distribution of welfare, the firm behaviors is not necessarily. Hence, the partial privatization may be just a policy aimed to impress the people that the government has adopted the privatization policy without actually changing the decision making process (Jomo, 1995a).

Privatization emulates debates because theoretically it is a good policy to improve the firm performance which is lacking under state ownership, however empirically the result is doubtful. Empirical evidences show mixed results. This indicates that evidences are inconclusive and more studies are warranted to better explain the phenomenon.

As the debate on the impact of privatization on firm operating performance is going on, there is another area of privatization that is challenging to study but relatively less researched, that is, financial performance of stocks of the firms that are privatized through share-issue privatization (SIP, hereafter). In SIP, a firm is privatized through shares issue to the public through a stock exchange. SIPs unlike private-sector companies are interesting because they are generally large, well-known and have been in existence for many years. For instance, the world single largest initial public offering (IPO, hereafter) in history involves SIP i.e. IPO of Japan Nippon Telegraph and Telephone (NTT) which raised almost US$40 billion (Megginson & Netter, 2001). Due to their size and long operating history, the firms privatized through SIP should have uncovered considerable information to the general public and hence, pose less uncertainty to investors. Consequently, privatization IPOs (PIPOs, hereafter) should have been less underpriced and in the long-run the PIPOs return behavior should have been better.

PIPO, for some respects, have many things in common with private-sector IPO of privately-held companies. However, it is also reasonable to argue that there are differences with respect to length of operating history, size and riskiness of the companies. Further, according to Perotti (1993), a government carries many objectives in PIPO. Beside their intention to generate revenue the government has other objectives such as to encourage share ownership to the people, to develop capital market, to gain support in privatization program and last but not least to lure votes in general election. Thus, with many strings attached on the privatization IPO, it appears that private-sector IPO is different from PIPO in many respects. Consequently, it is very challenging to study the phenomenon of underpricing in privatization IPO as an additional knowledge to the confirmed underpricing phenomenon in private-sector IPO.

Based on some regularity, Perotti (1995) offered a new theory which exclusively explains the underpricing phenomenon for PIPO. According to Perotti (1995), PIPO differs from conventional private-sector IPO to the respect that PIPO involves political motivation of the government. Perotti (1995) distinguishes government into two types: market-oriented and populist government. A market-oriented government is willing to accept lower gross proceeds due to the underpricing. This strategy is used by market-oriented government in order to build reputation. In contrast, a populist government is not willing to accept a high underpricing and lower proceeds. Perotti (1995) also shows that if the uncertainty about a future privatization policy is high, a larger fraction has to be sold at the initial offer. Otherwise the market would get impression that the government possibly does not want to give up control rights over the state enterprises. Depending on the level of political uncertainty, the offer has to be more underpriced.

Furthermore, Biais and Perotti (1997) argue that government should sell sufficient shares to median class voters in order for the privatization program to be successful. Median class voters will support the privatization efforts of the government. To attract median class voters to buy enough shares, underpricing is necessary in most cases. The more income inequalities in population, the poorer the median class voters are. Hence, the share should be more underpriced. The authors also predict that governments disseminate shares politically by dividing issues in several trances and preferring employees and domestic retail investors when assigning a certain number of shares to each trench.

Studies focusing on private-sector IPOs are abundant. Two main phenomena are revealed: first, the IPOs are underpriced and second, in the long run they tend to underperform some benchmarks. One such evidence was observed as early as 1975 by Ibbotson. Then, many studies report the same phenomenon (Ritter 1984; Miller and Reilly, 1987; Chalk and Peavey, 1983 for US market; Levis, 1990 for UK; Jenkinson and Mayer, 1988 for France;

Aggarwal, Leal and Hernandez (1993) for Latin America; Finn and Higham (1988) for Australia; Mok and Hui, 1998 and Su and Fleisher, 1999 for China; Dawson, 1987 for Hong Kong, Malaysia and Singapore; and many others).

