ABSTRACT

The objective of this study was to determine whether privatization policies lead to fair welfare contribution to the economy and society as a whole by using the bidder’s announcement return period as a proxy. In addition, privatization is the activity where state agencies sell their assets to the private sector which regards these assets as nationally-owned assets belonging to individuals of the society, thus selling at the fair price shall lead to the highest benefit for the society. The sample is based on the total number of 1,832 state-owned enterprise acquisitions by public firms. The mean difference test suggests statistical significance in the abnormal returns to bidders during the announcement periods which are 1.06%, 1.03% and 2.01%, for the full sample, deal value disclosure, and deal value not disclosed for a 5-day window, respectively. Furthermore, decomposing the samples into different countries, industries, type of M&A settings, also allow for different outcomes. The country settings result in higher abnormal returns for higher corruption level and communist countries which are statistically significant. The industry setting shows a statistically significant higher return for bidders in the regulated industries. The test of foreign versus local acquirer results in higher bidder returns. The case of local acquirer and diversified transactions also yield statistically significant higher abnormal returns. With the significant statistics results, the study has suggested that privatization activities through M&A creates abnormal returns to acquirers on average which means that the price the acquirer pays may be lower than the fair value for the target company value due to private benefit or motives of the parties involved in M&A activity. Therefore, the separation of samples into sub-sample groups was adopted to reflect on the private benefit motives. The study has shown that the privatization of nationally-owned assets tends not to maximize the welfare of the society as a whole.

Key Words: privatization, merger and acquisition, asset sales, acquirer’s return

E-mail: pyooprot@hotmail.com

1 Department of Banking and Finance, Faculty of Commerce and Accountancy, Chulalongkorn University, Bangkok 10330
INTRODUCTION

State-owned enterprises (SOEs) are regarded as the legal entity created by the government to undertake operations in producing and delivering products and services to the society. Rondinelli and Iacono (1996) argue that government ownership corporations have grown in many nations for slightly different reasons, primarily that government ownership was perceived as necessary to promote growth or national security. There had been tremendous growth in the use of SOEs throughout much of the world, especially after World War II. The traditional economic analysis of public enterprises operation has a welfare economic orientation, particularly the concerning with the issue of allocative efficiency. An allocative is efficient, if the existing resources in the economy cannot be reallocated without making any individual worse off. In contrast, private ownership firms rely on the policy of promoting efficiency within the firm which is cost minimization. The cost minimization strategy allows the firm to enjoy profit and being successful. According to Domberger and Piggott (1986), government generally has significant control over management of public enterprises to pursue non-commercial objectives for political reasons. This led the public enterprises away from producing products and services in an efficient manner.

As discussed in the above, government faces with constraints in order to minimize the cost of SOEs which led them to privatize in the later decades. There are various goals of privatization policy which are to 1) raise revenue for the state, 2) promote economic efficiency, 3) reduce government interference in the economy, 4) promote wider share ownership, 5) provide the opportunity to introduce competition, as well as, to develop the national capital market. However, the goals of privatization may be conflicting in terms of efficient resource allocation or arises of inefficiency. Over the past two decades, the privatization programs launched by the governments from all around the world had become popular. The first successfully launched privatization program by the Britain's Thatcher government leads the privatization program to be an alternative policy for government in many countries (Megginson and Netter 2001). Therefore, privatization is becoming one of the important elements of continuing global phenomenon of the increasing use of markets to allocate resources. Privatization in this context can be broadly defined as the sale by a government of state-owned enterprise (SOEs) or assets to private economic agents (Megginson and Netter 2001). Privatization can be done through various methods. This paper focuses on the method of privatization through sale of state property where a government trades its ownership claim for an explicit cash payment. This category is taken in two forms, direct sales and share issue privatizations (SIPs). The direct sales involve the sale of SOEs to an individual, an existing corporation, or a group of investors. The share issue privatizations (SIPs) are the sale some or all of the SOEs sold to investors through a public share offering. This form is similar to initial public offerings in the private sector. However, the
attention of this study is on the direct sales or asset sales that is privatization through merger and acquisition.

