THE PRIVATIZATION & ITS IMPACT IN NEPAL

(With Reference to Two (BPPM & HBFT) Companies Privatized in 1992/93)

By
K.C. Rebanta Bahadur

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

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2008

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ABSTRACT

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The privatization is becoming a fascinated tool of the government in the world. Nepal also does not remain as an exception case. It has also adopted the privatization policy after the restoration of democracy in 1990 but after the research and study of this work I found the result of this policy is mixed, not fully becoming effective in Nepal.

Dedicated to My Parents

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Rebanta Bahadur K.C.

Nepal, 11 February 2008

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Abbreviations and Acronyms

ADB= Asian Development Bank
BJM= Biratnagar Jute Mills
BPM= Bhrikuti Paper Mills Limited
BTF= Balaju Textile Factory
CEO= Chief Executive Officer
CPN (UML) = Communist Party of Nepal (Unified Marxist and Leninist)
CRPS = Council of Retired Public Servants
FNCCI= Federation of Nepalese Chamber of Commerce and Industries
FY = Fiscal Year
GDP= Gross Domestic Product
GM= General Manager
GON = Government of Nepal
HBTF= Harisiddhi Brick and Tile Factory Limited
HLPC= High level Privatization Commission
ICPE= International Centre for Public Enterprises
IDS = Institute of Integrated Development Studies
ILO = International Labor Organization
IMF= International Monetary Fund
MT= Metric Ton
NBBIL= Nepal Bitumen and Barrel
NFDC= Nepal Film Development Corporation

NFI= Nepal Foundry Industry
NICs= Newly Industrialized Countries
NIDC= Nepal Industrial Development Corporation
NLOL= Nepal Lube Oil
OGL= open general licensing
PEs =Public enterprises
PMT= Per Metric Ton
PSBR= Public sector borrowing requirement
PSE= Public Sector Enterprises
RHCDC= Raw Hide Collection and Development Corporation
SAP = Structural Adjustment Program
SCOPE= Society for Constitutional and Parliamentary Exercises
SOE= State Owned Enterprises
TA/DA = Training Allowances/Daily Allowances
THA = Treuhandanstalt
UK = United Kingdom
UNCTAD= United Nations Conference on Trade and Development
UNDP= United Nation Development Program
UNESCAP= United Nations Economic and Social Commission for Asia and the Pacific
UNIDO= United Nations Industrial Development Organization
U.P. = Utar Pardesh (North Region of India)
USA= United State of America
USAID= United States Agency for International Development
USSR = United State Soviet Russia
VAT =Value Added Tax
WB= World Bank
WTO= World Trade Organization

Chapter One

Privatization as a Global Perspective

Generally, the term privatization refers to the transfer of state ownership from government to private sector. It also refers to narrow down the government activities and broaden or widen private sector activities and efficiency in the economy. Privatization also the means to reduce the government involvement in the economy and adopt the market driven, liberalization, and free economy policy. The term ‘privatization’ has been used to describe range of actions designed to broaden the scope of private sector activity, or the assimilation by the public sector of efficiency-enhancing techniques generally employed by the private sector. Essentially, privatization is a process that covers the transfer from the public to the private sector of the ownership and/or control of productive assets, their allocation and pricing, and entitlement to the residual profit flows generated by them (Adam et al., 1992:6). In Nepal, The Privatization Act, 1994 defined the term ‘privatization’ as “involving private sector in the management of the enterprise, or to sell or lease it, or to transfer government ownership into public ownership, or an act to infuse participation by any means, either wholly or partly, or private sector or of the employees or workers, or of all desirous groups” (Article 2.b).

‘Privatization’ implies a move toward the divestment of total ownership by the government to the private sector. At the broadest level, privatization refers to the introduction of market forces into an economy. ‘Privatization’ may be defined as the transfer of a function, activity, or organization from the public to the private sector (Cowan, 1990:6) and involves both the ends and the means of this process. The means of privatization range from replacing public ownership with private ownership to the introduction of private management techniques into the public sector. Although much attention has been focused on specific examples of the first kind of strategy, for example, in the sale of huge public enterprises, it may be argued that the most extensive type of privatization is the search for internal reform within the public sector under the influence of private management models (Lane, 1995:184-185). Several major influences have propelled the privatization movement: pragmatic, economic, ideological, commercial, and populist. The goal of the pragmatists is *better government* in the sense of a more cost-effective one. Economic affluence reduces people's dependence on government and increases their acceptance of privatized approaches. The goal of those who approach the matter philosophically—some would say ideologically—is *less government*, or one that plays a smaller role as in a private institution. The goal of commercial interests is to get *more business* by having more government spending directed toward them. However, the goal of the populists is to achieve a *better society* by empowering people so they can satisfy their common needs, while diminishing the power of large public and private bureaucracies (Savas, 2000).

The process of privatization may assume a number of forms. In complete divestiture publicly owned enterprises or assets may be completely transferred by sale to private individuals or firms, after which the government bears no further responsibility for the operation of these enterprises or assets. Alternatively, in partial divestiture the state retains partial ownership of the divested assets by means of public stock flotation. The assets may also be removed from the direct control of the government by management contracting, which places operations in the hands of an outside management group, while leaving ownership in government hands; its major purpose (as is the case with leasing or franchising) is to restore an ailing firm to profitability (Cowan, 1990).

The consensus on the question of privatization is that it is generally a more efficient way of running commercial operations than when they are run by the government (Vickers & Yarrow 1985:20 cf. Nelson 1996:17). It is usually found that privatization brings about reductions in cost and price, improvement in service, increases efficiency, and efficient resource allocation, and reduces monopoly. Most studies from middle- and high-income countries show positive results after privatization, as far as profitability measures are concerned. Even some lower income countries have been successful in improving profitability through privatization (UNCTAD, 1995). Success stories of the United Kingdom and other Western countries have been cited as evidence that privatization can reduce subsidy costs and increase the productivity of formerly state enterprises. Attempts have been made to prove that privatization is a viable policy option for developing countries to better their performance.

Vickers and Yarrow (1988) observe that privatization as a policy option has been adopted with the following aims:

a) Improving efficiency;
b) Reducing the public sector borrowing requirement (PSBR);
c) Reducing government involvement in enterprise decision-making;
d) Easing problems of public sector pay determination;

e) Widening share ownership;

f) Gaining political ownership (1988:157).

Vuylesteke (1988) argues that the most commonly used methods of privatization are: public offering of shares, private sale of shares, new private investment in an SOE, sale of government or SOE assets, reorganization (or ‘break up’) into component parts, management/employee buy out, lease, and management contract (1988:8). The 1979 general elections in the UK were a watershed in making the transition from public ownership to privatization. Prime Minister Margaret Thacher decided to move in the direction of the ‘New Right’ doctrine, which led to widespread privatization. Many as a role model for other countries have considered the UK's experience of privatization. The 19 major privatizations took place in the UK during the period of 1979-1993, with gross sale proceeds of £56,847 million (Narain, 2003:354-56), which included British Petroleum (1979), British Aerospace (1981), Britoil (1982) Cable and Wireless (1983), British Telecom (1984), British Gas (1986), and British Airways (1987). Compulsory tendering (required competitive bidding) of local government services in Britain was mandated in 1988 (Savas, 2000:15). Despite an ambitious array of privatization proposals unveiled by the Reagan Administration in 1985, in the United States relatively, little privatization by sale took place at the federal government level, in part, because the United States had few government-owned enterprises. Conrail, the government-owned freight rail network, was sold but President Reagan’s effort to sell the United States Enrichment Corporation, which prepared enriched uranium for nuclear reactors, was blocked by a Democratic Congress (President Clinton, supported by a Republican Congress, accomplished this a decade later). Considerable contracting out of support services (for example, data processing, food service, building maintenance, etc.) was carried out by federal government agencies, and privatization by contracting continued to grow in local governments, both for support services and for direct services to the public (waste collection, street cleaning, ambulance services, etc) (Ibid: 15-16). In March 1986, after the political right won the election in France, the new prime minister announced that he would de-nationalize. The Privatization Commission, comprised of seven members recognized for their competence and independence, was set up. However the price for the shares to be sold, as fixed by the commission, was subject to review by the minister of finance, who had the right to increase it (not decrease), which he exercised in many cases. The privatization scheme was to sell 10% shares to employees, 15% to foreigners, 50% to the public and about 25% to 10 large shareholders comprising a 'stable nucleus', who were to pay 5% more than the ordinary buyer and agree not to sell the shares for at least two years. Seven major privatizations took place in the first phase 1986-87 and 21 in the second phase 1993-96 (Narain 2003: 361-364).

The role of transferring the social system into a market system in East Germany was assigned to the state-owned trust named Treuhandanstalt (THA), founded in 1990. It temporarily became the owner of about 8000 companies, with more than 45,000 plants; 33,000 shops, hotels, restaurants, pharmacies and cinemas; as well as 3.9 million hectares of agricultural and forest land. By law, THA was required to privatize its assets as fast as possible, as privatization was considered to be "the heart of the transformation process". The law also instructed THA to restructure and break up companies in order to create smaller units for the ease of privatization. It should be noted that all manufacturing in

East Germany was concentrated in 221 *Kombinate*, horizontally or vertically integrated conglomerates of plants. Some of these Kombinates employed up to 60,000 workers. When the end of 1994 closed down THA, about 75% of the former state business had been privatized. Most of the remaining companies were in liquidation and some had been offered for sale (Ibid 367-68).

In 1991, for the first time Mr. Yaswant Singh, finance minister in the Chandra Sekhar government (November 1990 - June 1991) in India, stated in his budget speech that the "government would disinvest up to 20% of its equity in selected public sector undertakings in favor of mutual funds and financial or investment institutions in the public sector". Similarly, Dr. Manmohan Singh, finance minister (contemporary prime minister) in the Narshimha Rao government (June 1991 - May1996), announced in his budget speech in July 1991: "In order to raise resources, encourage wider public participation and promote greater accountability, up to 20% of government equity in selected public sector undertakings would be offered to mutual funds and investment institutions in the public sector, as also to workers in these firms" (Ibid). The Indian government has fired the first salvo for privatization by disinvesting shares of 31 public enterprises in order to raise Rs. 2500 *crore* in two phases in December 1991 and February 1992. During the first phase of disinvestment, bids were received from 9 parties totaling Rs. 1427 crore; 51.62 crore shares constituting 4.7% of the equity were sold. In the second transaction in February 1992, bids were received from 19 parties for Rs. 1611 crore; 35.59 crore shares constituting 3.3% of the equity were sold. The total shares disinvested during 1991-92 thus comprised 8% of the total government share holding in the 31 public enterprises and the total amount realized was Rs. 3038 crore (Bastra and Bhatia, 1995 cf. KC 1999:96-97). Thus, India has also formally embarked on its privatization policy.

Hence, from a global perspective, in the 1970s the privatization movement was realized and reached momentum in the ‘80s and ‘90s. In this new global perspective Nepal could no longer remain far behind as a exceptional case from this widespread new global concept which had adopted by the nation states-government as a tool to uphold efficiency, increase the public participation, reduce the government control and financial burden and adopt the free economy and it had embarked on its own massive privatization program in 1991, after the restoration of democracy in 1990, Nepal.

1.2 Research Questions and Hypotheses

1.2.1 Research Questions

The main objective of the author through this study is to find out the impact of the privatization policy focusing on the implementation process of the privatization policy in Nepal and its effects, by analyzing privatized enterprises. This might lead to an assessment of the privatization policy that is its success or failure, so that we can identify the prospects of the policy in Nepal. In addition, the following are research questions for this study:

What are the factors that led the Government of Nepal to adopt the privatization policy, and what are the major processes applied to the implementation of the privatization policy in Nepal?

To what extents are the present legal and institutional-setting is being conducive to the implementation of privatization policy?

What are the main obstacles encountered in the process of implementation of the privatization policy in Nepal?

What is the impact of the privatization policy in Nepal?

What lessons could be learned from the privatization policy of Nepal (is the privatization of public enterprises essential in Nepal? If so, has it been successful)?

1.2.2 Research Hypotheses

There is ongoing debate concerning whether the implementation of the privatization policy is a viable option in regards to increasing efficiency, reducing the burden on the government with respect to PEs, generating employment, market-oriented competitiveness, and so forth. In order to address the above debate, the main assumptions (hypotheses) of this research are as follows (based on the available literature related to the Nepal's privatization policy):

Privatization policy has been implemented not only as a necessity of the country (internally) but also as a requirement imposed by the donor community. Privatization policy has been implemented to achieve some stated goals but they have not been achieved as expected. Privatization policy has some barriers of implementation that affect the policy's ability to meet its objectives. Privatization has brought about some positive changes, i.e. it has assisted in reducing the financial burden on the government, create the catalyst, facilitator, regulator, promoter and parental role of the government in the economy, contributed to enhancing the efficiency of enterprises, and facilitated popular participation by private sector in management; these benefits, however, are negligible. Privatization policy *per se* is not necessarily conducive to improving the efficiency of the enterprises.

The above hypotheses will not be tested in rigid terms but they will be checked (falsified) on the basis of the research findings. In summary, by this study I do not intend to prove a theoretical proposition or test quantitative hypotheses, but rather to explore and describe the specific phenomenon of implementing privatization policy in Nepal.

1.3 Structure of the Thesis

Chapter one is the introductory chapter, which provides a general outline of the thesis. Chapter Two deals with theoretical framework and literature review. In this chapter, the definition of privatization, the objectives of privatization, the techniques of privatization (methods and implementation) are explained. Also, in this chapter various writers' views of the subject matter are discussed in detail. In Chapter Three public enterprises in Nepal, their performance, the need for reform, and the need for privatization, review of Nepalese economy, policy and programs, institutional set up, among other things are discussed. Chapter Four, deals with the effects of privatization: cases studies of BPPM Ltd. and HBTF Ltd. in Nepal studying with two selected privatized enterprises and the impact of the policy (changes made after privatization), and the final chapter (Chapter Five) outlines and discusses the findings of the study on the basis of the descriptions and interpretations already presented in the earlier chapters. The chapter mainly discusses the results, based on the research questions that have framed this research work.

Chapter Two

Implementation of Privatization Policy: A Theoretical / Analytical Framework

The literature in a research study accomplishes several purposes: (a) it shares with the reader the results of other studies that are closely related to the study being reported. (b) It relates a study to the larger, ongoing dialogue in the literature about a topic, filling in gaps and extending prior studies. (c) It provides a framework for establishing the importance of the study, as well as a benchmark for comparing the results of a study with other findings (Creswell, 1994:20-21).

2.0 Introduction

The main purpose of this theoretical chapter is to provide the basic understanding about the concept of the privatization first and then discuss about the main influential factors to adopt the privatization policy to privatize the public owned enterprises, objective of the privatization, technique adopted for privatization of stare owned enterprises. In order to properly present the study and analyze the data in a comparable form, it is necessary briefly to review the literature on the subject matter in order to gain a clear understanding of the conditions essential for the successful implementation of the privatization policy.

In the first section, I will begin my discussion with reviewing privatization-related literature concerning the concepts of privatization, forces for adopting the policy, its objectives, techniques, and methods. In particular, the discussion will be based on “Techniques of Privatization of State-Owned Enterprises Volume I” (1988) by Charles Vuylsteke, “Privatization and Public Private Partnerships” (2000) by E. S. Savas, and other prominent writers’ work discussing different aspects of privatization.

2.1. Concept of Privatization

2.1.1 What is Privatization?

Privatization has been defined in various ways/terms. In prominent term, privatization means to transfer the ownership from government to the hand of private sector in different form or model of privatization. In another word, privatization means to reduce the government control power or activities from the economy activities of the nation and induce the favorable environment for private sector to involve in national economy. Privatization may be defined as the transfer of a function, activity, or organization from the public to the private sector (Cowan, 1990:6, GTZ, 2004). Privatization tends to imply a move towards the divestment of total ownership by the government, from the public to the private sector (Nelson, 1996:10). The term ‘privatization’ has been used to describe a range of actions designed to broaden the scope of private sector activity, or the assimilation by the public sector of efficiency-enhancing techniques generally employed by the private sector. Essentially privatization is a process that involves the transfer from the public to the private sector of the ownership and/or control of productive assets, their allocation and pricing, and entitlement to the residual profit flows generated by them (Adam et al., 1992:6). Regarding the political meaning of privatization, Prof. Paul Starr argues that there may be a broad and a more specific definition of privatization. “The first, broader definition of privatization includes all reductions in the regulatory and spending activity of the state. The second, more specific definition of privatization excludes deregulation and spending cuts except when they result in a shift from public to private in the production of goods and services” (Starr, 1988). He further clarified his definition by pointing out that the public sector includes agencies administered as part of the state and organizations owned by it; privatization refers here to shifts from the public to the private sector, not shifts within the sector (Ibid). A notable economist Joseph E. Stiglitz (Nobel Prize winner in 2001) argues that privatization entails the conversion of enterprises formerly controlled by the government into private hands (Stiglitz, 1992: 181). Similarly, Narain (2003:289) defined privatization, as "in the broad sense of the term, privatization is roll-back of the state in the lives and activities of citizens and strengthening the role of markets. In the narrow sense, privatization is transfer of ownership from the public to the private sector or transfer of control over assets or activities as in the case of privatization through leasing, where ownership is retained, leaving management of assets and activity to private parties."

'Privatization' means involving the private sector in the management of the enterprise, or to sell or lease it, or to an act to infuse participation by any means, either wholly or partly, of the private sector or of the employees or workers, or of all desirous groups (Article 2(b) of the Privatization Act, 1994 of Nepal).

The term 'privatization' therefore indicates a transfer mainly of the carrying out of activities economic in nature, either in whole or in part to the private sector, that were formerly carried out in the public sector through different modalities.