The long-run IPO performance has been documented mainly in developed countries such as US, UK and France. Ibbotson (1975) detected that IPOs tend to show negative performance during the second through fourth years following offerings. After more than a decade, Ritter (1991) formalizes the study on long-run performance of IPOs and reports that IPOs underperform various benchmarks during the first through five years of offering. Levis (1993) reports IPOs of U.K. firms are outperformed by several relevant benchmarks 36 months from their first trading day. Further, Aggarwal, Leal and Hernandez (1993) also report a negative three year market-adjusted return of 47 percent in Brazil, three-year negative excess return of 23.7 percent for Chile and one-year negative excess return of 19.6 percent for Mexico. On the other hand, the evidences of long-run IPO performance from emerging markets tend to show a different pattern. Kim, Krinsky and Lee (1995) report that their sample of 169 firms listed on Korean Stock Exchange during the period 1985-1989 outperform seasoned firms with similar characteristic for the two years and three years periods. Mok and Hui (1998) report a positive excess market returns over 350 days for A-share IPOs and B-share IPOs in Shanghai Stock Exchange.

On PIPO, Jekinson and Mayer (1988) are amongst the first that study the underpricing phenomenon and report that U.K. PIPOs are more underpriced than private-sector IPOs. Dewenter and Malatesta (1997) report that in U.K. PIPOs are more underpriced than private-sector IPOs. In Canada and Malaysia, the opposite is true. Further, Choi and Nam (1998) report a general tendency for PIPOs to be underpriced to a greater degree than the privately-sector IPOs. Jones, Megginson, Nash and Netter (1999) report governments consistently underprice SIP offers. On the other hand, Huang and Levich (1998) report no evidence that PIPOs' underpricing differs from that of private-sector IPOs. More recently, Aussenegg (2000) reports that there is no tendency for Polish government to underprice initial offers more than private company issuers do. On the long-run PIPO behavior, Megginson, Nash, Netter and Schwartz (2000) report that the net returns of 159 PIPOs in their sample from 33 countries are significantly positive for one, three and five year periods. Other study by Camstock, Kish and Vasconcellos (2003) report findings that during the first year after the first trading day privatization offers yield 50 percent lower returns than the market for a sample from six countries. At the end of fifth year of trading cumulative abnormal returns are -50 percent.

In short, long-run return behavior of PIPOs and private-sector IPOs are similar. The results are mixed; the tendency of underperformance is reported from developed capital market but over-performance is observed in emerging market. Hence, more evidences are needed to come to conclusive results that could lead to a new theory in long-run IPO in general and PIPO in particular.

Studies in Malaysian initial return performance are quite extensive, but not much study was conducted on the long-run performance of PIPOs. Malaysia evidences show that average initial returns of IPOs are positive and higher compared to developed markets. (Dawson, 1987; Yong, 1991;, Ku Ismail et.al, 1993; Mohamad, Nassir and Ariff, 1994; Nasir and Mat Zin, 1998; Jelic, Saadouni and Briston, 2001). Paudyal and Saadouni (1998) found that the long-run performance of both PIPOs and private sector IPOs over the first three years show no significantly positive or negative. Wu (1993) reports positive three and five year returns of 13.80 percent and 14.10 percent respectively. Further, Sun, Tang and Tong (2001) report no significant under- and over-performance for first, second, third and fifth year. However, they find significantly negative performance for the fourth year of seasoning.

1.2 Problem Statement

Several established theories, particularly property right (Alchian & Demsetz, 1972), public choice (Niskanen, 1971), and agency theory (Vickers & Yarrow, 1989) amongst others, predict privatization will bring improvement on firm performance. Although, majority evidences support the prediction, still many cases reveal inconsistent results. Some evidences (Megginson et. al., 1994, Boubakri & Cosset, 1998 and D'Sousa & Megginson, 1999 amongst others) are supportive to the theories but the work of Martin and Parker (1995), Newberry and Pollit (1997), and Harper (2001) showed otherwise. Specific evidences revealed from the study conducted in the former Soviet Union and Eastern European countries such as Russia, Ukraine, Bulgaria and Hungary due to certain features related to the countries i.e.: the lack of market mechanism, undefined property right, the absence of competition and institutional support, the centralized economy. Malaysian economy does not resemble plan-economy countries of Eastern European Countries. Thus, the problem is why the privatization program in Malaysia does not always work as predicted by theories and what the possible determinants of the problem are.

