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TEN IMPERATIVES FOR MIDDLE EAST PRIVATIZATION PROGRAMS

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EXECUTIVE SUMMARY

Governments in the Middle East and North Africa (MENA), particularly in the Gulf Cooperation Council (GCC)* countries, are seeking to privatize selected state-owned assets and industries as part of their broader economic development agenda. This can create a variety of benefits. For instance, they can use the power of markets to do such things as fuel economic growth, increase private-sector participation, boost competitiveness, attract foreign investment, and reduce the fiscal pressure on the government.

Among the imperatives that government should follow, 10 in particular can help with the successful development and execution of privatization programs. The 10 imperatives follow the three main stages of privatization: planning, execution, and completion.

* The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

PRIVATIZATION IS A CRITICAL ELEMENT OF NATIONAL DEVELOPMENT

Governments throughout the MENA region, and in particular the GCC, have embarked on ambitious national strategies to develop their economies and social sectors. A critical aspect in many of these strategies is the privatization of some state-owned assets and industries. These asset disposals are part of the broader refocusing of the government's role away from direct operations and toward policy setting, oversight, and regulation.

Privatization can create a variety of economic benefits: It can make government assets more competitive by subjecting them to market forces, improve the efficiency of the national economy, attract domestic and foreign private-sector investment, rationalize public expenditures to reduce the fiscal burden, and make progress toward better environmental, social, and governance (ESG) performance.

Privatization programs are often complex. Governments that do not have the right capabilities and processes in place often find that privatization presents unanticipated obstacles and takes far longer than they expect.

Lessons learned in the Middle East have been distilled into 10 imperatives, which can help the region's governments develop and execute programs successfully. These 10 imperatives can be followed during the three main stages of privatization, which are planning, execution, and completion.

PLANNING

1
Set up and activate the regulator role early on

2
Plan for a long-term, healthy competitive market structure

3
Protect citizen and government interests

EXECUTION

4
Set up pragmatic program governance

5
Properly manage change and communication

6
Provide potential investors with all necessary information and access to the public-sector entity

7
Provide clarity about how subsidies will be handled in the future

COMPLETION

8
Reduce or eliminate the risk to investors from future government decisions

9
Ensure a smooth transition for employees

10
Continue to monitor enterprises after the sale—and take steps if necessary to ensure that privatization objectives are being met

1

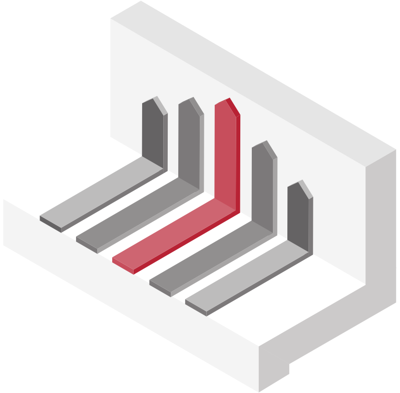
Set up and activate the regulator role early on

Governments need the right institutional setup and capabilities to provide clear, predictable oversight and governance for privatization. Such oversight and governance by regulators enable companies to develop business models with a reasonable degree of confidence. Regulators are critical to the success of privatization, as they are often the first point of official contact for any private-sector investor or owner.

2

Plan for a long-term, healthy competitive market structure

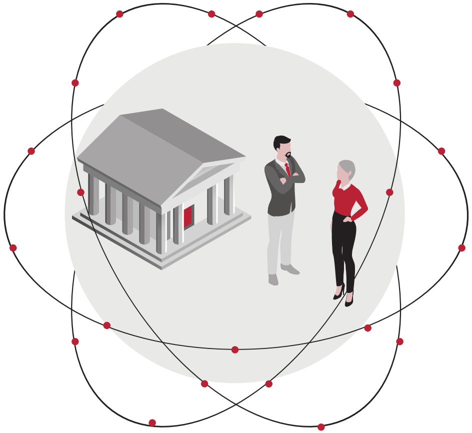
Sophisticated optimization models can help determine the appropriate number of private-sector companies according to various criteria, including operational capacity, storage capacity, asset age, and revenue figures.



3

Protect citizen and government interests

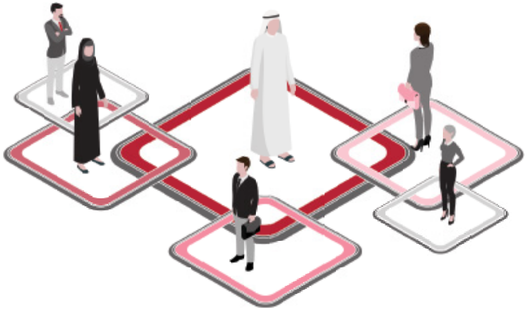
Governments can introduce measures to protect citizen and state interests in advance. For instance, governments can stipulate that they will freeze, or even unwind, a privatization initiative if the private-sector investors fail to satisfy market demand or if they engage in unfair competitive practices. Governments can also allow new participants to enter the market if conditions warrant, even if the private investors have received an initial exclusivity period. Selling public assets to the private sector in certain industries, such as those involving food security or national assets such as oil and gas, can be controversial. Proper precautions ensure that such sales do not jeopardize the socioeconomic interests of citizens and governments alike.