2.1.2 Forces that influence Promoting Privatization

Savas (2000) has mentioned the five forces that influence promoting privatization, i.e. *pragmatic*, *economic*, *ideological*, *commercial*, and *populist*. He summarized the characteristics of these five forces as follows (Savas 2000:5-6):

Table 2.1: The Influences Promoting Privatization

Influence	*Effect*	*Reasoning*
Pragmatic	*Better Government*	*Prudent privatization leads to more cost effective public services.*
Economic	*Less Dependence on Government*	*Growing affluence allows more people to provide for their own needs, making them more receptive to privatization.*
Ideological	*Less Government*	*Government is too big, too powerful, and too intrusive in people's lives and therefore is a danger to democracy. Government's political decisions are inherently less trustworthy than free-market decisions. Privatization reduces government's role.*
Commercial	*More Business Opportunities*	*Government spending is a large part of the economy; more of it can and should be directed toward private firms. State-owned enterprises and assets can be put to better use by the private sector.*
Populist	*Better Society*	*People should have more choice in public services. They should be empowered to define and address common needs, and to establish a sense of community by relying more on family, neighborhood, church, and ethnic and voluntary associations and less on distant bureaucratic structures.*

(Source: Savas, 2000: 5-6)

The common explanation of why privatization has become so important in developing nations is the debt crisis that emerged in 1981/82 and has been continuing unabated ever since. Ira W. Lieberman, a World Bank senior consultant and privatization expert, has argued that the following six factors have influenced the adoption of privatization as a critical feature of countries' economic policies (Lieberman, 1993:9-11).

The first key factor is the successful economic performance of Japan and the Newly Industrialized Countries (NICs) (Korea, Singapore, Hong Kong and Taiwan). Second, at the time that the growth model of Japan and the Asian NICs was proving so successful, there was growing awareness that other models for economic development, such as the command economy, had outlived their usefulness and needed to be rejected. A third factor that emerged in the 1980s is what some analysts call the fourth industrial revolution, driven by information-based technologies, which requires competitiveness. The fourth factor is the role of state-owned enterprises, which have monopoly status and have generally bred inefficiency and a lack of competitiveness. A fifth factor influencing privatization in the developing countries is that in the 1980s advanced industrial countries such as the USA and the UK expressed a strong ideological commitment to private enterprise. Finally, since 1989 the political revolution in Eastern Europe and the Soviet Union has lent new impetus to the privatization process, as the newly emerging democracies in most of these countries are utilizing privatization as a cornerstone of their economic reform process to create the basis for a market economy.

2.1.3. Objectives of Privatization

The following objectives are mentioned frequently in connection with privatization (Lieberman 1993: 11):

- Reduce the government’s operating deficit;
- Raise cash through SOE sales;
- Generate new sources of tax revenue;
- Deepen domestic capital markets and broaden domestic equity ownership;
- ‘Democratization’ of capital;

- Promote domestic investment;
- Attract direct foreign investment and new technology;
- Increase domestic and international business confidence;
- Increase competition;
- Create opportunities for employment through real growth;
- Increase productive and operating efficiency;
- ‘Turn around’ or restructure sick SOEs;
- Increase exports;
- Improve the quality of services; and
- Reduce the role of the state in the economy.

Vickers and Yarrow (1988) observed that privatization as a policy option has been adopted with the following aims:

- Reducing government involvement in industry;
- Improving efficiency in privatized industries;
- Reducing the public sector borrowing requirement (PSBR);
- Easing problems of public sector pay determination by weakening the public sector unions;
- Widening share ownership;
- Encouraging employee share ownership;
- Gaining political advantage (1988:157 cf. Clarke and Pitelis, 1993: 7).

Bennett (1997) has categorized the commonly stated objectives of privatization as follows:

1. *Political* goals, such as reducing the size of the public sector, restoring or strengthening the private sector, spreading share ownership more widely, and making productive enterprises more responsive and accountable to those for whom they produce;

2. *Efficiency* goals, such as increasing productivity and microeconomic efficiency. The development of capital market institutions, which intermediate between savers and investors, may also be classed as efficiency objectives;

3. *Fiscal stabilization* goals, such as maximizing proceeds of sales, reducing the future drain of subventions and capital contributions from government revenue, increasing tax revenues from higher profits and reducing the public debts;

4. *Resources mobilization* goals, such as promoting foreign investment in the country and releasing limited state resources for investment in other sectors like education and health (Bennett, 1997: 7-8).

Dobek (1993) argued that privatization is more than merely an economic operation. The decision to privatize may be triggered by political as well as by economic considerations. Even if privatization is initially undertaken to achieve certain economic goals, the government conducting it has to make this politically viable by generating sufficient political support for a particular privatization effort. The British case of privatization is an example of one that was politically motivated from its very inception (Dobek, 1993:4). Stiglitz argued that privatization is based on the premise that privately run firms are necessarily more efficient than government-owned enterprises. However recent theoretical and empirical literature has cast considerable doubt on this underlying premise, at least in so far as it concerns large-scale enterprises (Stiglitz, 1992:181).

Privatization could have several objectives, as discussed above. However, in many cases it has been prescribed and advocated for ensuring the economic and financial objectives as envisaged in the economic policy for the development of a country.

2.1.4. Techniques of Privatization

Pirie (1988) has identified a number of privatization techniques categorized according to the five dimensions of privatization as follows:

- Changes in ownership
- Changes in performance arrangements
- Changes in the financial base
- Deregulation by introducing competition
- Measures to remove or reduce opposition to privatization (Pirie, Madsen 1988, cited from UNESCAP, 1999:8).

UNIDO (1994) argued that the privatization of state enterprises can be accomplished by a public offering of shares, the sale of shares to private buyers, the free distribution of shares to the company's workforce or other people or institutions, the restitution of assets to former owners, and by management buy-outs or other forms of 'self' privatization. The effective implementation of any of these means of privatization calls for a proper institutional framework in order to manage and monitor the process of privatization.

Given the underdeveloped financial systems in most developing countries, the administrative arrangements may be very demanding (1994:10). Privatization policy, as an economic policy, has been adopted not only by developed countries but also by developing ones. As a result, there has been a gradual transfer of government assets and functions to the private sector. The most commonly used methods of privatization are: public offering of shares, private sale of shares, new private investment in an SOE, and sale of government or SOE assets, reorganization (or 'break up' into component parts, management/employee buy out, and lease and management contracts (Vuylesteke, 1988:8, Parker and Saal, 2003:33-36).

The above basic methods, as well as their characteristics and procedures, are summarized briefly in the following table:

Table 2.2: Summary of the Different Privatization Methods

Methods	Characteristics	Procedures
Public offerings of shares	Distribution to the general public of all or part of shares in public limited company (as a going	If PSE is in required condition, standard processing of public offering is on the basis of

	concern)	prospectus. If not in required condition, then readying process is necessary. Offer can be on fixed price to tender basis.
Private sale of shares	Sale of all or part of government share holding in a stock corporation (as a going concern) to a single entity or group. Can take various forms such as a direct acquisition by another corporate entity or a private placement targeting institutional investors. Can be full or partial privatization (i.e. transformation into joint venture).	Sale may be result of negotiation or competitive bidding process. May be done ad hoc or may be subject to mandatory country procedures or guidelines on valuation, prequalification, evaluation of proposals, terms of payment, etc. in some cases, prior restructuring is necessarily. Involves investor search.
Sale of government or enterprise assets	Sale of assets (instead of shares); private sale	Alternatives: sale of assets by government; disposal of some assets by PSE; other procedures for private sale of shares generally apply.
Fragmentation	Reorganization of a PSE into several entities (or one holding company and several subsidiaries). Each entity will then be privatized separately.	Depends on structure of PSE.
New private investment in PSE	Primary share issue subscribed by the private sector (dilution of government's equity position).	Public offerings or private issue of new shares on basis of standard procedures for new issues possibly in conjunction with disposal of government equity. New private investment may be for capitalization of new company embodying assets transferred by government.
Management/employee buy-out	Acquisition by management and/or workforce of controlling interest in PSE. Leveraged management / employee buy-out consists of purchase of shares on	Negotiations by government, management, employees, and lenders to cover wide range of issues.

	credit extended either by seller (government) or by financial institutions.	
Leases and management contracts	No ownership transfer. Under lease, fee is payable to owner of productive facilities; lessee assumes full commercial risk. Under management contract, owner pays for management skills, while manager has full management and operational control. Many variations exit.	No standard method.

(Source: UNESCAP 1999:22)

The main characteristics of the various methods, procedures, preferred applications/ special features and implementation issues of privatization, which are not discussed here, would be discussed in subsequent chapters to avoid the duplication (although they have been discussed very briefly in above table). Methods and procedures for privatization will be largely determined by:

(a) The objectives of the government;

(b) The current organizational form of the SOE;

(c) The financial condition and record of performance of the SOE;

(d) The sector of activity of the SOE;

(e) The ability to mobilize private sector resources;

(f) The degree of development of the capital market; and

(g) Socio-political factors.

Vuylsteke (1988) has extensively explained the above issues, care of which should be taken while implementing the privatization policy. The issues will be discussed when the specific implementation process of selected enterprises is explained.

Chapter Three

Public Enterprises, Performance, and Necessity for Reform

3.0 Introduction

In this chapter, I will continue my discussion by giving a brief introduction about Nepal and an overview of the evolution, performance, problems and necessity of reform of public enterprises in Nepal.

In this chapter, I will start by giving a short introduction about Nepal and then I will define what public enterprise is, in short, then, continue the discussion of public enterprises in Nepal. The main aim of this chapter is to discuss how public enterprises have been established in Nepal, the level of performance of such enterprises, what types of problems they are facing, and why we need the implementation of reform agenda, and so forth. This will give a background of the reform process in public enterprises in Nepal.

3.1 Brief Introduction about Nepal

Nepal is a landlocked and least developing country in the world. Geographically it is divided in three regions and among them 17% is covered by plain land (Tarai), 15% by mountain (Himal) and 68% by hill (Pahad). The total population is 25 million and population growth rate is 2.25 percent per year. Topographically the land of Nepal is started form 60 meter above sea level to 8848 meter. The Roof of the World (Mount Everest) also lies in Nepal. The Economic condition of Nepal is very poor and more than 80 percent people are totally depending on agriculture sector. The 80 percent economy condition of the country is fully depend on agriculture sector and only 10 percent economy is covered by industrial and trade sector. The agricultural sector could not be sole tools to achieve the economic development objective of the nation in the present global context. It has been started to pace in new economy by adopting different development tools. The industrial development had started by establishing the Britnagar Jut Mill since 1993. However it was became the first industry in Nepal. But this development process could not remained constant due to the tyranny Rana regime.

Historically Nepal always remains as an independent and sovereign country in the world. But the different political systems have been used to govern the country’s regime by the different types of ruler. Since 238 years the constitutional monarchy system has been existed in Nepal. But within this period the tyranny ruler Rana was ruled until 104 years. At this period the development process of the country was zero. Rana Prime Minister was governed the country for their self interest and benefit.

After the establishment of the democracy in 1950, the development process of the country was began. But until 1959 the political situation of the country was not stable due to the political instability. Within this nine years period the 11 government was formed headed by different person. But after 1960, the king Mahendra had dethrone the democratically elected prime minister Bisheshwor Prasad Koirala and took the regime and imposed the autocracy “Panchyet” system as a political system in the country. Nepal has been adopting the mixed economy system in the country after the new Panchyet system. Due to the lack of capital and qualified entrepreneurs, government was being compiled to open the service as well as trade industries in the country as a welfare government. Within this period government was established 62 public enterprises in the country.

In 1990 the democracy has been restored in the country and democratically elected government has decided to adopt the liberalization and market economic system in the country and made decision to privatize the public owned enterprises gradually and government only involve those sectors and where the private sectors are not interested and not viable economically and physically. The government also formulated new Privatization Act, 1994 at first time in the country and government phase out the privatization program.

3.2 Public Enterprises in Nepal

3.2.1 Growth of Public Enterprises

Public enterprises in Nepal emerged comparatively recently. Most of these enterprises came into existence during the Second, Third and Fourth plans in the 1960s and the first half of the ‘70s. With the initiation of the first five-year plan in 1956, public enterprises have been promoted in Nepal. For the first time the industrial policy of 1957 formally recognized the responsibility of the government in “promoting, assisting and regulating” industrial development in the country and the First Plan intended to establish state monopolies in the fields of transportation, telecommunication, hydro-electric power generation and irrigation, and to run some big industries, such as cement, sugar, cigarettes, textiles, iron and steel (GON, 1956:55). The emergence of public enterprises was stimulated by the inability of the private sector to adequately fulfill national objectives.

The corporate form of public enterprise appeared only in 1952 when the government that came to power after the revolution of 1951 decided to go for the majority holding—from 40% share ownership to 51% in Nepal Bank Limited, the only commercial bank operating in the country. The objective was clearly to control the financial market. Three struggling units (jute, cement and tea) were taken over by the government and two electrical companies were nationalized. Most of the enterprises were either established by the government or established by the donor countries (Manandhar, 1993:46). Similarly, at the same time India was preparing its first five-year plan after it got independence. The plan presented to the government by the Planning Commission in December 1952 indicated the need for “a rapid expansion of the economic and social responsibilities of the state” to satisfy the “legitimate expectations of the people”. It stated, however, that this “need not involve complete nationalization of the means of production or elimination of private agencies in agriculture or business and industry”. Only a “progressive widening of the public sector and a reorientation of the private sector to the needs of planned economy” was envisaged (Narain, 2003:21). Hence, the ideology of the controlling the economy by the government was obvious at that time, not only in Nepal but also in its neighboring countries.

There was successive growth in public enterprises with the exercise of development planning in the country. Public enterprises in Nepal were established mainly to serve the following objectives:

- Infrastructural facilities and services;
- Basic consumer and development goods;
- Adequate supplies of essential goods;
- Managerial support to needy enterprises; and
- Entrepreneurial support to needy enterprises (Shrestha, 1990:73).

The entire process of public enterprise growth in Nepal can be divided into four periods—(i) growth period (1952-1975), (ii) period of reconciliation (1975-1980), (iii) period of restraint (1980-1990), and (iv) promise of privatization (after 1990) (Manandhar, 1993:46).

The following table and chart provide an overview of the growth of public enterprises in Nepal during the various plan periods:

Table 3.2.1: Growth of Public Enterprise in Nepal during Various Plan Periods

Periodic Plan	Total Number	Change
Prior to 1956	1	-
First Plan (1956-61)	8	7
No Plan Period (1961-62)	11	3
Second Plan (1962-65)	22	11
Third Plan (1965-70)	34	12
Fourth Plan (1970-75)	61	27
Fifth Plan (1975-80)	59	-2
Sixth Plan (1980-85)	54	-5
Seventh Plan (1985-90)	63	9
Holyday Plan/No Plan (1990-92)	62	-1
Eighth Plan (1992-97)	46	-16
Night Plan (1997-2002)	43	-3

(Source: National Planning Commission, various plan documents)

The above table shows that the majority of public enterprises were established during the sixties and early seventies (1956-1975). The main reason of this was due to the political regime at the time, which focused on the planned economic policy, in which the state was seen as the dominant player, rather than the private sector (Panday, 1999). However, unlike in most developing countries, the growth of Nepalese public enterprises was not based on the nationalization of private companies, but in many areas, new enterprises were created, with the support of external donors, including China, former USSR, the Netherlands, Japan, and multinational agencies. In other cases, units already existing as government departments were converted into statutory corporations and other kinds of autonomous bodies.

In total, there were 62 public enterprises in Nepal in 1991 (the time when the privatization policy was being prepared), which were listed under different sectors as follows:

Manufacturing sector	28	Trade sector	9
Service sector	8	Social sector	6
Public utilities	3	Finance sector	8 (HMG/N 1991).

Though the public enterprises were established as government tools to provide goods and services to the people at affordable prices, the objectives were never achieved. Hence, pressure from the international donor agencies was vital to reform the economy, which had already been initiated before the adoption of the liberalization policy in 1991. The then-government had already implemented the structural adjustment program (SAP) in 1986 under the pressure of the World Bank and IMF (Sharma, 2004: 6) as macro-economic crises emerged. The structural adjustment process, which included privatization, tariff adjustments, liberalization of industrial licensing, easing of terms for foreign investment and more liberal trade and foreign exchange regimes, was initiated in the FY 1987/88.

These policies were supported by loan facilities from the World Bank and the IMF, but due to the trade and transit impasse with India in March 1989, only limited progress could be achieved in structural reforms. The SAP focused on both internal and external liberalization. These programs were advocated, applauded, and supported by the donor agencies, including the IMF and the World Bank (Acharya et al., 2003:3).

While the reform of the Nepalese economy was initiated in the mid-1980s, it was only in the early 1990s that Nepal introduced far-reaching reform programs when India liberalized its economy. Until the mid-1980s, Nepal's landlocked position and open border with India significantly limited its ability to pursue independent economic and commercial policies. By the mid-1990s, Nepal made significant progress in economic liberalization. Similarly, a large number of public enterprises were privatized and the agriculture input market was opened up for the private sector (Sharma 2004: 6).

Hence, after the restoration of the multiparty system in Nepal in 1990, the new government with the adoption of liberalization policy had taken the major policy shift. With the implementation of the Eighth Plan in 1992, the government has adopted the privatization policy instead of public enterprises policy in the country, as it embraced the economic liberalization policy for the improvement of the national economy.

3.2.2 Performance of Public Enterprises

Performance can be defined as: the degree to which a development intervention or a development partner operates according to specific criteria/standards/guidelines or achieves results in accordance with stated goals or plans.

(Www.ifad.org/evaluation/guide/annexa/a.htm accessed on 25 Aug. 2005). Linking with the previous definition of performance, the 'performance' of a public enterprise could be defined as the attainment of goals by the enterprise. In the context of public enterprises, 'performance' refers to the extent to which a public enterprise achieves the objectives that have been set for it. More specifically, performance is interpreted in terms of success in achieving the stated objectives. Performance is thus essentially correlated with the objectives.