Malaysian Economy is different from transition economies of Eastern European countries. It more resembles of free economy of western countries with rule and regulation are on place, property right is protected, and market mechanism works well. Thus, it is reasonable to believe that the effect of privatization on firm performance in Malaysia will be in accordance with what have been predicted by the established theories. However, the critics say that the merits of the privatization in Malaysia are questionable. Thus, one of the problems is whether the Malaysian privatization program generates favorable impact on firm performance as predicted by theories discussed and what are the determinants.

As an emerging economy, Malaysian capital market, to some extent, is different from the more established capital market of US and U.K. and those of other western countries for many respects. Characterized by relatively a shorter operating history, a smaller in size, usually less knowledgeable investors, more speculative retail players, relatively illiquid trading, less regulation on disclosure, and less investment publication, capital market in emerging economies such as Malaysia are generally less efficient than developed markets. Moreover, to some respects private-sector IPOs is a bit different from PIPOs. It is logical to believe that the behavior of short-run and long-run performance of private-sector IPOs and PIPOs are different. Furthermore, the behavior of IPOs in general in Malaysia capital market may differ from those of developed capital markets or even of relatively less-developed market of Eastern European capital markets. Privatization IPOs with politically motivated objectives, to some extent, will distinguish themselves from private-sector IPOs in general. Consequently, the problems are why the privatization IPOs in Malaysia is particular underpriced and what the possible determinants are and why in the long-run privatization IPOs from emerging economies such as Malaysia are overpriced and what are the possible determinants are.

1.3 Objectives

The aim of this study is to examine the effect of privatization on the financial and operating performances of state owned enterprises (SOE) and to evaluate the determinants that possibly responsible for the variation on the performance. The specific objectives of the study are the following:

1. To investigate the impact of privatization on the performance of the firm.
2. To investigate the determinants responsible for the change in the performance of the firm before and after privatization.
3. To investigate the level of initial returns gained by investors who participate in PIPOs.
4. To investigate the determinants of the level of initial returns.
5. To investigate the long-run PIPOs performance up to five years following privatization.
6. To investigate the determinants of the one-, three- and five-year long-run PIPOs performance.

1.4 Research Question

1. What are the impacts of privatization on firm performance?
2. What are the determinants of the change in the performance of the firm before and after privatization?
3. How much the initial returns gained by investors who participate in PIPOs?

4. What are the determinants of the PIPOs initial returns?
5. How the long-run PIPOs performance behaves up to five years?
6. What are the determinants of that behavior?

1.5 Scope of Study

This research attempts to study the phenomenon of privatization in Malaysia. The study covers state-owned enterprises that are privatized by offering all or partial share to public through capital market from 1983 to 1999. Full privatization is not a norm in Malaysia, thus the sample comprises all partial privatization. Choosing share issue privatization is not without reason; share issue privatization provides the most complete data. The study is to examine changes in financial and operating performance of privatized firms, factors affecting those changes and short-term and long-term share price performance of privatized IPOs (PIPOs, hereafter).

1.6 Research Contribution

This study contributes to literature on privatization in several forms. First of all, it provides additional evidence on the impact of privatization on firms' performance, the short- and long-run performance of share-issues privatizations (SIPs) from emerging market. Secondly, unlike several previous studies that focus on the findings of impact of privatization, and short- and long-run PIPOs return behavior per se, this study also provide the possible factors related with those variations in performance. In addition, the data is collected from a single country, so it is more homogeneous and hence, more robust results are expected.