Most privatizations are being taken in the form of voucher privatization or direct sales of SOEs to existing companies (asset sales) in the communist countries. Apart from communist countries, privatizations of larger SOEs are in the form of share issue privatizations (SIPs) through the public share offerings via capital market. The 19 largest and 27 of the 30 largest common stock offerings in history have been processed by SIPs. The total proceeds from all SIPs amount to over US$446 billion. The advantage of SIPs is the sales of shares to public through a well organized capital markets which attracted the privatization of large SOEs. The studies of SIPs have received intense attention by academics while privatization through asset sales has been neglected by academic community since such asset sales are not commonly found. Although, the asset sales are less initiated in the history but the values of privatization through this method is increasing recently. Moreover, the advantage of studying privatization through assets sale is appropriate for the transaction that its value is not big enough to gain economies in privatizing thorough IPO. In this case, it is likely that the asset sales provide an alternative to SIPs. In addition, it is important to keep in mind that there are differences between SIPs and asset sales of SOEs activities. The conduct of SIPs are done through public sale whereas the asset sales of SOEs are regarded as an off-market transaction, meaning that the offered price is unobservable until the deal is complete and effective. The off-market nature allows the handling official to avoid the public scrutiny of the sale. This reason is appealing to study the acquirers’ announcement period return in asset sales of SOEs.

The conduct of asset sales in SOEs and corporate merger and acquisition seems to be different because managers of the privately-owned target tend to maximize the proceeds from bidders whereas the values of asset sales in SOEs are not always maximized due to the fact that transactions occur through an off-market process. Therefore, the motivations of privatization seem to be more complex since the government party is the primary enforcer of contracts where they have power to privatize the SOEs and the policy decisions-making are driven by incentives that benefit the interested group (Stiglitz 1998). Moreover, there is no particular group of individuals in a country that will always monitor the action of the government which may lead the political parties to diverge from the social welfare maximization manner. Therefore, the use of its power in privatization that underlies with incentives for secrecy may not lead the economy to be Pareto efficient. With the existence of private incentives to government, the impact of privatization should be examined and compare with corporate merger and acquisition to enhance better understandings in the differences between the two targets. The focus of this study examines the acquirers’ announcement period gain of privatization through asset sales and decomposes the samples into different groups to compare the differences.
The establishment of state-owned enterprises (SOEs) was to promote growth for the society as a whole since the private sector may not be able to invest in certain type of industries. However, SOEs face with constraints to efficiently manage the firm which, in turn, call for privatization. The privatization program was, thus, launched in order to relieve budget deficit or loss of SOEs by selling the SOEs to private investors. The asset values of SOEs should be at it fair price when selling off to the private sector because these enterprises are regarded as the national asset where every individual in the society has an ownership or claim towards it. The problem arises in the process of determining the pricing for SOEs because government often pursues multiple objectives in selling of SOEs. Therefore, the question of welfare maximization arises under the privatization policy and needs to be examined.

OBJECTIVE

The objective of study was to determine whether privatization policies are processed in a Pareto Efficiency outcome or welfare maximization manner to the economy by using the bidder’s announcement return period as a proxy. Moreover, with different countries and industries settings, it also allows for different outcome. Therefore, decomposing the transaction of privatization to each group will provide a better understanding on how different settings affect the degree of welfare maximization.

METHODOLOGY

Table 1: Table of Hypotheses developed in the study

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hypothesis: I</td>
<td>There is abnormal return in acquirers’ announcement period in privatization through asset sales</td>
</tr>
<tr>
<td>Hypothesis: II</td>
<td>There is higher abnormal return in acquirers’ announcement period in Communist countries than Non-Communist countries</td>
</tr>
<tr>
<td>Hypothesis: III</td>
<td>There is higher abnormal return in acquirers’ announcement period in high corruption than low corruption countries</td>
</tr>
<tr>
<td>Hypothesis: IV</td>
<td>There is higher abnormal return in acquirers’ announcement period in the regulated industry than the non-regulated industry</td>
</tr>
<tr>
<td>Hypothesis: V</td>
<td>There is higher abnormal return in local acquirers’ announcement period than foreign acquirers</td>
</tr>
<tr>
<td>Hypothesis: VI</td>
<td>There is higher abnormal return in diversification M&amp;A in the announcement period than non-diversification M&amp;A</td>
</tr>
</tbody>
</table>
In the absence of inefficiencies, the privatization values should be at fair price in order to benefit the public as a whole because SOEs are regarded as a firm that is owned by every individual in the nation but the government is an agent who has the authority to manage and control it. Therefore, the transaction of privatization through asset sales at fair price is a Pareto efficient condition. However, the power and incentives granted to government may have an impact on the value of the firm at the sale of SOEs to deviate from the fair values and it could be more pronounced in asset sales. This proposition seems to be attractive due to the consistency with early findings of underpricing in privatization firms via SIPs program. As there are extensive studies in SIPs, the privatization policy that results from asset sales is another interesting aspect to study and compare since private benefits granted to the government party do exist in both alternatives. This remarkable point gave rise to the hypotheses of this study.