The performance of public enterprises in Nepal has been an area of public concern and criticism. Successive government reports, documents, and research studies have unequivocally criticized their poor performance, inefficiency, and wastefulness. Some have even questioned their objectives and existence (IDS: 1987 cf. Manandhar, 1993:60). It is widely believed that in most developing countries the performance of the PE sector has been disappointing. For example, in Nepal, SOEs have become an unsustainable burden on the budget and the banking system, absorbing scarce public resources. Despite measures to improve the performance of SOEs in the 1980s, public sector financial losses remained to constitute an ongoing burden to the treasury and to the economy. In 1992, gross transfers to the SOEs were more than the combined expenditure on health and education and total losses in the public sector were equal to 1% of GDP (Sharma, 1995:7).

Public enterprises in Nepal and elsewhere suffer from similar problems. They are very often over-manned, due to politicians and bureaucrats loading them with supporters, friends, and often relatives. Most importantly, bureaucrats and politicians make management decisions for political reasons; profitability, customer service and efficiency should be the primary concerns, but unfortunately, these only get the requisite attention when businessmen operate those same businesses (Clarke, 1999). Such allegations could be found in the Nepalese case also, as the PEs are accused of low performance, overstaffing and operating under a lack of autonomy due to political interference, and so forth (Manandhar, 1998; MoF, 1999:6; CRPS, 1995:11; Sharma, 1995:7).

Performance of public enterprises could be measured in various ways; Victor Powel (1987) has explained that there are several indicators for measuring public enterprise performance. However, the indices can be classified into the following six groups (cf. K.C.1999: 144):

• General performance indices
• Management performance
• Financial performance
• Investment performance
• Costs breakdown (input co-efficient), and
• Physical performance (i.e. resource use).

All the indices could not be used in the present study; however, an attempt has been made to evaluate the performance of Nepalese public enterprises largely looking at the financial performance.

Financial performance is a significant consideration in the performance evaluation of public enterprises. Financial profitability, with regard to the financial performance evaluation, shows that the PE's "ability to earn profits proves a measure of its market strength, its ability to keep down costs. Profitability also affects the amount of investment, for much industrial investment is financed out of reinvested profits, and hence the contribution of the firm to the overall growth of the economy" (Killick, 1983:183 cf. K. C, 1999:144).

The poor financial performance of public enterprises has had a direct impact on government budgets. Table 3.2.2 shows that government funds dedicated to public enterprises increased significantly (around 22.27% annually) during 1994/95–2001/02, while the flow of funds from public enterprises to the government recorded only a rise of 14.55% during the same period. This clearly shows that public enterprises are a drain of scarce resources rather than a generator of resources, even though the situation improved slightly after 2001/02 in terms of rate of return from the PEs. Similarly, since 2000/01, the government stopped providing the capital subsidy, which can be interpreted as a positive sign.

Regarding the financial performance of PEs, most of them incurred operating losses in FY 2002/03 aggregating Rs. 1.61 billion (see the table 3.2.2). During this period, the profit level of public utility enterprises has been positive, while losses of service and social sector have been transformed into profit. Operating losses of PEs belonging to industrial and trading sectors, however, have gone up. Aggregate operating profit of PEs in FY 2003/04 is totals Rs. 3.89 billion. The table painted a bleak picture of the financial performance of public enterprises, which justified adopting an alternative policy option to minimize the types of losses incurred from this sector.

Table 3.2.2: Flow of Funds between Government and Public Enterprise

- (Rs. in Million)

particular	96/97	97/98	98/99	99/00	00/01	01/02	02/03	2003/04	2004/05	2005/06
A. Fund from Govt. to PEs	2780.0	6298.0	7065.1	7562.7	6213.7	7950.5	8255.1	5988.8	1150.5	1197.2
*Share capital	858.7	1553.0	868.2	1839.0	1420.0	1373.0	1088.8	1036.0	319.3	392.0
*Loan capital	1272.4	3822.0	5303.3	4658.8	4090.0	5945.0	6898.0	4663.3	589.3	642.5
*Operating/Transport Subsidy	571.4	726.0	713.6	988.0	698.7	577.5	268.3	289.5	241.9	142.7
*Capital subsidy	77.5	197.0	180.0	76.9	5.0	55.0	0.0	0.0	0.0	0.0
B. Fund from PEs to Govt.	3966.7	5330.4	4585.5	4913.3	6830.0	8523.2	8784.3	9159.8	6215.6	3488.2
*Indirect taxes										
*Income taxes	860.2	1144.5	1231.0	1317.8	1150.0	2190.2	2928.0	3500.0	1251.0	811.6
*Dividend	1063.0	1357.9	1134.2	1194.5	1780.0	2623.0	2336.3	2511.3	2500.0	1031.9
*Interest	843.1	1734.0	1357.5	1153.0	1660.0	1568.0	1463.0	1220.3	924.6	549.5
*Principal	1200.4	1094.0	862.8	1248.0	2240.0	2142.0	2057.0	1928.2	1540.0	1095.2
C. Cash Flows From govt. to corporations	-1186.7	967.6	2479.6	2649.4	-616.3	-572.7	-529.2	-5065.1	-5065.1	-2291.0

(*Source*: Ministry of Finance, 2006)

Nepalese public enterprises have been widely criticized from the viewpoint of financial performance. The government invested huge amounts of capital (1197.2 million in 2003/04) in public enterprises, but the financial return was not satisfactory compared to the capital employed. While public enterprises were supposed to generate invest-able surpluses for government, they actually often posed burdens on government budgets, in many cases amounting to significant sums.

The percentage of gross profits to the capital employed was much higher in the earlier period (see the table and chart below); it was 5.9% in the year 1970-71. However, for a number of years, it also presented a negative figure. Public enterprises had the greatest negative rate of return on 5.22% in the year 1990-91. However, the rate of return on investment in public enterprises had been improved with a variation for some years.

Table 3.2.3: Profitability of Public Enterprises (1988/89 –2005/06) -(Rs in Million)

Year	Capital Employed	Gross Profit	Gross Profit as % of Capital Employed
1988-89	3331.3	-156.0	-4.68
1989-90	7399.0	105.0	1.42
1990-91	17118.0	-38.8	-0.23
1991-92	18476.2	-244.6	-1.38
1995-96	35843.2	-1871.7	-5.22
1999-00	50530.3	-1145.5	-2.27
2000-01	62010.9	1377.6	2.22
2001-02	83420.5	2404.4	2.88
2002-03	82910.5	-1353.2	-1.63
2003-04	150088.2	-5475.3	-3.65
2004-05	97232.0	-1614.4	-1.66
2005-06	128555.8	3894.8	3.03

(Source: Ministry of Finance, 2006)

3.2.3 Problems of PEs in Nepal

All PEs face some common problems, including objectives, control, pricing, information and financing. The objectives of PEs are not clearly defined. Their goals are ambiguous. Yet without clearly defined objectives it is hard, if not impossible, to pin down what the PE manager is expected to achieve. Similarly, the question of control is another common problem that must be taken into consideration; the right balance between control and supervision on the one hand, and autonomy and flexibility of business operations on the other, has not yet been found. In many cases, the problem is that legal control is for the purposes of appearance only, and the real control is political and informal (Aharoni, 1986: 378-380). Although there is a legal provision for how PEs operates in Nepal, it is heavily influenced by the ministry under which it operates. The minister and his or her deputies are the real controllers of PEs in Nepal, which reduces/eliminates the autonomy of the PEs. Political interference, especially to employ party supporters in the PEs, is routine. Hence, almost all PEs are overstaffed (MoF, 1999). The continued inefficiency and ineffectiveness of the SOEs in Nepal have had a profound negative impact on the economy, particularly in the areas of sustainability and their overwhelming demand on government resources. According to Sharma (1995), key problems contributing to the present state of affairs of SOEs include: conflicting objectives, creation of monopolies and protection from competitive pressures, ineffective supervision and control, managerial deficiency (lack of managerial skill and knowledge on board membership), lack of expertise, and so forth. The problems of state-owned enterprises in Nepal can be summarized as follows:

- They are a constant drain on the government budget
- They use their leverage as state-run enterprises to accumulate bad debts at state controlled commercial banks
- They are wasteful of scarce resources
- Their boards of directors are ineffective in representing the interests of the owners who are the government and ultimately the people of Nepal
- Management has no commercial managerial ability or dynamism, and has a public service mindset under which they ‘administer’ rather than ‘manage’ the companies
- Companies are bound by, and run along, public service lines and restricted by public service regulation and procedure

- There is a lack of technical expertise, even in basic areas such as accountancy, labor management, and production planning
- There is an absence of responsible fiscal management and no sense of responsibility to either the government as the shareholder, or to other creditors
- Over-manning is practiced at every level and is particularly acute in the ‘administrative’ grades
- There is no consideration for the interest of the consumer
- There is no consideration for the interest of suppliers or the people with whom the enterprise does business (Sharma, 1995:35-36).

Recognizing the problems of SOEs and their financial drain on the economy, the then government announced policies to reform the performance of SOEs through various means, particularly through privatization. The particular reasons for adopting this policy will be discussed in the next chapter (in 4.1.1 Agenda Setting).

3.3 Necessity of Public Enterprises Reform

In spite of the early contributions of PEs to the Nepalese economy, their overall performance has consistently lagged behind. These enterprises have failed to function in an efficient manner. Excessive political interference, lack of adequate autonomy and accountability, absence of professionalism, financial indiscipline and conflicting goals have been the main reasons for the poor performance of public enterprises in Nepal (KC, 1999:10).

The World Bank examined the condition of Nepalese public enterprises in 1985. The bank found that the performance of public enterprises had deteriorated steadily since the early 1980s. Many public enterprises were becoming a serious drain on fiscal resources (The World Bank, 1985:30) and the World Bank recommended that Nepal implement SAP, which was carried out in 1986. SAP proposed sound macroeconomic management, effective management of public finances, support for agriculture and light manufacturing, liberalization of trade, and at the initiation of reforming public enterprises (The World Bank, 1996).

Privatization was conceived and advocated as a suitable measure in view of the dismal performance of PEs. It gained popularity both in developed and developing countries, particularly in the 1980s and 1990s. The move towards economic reforms and liberalization has paved the way for privatization globally. Nepal could not remain fail to conform to the global trend. Therefore, having become aware of the gloomy forecast for PEs in Nepal, the initiation of reform in a global context and the convictions of the new government paved the way for the initiation of reform in Nepal.

After the restoration of a multiparty, parliamentary form of government in Nepal in 1990 and the promulgation of the democratic constitution, the system of governance has been altered to suit the reforms either recommended by the donor community or the rise of expectation of the people to get immediate results. After the first parliamentary election in 1991, the Nepali Congress Party won the majority in the parliament and formed a government under the premiership of G. P Koirala. The newly elected government made a major commitment towards a comprehensive privatization program of state-owned enterprises as part of an overall program of liberalization of the economy. This represented a marked departure from previous government policy of undertaking economic development with very little emphasis on private sector development and with state enterprises playing leading roles.

The details of the policy initiation of PEs and the necessity for the introduction of the privatization policy will be discussed in the next chapter (Chapter Four).

3.4 Inception of Privatization Process in Nepal

Public enterprises (PEs) are usually defined as government-owned entities and active operation of agencies engaged in supplying goods and services to the public which otherwise might be supplied by privately owned profit-motivated firms. The term emphasizes government ownership without a profit motive. Presently it covers:

- Industrial, commercial and economic activities,
- State ownership,
- Self-contained managerial care i.e. autonomous (Satish Chandra, 1997).

The first public enterprise to have legal validity in Nepal was the Nepal Bank Limited, established in 1938. After the inception of the bank as a public enterprise, a series of additional PEs were established. In total 62 PEs were established in Nepal. In spite of this impressive growth in the number, role and scope of public enterprises in Nepal, their performances—financial or otherwise—has always remained below a satisfactory level (Manandhar, 1998).

The Government of Nepal has established a number of public enterprises that were supposed to play a catalytic role in the social and economic development process of the nation. The Government has been investing huge amounts of resources annually into this sector to achieve the stated objective. By FY 2003/04, the net capital investment in these enterprises totaled Rs1.97.23 billion (MoF, 2006 Economic Survey 2005/2006:139).

State-owned enterprises in Nepal are in an almost universally poor condition. The standards of PEs are lowered by a series of factors, which include suffering from losses, political interference, frequent changes of board membership and of the chief executive officer, mismanagement, lack of capital, over staffing and poor financial management and other accounting and record-keeping are the subject of frequent and (one Rupees is an official currency of Nepal and one US $=63.35 Nepalese Rupees (as of 20th January, 2007) justified criticism. In order to overcome such problems, and with the aim of contributing to national development by raising their efficiency, the privatization program of public enterprises in Nepal was initiated in the late 1980s and has gained momentum since the early 1990s, when the democratically elected government came into power after the restoration of multiparty party democracy system in the country.

Analysis of the financial management of public enterprises in FY 1991/92 revealed a total net operating loss of Rs.1, 145.5 million. By the end of FY 1991/92, net investment in the PEs totaled Rs. 50,530.3 million. In FY 1991/92, return on investment in the PEs registered a negative 2.4% (MoF, 2000- Economic Survey 1999:74). When the bleak outlook for PEs became apparent, the then-government accelerated the pace of privatization with great hopes for success. In 1991, an attitudinal survey on privatization was sponsored by USAID. The ongoing deteriorating condition of PEs made compelled the government to introduce an alternative policy option for the improvement of PEs. Consequently the government introduced a privatization policy in 1991 by issuing a government concept paper, called 'a white paper of privatization policy', which outlined a set of three broad objectives of privatization in Nepal:

- A reduction of the managerial and financial burden on the government,
- The promotion of functional expertise to enhance productivity and output, and
- The promotion of the private sector's role and public employees' participation in industrial investment.

The assistance and pressure from the donor community had, and still have, a major impact on the strategy of privatization in Nepal (Reejal, 1998). Overall, 29 small- and medium-sized enterprises have been privatized since the program began. Three PEs, namely Bhrikuti Paper Mills, Bansbari Leatherage Ltd. and Harisiddihi Bricks and Tiles Factory were privatized in the first phase 1992. Similarly, seven PEs were privatized in the second phase in 1993-94, six PEs in the third phase in 1996-97 and thirteen PEs after

1997. Among the privatized enterprises, assets and business of three PEs and share of ten PEs were sold out, nine PEs were liquidated/dissolved, and two were leased out (one for ten years with asset sale and another for 50 years).

Despite the legal provision and initiation for better privatization, critics argue that the program has not been properly implemented. There is no consensus among the various political parties concerning the program. Critics have also argued that the privatization objectives have not been achieved and the privatization policy is not a viable policy option for developing countries such as Nepal. On the one hand, “the majority of public corporations, where billions of rupees (rupees = Nepalese currency) of this resource-poor country have been poured, have failed to deliver expected services, their productivity is low, and qualities of their products are short of standard. The PEs, which had privatized, has not maintained their qualities standards and efficiency yet. The returns are negligible. They are still plagued with the government intervention in professional matters like recruitment of personnel, investment, procurement, etc. Professionalism for good governance is still not a reality in these corporations...” (MoF, 1999- Budget Speech, 1999:4).

On the other hand, “...most of the privatized enterprises had faced adjustment problems during the first twelve months after privatization owing to labor resistance, delay in handing over of the enterprise to the private sector and management, etc. The picture is more disappointing for all 5 enterprises privatized in phase II (on all fronts capacity utilization, employment and employee productivity).”(Reejal, 1998:223-24). In addition, in the context of Nepal's privatization program, there are two prominent points of criticism. The first criticism is directed towards the privatization policy of Nepal, which has resulted in the complete withdrawal of the government from a particular sector after its privatization, whereby the government no longer even acts as a regulator to ensure the supply of goods and provision of services to the consumers at an affordable price. The second criticism concerns the privatization process, for which the government has been accused for its improper approaches to issues such as: undervaluation of the sold enterprises, lack of transparency, and improper and unbalanced utilization of the revenue generated from the proceeds of the sick SOEs. In fact, in the context of the performances of the privatized enterprises, the experience of privatization in Nepal has been extremely discouraging (Adhikari and Adhikari, 2000). At the same time, international financial institutions like the WB, IMF, and ADB have compelled the government to adopt and implement the privatization policy as a panacea for the developing countries.

The failure and success of any policy depend, to a great extent, upon the context of the policy environment and the ability to effectively implement it. Outcomes of privatization policy in developed countries are different from those in developing countries. Indeed, outcomes may even differ among developing countries. In the context of this broad scenario, the aim of this study is to explore the implementation process of privatization efforts, to identify the problems that have been met in the process of privatization and to identify the prospects of privatization policy for a developing country such as Nepal. The specific objectives of the study are:

- To examine the influence of administrative reform on the implementation of a privatization policy for the improvement of public enterprises.
- To assess the role of the institutional design and legal framework in implementing policy reforms, especially on privatization policy.
- To investigate the policy characteristics and arena of conflicts on the process of agenda setting to the implementation phase and identify the problems that are encountered in the process.
- To look at the changes brought about by the implementation of the policy to enterprises in Nepal.
- To identify whether privatization is a success or a failure, a distinction this will enable a conclusion to be made concerning the prospects of the policy in Nepal.

3.5 Review of Nepalese Economy

Agriculture occupies a predominant role in the economy of the country. It has registered a significant contribution of over 36% to GDP and provided direct and indirect employment to about 90% of the population. However, contribution from non-agricultural sector has been increasing steadily over the years and is expected to improve further in the future.

Despite the planned development efforts initiated in mid fifties, the economic growth of the country, still dependent on Monsoon based agricultural sector, could not be achieved at a desired level. GDP increase during the last two decades is estimated at an average between 3.8 to 5.2% per annum, depending largely on weather.

Economic Policy in Panchayat Regime:

The successive governments in the past political order incorporated several protective and conservative economic measures by adopting the mixed economic policy. With an objective of enhancing economic activities in the country at a faster rate, the government intervened in all sectors of the economy.

As a result of this, the government investments in manufacturing, trade, services and infrastructural development has increased substantially in each year. More than 60 enterprises were established in the government investment. Various protectionist measures such as control of trade and industry licenses control of foreign exchange, import and export restrictions, high tariff rate, control in financial institutions and their activities had been adopted to protect the country's economy with an objective of achieving the faster economic development of the country.