Several contributions to the theory are expected from this study. Firstly, a theory of soft budget constraint (related to the tendency of a government to give subsidies, grant soft loan and bail out ailing companies amongst others) which is borrowed from economic theory (which was never used before by any researcher to study privatization) is applied in this research to explain the post-privatization performance phenomenon. Secondly, a relatively new theory explaining the phenomenon of initial underpricing specific for PIPOs introduced by Perotti (1995) is used along with conventional theory of IPO underpricing. Thirdly, more recent data and more samples are utilized; hence the results are expected to be more comprehensive.

Furthermore, two empirical contributions to the real world are identified from this study. First, it provides the extent of impact of privatization on firms' performance and the determinants of that performance which is very important for Malaysia government in designing future privatization and improving the mechanism for current privatization. Second, it provides the information on the level of initial return long-run return behavior of IPOs, and the determinants that affect that performance which is very valuable to investors in their investment decision and in designing their security selection processes.

1.7 Limitation of the Study

The generalization of research findings from this study may be limited by several factors such as the number and uniformity of the samples used for the study. The sample constitutes merely of state-owned enterprises privatized through share issued to the public. The number of observation varies between 30 companies for a certain statistical analysis and 37 for other analyses. This small number of sample, for instance, limits the detail analyses of the data. Limitation of the study is also related to the data regarding of the proxy for soft budget constraint. Ideally the proxy for soft budget constraint is the amount of subsidies granted by government to the companies or the amount of soft loan received by the companies. However, due to its sensitive nature, it is very difficult if not impossible to get the data. Hence, the ratios of short-term and long-term debt to total assets are used. It is expected that these ratio could capture the essence of soft budget constraint though the accuracy is compromised.

1.8 Definition of Key Terms

The following is the definition of each key term used in the thesis:

1. Privatization - refers to the sale of all or part of a government's equity in state-owned enterprise to the private sector, or to the placing of SOEs under private management through leases and management contracts (Vuylsteke, 1988).
2. In Malaysia Privatization Policy is handled by Economic Planning Unit (EPU), a government agency under the office of Prime Minister. EPU defines privatization as the transfer to the private sector of activities and functions which have traditionally rested with the public sector. This definition applies to enterprises already owned by the Government and to new projects which normally have been implemented by the public sector. Privatization involves transfers of management responsibility, assets (with or without liabilities) or the rights to use assets, and personnel (Privatization Masterplan, 1991).

3. Share-issue privatization is a privatization of state-owned enterprises by selling shares in capital market.
4. State-Owned Enterprise (SOE) – World Bank defined state-owned enterprise to include firms that all or part of the equity is owned by the state or government (World Bank, 1991). In Malaysia state-owned enterprises are known as Government-owned Entities (GOEs) which refers to entities that are owned by the governments: federal, state and local government (Privatization Masterplan, 1991).
5. Underpricing – refers to a situation when the price of a stock at the first day of trading is higher than the offer price. There are two ways of computing the underpricing: unadjusted and adjusted by market returns in case the time between the date of prospectus and official listing date is quite awhile (various sources).

1.9 Organization of Thesis

This thesis is organized into 8 chapters. The first chapter introduces the recent phenomenon of privatization as the study background. It also explores the basic problems encountered in privatization program of state-owned enterprise in Malaysia and poses questions to be addressed in this research.

In Chapter 2, the literatures on privatization are reviewed; the definition, reasons, and methods of privatization are described. Moreover, the empirical studies are presented and some theories related to privatization are assessed and discussed. Finally, the Malaysian privatization experiences are also presented as a prelude to understanding the Malaysian privatization program.