To evaluate the performance of acquisitions for acquiring-firm shareholders, the focus is on acquisitions that are material to the acquirer. The investigating samples are acquisitions constructed from SDC database. The samples of privatization through asset sales with announcement dates between January, 1990 and June, 2010 are being interested. The consideration is only on acquisitions where acquiring firms end up with the majority of shares of the acquired firm or SOEs (more than 50 percent holdings). The acquisition with the result in more than 50 percent holding calls for significant control over the target firm. The data exclude acquisitions where the acquiring firm already has control of the acquired assets, therefore, the requirement is where the acquiring firm has less than 50 percent control of the shares of the acquired firm before the announcement. The privatization transactions being included are from the countries across the world. Therefore, international market data will allow the study to generalize the findings.

The acquirers’ announcement period return is based on the estimate of Cumulative Abnormal Return (CAR (-2, +2) and CAR (-10, +10)). This return is used as the proxy for measuring the degree of bidder gain as well as the implication in the degree of welfare expropriation by state ruler. To be more specific, the abnormal returns in acquirers’ return results from the discounted price of SOEs assets offered to the bidder assuming that the market value is correctly priced. The discounted price offered is viewed as deviating from welfare maximization by the government party since the efficient conduct of selling assets to investors should be at a fair value creating zero abnormal returns. Therefore, the focus of the study was on determining differences in the degree of abnormal returns to acquirers among the samples classification. To test for other incentives in privatizing the SOEs, rather than maximizing the welfare of society manner, the acquirers’ announcement period return is use as a proxy. Thus, the abnormal return of acquirers’ announcement return period is derived from the cumulative abnormal return (CAR) calculation in the window period between two days before and
after, and, ten days before and after the announcement date. Therefore, the measure of CAR (-2, +2) and CAR (-10, +10) is computed as the difference between the return to shareholders during the window and the value-weighted market index return. The daily abnormal is, thus, estimated using the following equation:

\[ AR_i = r_i - r_m \] (1)

where \( r_i \) is the return on firm \( i \) and \( r_m \) is the value-weighted market index return. The market parameter is not estimated based on a time period before each transaction since in the case of there is a high probability that previous takeover attempts would be included in the estimation period (especially in the case of frequent acquirers), thus making beta estimations less meaningful.

The CAR is further taken to test other hypotheses. According the hypotheses development, their objectives are to test the degree of public welfare maximization by the government based on the samples classification. Therefore, the procedure of testing the hypotheses is through the use of mean difference methodology. As stated earlier, the comparisons are based on the economic system, corruption perception index, characteristic of industry, and the type of acquirer. The mean of the abnormal returns to acquirers’ in the announcement period are applied to test for the mean difference among subsamples. Therefore, the uni-variate analysis reveals the different degree of abnormal returns to bidders among samples classification, reflecting the level of welfare maximization by the government party.

RESULTS AND DISCUSSION

Cumulative abnormal returns from the announcement of an M&A activity are calculated relative to the expected returns for the window around the announcement date. The measure of cumulative abnormal returns is computed as the difference between the return to shareholders during the window and the value-weighted market index. The cumulative abnormal returns are based on the point of view of returns to acquirer since it is the proxy for measuring welfare contribution by the government's privatization policy. The used of two different windows in the calculation of CAR was to obtain some insights into the different timeframe. The two windows are: 5-day period (-2, +2) and 21-day period (-10, +10).