Guided by the principle of equitable justice, several parasitical bodies were established to supply the goods of daily needs to the people at a cheaper rate as well as to provide various subsidies to the people. Performance of these bodies was not at a desired level. Most of them were operated at losses. Some of the PEs enjoying monopolistic situation in the market have also registered poor performances in terms of profit and efficiency.

Even the private sector investments could not be diverted in desired sector. Investors were interested in investing to those sectors where there was high protection rate or to those sectors where the chances for smuggling are. Despite the priority of the government for the development of the agro based and high value added industry in the country, the investors exhibited their on the establishment of industries utilizing the imported raw materials, such as plastic bags, iron rods, vegetable ghee and electronics. If the vegetable ghee plants in Nepal operated in fullest capacity not only they would fulfill the domestic demand, but also could fulfill the unmet demand of Indian state of Bihar and U.P.

The problem of unemployment and under employment because severe. About more than 60% of the population of the country were pushed to below the poverty line. The living standard of the people at large was at a miserable condition. In order to improve the living standard of the people at large, the government launched a program called the Basic Need Fulfillment Program in the middle of the decade of eighty. Since the program was merely an eco-political slogan, people were less optimistic about possible positive outcome of this program, but the government increased its investment to confirm its commitment to this program.

Since mid eighties, due to the pressure exerted by the donor agencies such as World Bank, ADB, and IMF, the government started to open country’s economy at a slower pace by launching structural adjustment program.

Analyzing the distortion in economy and its effect on the economic development of the country, some governments in the Panchayat Regime had half heartedly tried to correct the distortion in the economy with the adoption of market friendly economic policy at a minimal level as to make its economy more competitive and liberal since mid eighties.

As a result of this, a couple of joint venture banks were established and trade and industry sectors were liberalized. Still several sectors were kept under the control of the government and investors had to seek permission through the government in those sector. The foreign investment, although was open in the country since 1982, but due to the cumbersome licensing procedures and the hindrance in repatriation, could not be attracted at the desired level. As a result, the country could not be benefited from the foreign investment and technology transfer. The government indirectly made the investment decision of the private sector by using the controlling tools such as foreign exchange and license control.

As a result of his conservative policy, the numbers of “Tax Evaders”, “Commission Agent”, and “Renters Class of Entrepreneurs” have been developed leading to the distortion in the economy. Since most of the investments were made without analyzing their comparative advantage, demand for excessive protection has been made by the private sector. Licenses for the industry and the imports were controlled and handful investors had become successful in receiving the licenses for these activities.

3.5.1 Economic policy in new political order

a) Policies of Nepali Congress Government

Analyzing economic distortion in the country as well as the resources available at its disposal for fulfillment of people's expectation through the faster development of the country, the Nepali Congress Government, in spite of being a government of a social democratic party, adopted the liberal economic policy to make the economy more market oriented and competitive, since 1991/92.

The government started to withdraw itself from those sectors where private sector has shown interest for its involvement. Most of the economic sectors have already been made open to the private sector and accordingly necessary sect oral reform policies and programs such as in industry, foreign investment, trade, tourism, banking & monetary and capital markets have been carried out for facilitating the private sector participation in the economic development of the country.

The main objective of the government is to facilitate the private sector investment in the economy development of the country by means of further liberalization of the country economy.

In order to realize its objectives following policies and programs have been laid down:

- Continuous development and expansion of modern and dynamic sectors;

- Intensive and commercialized development and extension of viable traditional sectors for market oriented development;
- Self reliant and sustainable development of commercially viable production sectors;
- Relief and support for the sustenance of life in remote areas with limited physical resources and potentials.

Reforms:

Government realizing the necessity of promoting dynamic sectors such as industry, tourism, and export trade for the accelerated growth of the country's economy, has adopted various measures for the development and expansion of these sectors. The measures adopted so far are as follows:

- The Nepalese currency has already been made full convertible in current account. People earning foreign currencies are allowed to open in foreign exchange account.
- The financial and banking sector are made more competitive through the entry of new entities in the marker by issuing new licenses. The interest rate is deregulated.
- The trade sector is liberalized significantly by lifting the quantity and commodity restrictions. The open general licensing system (OGL) has been adopted for the import of the goods based on the principle of competition and sustainability.

- The capital market has been restructured with the development of market markers and brokers. The trading of the shares in the floor of the security exchange centre has already been started. Security Exchange Board has already been established for the monitoring and regulation of the capital market.
- Industry and foreign investment sector have been liberalized. Procedure for the registration and licenses of industries and have been simplified. Limited numbers of sub sectors are put under the categories of the industries requiring licenses for their erection in private sector. Restriction for foreign investment has been lifted and foreign investors are encouraged to invest in Nepal by providing several incentives and facilities in the form of increased tax exemption, unrestricted repatriation and residential visa facility. Only the limited sector such as cigarette, alcoholic beverages and the arms and ammunition have not been opened for the investors.
- State monopoly was eliminated in areas such as domestic aviation, and the importation and distribution of fertilizers.
- The tariff structure is revised and simplified. The tax system is on the way to restructuring. Concepts of value add tax is highly marketed, but yet to be materialized.
- The privatization of public enterprises, as an integral part of its economic liberalization program, has already been started. The restructuring of the state owned entities enjoying monopolistic situation has already been visualized.

Adapting the policy of economic liberalization, the Government of Nepal (1991/92) has incorporated the policy of encouragement of private sector participation in the country's economy. With an objective of diverting its resources to the welfare of poor in rural areas, the Government of Nepal expressed its non involvement in those business and manufacturing activities where the private sector are interested. The policy also incorporates the involvement of private sector in PEs either through purchase of assets and business, shares or through the participation in management. Within this policy framework, the government decided to transfer the ownership and management of those public enterprises, which are not fulfilling any social objective to private sector.

b) Policies of Nepal Communist Party (UML) government

After mid term poll of 1994, the first communist government of the country had been formed in December 1994. Till March 1995, the new government reviewed the economic structure of the country. Since the Philosophy of Marxism and Leninism had influenced this government, most of the economists of the country had hoped that this government would follow the state regulated economic approach. Understanding the global economic changes and the country's economic compulsion, CPN (UML) government formulated a mixed economic policy encouraging private sector's participation in the economy.

Although the government opted for the market competitive economic regime based on mixed economic philosophy, it tried to review all important policy reform programs carried out by the previous government by forming several task forces. It found the Value

Added Tax unsuitable to Nepal for immediate implementation and preferred for its further study.

The policy paper of the government clearly revealed the government's preference for selective privatization of state owned enterprises. The sick industries, industries non-fulfilling the social objectives and the industries that are not necessary to be in government ownership were voiced as the potential candidates under the scheme of selective privatization. In order to gear up faster development of the country, the government advocated its continued involvement in those industries where private investors are disinterested.

Opening of fair price shops to intervene in the market jeopardized the government's commitment to adoption of market friendly economy.

3.6 Review of Privatization Policy and Programs

3.6.1 Privatization in Previous Political System

3.6.1.1 Efforts to Improve Efficiency

Government at the later part of previous political order realized that the policy of adopting state owned enterprises as the means of economic development could not produce the desired outcomes. Most of the enterprises suffered from administrative or financial burden and were not able to achieve their objectives. Their performance records were very unsatisfactory.

While launching the seventh five-year plan, the government introduced performance evaluation and reward & punishment system as the tools to improve performance of PEs. This system required government on consultation with management of PEs to set annual targets at the beginning of each fiscal year and to make quarterly review of the performance against the set targets. The system basically aimed to make management accountable for the performance of their respective PEs. However, this system lost it effectiveness on the following grounds.

The target setting, the crux of this system, under government screening gradually turned into an administrative ritual and lost its managerial purpose. Target setting was generally never SMART, where,

S: Specific

M: Measurable

A: Accurate

R: Reasonable

T: Transparent

The government simply took and linked this target setting exercise as a part of pre-budget exercise to allocate subsidy or grant to PEs in the annual national budget. The whole target setting exercise was less towards basic performance improvement. Furthermore, those public enterprises not requiring further cash were treated differently during the exercise, the resulting the general impression that the government was contended if there would be no budget demand from PEs for their annual operation.

On the other hand, there were instances where chief executives were mildly diverted towards setting low targets. Also, there were hardly instances where chief executives were sacked on low performance ground.

There were instances where the government had failed in granting genuine autonomy to management on decisions to hire, and fire, price fixation, and relocation of products, restructuring boards with more business oriented directors at the cost of civil servants, costing out noncommercial objectives and compensating the enterprise for fulfillment etc.

3.6.1.2 Privatization Efforts

The government, realizing the less effectiveness of performance evaluation system, made policy statement on two different occasions in Rastriya Panchayat (the then parliament) to undertake privatization of PEs.

Even time schedule and target of privatization about 13 PEs within the fiscal year were announced by the Finance Minister of that time. However, it could not take shape, and limited to more expression of wish. The possible reasons for such non-take off could be the following:

Privatization was considered a simple process of sales of assets and change of ownership. The whole privatization process was looked in isolation as complete in itself, but not as an element of the overall package of market friendly economic policy. The inherent conflicts between privatization and other public policies at that time were not properly considered. The complexity involved was not seriously thought prior to announcement.

The objective(s) of privatization were not very much defined. The reduction of government burden and maximization of revenue from sales into protected market were primary consideration rather than focusing on elimination of monopoly power and unleashing of competitive activities.

The entire implementation covering privatization technique, preparation for sales, pricing and valuation, financing, and managing the transaction etc. was not considered. It was a case of “cart before horse”.

The reasons cited above clearly suggest the lack of proper planning and realization of consequences of privatization among the top decision makers of the country.

Later another Finance Minister as a part of his structural adjustment program had initiated the privatization program. Attempts have been made on the privatization of Balaju Textile Industry in the initiatives of the government where as the divestiture of NIDC’s shares in Himal Cement Company and that of Bhrikuti Paper Mills in the initiation of their respective management were the some citable instances of privatization exercises in Nepal in the previous political order. However due to political disorder, lack of political commitment, bureaucratic predicament and unexpressed reservation, the exercise of the privatization of PEs could not be materialized.

Well before this, there were the instances of privatizing two small manufacturing entities in mid eighties.

3.6.1.3 Privatization after New Political Order (Since 1991)

The Nepali Congress government, when came into power in 1991 drafted and made the Eighth Five Year Plan public. The plan has given due importance to the private sector for the economic development of the county. After carefully examining the various economic issues and the problems faced by the country, the government despite of being a government of social Democratic Party, decided to adopt the liberal economic policy. As a result, of which most of the sectors are made open to the private sector.

The philosophy of competition and comparative advantage of the investment, two basic components of marker economy have been made the central string of the policy reforms of the country. To maintain consistency in the sect-oral policy as well as in overall economic policy of the country, the government decided to start the privatization of the state owned enterprises, which are highly inefficient and loss making entities.

3.6.1.4 Public enterprises and privatization policy

The government of the Eighth Plan Document has clearly indicated its will of disengagement from number of fields where the private sector can perform efficiently without jeopardizing the social interest. The plan document has categorically stated for the strengthening of existing viable public enterprises and placing them on a commercial basis, closing down, sell and merger of other nonperforming entities. It has clearly indicated for the privatization of those public enterprises which can be operated as commercial under taking but not provides” public services” are of non-sensitive nature.

The Eighth Plan has stated the following age the objectives in the field of public enterprises and privatization.

To increase efficiency and productivity by the better use of managerial and entrepreneurial talents of the private sector as well to increase the cooperative activity,
To increase the efficiency of those public enterprises which shall not be privatized or shall be privatize afterwards through appropriate rehabilitation program with an objective of enhancing efficiency and better management of these corporation.

The following have been listed as the policy of public enterprises and privatization program in the eighth plan of the country.

- A long-term strategy on privatization will be devised. Corporation of industrial and commercial nature will be gradually privatized.
- The private sector will be allowed to operate project in the social services sector such as, hydro electricity and drinking water, but public enterprises set up in these areas will continue to operate in the government sector. The corporation in government sector will operate difference and other important areas.
- As far as possible current employ will be included when privatizing corporation or when under taking program. But if the numbers of employees/labors are more than necessary, they will be removed only after adequate compensation.
- All policies and programs relating to privatization will be transparent.
- A center unit will be formed to privatize corporation or to launch improvement programs. This unit will conduct all work with the support of concerned ministries.
- The privatization of public enterprises will be under taken in groups such as those been privatize immediately, those to be privatize after a certain period of time, or those to be privatize after restructuring in the long term. Necessary improvement will be launched for corporation to be privatized latter and those not to be privatized at all. Corporation will be shut down, should it be difficult to under take improvement programs where privatization cannot take place and where it is irrelevant to continue operating as a public enterprise.
- It will be clearly stated in the future whether or not there is a possibility of reducing the number of employees or labors, and if a reduction is possible, how much compensation they will be given.

- Considering the structure of the corporation, necessary legal support will be prepared for privatization. Corporations set up through special legal provision will be brought under through company laws and privatized.
- Public awareness programs on privatizations will also be launched. Employees/ labors will also be given the chance to be involved in the privatization process.
- Programs will be launched for structural changes, financial and management reform and to create the management accountability through the appointment of the top-level management in order to enhance the performance of corporation to be privatized later, or not at all.

Besides these objectives and policies, the Eight Plan the document has also enlisted the followings as programs in the field of privatization of public enterprises.

- To classify public enterprises into three categories such as (a) those to be privatized immediately, (b) to be privatized in the middle of the programs or (c) to be privatized in long term on the basis of long term privatization strategies.

- To formulates the program by enlisting the PEs programs to be privatized within Eighth Plan, on the basis of the long-term policy.

- To carry out in depth study in the field of nature and problem of the PEs and accordingly to carry out the valuation of the company.

- To design clearly the policies and programs on employees/workers, and their compensation, training and rehabilitation and implement those procedures while implementing the privatization program.

- To determines the methods of privatization of each company by analyzing the economy condition, market position, employment situation, and investment feasibility etc.

- To sell out the assets or to lease out those companies that cannot be privatized. To close down those corporations whose assets cannot be sold or be leased out.

- To develop the legal framework for privatization of the corporation by analyzing by their nature. To privatize corporation established under the especial charters by incorporating them under company act.

- To carry out the public awareness program so as to make the people aware with the benefit of the program.
- To establish a privatization fund from the sales proceeds of the companies privatized so as to meet the expenditure of basic works for future privatization as well as for compensating workers/employees.

- To allocates certain percentage of the share for the employees to increase their participation in privatization.

- To provides the deferred payment facilities in the privatization of large PEs.

- To establish a privatization commission an expert committee to carry out the privatization program successfully.

Within this boarder guideline of the Eighth Plan, the Government of Nepal had put forward a policy paper on privatization of public enterprise. The white paper on privatization program issued by the Government of Nepal in corporate the following objectives.

- Reduction of managerial and financial burden on the government.
- Promotion of functional expertise to enhance productivity and output, and
- Promotion of private sectors role and public/employee participation in industrial investment.

3.6.1.5 The First Phase of Privatization Program

Extensive studies have been carried out to select the potential candidates for the privatization in the first phase. The assistances of UNDP and World Bank had been utilized for the purpose.

A high-level privatization commission headed by minister of finance was formed to guide and monitor the program. The committee had included the members of parliaments, president of FNCCI, secretaries of finance ministry, law and justice ministry and labor ministry as its members and secretaries of concerned ministries as its temporary members.

A Privatization Cell was established in the ministry of finance. This cell was entrusted to provide all the necessary administrative and professional supports to the commission. Several export both local and expatriates rendered their services to the cell.

Carrying out the extensive study on six companies, namely Bhrikuti Paper Mills, Bansbari Leather and Shoes, Harisiddhi Bricks and Tile ltd, Birguanj Sugar, Bhaktpur Brick and Tile ltd and Balaju Textile ltd, the first three manufacturing PEs, mainly Harisiddhi Bricks and Tile factory ltd, Bhrikuti Paper Mills ltd and Bansbari Leather and Shoe factory limited where selected as the candidate for first phase privatization.

On the recommendation of High Level Privatization Commission as well as the experts in the field, the Cabinet approved “Sale of Assets and Business” as a method of privatization of these companies.

The activities such as administration of transfer of ownership, handover of the business to successful bidders and liquidation of the parent companies have been contracted out to a local firm of chartered accountants. With an intention to encourage maximum employees and public participation in the newly privatized companies, a condition whereby the purchaser must offer 24 to 30 percent shares to the above groups has been attached with the sale and purchase agreement. Of which 5 percent of the shares were reserved for employees at a discount of 25 percent to be subsidized by the Government of Nepal.

With the implementation of the first phase of privatization, the Government of Nepal, with objective of devising a long-term privatization strategy, developed a “Privatization Program”. UNDP and World Bank have assisted in designing this program.

The report submitted by the team of consultant has categorized the PEs into following four categories (detail list enclosed in annex 1).

1. Companies suitable for privatization without any further study: 27 companies have been identified as suitable candidates for immediate privatization.

2. Companies are requiring additional preparation prior to privatization: 14 companies have been identified as the companies requiring additional action before they are pushed into actual privatization.

3. Companies to be liquidated: 8 companies have been identified as the nonviable companies. The study team has recommended for their liquidation.

4. Companies to be restructured: 11 companies have been identified as the companies to be restructured.

The officials in privatization cell indicated that the government, revaluating this report, has already developed a long-term privatization program. It is a phase program, outlining the entire privatization process in a phase and planned manner in conformity with government's policy and objectives under the Eight Plan (1992-97). If this program is implemented successfully, most of the companies in the government sector shall be privatized, restructured, or liquidated. Only those companies that are economically enviable shall be liquidated.

3.5.1.6 The Second Phase of Privatization Program

The second phase privatization program includes 15 PEs. (Annex 2) of various nature. Out of them, seven are on the cent percent ownership of the government where as the rest are of "Second Generation" (majority share owned by those PEs which are wholly owned by the Government).