4

Set up pragmatic program governance

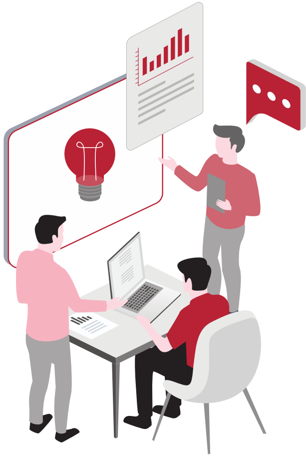
Governments need joint committees that encompass senior representatives and decision-makers from key ministries and authorities to prevent bureaucratic obstacles. Joint committees should meet regularly to provide strategic guidance, to support the government teams actually implementing privatization, and to ensure that required decisions are made on time. Supervising, managing, and successfully delivering a large privatization program typically involves multiple government stakeholders. Pragmatic program governance prevents that requirement from resulting in an increase in the kind of bureaucracy and time lines that discourage private-sector investors.



5

Properly manage change and communication

Governments need to employ effective management of change and communication. Privatization programs involve numerous stakeholders, including government entities, private-sector players, and employees. All have their own perspective, interests, and expectations. The government's privatization teams therefore need to ensure that all relevant stakeholders are aware of the latest program updates and changes. These teams should address queries in a timely manner, and resolve issues quickly. The government can use change management techniques to help employees anticipate what will occur in the workplace; help them understand the rationale and motivations of investors; and, most importantly, allow employees to adapt to privatization. Similarly, governments should inform consumers that privatization will benefit them individually, not just be good for the broader economy.



6

Provide potential investors with all necessary information and access to the public-sector entity

Governments should offer full, meticulous documentation and due diligence reports—including financial, legal, technical, and tax reports; organized visits to company sites; extensive meetings with the management team; and continuous communication about the latest updates concerning the transaction. Private-sector bidders seek to know all details about the assets for sale. Potential investors resort to the most conservative scenario in their valuations if they lack such information or do not have access to the facilities, assets, and management. Any withholding of information during the valuation stage, inadvertent or not, will affect bidding.

7

Provide clarity about how subsidies will be handled in the future

Governments should devise sector-specific business models for their target sectors. These will govern the mechanism of subsidies in the post-privatization era as a means of providing private investors with a clear path to profitability. Privatizing a subsidized sector entails several challenges. Subsidies typically imply fixed prices, which indicates that a market does not yet function independently of government support. Those fixed prices affect private investors' anticipated revenue streams and how much they are willing to bid for state-owned enterprises. Investors need to understand how they will sustain profits; otherwise, they will offer a low purchase price or even be deterred from investing. Many governments will try to reduce subsidies over time, but that may not be feasible in all situations. For investors, the most important elements are clarity from governments and visibility about the future direction of subsidies.

8

Reduce or eliminate the risk to investors from future government decisions

Governments must be clear about future laws, policies, and regulations that could affect the price that private investors are willing to pay. For many private investors, the value of privatized entities lies less in the underlying assets than in the future revenue streams that those assets generate. That applies in particular to heavily regulated industries such as utilities and public transport.

Information on future government decisions often can come with a guarantee. For example, one government developed a compensation and claims agreement that proposed reimbursement for certain types of government-induced risks to give private investors a degree of comfort on future revenue streams. The agreement provided the private investors with guarantees that they would be financially compensated for certain official acts that would lower future revenue streams compared with the baseline on which they made their bid. Such acts include the re-nationalization of the enterprises and certain legal changes. The government designed the guarantees to attract private investors and incentivize them to offer the maximum sale price.

9

Ensure a smooth transition for employees

The government and private investors need to set the expectations of employees proactively during the transition. That means informing them about their likely career paths, compensation, changes in responsibilities, and any other relevant effects. A critical element in the overall performance of a privatized asset is how employees respond. The shift in ownership to the private sector can be stressful for the workforce, particularly given that many people in the MENA region covet public-sector jobs because they are secure and often well-paid. Governments also need laws and regulations that define the treatment of employees working in sectors subject to privatization. Investors need to treat employees fairly in order to minimize problems, especially in industries with a shortage of private-sector skills.

10

Continue to monitor enterprises after the sale—and take steps if necessary to ensure that privatization objectives are being met

Following the transaction, the government should dedicate the right resources and capabilities to ensuring that privatization objectives are met. Completing the sale of an enterprise to the private sector is a major milestone, but the privatization process is not yet complete. There are still a number of completion requirements, including incorporating the entity under its new ownership. In the short term, the government needs to ensure that competition in the sector remains fair and that customers experience consistent service levels and pricing—ideally, service and prices should even improve over time. In the long term, governments need to monitor the impact of privatization in areas such as economic development, job creation, and foreign investment. If the objectives of privatization are not being met, the government may need to step in once again, under predefined circumstances and in line with current laws and regulations, to reach a more favorable outcome.

CONCLUSION

The complex and time-consuming nature of privatization programs can be daunting. Working properly, MENA governments can avoid many common pitfalls. Privatization can help MENA governments implement their ambitious development agendas—including objectives such as increasing ESG performance—and make their economies more competitive.

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