Chapter 3 provides the literature review on capital market. Empirical studies on short-run IPOs underpricing are presented. The behavior of privatized firm stock price in long-run were presented and analyzed. Some theories of IPOs underpricing and long-run IPOs price performance are discussed and critically assessed. The theoretical explanation of both was described in detail in this chapter. Research framework and hypothesis are explained in Chapter 4. Each hypothesis is preceded by a short discussion and generated based on literature reviewed on the previous chapters. Chapter 5 presents the methodology adopted in this study. The research design used for this study is a quantitative approach in which the secondary data like financial statements and other documents from capital market are extensively used. In Chapter 6, the results of the study of privatization performance were presented. The performance of companies before and after being privatized, various factors associated with them were investigated. Furthermore, the results of the study of the performance of share price in capital market in the short-run and the long-run were presented. Various factors having significant relationship were also investigated. Chapter 7 provides the synthesis of the results of the study and discussion. The findings of the study are summarized and implications of the study are assessed. Furthermore, some policy recommendations are derived from the findings and explained in this chapter. Finally, areas for further researches are identified. The main research findings and the overall conclusions of the study are presented in Chapter 8.

CHAPTER 2

PRIVATIZATION

2.1 Introduction

Privatization could be considered as a program of transition from a planned economy to a market-based economy. It has been implemented in the developed, less developed and emerging economies. The degree of implementation for each country could be different, however, the objectives are very much similar one of which is to improve the lackluster and unsatisfactory performance of state-owned enterprises. This chapter aims to review the phenomenon of privatization. Section 2.2 presents definitions and objectives of privatization. Privatization programs around the world and in Malaysia are presented in Section 2.3 and Section 2.4 respectively. Section 2.5 discusses the theory behind privatization. Section 2.6 present empirical studies on privatization. Section 2.7 described the determinants of post-privatization performance and finally Section 2.8 summarizes the chapter.

2.2 Definitions and Objectives of Privatization

Privatization program has been adopted and implemented by almost all governments all over the world for more than two and half decades, yet many people have not had an opportunity to understand this phenomenon. The unclear and ambiguous understanding of the term may lead to confusion for the readers. Thus, it is essential to dedicate a section for definition and objective of privatization in this chapter. This section is intended to give readers an understanding of privatization programs. This section comprises of definition of privatization to give readers the understanding of privatization and objective of privatization which explain what privatization for.

2.2.1 Definitions of Privatization

Different authors define privatization differently. Some authors define privatization narrowly and some others define privatization broadly. Kikeri, Nellis, and Shirley (1994) define privatization narrowly to mean the transfer of a majority of ownership from states to private sectors by the sale of ongoing concerns or assets following liquidation. Ramamurti (1992) argues that a privatization “refers to the sale of all or parts of a governments’ equity in state-owned enterprises to the private sector.” World Bank (1996) defined privatization as “the divestiture by the state of enterprises, land or other assets.” Hanke (1987) defined privatization as a transfer of assets and services functions from public to private hands. These authors emphasize activities ranging from selling state-owned enterprises to contracting out public services with private contractors. Thus, the privatization is the transfer of ownership fully or partially from governments to private sectors through various methods such as direct sales, share issues, leasing, etc. Some other authors look at privatization as a wider phenomenon comprising of interrelated activities that reduce the government ownership and control of enterprises and that promote private sector participation in the management of state-owned enterprises. Vickers and Wright (1998) view privatization as an umbrella term for a variety of different policy that are loosely linked which mean the strengthening of the market of the expense of the state. Hartley and Parker (1991) define privatization as “the introduction of market forces into an economy in order to make enterprises to work on a more commercial basis. They mean that privatization includes denationalization or selling off state-owned assets, deregulation (liberalization) competitive tendering, as well as the introduction of private ownership and market arrangements in the ex-socialist states. Cook and Kirkpatrick (1988) defined privatization as a range of different policy initiatives intended to change the balance between the public and private sector and the service they provide.

In Malaysia privatization is generally defined as the transfer of ownership from public to private sector. It could also be referred to the changing status of a business, service or industry from state, government or public to private ownership or control. Occasionally, the term privatization is to include the use of private contractors to provide services previously rendered by the public sector. Full privatization is not the norm in Malaysia, hence most privatization involves transferring only some of the government ownership. In sum, privatization is a policy of transferring government ownership to private ownership through various methods. Based on these various definitions of privatization discussed above, this study uses the definition of privatization which is a bit narrow that is share issue privatization (SIP, hereafter). In this definition, privatization includes the transfers of a full or partial government ownership to private ownership through the sale of equity in the capital market.