Out of 14 PEs of this phase, 5 PEs, namely, the Balaju Textile (BTF), Nepal Film Development Corporation (NFDC), the Raw Hide Collection, and Development Corporation (RHCDC), Nepal Bitumen and Barrel (NBBIL) and Nepal Lube Oil (NLOL) have already been privatized. The Tobacco Development Company and the Jute Development and Trading Corporation have been liquidated.

The "Sale of shares" has been chosen as the method of privatization for the PEs already privatized in this phase.

3.7 Institutional Set Up for Privatization

3.7.1 Privatization Act, 1994:

The Privatization Act 2050 has been promulgated to carry out the privatization program effectively with the help of legal framework needed for the program. The act has incorporated the provision of the organization set up, method of privatization, bid evaluation criteria, and method to make transaction transparent etc.

3.7.2 Privatization Committee:

Before enactment of the Privatization Bill 1994, the cabinet had constituted a High-level Privatization Commission (HLPC) under the chairmanship of Minister of Finance. The commission was responsible for issuing guidelines and recommending to the cabinet in the privatization program.

“Privatization Act” enacted in 1950, has a provision for the composition of a Privatization Committee headed by the Minister of Finance. The other members of the committee are:

- Chairman of Finance Committee of House of representatives,
- Two members of parliament,

- Member of National Planning Commission,
- Secretaries of Ministry of Finance, Ministry of Labor, Ministry of Law, justice and parliamentary affairs,
- Secretaries of line ministries,
- President of Federation of Nepal Chamber of Commerce and Industries.
- Joint Secretary of Corporation Coordination Division of Ministry of Finances-the member secretary of the committee.

Responsibilities of the Privatization Committee include:

- To recommend the program and priorities of privatization to the Government,
- To issue guide for privatization study,
- To recommend appropriate modalities,
- Coordinate, trouble-shooting, implementation, post-sale monitoring etc.

3.7.3 Privatization Cell:

A Privatization Cell, under the Corporation Coordination Division, in the Ministry of Finance has been established to act as a secretariat of the Committee. The cell is also responsible for providing expert services in various fields. The Cell is also made responsible for implementation of entire privatization process starting from selection of the candidate to the post privatization monitoring activities.

a) Methods of Privatization:

Method of privatization according to the Privatization Act may be either in any one or all forms as outlined below:

- Sale of shares to general public, employees, workers and person willing to undertake management of the PE with the provision that public participation is maximized to the extent possible,
- Cooperatization,
- Sale of PE's assets,
- Leasing,
- Management contract and
- Others.

b) Bid Evaluation Criteria:

As per the provision in the Privatization Act, bid shall be evaluated on the basis of:

Higher and attractive price,

Retaining existing nature of the unit

Retention of the staff and employees

Future prospect of employment opportunities

Experience in management and

Promising future management/business plans, through additional investment, capacity expansion, diversification etc.

3.8 Review of Implementation of the Privatization Program in Nepal

The implementations of privatization process of the three companies privatized in fiscal year 1992/93 have been reviewed on the following aspects:

Selection of candidates

Preparation for privatization

Transparency in the process

Methods of privatization

Bidding process

Bid evaluation criteria

Award and transfer process

3.8.1 Selection of the Entities:

In accordance with the budget speech in Parliament in 1992/93, 6 companies were selected as the potential candidate for privatization, on the basis of preliminary information gathered by the Ministry of Finance. According to the officials of the Privatization Cell, the basis for the selection of these companies includes their economic condition, number of employees, financial performance, need for future investment, working capital need market and competition.

In-depth studies have been carried out to analyze the actual socio-economic and financial condition of each company selected. During the study it was revealed that due consideration have been given in analyzing issues of employees redundancy & compensation, market of products & competition, restructuring need and investment requirement, and attraction of private sector for the participation in the company, while selecting the entities for privatization.

It could be noticed during the study that Bhrikuti Paper Mills, Bansbari Leather and Shoe Factory and Brick and Tile Factory, Harisiddhi were recommended by the Consultants as the candidate for immediate privatization on the following basis:

- Analyzing economic viability of the company,
- To make the privatization process simpler and easier, smaller firms have been selected,
- Analyzing the preference and attitudes of the investors,
- Analyzing monopolistic situation and public concerns,
- Analyzing the capital needs.

3.8.2 Preparation for Privatization

According to the privatization cell, following activities have been carried out for preparation of the privatization of three companies selected for privatization in 1992/93.

- Establishment of High Level Privatization Commission under the chairmanship of Finance Minister together with the formation of a Privatization Cell to coordinate as well as to carry out different studies.

- Engineering, organization, market, and legal appraisal of each company by a team of consultants consisting of both the local and expatriates.
- Valuation of assets and business by a team of consultants consisting of both the local and expatriates.
- Preparation of information memorandum to sell out to the potential investors. The appraisal of this document during course of the study revealed that the document enclosed the legal entity of the company, its historical information, detailed information's in the engineering, organization, business and financial aspects of each company. The document also included the well-defined procedure for participating in the bids as well as the draft sells and purchase agreement.
- With the assistance of World Bank, UNDP, and USAID, a seminar was held in Katmandu (Capital City of Nepal) for creating awareness among the top-level government and public enterprises' employees.
- With the help of ILO and UNDP, a redundancy study has been carried out to identify the level of redundancy and the way of compensating employees.
- With the recommendation of the experts associated with the study, the government has chosen the "Sale of Assets" and business as the method of the privatization. Necessary advertisement in the well circulating local papers and in Television and radio has been done. Nepalese Embassies abroad were also involved in disseminating the information.
- Prior to the advertisement for the bids, government decision has been made to take the waiver on the financial rules and regulation so as to limit the bid submission time to 35 days.

3.8.3 Transparency in the Process

According to the official of Privatization Cell, following measures have been applied to maintain the transparency during the entire procedure:

- Inclusion of the President of FNCCI as the private sector representative in the Privatization Commission as its member.
- Advertisement in the public media to make all the citizens as well as the potential bidders aware of the biding procedures.
- Opening of the bid in the presence of the representatives of the bidders and counter signing by their representatives.
- Issue of press notice consisting of entire information such as valuation price, price offered by each bidders with their condition, basis of selection of successful bidders and the conditions in the agreement by the commission after final award of agreement with the successful bidders.
- Publication of the booklets on the entire process of the privatization by the privatization cell.

During the course of the study, it has been noticed that the offer price and the conditions of the bidders were not disclosed till the final agreement had been done. When reservations were put on that, the officials justified it by defining it as a precautionary step to avoid the possible collusions among bidders.

During the study, it has been noticed that the bid evaluation criteria, though were clearly defined internally, have not been made public in this phase.

3.8.4 Methods of Privatization

On the recommendation of the experts, the “sale of assets and business” has been selected as the method of the privatization of the companies privatized in the FY 1992/93. The identification for the selection of this as a method of the privatization includes:

- Inadequately developed capital market in the country incapable of selling the large number of shares of the companies at a time.
- Possibility of public reluctance for the purchase of shares of debt burdened & inefficient companies with longer history of losses.
- It would not be practical and justifiable to issue shares to individuals and employees, until the management and staffing problem were resolved.
- To transfer the clean management, asset and business of the company to the new management. As a result of which the functioning of the company would be smooth.

The justifications placed by the consultants and the officials of the Privatization Cell hold the truth. The method selected at that time was logical if the companies’ performances; capital market growth and the public’s faith in the stock market of Nepal have been examined carefully.

Where ever it is possible, officials in the privatization cell prefer to select “sell of shares” as the method of privatization in the future privatization as it is easier for the transfer of the business and assets to the buyer(s).

a) Bidding Process

From the office record of privatization cell, it was revealed that the advertisement has been made for the invitation of the proposal from the bidder(s), irrespective of their nationality, providing 35 days for the submission of the proposal. The advertisement was published in both the Gorkha Patra and Rising Nepal (National Daily News Paper) for three consecutive days. The advertisement had clearly spelt out the procedure for the application.

The notice published for the invitation of bids or proposal has clearly stated that person wishing to participate in the bidding process should purchase the information memorandum of each company by depositing NRs. 250 thousands in the government deposit account.

During the study, the reservation had been made and justification had been sought from the official in placing such a high amount of money as a prerequisite for the purchase of the bid forms. The justification given by the privatization cell was to obstruct the unserious bidders in the bidding process. Realizing the concerns of the public at the prerequisite amount, privatization cell has started to distribute the information kits on free of charge in the second phase of privatization. This indicates the improvements in the bidding procedures as well as maintaining the transparency in the process.

The bidders submitting the proposal should clarify about theirs banking credibility, business plan, offer price, payment modes, and management skills in their proposal.
The bids have been opened in the presence of the representatives of the bidders. However, the price and the condition were not disclosed till the agreement with the successful bidder has been made.

Negotiations had been made at two levels. The preliminary negotiating team headed by the company's chairperson of boards, negotiated with the bidders to clarify the government position on issues raised by the bidders. High level negotiating team comprising Ministers of Finance and Industry negotiated with the bidders as per the recommendation of the primary team.

b) Evaluation Criteria

Although criteria for the evaluation of bids were not made opened during the process, but the bid s submitted by the bidders have been found to be evaluated on the following criteria:

- Offer Price,
- Payment Schedule,
- Management capability (Industrial Experiences of the Bidders).

- Redundancy,
- Measure to increase the efficiency and productivity of the employees/workers,
- Business Plan

According to the privatization cell, the maximum weight age has been accorded to the offer price due to the financial regulation as well to maximize the return from the sale.

c) Award and Transfer Process

The assets and the business of the existing companies have been transferred to the new companies set up by the successful bidders. The government and the purchaser have signed an agreement on the sale and purchase of the business and assets.

A local firm has been found to be contracted out to administer the process of transfer of the management, assets, and business to the purchasers and liquidate the existing companies.

Problems have been experienced during the transfer process in the form of worker agitations and disputes on the assets. But these problems were resolved through the mutual consultation among the representatives of the employees/workers, new management, and the government.

List of the Public Enterprises

a. Suitable for Immediate Privatization

1. Agriculture Tools Factory
2. Agrolime Industries Ltd.
3. Bhaktapur Brick Factory Ltd.
4. Royal Drugs Ltd.
5. Balaju Textile Industries Ltd.
6. Nepal Foundry Industry Ltd.
7. Nepal Bitumen & Barrel Industry Ltd.
8. Nepal Coal Company Ltd.
9. Bio-gas and Agricultural Implements Development
10. Seti Cigarette Ltd.
11. Nepal Rosin & Turpentine Industry Ltd.
12. Hetaunda Textile Factory Ltd.
13. Hetaunda Cement Industry Ltd.
14. National Construction Company Ltd.
15. Janakpur Cigarette Factory Ltd.
16. Nepal Transportation Corporation.
17. Lumbini Sugar Factory Ltd.
18. National Insurance Corporation.
19. Nepal Lube Oil Ltd.

20. Butwal Spinning Mills Ltd.

21. Raw Hide Collection and Development Corporation.

22. Nepal Engineering Consultancy Service Centre.

23. Economic Services Center (National Productivity and Economic Services Centre)

24. Agriculture Project Services Centre.

25. Nepal Metal Company Ltd.

26. Nepal Oriend Magnesite Company Ltd.

b. Companies requiring additional preparation

1. Gorkhapatra Corporation

2. Janak Education Material Centre Ltd.

3. Nepal Telecommunication Corporation.

4. Royal Nepal Airlines.

5. Rastriya Banijya Bank.

6. Nepal Bank Ltd.

7. Tobacco Development Committee.

8. Herbs Production and Trading Corporation.

9. Dairy Development Corporation.

10. Nepal Tea Development Corporation Ltd.

11. Industrial Estate Management Ltd.

12. Udaypur Cement Industry Ltd.

13. Himal Cement Industry Ltd.

14. Tobacco Development Committee

c. Companies to be liquidated

1. Royal Nepal Film Corporation

2. Rural Housing Company

3. Nepal Housing Finance Company

4. Cottages and Handicrafts Emporium Ltd.

5. National Trading Ltd.

6. Cultural Corporation

7. Sri Raghupati Jute Mills Ltd.

8. Timbre Corporation of Nepal

d. Companies to be restructured

1. Nepal Oil Corporation

2. Agricultural Input Corporation

3. Nepal Food Corporation

4. Nepal Telecommunication Corporation

5. Nepal Water Supply Corporation

6. Nepal Electricity Authority

7. Agriculture Development Bank

8. Nepal Industrial Development Corporation

9. Security Exchange Center Ltd.

10. Credit Guarantee Corporation Ltd.

11. Nepal Transit and Warehouse Company Ltd.

12. Nepal Television

Annex 2

Companies of second phase of privatization program

1. Balaju Textile Industry Ltd.
2. Royal Nepal Film Corporation
3. Rawhide Collection & Development Corporation
4. Nepal Lube Oil Ltd.
5. Nepal Bitumen & Trading Corporation
6. Nepal Tea Development Corporation
7. Dairy Development Corporation
8. Agriculture Tools Factory Ltd.
9. Nepal Foundry Industry Ltd.
10. Sri Raghupati Jute Mills Ltd.
11. National Construction Company Ltd.
12. Nepal Coal Company Ltd.
13. Tobacco Development Committee
14. Jute Development & Trading Corporation

3.9 Summary

In this chapter the definition of PEs in general, as well as the growth, performance and problems of PEs in Nepal and the necessity for public enterprise reforms in Nepal and so forth have been discussed in brief. In Nepal, there was rapid growth of public enterprises, especially during the Fifth and Sixth Plan periods. In total, there were 62 enterprises by the end of the Seventh Plan period (1985-1990) yet their performances were disappointing. During the Seventh Plan period, returns of enterprises were virtually negative, which led the government to adopt a privatization policy.

Chapter Four

4.0 Effects of Privatization: Cases Studies of BPPM Ltd. and HBTF Ltd.

4.1 Study of Bhrikuti Paper & Pulp Mills (BPPM) LTD:

Bhrikuti Paper & Pulp Mills (BPPM) was registered in 1981/82 under the Nepal Company Act, 1964. It is located at Gaindakot Development Committee, Word No. 2 of Nawalparasi District on the side of main highway linking Mechi to Mahakali (Maheendra Highway) at 2 kilometer from Narayangadh. It had 650 Ropani (counting unit of land) land before privatization but after privatized the company had purchased 50 Ropani additional and then company land had owned total 700 Ropani land.

The main objective to establish the BPPM Ltd was to accelerate the country's economic condition by producing the machine made writing and printing papers for private and public use as well. The plant was installed with the help/aid of Chinese Government. Therefore, the required technological support, layout and design of the building and machinery etc. all were installed and completed by the Chinese experts. After the required technological and managerial support was completed, the company had started to operate the commercial activities since 1986/87 and the plant had been working smoothly.

The capital structure of the company before privatization was as following:

Types of Capital	**Amount (NRs. "000")**
Authorized Capital	250,000
Issued Capital	70,000
Paid Up Capital	64,501

Source: BPPM Management

The issued shares of the company were as follows:

Shareholders	**% of share owned**
Ministry of Industry	25
Department of Industry	25
Office of Accountant General	50

Source: BPPM Management

The Bhrukiti Paper Mill (BPPM) was privatized in 1992 along with other two manufacturing enterprises. The current capital of the BPPM was Rs. 80.38 million before privatized but capital paid amount was Rs. 20.46 million. The company had been facing the competition market of its product with the existed new factories of the private sector.

4.1.2 Process Undertaken to Privatization of Bhrikuti Paper Mill Limited

4.1.2.1 Procedure: The different process and procedures were adopted in the process of the privatization of BPPM, which is explained briefly as following:

The specialists in the process of evaluation and privatization of BPPM enlisted the three approaches of the privatization.

Table 4.1.2.1

Evaluation of the Assets of Mills

Valuation Approach	**Value (in Million)**
1. Establishment of new mill of similar kind (in ongoing business program)	Rs. 34.40
2. Liquidation of Existing mill (valuation cost)	Rs. 15.40
3. Value of future cash-flow of existing factory	Rs. 12.60

Source: Ministry of Finance, Privatization Unit

The mill was recommended to privatize through the “Sale of Assets and Business” modality according to the study and evaluation of the mill’s assets and business. It was also recommended to evaluate the bidders on the basis of liquidation value and not to sale below this value. Meanwhile on information memorandum it was mentioned that without considering the major fire unit break in raw material section devastated the company operated and brought its manufacturing activities. Almost to stand mill the effects of and loss of property proposal have to be submitted by bidder and after it will be done according the understanding made both government and the purchaser.

The privatization notice, which was made and recommended, by the specialist and high level commission of privatization was channeled through the different means of communication; carry to submit the proposal from the private investor. The government was not determined any conditional terms while it invited the bids but later the government had determined/mentioned that the bidder was not allowed to differed payment, in the detailed paper.

4.1.2.2 Analysis of the Bids

The eight bids were submitted from the different groups of investor.

Table 4.1.2.2

List of Bidder and Commitment Values

S. No.	Bidders	Committed Values
1	Cabre Group (including current assets)	Rs. 25.95 Million
2	Himal Pipe Co. Pvt. Ltd. (incl. current assets)	Rs. 22.98 Million
3	Dhananjaya Acharya	Rs. 8.00 Million
4	Tungabahdra Machinery and Tools	Rs. 15.00 Million
5	Salt Trading Corporation	Rs. 14.18 Million
6	Everest Paper Mill	Rs. 10.00 Million
7	Star Board Products India Ltd.	Value was not mentioned

Source: Ministry of Finance

The Cabre Group and Himal Pipe Co. Pvt. Ltd. these two companies' proposal were selected to analyze the committed value, business planning, payment schedule, retirement of the employees and workers, managing capacity among the others bidders.

Table 4.1.2.3

The Comparative Analysis of Cabre Group & Himal Pipe Co. Pvt. Ltd.