The results the cumulative abnormal returns to the acquirers over different time windows are reported for both the full sample, sample with deal values, and no deal values, as well as classifying the samples into different composition. In every sample models, the empirical results show that there are abnormal returns to the bidders and statistically significant. Based on the 5-day period, the full sample, deal value disclosed, and deal value not disclosed experienced abnormal return of 1.06%, 1.03%, and 1.11%, respectively, at 0.01 significant level. It is not surprising that under the non-
disclosure in deal value demonstrated the highest abnormal returns as it may be correlated to the private benefit motive. In addition, the 21-day window empirical result suggests for significant abnormal returns in all sample models with higher degree of abnormal return than the 5-day window due to the fact of longer period of return shall exist higher returns to the acquirers. In all sample groups, CAR(-10, +10) reported at 2.01%, 1.94%, and 2.14% for full sample, deal value disclosed, and deal value not disclosed, respectively. However, the study found no significant difference in the abnormal returns between two sets of sample, deal value disclosed and no deal value disclosed, for both two window periods. The findings of abnormal returns in privatization through M&A activities suggest for possible private benefits. Moreover, the empirical result is also consistent with previous findings, Doukas, Holmen, Travlos (2002) displayed significant abnormal returns for acquirer on average with different short window periods based on focused acquisitions. Other studies on various M&A activities across different industry also suggest for abnormal returns to bidder with the focus on US market by Maquieira et al. (1998) and Mulherin (2000). In contrast, other studies, Campa and Hernando (2004), has conclude cumulative abnormal returns are null on average for acquirer with significant positive returns to targets. As stated earlier, from such complete samples of privatization through merger and acquisition activities show the significant abnormal returns around the announcement period which calls for further investigation in the samples composition in order to assess any private benefit motives under these transactions. In accordance with the hypotheses adopted in the earlier section, the uni-variate results suggest for the percentage of abnormal return as a result of statistics measures with different samples composition for comparison between each group.

The empirical results have evidenced that abnormal return for the acquirer in the Communist target countries tend to be higher in all sample group, consistent with hypothesis adopted earlier regarding to Communist countries environment and character where it may leads to higher abnormal returns as compared to Non-Communist targets. Thus, the CAR for Communist countries are statistically significant at 1.99%, 2.02%, and 1.92% for full sample, deal value and no deal-value disclosed for 5-day window. The higher level of abnormal returns in Communist country group of the target has shown that there exist such private incentives in conducting privatization. In addition, the difference test between these two groups also evidenced that the return of Communist sample data is significantly different from Non-Communist contries in full and deal value disclosed sample at 0.05 significant level. However, the long window period only result in abnormal returns for each sample composition but no statically significant in the difference. As a consequence, it can be inferred that the hypothesis adopted in the earlier part is true that Communist countries tend to provide private benefit for its policy-makers since such benefits is the cost to society for not being able to sell of SOE
The sample classification by industry's characteristic, regulated and non-regulated industry, results in abnormal returns for both type industry. The abnormal returns for regulated industry group are at 1.37%, 1.14%, and 1.91% where as non-regulated industry are at 0.85%, 0.94%, and 0.72% for full, deal value disclose, and deal value not disclose, respectively which can be seen that the regulated industry experienced higher abnormal returns. However, the two groups of industry abnormal returns are different from the non-regulated in industry in the sense that such industry are imposed with rules and regulations or highly protected from the state agency which then requires higher of involvement form the policy makers leading to higher degree of abnormal returns on the overall.

The mean difference of both local and foreign bidder experiences statistically significant returns where as the abnormal returns for local bidder is higher and consistent with previous evidence that the privatization tends to favor local bidder by more than foreign bidder this may be because the better relationship domestically. For CAR(-2, +2), there is significant difference between the two groups of sample for the full sample as well as deal-value not disclose sample. It can be clearly seen that such private benefit under the privatization program tends to favor local bidder and higher abnormal returns in the deal value not disclose data as the non-disclosure of transaction size requires no public announcement, thus the motive from such no requirements can lead to higher extraction for its private benefit.