2.2.2 Objectives of Privatization

Privatization of state-owned enterprises is based on a strong proposition that private sector enterprises are subject to economic disciplines which are not present in the state enterprises. The disciplines of competition and the need to earn a profit in order to grow keep private sector enterprises relatively more efficient than their public sector counterparts. Therefore, one common objective of privatization by transferring state ownership to private investors is to make the enterprise become more efficient and more profitable. The World Bank (1996) reports that in established market economies and middle to high income developing economies it is believed that private ownership is a significant determinant of economic performance. The privatization may also have other objectives such as changing behavior of economic agents and discipline of the market, reducing budget deficit to harness savings and finally promoting wide share ownership.

On the other hand, different countries have their own specific objectives of privatization of state-owned enterprises. Those objectives depend upon the condition and the situation the countries are facing. However, whatever the political motives of those countries toward privatization policy, every country tends to have common objectives of increasing firm efficiency and profitability and reducing government financial burden.

2.3 Privatization Program around the World

Privatization is moving forward very quickly in many countries throughout the world. The rationale for privatization is now widely accepted after decades of discussion. In this section recent the developments of the privatization program in major region around the world are reviewed briefly.

Latin America has led the developing world in terms of the pace of its privatization. Governments in Latin American consider privatization as a quick means of economic reform, specifically, as a mean of attracting foreign investment and fostering economic liberalization. Privatization progress in this region has been mixed. Some countries have been successful while some others are only beginning.

Asian nations have made significant progress toward achieving their privatization goals and are now beginning to privatize larger state-owned enterprises and public utilities. In Asia privatization through public offering is the most common method. In addition to domestic offers, Asian countries opened their stock markets to foreign investors as well. Privatization efforts have commenced in China since a couple of years ago. Several high-publicity initial public offerings (IPOs) on regional stock exchanges have occurred. Additionally, central governments in China had order state governments to provide a list of local agencies suitable for privatization. These are China's first serious steps toward large scale privatization. To date, most private sector involvement has been in the form of joint ventures with foreign partners.

Although nations like Pakistan have ambitious plans, the process of privatization in these countries continues to move slowly. Labor concerns and lack of capital have hindered privatization efforts in that country. Privatization is new to Thailand and Vietnam and their governments have not developed longstanding commitment to the process. In Thailand, state-owned enterprises account for a large portion of government revenues. Vietnam has recently initiated a privatization program, but that country is more concerned with attracting capital from foreign sources in the form of aid and investment.

Finally, labor issues have continued to play a role in shaping privatization strategy. Employees of state-owned enterprises are often concerned about the potential job loss caused by the elimination of redundant positions in privatized firms. The governments of the region have made concerted attempts to address these concerns in their privatization plans. Examples of programs that guarantee worker jobs and/or retraining can be found in Pakistan and Malaysia. Taiwan, the Philippines, and Sri Lanka all of which make extensive use of employee ownership initiatives, such as employee stock ownership programs (ESOPs).

A few years ago privatization and private sector development were relatively insignificant in Africa. Now, they are parts of the economic reform programs of most African countries. Countries in this region have so far approached privatization hesitantly, mostly as a revenue-enhancing measure or to relieve the budget of the strains of debts incurred by state-owned enterprises. Now, several countries have established and maintained successful privatization programs capable of carrying out transactions on a sustainable basis. These countries including Egypt, Ghana, Zambia, and Nigeria amongst others are continuing programs of moderate success from previous years. Morocco and Egypt have probably been most successful in making the recent transition from the planning stage to implementation.

Despite a seemingly strong commitment to the concept of privatization, many of the other sub-Saharan countries have had difficulty sustaining an active program. Tanzania, for example, initially moved forward politically with privatization but was unable to sustain the effort because of sharp declines in its already weak economy. The Seychelles has maintained a strong public sector and has shown no immediate intention to develop a privatization program even though it is a middle income country with access to capital through its tourist trade.