S. No.	Particulars	Cabre Group	Himal Pipe Pvt. Ltd.
1	Committed Value (Including current assets)	Rs. 25.95 Million	Rs.22.98 Million
2	Present Value	Rs. 24.40 Million	Rs. 22.40 Million
3	Demand in the Government of Nepal's investment	Rs. 16.70 Million	Rs. 4.00 Million within 2 years
4	Condition of payment	15% interest within 10 years	By issuing share among public, employees and worker.

5	Alternative of mortgage	Mortgages of Assets	Mortgage of residential area.
6	Share holding of public and employee	24-44% for public 5% to Employees and Workers.	30%
7	Current Assets	Non acceptance of Current assets	Acceptance in Book Value.

Source: Ministry of Finance

After analyzing the proposal submitted by Cabre Group and Himali Pipe Pvt. Ltd. The high level commission of privatization was accepted the proposal submitted by Himali Pipe Pvt. Ltd. Subsequently, the highest bidder Himali Pipe Pvt. Ltd. Was forwarded a payment schedule and company was interested to pay within two years agreed by the government and company.

Table 4.1.2.4

Payment Schedule of BPPM

S. No.	Particulars	Value (Rs. in Million)
1	On agreement date	10.490
2	Completion date	406.68
3	Four months from completion date (by adjusting current assets and liabilities)	137.630 (Adjustment was made on current assets by 8.3956 Million and current liabilities by 2.90)
4	Two years from completion date (By issuing share to public and employee)	40

Source: Ministry of Finance, Privatization Unit

Participation of Workers/Staffs:

Out of the total shares of the BPPM, 5% were reserved for employees at a discount rate of 25% subsidized by government.

Participation of General Public: Out of the total shares of the BPPM, 25% share was to be distributed among general public within 2 years from the date of completion.

Terms and Condition of Agreement:

The terms and condition accepted and agreed during the process of privatization of Bhrikuti Paper Mill Ltd. were as:

- The buyer pays Rs. 22.98 Million to the assets and business of the BPPM. The current capital and other assets will be evaluated after the examination and evaluation.
- They have to pay according to the schedule.
- The government will charge 17% interest rate including 4% surcharge in the case of due amount and delay of payment scheduled by the agreement between government and company. But the discretionary power remains to the government of Nepal.
- The subject name of the company could not be changed.
- Among the 35% equity shares 5% share will be sold to the staffs/worker and general public respectively but preference will be given to the staffs/workers then general public.
- The present employees/workers economic facilities are to be continued.

- If the terms and condition including payment schedule is not followed, the government should take following action by issuing notice 3 days advance:
- The agreement has to be dismissed and amount paid by bidder will not be returned.
- Assets and Business will be resold and
- Appropriate legal action will be taken according to concerned law.

4.1.3. Financial Resources and Structure of the Share Capital in BPPM Ltd. (After Privatization)

4.1.3.1 Financial Sources

Table 4.1.2.5

Financial Sources of BPPM Ltd.

S. No.	Financial Resources of BPPM Ltd.	Figure in Hundred Thousand (000,000)
1	Share Capital	2322.50
2	Convertible Debentures	755.00
3	Internal and other financial resources	1190.88
	Total Capital and Reserves (A)	4268.38
4	Long Term Loans	5733.11
5	Short Term Loans	650.88
	Total Loans (B)	6383.99
	Grand Total (A+B)	10653.37

Details of total equity share (Rs. in Lakhs=100 thousand)

Promoters 1890.00

Staffs 55.00

Public 377.50

Total 2322.50

Main promoters of this company are as follows:

- M/S Hulas Steel Industries Pvt. Ltd., Simara.
- M/S Hulas Metal Crafts Pvt. Ltd., Brightnager.
- M/S International Match Co., Barunda.
- M/S Omnee Pvt. Ltd., Birgaunj.

4.1.3.2 Total Cost of Project and Financial Resources

Table 4.1.2.6

Cost of project and financial resources of BPPM Ltd

(Amount in Rs. 00,000)

Cost of Project	Amount	Financial Resources	Amount
Fixed Assets	9387.91	Share Capital & Reserve	4268.33
Current Assets	1264.46	Total Debt	6385.99
Total	10652.37	Total	10654.32

Source: BPM Ltd.

4.1.3.3 Structure of the Share Capital in BPPM Ltd.

Table 4.1.2.7

Structure of the Share Capital in BPPM Ltd.

Particulars	No. Of Shares	Rate	Total Amount
Authorized Capital	12,151,000	100	1215100000
Issued Capital	41,000,000	100	410000000
Distributed Capital	3,500,000	100	350000000
Promoters	2,450,000	100	245000000
Public	1,050,000	100	105000000
Paid up Capital			177872060

Source: BPPM Ltd.

4.1.4 Impact analysis of BPPM Ltd

The following indicators have been used to analyze the impact of privatization for this company:

4.1.4.1 Investment

The investment shows positive impact in BPPM Ltd. The following are the new investment in plant and machinery, buildings and others:

Buildings	Rs. 708.49 Million
Machinery	Rs. 140.28 Million
Others	Rs. 11.21 Million

Source: BPPM Ltd.

4.1.4.2 Total Expenditure

In fiscal years 1989/90, the total expenditure had been Rs. 82.2 Million but after privatized the total expenditure of the company has increased which the following table shows this trend is increasing year by year.

Table 4.1.2.8

Expenditure

Fiscal Year (FY)	**Rs. (in Million)**
1998/99	108.10
1999/00	126.10

2000/01	320.40
2001/02	448.28
2002/03	629.78
2003/04	608.61
2004/05	603.44
2005/06	723.82

Source: BPPM Ltd.

4.1.4.3 Output/Production

Due to constraint of available date, here I have presented only three years available data regarding before privatization of the company. In the available data there has not mentioned about the product diversification. But the company has started to produce pulp in later.

Table 4.1.2.9

Total Production Unit

After Privatization		**Before Privatization**	
Fiscal Year (FY)	Metric Ton (MT)	Fiscal Year (FY)	Metric Ton (MT)
1998/99	3498	1989/90	2968
1999/00	4086	1990/91	2574
2000/01	7659	1991/92	2665
2001/02	9172.44		
2002/03	9971.47		
2003/04	10112.28		
2004/05	10671.95		
2005/06	13193.68		

Source: Ministry of Finance, Privatization Cell, and BPPM Ltd.

Above table shows the production unit of the BPPM Ltd. is increasing after privatization year by year. But it also shows that before privatization the production units are fluctuating (increasing and decreasing) due to insincere of the management. After Privatization Company has become compel to be competitive with the market and it has to think to survive in the market. Therefore, the concerned body became conscious to reduce cost and increase efficiency. So, it has adopted to increase quantity to maintain the cost efficiency. It has also adopted the market driven approach.

4.1.4.4 Total Sales Units of the BPPM Ltd.

I have been presented the following data of the sales units of the BPPM Ltd. after and before privatization in the following table.

Table 4.1.2.10

Total Sales Units

After Privatization		**Before Privatization**	
FY	MT	FY	MT
1998/99	3622	1989/90	2947
1999/00	3885	1990/91	2523
2000/01	738	1991/92	2560
2001/02	8140		
2002/03	10088		
2003/04	10625		
2004/05	10773		
2005/06	13524		

Source: Ministry of Finance and BPPM Ltd.

From the above table also shows the sales units of production is increasing upwardly per year after privatization the company but sales unit of the production is not constant and it shows it has been fluctuate before privatization. So, it indicates that after privatization the sales revenue also is increasing of the company steadily.

4.1.4.5 Price of Product

After privatization of the price of the product has been rising subsequently, which we can show by the following table but before privatization the price per metric ton (PMT) was Rs.29769 in fiscal years 1989/90.

Table 4.1.2.11

Price of Per Metric Ton

FY	**Price in Rs. (PMT)**
1998/99	36637
1999/00	42685
2000/01	48367
2001/02	41821
2002/03	41164
2003/04	42375
2004/05	45543
2005/06	48383

Source: BPPM Ltd.

The production cost has been increasing along with the increase in production unit of the company. Therefore, the price of the product has been increasing especially due to the increase of the price of raw material (imported waste Paper), labor cost, and various types of incentive for the employees etc.

4.1.4.6 Total Export (Market Expansion)

The production of the BPPM Ltd. has been consuming by the local market fully before privatization but later, after privatization the company has launched an ambitious project to produce 88 TPD, targeting to the international market especially Indian market. In FY 1989/90 and 1990/91 it was exported 23 MT and 217 MT but due to the recession in the international market and dumping sales by the CISs, South Korea, Canada and Indonesia, the international price fell sharply and the Nepalese products could not be competitive in the international market. As a result, the company is presently facing tough market problem. However, the price situation of the product in the international market has been improved slightly in recent days.

The company is blaming to the government not to be competitive its product in the international market due to levied on its import of raw material 5%. According to the company management, government has become insensitive towards the problems faced by the domestic product e.g. the customs at the rate of maximum 5% is levied on the import of newsprint and there are no local tax and Value Added Tax (VAT) on it but it has to pay high customs duty, VAT and other local taxes while it import the raw material and chemical required to produce the paper. According to the management, the government must have to give some amount of incentive in the form of soft loan, tax exemption etc. to protect the local industries.

4.1.4.7 Borrowing

Table 4.1.2.12

Borrowing of the Company

(Rs. in Million)

FY	**Borrowing**
1998/99	Rs. 286.5
1999/00	Rs. 487.3
2000/01	Rs. 708.4
2001/02	Rs. 839.32
2002/03	Rs. 998.93
2003/04	Rs.1026.28
2004/05	Rs.1025.61
2005/06	Rs.951.24

Source: BPPM Ltd.

Before privatization the date has not been available regarding the borrowing of the company but after privatization the above table indicates that the company has borrowed huge amount of money for the post-privatization and improve the company efficiency. But this borrowed amount has been increasing per year. Even though the company borrowed this amount money to inject or improve the company efficiency, it also shows that the company is falling in the great debt trap. If company does not take immediate measure or correction action in near future, it might have to face the problem of its identity.

4.1.4.8 Tax Payment

The statistical data regarding the tax payment is not available about pre-privatization of the company. Rather, government was providing the subsidies to run the company. In fiscal year 1989/90, the government had provided 57.39 Million grants. Post-privatization the company has to start to pay tax to the government. So far, the company has paid the following amount of tax in different fiscal year to the government after privatization.

Table 4.1.2.13

Tax Amount Paid in Various Types

FY	**Tax Amount (in Million)**
1998/99	6.66
1999/00	8.03
2000/01	23.50
2001/02	23.23
2002/03	23.91
2003/04	30.43
2004/05	39.83
2005/06	44.53

Source: BPPM Ltd.

4.1.4.9 Technological Improvement

The company has started to improve its technological improvement and adopted new technique to produce paper. Consequently, it has started to use of waste paper as a raw materials and substitute coal into rice husks, which became very cheaper in compare with coal. In FY 1989/90, the company had consumed 3872 metric ton coal to produce 2968 metric ton of paper. The total cost of it Rs. 13.74 Million at the rate Rs. 3549 per metric ton plus Rs. 4.85 Million for electricity cost, where as the company has consumed 18813 metric ton of rice husks to produce 7659 metric ton of paper in FY 1990/91. The total cost of rice husks was Rs. 14.49 Million at the rate of Rs. 770 per metric ton plus Rs. 22.05 Million for electricity cost (the electricity price has been increased). According to this data, it indicates the energy production from the rice husk is significantly cheaper than coal. Moreover, it is believed that the rice husk is less polluted than coal in term of health consideration of the worker as well as the dwellers of the surrounded areas. Finally, due to the technological improvement it has bought better result in the every sphere of the company.

4.1.4.10 Economic (Profit/Loss) Condition of the Company

The company has been running on nominal profit since its establishment but the company's economic condition seems fluctuate (profit/loss) after having privatized which the following table shows:

Table 4.1.2.14

Profit/Loss

After Privatization		**Before Privatization**	
FY	Profit (Loss)	FY	Profit (Loss)
1998/99	Rs. (-3.12) Million	1989/90	Rs. 12.00 Million
1999/00	Rs. 7.43 Million	1990/91	Rs. 4.30 Million
2000/01	Rs. 10.58 Million		
2001/02	Rs. (-41.53) Million		
2002/03	Rs. (-228.20) Million		
2003/04	Rs. (-172.33) Million		
2004/05	Rs. (-110.05) Million		
2005/06	Rs. (-77.29) Million		

Source: BPPM Ltd.

However the company was privatized, it was not able to earn profit in the succeeding year but before privatization, the company was earning profit, which shows by the above table. But after privatization, company is running on loss except succeeding fiscal year 1989/90 and 1990/91. In FY 1989/90, the first year after privatization of the company was beard loss amount Rs. 3.12 Million, especially this result occurred due to the transitional phase of the company and resistant of the employees/workers regarding the changing ownership of the company from government to private sector. As a resistant, the employees/workers were held the series of strikes and demonstration, which made company out of run at that period. But after the following FY 1991/92, the company has been facing different types of problems due to the Mousiest insurgency period in the country.

4.1.4.11 Employment Ratio/Record of the Company

It has been the preliminary expectation that the active participation of the private sector in the industrial and commercial sector would increase the economic activities in the country, which would generate the employment opportunities. Such types of other indicators also help to assess the performance of the privatized enterprises from the national point of view. To assess this situation the following table could be helpful which has presented the employment data before and after privatization of the company.

Table 4.1.2.15

Employment Record of the Company

After Privatization		**Before Privatization**	
FY	Number	FY	Number
1998/99	342	1989/90	280
1999/00	383	1990/91	283
2000/01	478		
2001/02	481		
2002/03	547		
2003/04	552		
2004/05	549		
2005/06	532		

Source: BPPM Ltd

However, employment opportunities have been increased substantially after privatization than before. The problem has been existed due to hire the Indian labors. The company is providing the top priority to the Indian labor than Nepalese.

4.1.4.12 Facilities Provided to Employees/Workers

The company is providing the following different types of facilities after privatization to motivate the employees/workers:

- 12.5% special allowance.
- 15% house rent allowance.
- Rs. 450 as a dearness allowance.
- TA/DA allowances increased by 70%.
- Life insurance and accident insurance premium has been increased by 40%.
- Compensation and un-utilized leave en-cashable @150% introduced.
- Incentive as per production and productivity.

Note: Level 1 labor earning has been increased by 43% after privatization excluding O.T; indirect allowances, benefits and incentive payment.

The company has especially focused on the employees/workers motivation, increase productivity efficiency, upgrade skill through timely review and performance appraisal, improvement on working condition, technological improvement and reviews of employees/workers salaries and other facilities.

Sources: BPPM Ltd.

4.1.4.13 Relationship between Employees/Workers and Management

The company has built the congenial and friendly relationship between workers and management, which has created the efficiency and effectiveness in the company's performance result. But I found that some employees are not satisfied with the company's management. According to the unsatisfied employees, the company's management has appointed the Non- Nepali citizens in the top level of management i.e. Manager, General Manager (GM) and Chief Executive Officer (CEO) and a few opportunities of promotion is given to the Nepalese employees at the top level of management.

4.1.4.14 Environment Problems

The company is creating serious environment problems. One the one hand, the affluent water is polluting the local river and smoke, ash and fire particles are creating the air pollution around the neighborhood on the other. Native dwellers blames that the water of the river has become unusable which is the major source of irrigation of the local land for agriculture. Similarly, the smoke and dust pollution has become serious. Ashes of the fire and fire particles has been created the several problems such as the washing clothes can't be dried in the open space and residential areas and even the kitchen room of the house also filled with the dust and ashes. More serious problem, when the plant is operating the burning rice husks shower is spoiling the clothes of the pedestrians through its smoke. Moreover, when it lies on the eyes of the pedestrians, eyes have infected and victims have to rush to the hospital for the treatment. There is also possibility to break out the fire on surround the neighborhood causing the burning ashes. The other possibility of break out the fire is from the company's raw materials and chemicals such as the particles of dried straw, waste papers, and chlorine gas etc. All of them are extremely susceptible to break out the fire. There were some cases was happened in the past but all of these problems has not been happened totally after the privatization of the company but also in the before privatization was similar.

The company has installed the water treatment plant to avoid the water pollution but it has not been becoming the sufficient to purify the water pollution that has created by the company. But it has still to do something for the air pollution that has made difficulty life to the native dwellers.

4.1.4.15 Others

The company has still paid to Rs. 11.06 except the sales proceeds to the government. The company has not paid this amount because company want to take this amount of money as a compensation where the fire was broken out during the privatization process was taking place but the company's assets was remained to hand-over through the government to owner. Regarding this issue the government and private party could not solve mutually and later they have gone to arbitration as per the agreement between the parties.

4.2 Study of Harisiddhi Brick and Tile Factory Limited (HBTF)

The Brick and Tile Factory Limited were established in 1969 according to the Nepal Company Act. However, the building, plant, and machinery had almost constructed and installed in 1968. The Chinese Government was provided the aid to install the plant and machinery. Therefore, the Chinese government was also helped to design the building, plant, and machinery by sending the exports. After the installation, the plant has been working smoothly and it had produced 29 million of bricks and 1.3 million of tiles in 1971/72 (A record of production of the company shows). But after run the company the production amount of bricks and tiles had been fluctuating till date of privatization 1990/91. In 1990/91 the company had produced only 18 million bricks and 0.9 million tiles. This production amount is very low in terms its rated full capacity and there is still sufficient potentiality to expand its production capacity and productivity. But the company needs additional investment to run the company in its full capacity. There is adequate source of clay of good quality even for more than 50 years of bricks production. The government had decided to transfer the government ownership to the private sector. After looking over the ownership of Brick and Tile Factory Ltd. the present owners had changed the name of Brick and Tile Factory Ltd. by replacing the new name Harisiddhi Brick and Tile Factory Ltd.

The company current capital was Rs. 16.2 million but amount to be paid was Rs. 27.3 million. This company was facing the competition market with the product of private sectors that was established as a new company in the economy.