As mentioned in the previous section that the corruption perception index (CPI) is the index that has accumulated different factors that shows the incentive of corruption of each country. Therefore, lower CPI index reflects the higher degree of corruption in each country. The study has hypothesized that the country with lower CPI tends to have higher degree of abnormal returns meaning the M&A activities were not sold at its fair value and the empirical result is also consistent with such assumption. The sample group of low CPI Index has the significant abnormal returns measured by cumulative abnormal returns in the range of 2.0% - 2.5% and 2.9% - 3.2% for 5-day and 21-day window, respectively. Furthermore, mean difference of low CPI Index and high CPI index is significant at 0.05 in full sample and deal value disclose sample. It is not surprising that such difference is meaningful, as the higher degree of corruption within the country, there is higher motive to take advantage for its private benefit from selling the state-owned assets to the public.

For the diversification and non-diversified deals hypothesis, this study found very low degree of abnormal returns and not significant in any of the model which is consistent with one of the findings Raj and Forsyth (2002) with 1.60% abnormal return and insignificant with for 31-day window on the application of UK data. Thus, the assumption that diversified industry tends to have higher abnormal
returns cannot be concluded as such under this study.

From the overall uni-variate results, it can be noted that long-window period suggest for higher significant abnormal returns but the mean difference of abnormal return returns in each group of data tends to be insignificant. This investigation can be inferred that these private benefits exist for short period of time rather than the longer period of time since private benefits are received on the date close to announcement and to the parties who are involved. In addition, the difference of deal value disclose and deal value not disclose, there exist no mean difference in every decomposition of the sample group, thus, it can be said that with the status of either announcing transaction value or not announcement does not distorts the public benefit.

In conclusion, uni-variate test suggest that there is abnormal returns on average in the conduct of privatization program through merger and acquisition activities. With such of abnormal returns, the study shall further investigate to measure or evaluate whether there exist private benefits under privatization program with the use of various benchmark to measure for the abnormal returns such as target country characteristic, industry characteristic, type of bidder, corruption perception index, and diversification M&A. From the empirical results, there exist significant abnormal returns in the benchmark applied with the statistically mean difference in each sample group, except for diversification. Thus, the study can be concluded that private benefits do exist since the state agency does not conduct the asset sales program at its fair value whereas these assets are owned by each individual in the state and shall be sold at its fair price.

CONCLUSION

From the empirical study, it can be concluded that private benefits is the primarily incentive for the political parties to corrupt and extract benefit since the proceeds from the sale of SOEs asset does not go to the government pocket whereas those benefits allow the government to enjoy. In this way, the government tends not to maximize the social benefits, not selling the SOEs assets at the fair value, as long as the private benefits outweigh the cost of cheating. In maximizing the social welfare, the sale of SOEs should be a fair value which creates no abnormal return to acquirers. In this study, there is abnormal return for the acquirers, and thus it is possible to conclude that “corruption arises in the privatization through asset sales” and it needs to be further examined by controlling the private benefit factors. As discussed in the previous result, Communist countries’ governments tend to intervene by more in order to achieve the multiple objectives. The government agent of Communist nations have the authority and power to influence over the privatized firms in the later period, which leads the privatized SOEs subjected to regulations enforced by the government. In this way, there is higher degree of abnormal return in the Communist privatization program than Non-Communist
countries because the lower price of SOEs assets in compensated with the control of government agent over private firms in the later period. Therefore, government intervention after the sale of SOEs is regarded as an inefficient policy since the welfare would not be maximized in terms of not leading to optimal resource allocation for the public sector. Furthermore, it is not surprising that those higher levels of corruption countries have higher abnormal returns due to the fact they tend to receive bribes or act in their own interest rather than public as a whole. For the industry setting result in higher abnormal returns for regulated industry is because these industries are restricted with a significant control by the government. Therefore, the constraints imposed by the government may have multiple objectives which also include the political motives. The regulate industries are mainly monopolies firm where the firm achieve definite profit. This assurance is very attractive to private investors in buying these SOEs asset. The conduct of share allocation towards the group of investors that they can control or provide them future benefits are often preferential which is consistent with the empirical findings. In the overall findings, it can be concluded that privatization programs of SOEs through asset sales tend to be underpriced and the findings suggest for private incentives of the government and connected parties which does not lead the society to gain highest benefits from such programs since the benefit parties extract such public benefit.

REFERENCES