When the government took the decision to privatized the public owned enterprises especially 3 PEs after the restoration of the democracy in the company, the government formed a team of specialist to study the financial situation, profitability ratio, necessity of reinvestment, management situation, condition of the different sector’s staffs and workers, and its impact on market economy and the necessity of the government involvement in PEs in the process of selection to privatize the PEs. The consumers submitted the team of specialist its report that the production of the factory is running it's under capacity, the market competition is very high, and the factory was running only with a small profit from the interest of deposited amount. By mentioning the aforesaid reason, the team was recommended to privatize the company.

The Brick and Tile Factory was established in 1969 with the hope to produce high quality of brick and tile to fulfill the local demands for the construction of building and others as emblem of mutual cooperation and friendship with the neighboring country China.

The Harisiddhi Brick and Tile Factory Ltd. are located at Harisiddhi Village Development Committee of Lalitpur district on the side of the main highway linking Katmandu to Godawari at a distance of 8 km from Katmandu. The plant is linked with this highway by blacktopped road of about 500 meter. It has 522 Ropani of good land. It has access to a large area of farmland, which contains the clay deposits of good quality essential for its operations.

The company has been leasing annually about 100 Ropani of land for mining. All the necessary infrastructure such as water supply system, electricity supply road, boundary walls, drainage, culverts etc. are complete and two runways lines available for mining site.

The HBTF Ltd. is mainly focusing on bricks and tiles production after its privatization in 1992 and it has also started to provide various types of incentives to motivate and maintain efficiency and productivity to workers. For many years 179 staffs has been working at the same level, where they were upgraded (promoted) and allowances has been increased from 100% to 137% who has been working in the technical field. The company has provided the training. Consequently, a group of 120 workers were trained and company had started to produce bricks and tiles at the night shift as well. Therefore, the production units of green bricks and tiles have been increased.

There are three brick making plant in the existing building; one is tile making unit and others two are the large size kilns connected to 66-meter high chimney. There is also administrative office building, maintenance workshop, store for spare parts, tile and brick drying house, sub-station, pump house, watchman quarters, sanitary and water supply system and also there are the number of small buildings including a generator house, a pump house and a locomotive shed and garage, there is also four store houses which have a capacity to hold 300,000 of bricks for storing and drying. After expansion and modernization of the company, there are four brick shops and two tile shops whereas the production capacity of new brick shop alone is two thirds of the existing three brick shops.

The main raw material required for the production is soft plastic clay, which is free from harmful ingredients such as excessive lime, stone, pebbles, iron pyrites, and sodium salts. The company has owned 522 Ropanis of land and there is adequate clay in the area, which is owned by the company to meet the company's requirements for 50 years.

4.3 Impact Analysis of HBTF

The HBTF was incorporated as a public enterprise with the help of Chinese technical and financial assistance in 1969. The major products of the company are bricks and tiles. This company was privatized in FY 1992/93. The impact of privatization of this company is positive in terms of the investment, production units, sales revenues, employment rate and technological improvement and advancement.

a) Expenditure of the HBTF in different fiscal years

Table 4.2.1

Expenditure on Bricks and Tiles Production

FY	**Rs. (in million)**
2000/01	22.70
2001/02	27.89
2002/03	30.56
2003/04	47.22
2004/05	54.95
2005/06	66.87

Source: Ministry of Finance and HBTF, Lalitpur

The table shows that the expenditure of the HBTF before privatization in FY 2000/01 and 2001/02 is increasing and this trend also has existed after privatization. It's apparently indicates the increasing trends of investment. This trend has been existed due to the new investment Rs. 120 million on new installations of plants and equipment and added one new additional brick and tile shop. Similarly, it has also bought one new dry press unit plus kiln and one local kiln.

b) Production Units of the HBTF

The company had produced the highest production units in 1990/91 before privatization but later this trend had not achieved. Even after privatization, the company was not success to produce the sufficient unit of production due to the various factors in the beginning years of privatization but later due to the better management and various types of incentives program it has started to produce the better quantity of the production. This trend is going on till date now. Now the company has planned to expend its production capacity and installed the new plant for brick making.

Table 4.2.2

Production Units of Bricks and Tiles

(Number in Pieces.)

FY	**Tiles**	**Bricks**
2000/01	709000	13327000
2001/02	909000	18043000
2002/03	1449000	31883000
2003/04	1623000	36499000
2004/05	1554000	33408000
2005/06	1720000	34762000

Source: HBTF, Lalitpur

The table shows the trend of production is constantly increasing even before privatization of the company and after privatization the company has also been gradually started to increase the quantity of the production. The company has seriously taken in consideration about the production units, which had not been taken seriously by the authorized body of the government before privatization.

The cost of the production has also been increasing gradually than previous years due to increasing cost of raw materials, utility cost, labor cost, and incentives provided to the workers, according to the management of the factory. Generally this cost should be decreased after privatization but factory management body claims that the price is nothing in comparison with company's better performance, supply in time, better quality and cooperative behavior with the customers. After privatization the factory has been faced various types of hindrances and obstacles which has not been possible to mitigate in proper time due to the transitional period of the factory but now gradually all these problems are being cleared and the performance of the factory is growing up. The following table shows the production cost of the Bricks and Tiles in different fiscal years.

Table 4.2.3

Production Cost of Bricks and Tiles

(Per Thousand Pieces)

FY	**Bricks**	**Roofing Tiles**	**Flooring Tiles**
2001/02	1363.91	4593.45	1642.42
2002/03	1318.42	4636.55	1751.68
2003/04	1606.12	5654.87	2047.82
2004/05	1619.17	6378.81	2095.20
2005/06	1715.00	6250.00	2152.00

Source: HBTF Ltd, Lalitpur

c) Sales Revenue of the HBTF

Table 4.2.4

Sales Revenue from Bricks and Tiles

(Rs. in million)

FY	Total Sales Revenue
2000/01	21.37
2001/02	27.72
2002/03	37.33
2003/04	42.79
2004/05	47.44
2005/06	41.49

Source: HBTF, Lalitpur

The table shows the company sales revenues have also been increasing significantly. Before privatization, the company's sales revenue was Rs. 21.36 million in FY 2000/01 and Rs. 27.72 million in FY 2001/02 respectively. After privatization, the ratio of the company's sales revenue is increasing per year except FY 2005/06. However, this amount is significantly high than before privatization.

d) Employment Rate

After privatization, the company has not changed it policy to reduce the labors/workers. Moreover, it has employed additional labors/workers to operate the extra night shift of the manufacturing. Therefore, the following table shows the rising numbers of the workers/labors after privatization.

Table 4.2.5

Employment Rate of HBTF

(In number)

FY	Employees Number
2000/01	578
2001/02	595
2002/03	611
2003/04	618
2004/05	609
2005/06	593

Source: HBTF Ltd, Lalitpur

Except the above increasing number the company is employed the additional numbers of unskilled workers for a temporary requirement around 800-900 per year to meat the seasonal requirement of the manpower on the basis of daily wages.

Provided Facilities to the Employees:

- The management of the factory has decided to increase the salary of the employees by 8% from December 1994. The main objectives of the company were to make sincere and responsible employees toward their work performance and also motivate the employees who also increase the efficiency and productivity of the factory.
- The management has also decided to provide extra salary from 4%, 8% and 12% on the basis of their production increment.
- The management has also decided to increase the additional incentives and allowances from 100 % to 135% to those employees/workers who works in the production/manufacturing sectors.
- The management has also decided to provide an award of Rs. 60,000/- in aggregate to the brick shop or tile shop according to their maximum production.

- The factory has also started to provide additional transportation facility for the staffs/workers.

e) Capacity Expansion:

According to the factory management, it has expended the tremendous capacity of the factory. The factory had three brick shops and one tile shops before privatization but later, after privatization it has four brick shops and two tile shops and the production capacity of a new brick shop is two third of the existing three brick shops.

f) Capacity Utilization:

In term of the capacity utilization, the factory scenario of the production is not very optimistic due to the various reasons. Among them more competitors in the market, increase in the cost of production where company's payment has increased to the farmers by 7-8 times. Before privatization, the company was paying about Rs. 1800 per Ropani as a compensation for their land opportunities cost but now it is about Rs. 14,700 per Ropani. Similarly, the cost of coal has also gone up significantly. As a result, the price of the product has also gone up sharply. Consequently, the demand of the bricks and tiles is declining and factory is bearing the loss.

g) Debt Ratio of the HBTF:

The company is suffering from the high debt trap. In FY 2003/04, 2004/05, 2005/06, and 2006/07 the total debt of the factory is Rs. 175.18 million, 118.10 million, 125.08 million, and 181.89 million respectively. These increasing trends of the debt ratio of the factory clearly indicate that the future of the HBTF is not easy. It is suffering from the debt-servicing problem. There is also another problem where the government has not allowed selling the land owned by the company because the real estate value of the land could be manipulated and investors could be able to buy it very cheap price. Investors are those who actually do not want to run this industry and want to make windfall profit through this process. But this is not regional argument. The government had also to foresee this problem before privatization. In that case, it could another option not to sell the land but leasing it out for a fairly long time. But now the company is bearing huge amount of debt servicing while it is becoming unnecessary precious land lying idle. By selling this land it could be a one remedies measure to solve its financial debt problem. According to the management, due to this reason the company would be compelled to declare itself a sick industry in near future, which is not match with the sprit of the privatization program. In the long run, such types of policy would hurt the national privatization program as a whole. One of the major reasons of private sector's reluctance to invest in the public enterprises is a contemplated environment for privatization program and there are also several unproductive conditions that make more difficult for the private investors.

h) Product Diversification:

The company has started to diversify its product after owned by private sector for competition market. Before privatization it was produced only normal bricks and tiles but later, it produced more strong, comprehensive, and durable product having better look. The factory has also started to produce roof tiles, which can be used in rural areas, merely keeping in view with the social factor.

i) Improvement on Technology, Plant, and Equipment:

After privatization, the company has invested a lot amount of money to improve and install new higher quality of technological plant and equipment, which I have already mentioned. Now the factory is producing some amount of tiles and bricks by using Double De-Aired technology to produce better quality and durable which price also high. The company is also trying to produce better quality with the aims of export its product in foreign market especially Japan which demanded its bricks. The company has already exported some amount of its brick and now it is trying to get a contract with some agent in Japan, According to the management of the factory.

j) Participation in Social Welfare Activities and its Environment:

Environmental situation of the surrounded areas are same than before privatization. The company is emitted air pollution from the beginning. But there has no environmental safety net yet.

The company is also involving in social welfare activities providing the support and assistance. It has set up a school within the periphery of the factory especially targeting to provide the education of staffs/workers children. It has also provided the financial and physical assistance to construct the temples, police posts, and health post etc in various times. It is also providing the seasonal job to the local people as well.

k) Financial (Profit & Loss) Condition:

We can see the financial situation of the company to study by the following table.

Table 4.2.6

Profit/Loss of HBTF

(In million)

FY	**Profit/Loss**
1999/00	-0.28
2000/01	2.80
2001/02	-0.11
2002/03	1.65
2003/04	8.33
2004/05	2.24
2005/06	-7.94
2006/07	-20.27

Source: Ministry of Finance, and HBTF, Lalitpur

The financial condition or the profit and loss situation of the company is unstable. The above table shows the fluctuate situation. Before privatization, the company's financial situation was not sound and stable. But after privatization, the subsequent year company was able to enjoy profit until three years. But again, the financial situation of the company has been going to be deteriorating. This situation might be occurred due to the above-mentioned reasons. In this period, the company has paid all the due amounts except the disputed amount of interest and penalty. The government was charged amount Rs. 5.3 to the company as interest and penalty, which the party has not been, agree and have gone to the court to settle this disputes.

4.4 Summary

According to the above two case analysis regarding to analyze the impact of the privatization of public enterprises, it shows the overall impact is positive except some shortcomings. Both privatized companies have improved significantly in its production capacity, total sales units, increased in capacity utilization, quality improvement, technological advancement and improvement, market expansion, production diversification, revenue earning to government, increased employment opportunities and increased numbers of workers/employees, increased facilities to workers/employees, involvement in different social welfare programs etc. except increasing amount of borrowing, increasing amount of total expenditure, new competitive environment in the market, rising price of product due to increasing in raw material and facilities provided to employees/workers, and some environmental problems and government rules and regulation where the government has to provide the healthy and conducive environment to foster the new big possible investors to attract in the national economy which is possible.

Chapter Five

Implementing Privatization Policy in Nepal: Discussion of Findings and Conclusions

5.0 Introduction

As I pointed out in the first chapter, the purpose of this study was to understand the implementation process and the impact of the privatization policy in Nepal. In this regard, an attempt has been made to discuss the entire implementation process in general, and in particular, two separate cases. I have also attempted to examine the changes brought about after the implementation of the privatization policy and compare them with the pre-privatization situation. This comparison enabled me to reach a conclusion regarding whether the policy was/is a viable policy option.

The aim of this chapter is to present the major findings of the study in relation to the issues mentioned in the first chapter (research questions). In this chapter, I will discuss about the summary of the research findings, which has been drawn from the case study. Policy recommendations and future research have been also discussed finally.

5.1 Summary of the Research Findings or Results of Privatization

Privatization has been advocated as a suitable policy measure mainly because of the poor performance of public enterprises. As a result, it has gained popularity both in developed and developing countries particularly in the 1980s and early 1990s. In this context, Nepal could not remain far from this global trend. Therefore, considering the enhanced participation of private sector in the national economy, the government was taken a bold step to hand over the state owned public enterprises to private sector management nearly a decade back, in order to reduce the unsustainable financial and administrative burden of the state. The share capital of the annual budget of the country has been increased but the health condition of these enterprises has been noticed to decline continuously. Whereas the declining condition of public enterprises mean to increase the dependency on foreign aids and economy which results not only the economic backwardness, but also creates unfavorable balance of payment and also limits the employment opportunities. Therefore, private sector should be mobilized actively to encompass the dependency and to meet the self-sufficiency.

Nepal's attempt toward privatization can be traced into two program of first phase was on "ad hoc" program without any clear objective. But the second phase is with a clear objective and a "grand design" a total of 29 public enterprises have been privatized under different modalities. Among 29 privatized enterprises, the conclusion has been based on only two privatized enterprises.

BPPM have been running in good condition after privatization in terms of additional investment, technological improvement, product diversification, production, and sales. It has also contributed to additional employment, export, and profit and government revenue as well. The capacity utilization has also gone up from 66.7% to around 90 %.

Daily production capacity has also been jumped up from13 MT/pd to 88 MT/pd. As a whole, it is doing good progress.

In the case of HBTF has also done very good performance after privatization in terms of additional investment, technological improvement, product diversification, production, and sales. In compare with the post privatization, it has contributed to additional employment, export, and profit and government revenue too. However, the company has achieved significant achievement in terms of above mentioned, but the HBTF products are suffering from the market problem and now it is running at loss. According to the HBTF management source, the economy is not expanding and the construction activities have come down significantly. On the other hand, more competitors have been entered in the market. As a result, the company is bearing high supply and low demand. HBTF has discounted its increased price by almost 25%, but still it could not generate additional demands for their products. HBTF is planning to export its products in Japan and Tibet, if succeed, definitely the profit margin will be significantly improve.

In the both enterprises, three things are common; they have increased the prices of the products, total expenditure, and borrowing amount of the capital. Increasing price indicate that the government has heavily subsidized in the price of public enterprises' products. But after privatization, all of the privatized companies has increased its price level to cover the real cost and profit per unit. On the other hand, the increasing borrowing capital indicates that the new management have been injected more money to improve the condition of the company and also tried hard to cope with the scarcity of fund.

From the above discussion, we can draw the conclusion that the both privatized companies are doing well. Even though, there are some problems in the organization and the privatization proves. But most of the problems are originated from the economy itself. Scarcity of the capital, absence of big investors, skilled manpower, impractical government regulation, absence of corporate culture, under developed capital market, small size of economy, market problem of the product, lack of easy access with the sea port, ignorance of people etc. have nothing to do directly and specifically with the privatization program itself though they do affect the success of privatized enterprises as observed above. Both companies are suffering from above mention factors directly and indirectly. In this context, the government has to show its sensitivity toward these privatized enterprises and should try to solve some genuine problems such as scarcity of fund and short coming in the government rules, regulation, privatization act, tax and other economic policies.

Naturally, the privatization process in Nepal is not exception to the problems. The economy is in the early stage of development so there are several structural problems. These structural problems could be addressed in the due course of development process, which itself requires privatization and liberalization to eliminate some of the inherent problems of the economy. In this context the privatization, liberalization and sustainable economic development process have to go side by side. They are interrelated and cannot go separately. Furthermore, most of the other economic problems could be solved to a large extent if privatization process is carried out efficiently, prudently and logically.

5.2 Main Obstacles Encountered in the Process of Privatization in Nepal

When it comes to implementation, things tend to develop in unexpected ways. Grindle and Thomas proposed that when policy decisions are not implemented, this might be due to opposition by influential groups and a lack of resources among decision makers to tackle this opposition (Askvik, 2001:21). Based on this study, it seems that the explicit opposition to the adopted policy has been, to some extent, limited, as we saw in the opinion of the major political parties, where we found that they had more common ground than differences. However, the opposition of the employees was/is crucial; at the same time opposition from the general public also existed, as we have seen through the cases filed in the Supreme Court of Nepal. Despite explicit opposition from the political parties regarding policy content as such, the problems of implementation were more closely related to the process of implementation and other factors, such as evaluation of the enterprise, selection of bidders, political instability, political commitment/consensus, lack of developed capital market, lack of investors, poor conditions of public enterprises, lack of confidence in government transactions, lack of monitoring and evaluation systems, problem of delaying, the formation of privatization committee, privatization fund and buck passing. At the same time, the private sector-media (especially left-leaning) and opposition parties accused the government of a lack of transparency in the process of implementation. In fact, all of these problems contribute to the goal of privatization. At the same time, privatized enterprises have also faced some problems, which appear to affect the impact of privatization. The problems that they have faced have been identified as weak management, lack of entrepreneurship in the private sector, lack of a conducive environment for the operation of the enterprises, lack of adequate cooperation from the government, lack of funding for expansion, lack of market, frequent protesting of laborers, unfavorable export and import policy of the government, lack of trained manpower in the country, deteriorated law-and-order situation in the country, and ongoing conflict between the different political forces.

Main problem of above-mentioned factors is to be lack of political will and commitment to avoid these shortcomings due to their own self-political and economical interest and due to their different political ideology of the political parties. All political parties has to be show their political will and commitment for the effective implementation of the privatization act 1994 and they have to rise beyond from their self political ideology and interest to provide the conducive environment to private sector in the economy and implement privatization policy effectively in the country where Nepal has become a member of WTO and it has already entered in the open, liberalize and globalize economy where the private sector plays the vital role in the national economy.

5.3 What Lessons could be learned from the Privatization Policy of Nepal?

The study indicated that we could learn a lot from the Nepalese privatization policy. The lessons learned can be summarized as follows:

- Privatization is a political process to make it economically successful. Politicians must listen to public opinion and win support, even to commit to privatization. Moreover, political commitment, continuity, and consistency should be the hallmarks of privatization.
- The privatization program should be geared towards the development and promotion of the private sector.
- In order to attain operational efficiency of the privatized units, they should be restructured prior to privatization.
- There must be an in-depth study and proper investigation of the possible options and modalities of privatization.
- One should not allow considerations of sale price to dominate the whole privatization activity. Of course, price is important; however, it must not be the sole consideration.
- The conditional ties of privatization should include factors like management improvement, improved technology, quality improvements, and transparent pricing policies, among other things.
- It is important to choose the most appropriate method of privatization. It has been more than 25 years since the privatization process began. There are many methods. It is not a simple formula.
- There is no set standard for privatization. Each country has its own unique culture and tradition; no two sets of privatization are ever identical. The approach must be custom tailored to each individual task.

- The process of privatization must be transparent. The public must be notified how and in what way the process is being carried out. This information must not be kept from the public.
- Different problems may arise during the implementation process. One should be able to identify the problems in advance. It is like playing chess; it is to anticipate in advance, what is going to happen and be able to act accordingly.
- A privatization program should educate the employees and laborers and effectively communicate with them to ensure a smooth implementation.
- The process of privatization should be used to extend share ownership wherever possible. It enhances the economic and social benefits. The advantages of wider share ownership to the new company are several. If people own shares, they feel a sense of loyalty to the company and are more likely to use it instead of its competitors.
- Improving the performance of remaining public enterprises is no less urgent than privatization.
- The last lesson is that government must be determined to do it. The benefits take a little time to become evident, as it is a continuous process. Therefore if you want to enjoy the benefits of privatization, it is not simply a question of contemplating it, you have to actually do it. Making a sound policy alone is not enough, as the implementation is vital to attaining the goal.

5.4 Policy Recommendations and Future Research

a) Policy Recommendations

Based on the discussion in the previous chapters regarding the problems and prospects of privatization in Nepal, the following recommendations have been made for the improvement of the policy:

- As we have found, there are no representatives of trade unions, management and employees of the PEs to be privatized in the Privatization Committee; it is urgently necessary to include them in the committee to ensure that there are no misunderstandings regarding the PEs and that all voices are heard. Also, this provision would ensure the transparency of the process and help to get cooperation from all stakeholders.
- As we have found that there was no political consensus among the major political parties, especially on the privatization process, attempts should be made to achieve a broader consensus among the major political parties, including the civil society members, trade union leaders and employees of the PEs, media and academicians.
- To reach consensus on the program, to ensure the transparency and soliciting greater support for the program, an awareness program would be helpful. Hence, the use of media such as radio, television, newspapers, etc. would be useful.

- Similarly, counseling programs for the employees/workers and stakeholders prior to the announcement of candidature should be carried out to obtain a higher-level cooperation from them.
- As some of the respondents opined that the total period of privatization after the announcement of certain candidates was too long, so the PEs in the pipeline for privatization developed unprecedented problems, not only from the employees but also from the management itself, as they were trying to misuse the resources of the enterprises for their own benefit, hence the economic/financial condition of the PEs deteriorated. To eliminate this problem, efforts should be made to shorten the time of each transaction by undertaking the necessary action before the announcement of privatization. The Privatization Committee should ensure the valuation and other necessary action before announcing privatization so that none of the stakeholders can misuse the resources for their own personal benefit.
- After the enactment of the Privatization Act in 1994, privatization regulations have not been enacted to ensure a high standard of privatization. Hence, a separate regulation should be enacted as soon as possible within the framework of the Privatization Act for regulating and accelerating rational uses of the privatization proceeds. As the Auditor General's report also indicated the improper use of privatization proceeds, regulations could form a legal basis, which could not only enable the smooth privatization but also fulfill the lack of legal provision for privatization expenses. Similarly, legal provisions should be added to the regulations for the monitoring and evaluation of the privatized enterprises on a regular basis by the government. Furthermore, regular AGMs

(annual general meetings of the shareholders) should be compulsory for the privatized enterprises to ensure the interest of the shareholders. The management should be responsible for this and such provisions should be included in the new privatization regulation.

- As the private sector is still at an early stage, privatization should not be target based but need-based. Similarly, economically unviable enterprises should be closed down rather than trying to privatize those, which the private sector is not willing to take over. The industrial environment of the country has deteriorated day-by-day as the internal conflict deepens. The privatization program has also been affected since the private sector is unwilling to buy the PEs, the government should not aim to privatize loss-making PEs.
- The government should ensure the transparency of the valuation process and measures adopted while awarding the contract, by publishing valuation procedures and values ascertained for each company or keeping the valuation report in public libraries after concluding the agreement with the successful bidder. The Privatization Cell could interact with the media by disseminating the basis of the valuation and final award in due course, which will certainly stop accusations of undervaluation and so on.
- Pre-privatization restructuring of the company should be undertaken based on the experts' recommendation prior to the invitation of proposals from interested bidders. If necessary, the issues of overstaffing, over-capitalization, problems of liability, etc. should be addressed for the smooth operation of the company after privatization.

- Given the limited staff size, the Privatization Cell is not in a position to act as a regulatory agency. Hence, it should be manned adequately with professionals for ideal implementation. A strong regulatory and monitoring institutional framework should accompany the privatization program and the cell should be restructured along these lines.
- The bid evaluation criteria including the weights of each parameter should be clear and disclosed transparently to all concerned prior to the invitation of the bids. Similarly, the negotiation period should be made shorter by developing the well-defined terms of reference of the negotiation. Wherever possible, provisions relating to the fines and penalties, employments and business plans should be maintained with uniformity while finalizing the sales and purchase agreement.
- Though the privatization of PEs in Nepal has become inevitable in the changing context of liberalization and free market economy, since Nepal is a member of WTO, selective privatization should be carried out. Industrial/manufacturing, trading and banking sectors, for which the private sector is developed, should be privatized first on a priority basis. However, PEs related to the service sector and natural resources should be privatized only after strong regulatory mechanisms are put in place.
- As stated earlier, merely transferring PEs to private control is not enough for Nepal, as most of the privatized enterprises have not performed as expected. Hence, rebalancing the public and private sectors would be better (public-private partnership- PPP). The role and responsibility of the state as well as the scope and activities of the private sector need to be carefully defined with regard to

privatization in Nepal. Only those enterprises for which the private sector is ready should be privatized and the rest of the enterprises should be under government control, but efficiency and effectiveness should be enhanced by giving them more autonomy (in this regard, a performance contract would be the best option, although the result of such an option has also been disappointing for the time being, due to the ongoing conflict situation in Nepal).

- The share sale method, compared to other methods of privatization, could be more appropriate, effective, and transparent. Hence, priority should be given to involving public and employees as owners to ensure effective participation in privatization efforts.
- The new push for privatization in Nepal is, basically, a result of general despair with public sector inefficiency, rather than hope for the private sector's efficiency (Manandhar, 1998:109). As is evident, on the one hand the private sector is asking for liberal and free economic policies, and on the other hand, they have demanded incentives, subsidies, and protection from competition. Unless the enterprise is left to work in a competitive environment with professional management, the transfer of ownership alone hardly brings about the expected changes in enterprise performance. Hence, in order to enhance the operational efficiency of the enterprises, the government should focus on the need to develop the private sector concurrent with the transfer of ownership. Until the private sector is fully developed, the privatization program could not be successful as expected.

Therefore, there is an urgent need for the promotion and development of the private sector in Nepal. The ongoing peace process in the country must be sustainable for the overall development of the country, as it has vicious effects not only on the economic sector but also on the country overall.

b) Future Research

This study has covered the implementation process of the privatization policy. It has addressed how the privatization policy has been formulated, how the decision has been made, and how the policy has been implemented in different PEs. At the same time what types of problems have emerged during the implementation phase, whether the objectives of privatization have been met (impact), how the policy could be improved in order to achieve the objectives, etc. have also been discussed in this study. However, the study could not cover why the performance of privatized enterprises did not improve as expected, and why the overall performance of privatized enterprises was not positive. Whether it is due to privatization (shifting from the government to the private sector) or other factors, for instance, ongoing conflict, the deteriorating law-and-order situation of the country, which has even compelled multinational companies to be closed down (some time ago Unilever Nepal Limited was shut down for some time due to the threat of the Maoist rebels), may be important subjects of further research that this study could not address. Similarly, looking only at the implementation aspect of all privatized enterprises (this study covered only two cases), or covering all enterprises only in the aspect of performance (without addressing the implementation aspect) would be a worthy future study to explore the issues with more depth.

Comparing the performance of public enterprises with the enterprises run by the private sector could also be a worthy way to develop a better understanding of whether the private sector is doing better than the public sector, as is widely perceived.

5.5 Conclusions

The following conclusions have been drawn on the privatization process in Nepal based on the study carried out. The conclusions have been presented in connection with the hypotheses formulated in Chapter One.

The first hypothesis of this study was: privatization policy has been implemented not only as a necessity of the country (internally) but also as a requirement imposed by the donor community. The study confirmed this hypothesis, as we found that due to the deteriorating conditions of the PEs and the ideological shift of the new government with the advice and suggestions of the international donor community, the government formulated and implemented the privatization policy in Nepal.

Similarly, the second hypothesis was that the privatization policy has been implemented to achieve some stated goals but they have not been achieved as expected. As stated earlier, there were three objectives of the privatization policy in Nepal when the government embarked upon the policy: (a) reduction of managerial and financial burden on the government, (b) promotion of functional expertise to enhance productivity and output, and (c) promotion of the private sector's role and public employees' participation in industrial investment. The study showed that to some extent the managerial and financial burden of the government has been reduced, as the government is free at least from the privatized enterprises (29 enterprises so far). The second objective has not been met as expected, as the privatized enterprises have not been able to increase managerial expertise as almost all enterprises have been barely surviving. Though production has increased in almost all of the privatized enterprises, overall performance has not been positive. The third objective has been met partially, as the participation of the private sector was active during the implementation though there was very limited competition in the bidding process. Hence, the major objective of the privatization was not met. At the same time, public employees' participation in privatized enterprises has been totally nil, as they were not interested in taking over the 5% shares allocated for them at a reduced price. This could be attributed to the ailing situation of the enterprises that have been privatized so far.

The third hypothesis was that privatization policy has some implementation barriers that affect the policy's ability to meet its objectives. The study showed that there were many implementation barriers that in turn affect the achievement of the objectives of the policy. Similarly, the privatized enterprises have also suffered from some problems, due to which they could not operate the companies in a favorable environment. Hence, the third hypothesis has also been confirmed.

The fourth hypothesis was that privatization has brought about some positive changes, i.e. assisted in reducing financial burdens on the government, contributed to enhancing the efficiency of enterprises, and facilitated popular participation in management; these benefits, however, are negligible. As almost all privatized enterprises have suffered in one way or another, and the overall financial performance has been negative, the overall picture of the privatization in Nepal is negative, although it is yet to be confirmed whether this is due to privatization or other external or internal factors, i.e. ongoing conflict.

The final hypothesis was that the privatization policy *per se* is not necessarily conducive to improving the efficiency of the enterprises. The overall result of the study shows that in principle, privatization would enhance the efficiency of the enterprises by ensuring open competition and a liberalized market economy, the participation of private sector expertise to enhance the productivity of the enterprises, etc. but it could not contribute equally in all economic environments. It depends on other factors, like the law-and-order situation of the country, a favorable environment for foreign investment, sound economic policy, committed and positive attitudes of the government for the development of the private sector, political stability in the country, and so forth. Hence, privatization in the absence of those crucial factors does not necessarily enhance the efficiency of the enterprises.

According to Rondinelli, privatization was commonplace throughout the world in the nineties; in communist, socialist, and capitalist countries, in developed and developing countries, in democracies and dictatorships; more than one hundred countries had officially endorsed privatization and more were considering it (1998: 149-70). In the United States Democrats and Republicans, liberals and conservatives were supporting it. It was no longer a partisan or ideological issue but a pragmatic and increasingly routine approach to governing and to managing public services (Daley, 1996: 629-31). In this global situation, Nepal could not be exempt and therefore the privatization policy was adopted in the nineties in line with the global wave, in the hope that the policy could improve the efficiency of PEs. So, what this shows is that adopting the privatization policy in Nepal was not only an option but also a compulsion. However, it should not be overstated. As the major advocate of privatization, the World Bank has conceded/admitted that privatization in developing countries was overstated and it has not been had the expected positive impacts (Kessides, 2004: 6). Though privatization was regarded as successful in South American countries like Chile (Birch and Haar, 2000), the trend has now changed. Opinion polls in several developing and transition economies, especially, in Latin America, reveal growing public dissatisfaction with privatization. Disapproval ratings were higher in 2002 than in 2000 and higher in 2000 than in 1998. In 2002 almost 90% of Argentines and 80% of Chileans surveyed disapproved of privatization (Kessides, 2004: 6). It has been stated that “as with all economic elixirs, privatization has been oversimplified, oversold, and ultimately a disappointment delivering less than promised.”

Finally what we can conclude from the study is that although the overall impact of privatization in Nepal is not very promising, it is necessary for the overall development of the country, as the government cannot continue to run such loss-making enterprises in the age of globalization and liberalization (as the government has already been admitted as a member in the WTO system); nevertheless privatization should be implemented in a cautious manner. The government should go ahead with the policy selectively but conduct a re-evaluation of the process it applied earlier and learn from the previous shortcomings. It should educate the people and disseminate to them the pros and cons of privatization in order to obtain public support, so that this process that is necessary for the country may be carried out effectively.

5.6 Others:

5.6.1 Telecom Sector in Nepal:

Development in the 21st century cannot be envisaged without the development and expansion of telecommunication technology. Therefore, development, expansion, and proper mobilization of this sector are vital for the overall development of the country. It is necessary to develop and expand this sector as a foundation for the enhancement of public awareness despite the country's difficult and remote terrains, weak economic status and structural system, for increased accessibility to new technology and inventions, to save time, development of knowledge and skill, proper dissemination of information to general public on the development of science and technology, for ensuring information rights, as well as for getting merged into the mainstream of globalization.

In the present situation when the private sector is also being attracted due to the liberal, inclusive and competitive environment adopted by the country under the democratic political system, there is a need to provide support to the development of all the sectors in the country, including political and socio-economic sectors, by providing services and facilities even in rural areas in a reliable, qualitative, competitive and easily accessible way through the widespread use of modern technologies and by introducing variations in the services and facilities provided by this sector.

Modern telecommunication services in Nepal are comparatively recent: first Telephone Exchange was established only in 1960. Till this day, Telephone Services are provided by Government monopoly Nepal Telecommunication Corporation (NTC). Recently the Government of Nepal has initiated sector liberalization and two new operators (United Telecom Pvt. Ltd. and Spice Nepal Telecom Pvt. Ltd.) are being issued licenses for Cellular & WLL network.

Internet and value added services are already liberalized and there are several private operators offering the services.

Government has decided to privatize NTC. As a first step, NTC will be converted to NTC Pvt. Ltd. after which the government intends to initiate disinvestments of NTC.

Nepal telecommunications Corporation (NTC) provides telecom services in Nepal. It is a state owned enterprise having assets of NRs 20 billion annual revenues of NRs 5 billion (US$1=NRs 65) or US$ 180/line. Its net annual profits are US$ 30.0 millions.

At present 340,000 lines are installed out of where 290,000 lines are distributed throughout the country national penetration of telephone is 1.3 telephone/100 populations. Major portion of the telephones is concentrated in Katmandu where telephone density is about 21%. Rural Areas have 1 line per 1000 population NTC has over 4,700 working staffs.

The government has already implemented the national telecommunication policy, 1992 for liberalization of telecom sector and by this way to satisfy the need for services by introducing private participation. Telecom Act, 1997 has already been informed to introduce competition in the sector.

As per Telecom Act, 1997 a new independent regulatory entity called Nepal Telecommunication Authority (NTA) was established in 1998 and has commended drafting regulatory policies and licenses. The objectives of NTA are to make telecom services reliable and accessible as well as to regulate it NTA has already issued licenses in different fields of telecom services such as:

> Internet including e-mail to 15 operators

> Radio Paging to 3 operators

> Video conferencing to one operator

> Fax mail services to 6 operators

> Fixed Telephone services to NTC

> GSM cellular Mobile at present to NTC and in process to second operator

> VSAT services provider to 9 operators

> VSAT user to 25 different private companies

> WLL service provider to NTC

> Basic Service using WLL to a second operator is in process

5.6.2 Government Policy:

Government has adopted the following policies and practices regarding the telecom sectors:

> The telecommunication sector will be made more liberal and competitive by encouraging participation of the private sector,

> Telephone distribution will be made easy, accessible, and scientific. Initiative will be taken towards reducing telephone tariff or maintaining uniform tariff on local calls throughout the country.

> Investment-friendly environment will be created to attract additional service providers through a competitive environment.

> Initiative will be taken to construct Information Super Highway in SASEC region with Nepal as a transit.

> A system will be developed to provide different ICT-related telecommunication services by establishing telecenters all over the country.

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