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PRIVATIZATION IN INFRASTRUCTURE

Between 1981 and 1992, about 16,000 state-owned enterprises had been transferred to the private sector worldwide. (Kikeri, Nellis, & Shirley, forthcoming) In light of the growing evidence on the benefits from privatization, an increasing number of governments are privatizing or seeking to privatize what were previously considered "strategic" sectors such as power, telecommunications, and other infrastructure. A recent study by the World Bank found that out of US\$ 61.6 billion received in privatization revenues in developing countries between 1988 and 1992, US\$ 21 billion was from privatizations in infrastructure (Sader, 1993).

The most prominent privatizations in infrastructure to date have taken place in Latin America, predominantly in the telecommunications sector. Some countries such as Malaysia, and South Korea have opted for partial privatization and still others, particularly in low-income regions, are privatizing management through management contracts & leases such as Guinea (water supply), Côte d'Ivoire (electricity). This article focusses on three cases of full privatizations in telecommunications (Argentina, Chile, & Mexico) and one in electricity (Chile).

EMPRESA NACIONAL DE TELECOMUNICACIONES (ENTel)

ENTel was formed in 1956 after the Argentinean government purchased and integrated UTRP (the existing telephone company) with other small local companies. By 1990 ENTel owned and operated 90% of all Argentinean phone lines. However its services faced enormous shortfalls in fulfilling demand due to a myriad of managerial, operational, and labor problems. For example, in 1985, the number of unmet phone orders was 53% of the number of lines in service. (Hill & Abdala, 1993) The privatization of ENTel was one of



the earliest to take place in Argentina, the primary objective being to improve the quality of services and reduce the country's foreign debt.

For the purpose of privatization, ENTel was divided into two companies, Telefónica & Telecom. Each of the companies sold 60% of their shares to a strategic (core) investor that was chosen on the basis of international bidding. In order to achieve its goal of debt reduction, the Argentinean government used a debt-equity swap mechanism. The winning bid was based on the amount of debt papers offered over the minimum requirement of US\$ 3.5 billion. By the end of 1990, Telefónica was acquired by a consortium of Stet, France Cable et Radio, J.P. Morgan, and Compañía Naviera Pérez; while Telecom was acquired by another consortium consisting of Telefonica International Holding, Citicorp, and Banco Rio among others. Of the remaining 40% shares in each company, 30% was sold in tranches through public offerings in national and international stock markets, while 10% was reserved to be sold to employees of ENTel. The shares sold to employees are held in a trust by a national commercial bank. Dividends earned by these shares will pay for them over a period of time, after which they will be handed over to the employees.

Total privatization proceeds (in cash) from the sale of ENTel was about US\$ 2.2 billion and total reduction in commercial bank debt (in face value) was US\$ 5.03 billion - roughly 14% of the total debt to commercial banks and 7.7% of the total external debt. (Harell, 1993 edited by Boeker)

Both Telecom & Telefónica are important stocks traded in the stock market and at the end of 1992 represented nearly 40% of total market capitalization. The share price of Telefónica increased by 8% between 1991 and 1992 from ARS¹ 2.9 a share to ARS 3.13².

¹ARS signifies Argentinean pesos.

²IFC Emerging Stock Markets Database - Stock Data.

Telefónica alone aims to install 250,000-300,000 lines per year between 1992-1995 at a cost of US\$ 3 billion. (Latinfinance, April 1992) Under a seven-year exclusivity, Telecom also plans to add nearly 600,000 phone lines between 1991-1997, and invest about US\$ 3.4 billion. (Hill & Abdala, 1993)

COMPAÑÍA TELÉFONOS DE CHILE (CTC)

Founded in 1880 as a private company, CTC was acquired by CORFO (a government holding company) in 1974 and then privatized again in 1987. It is the largest telecommunications company in Chile servicing nearly 94% of all phone lines. At the time of divestiture CORFO held approximately 90% of CTC's stock.

The sale of CTC began in 1987³ when CORFO released 25% of its shares mainly to domestic investors. Employees of CTC purchased 6.7% of total company stock using their severance payments which were forwarded to them by the government mainly for that purpose.

In August 1987, 30% of the company shares were offered to a strategic investor on the agreement that the investor would purchase additional shares to increase its equity to 45%. In January 1988 after a process of international bidding, the Bond Corporation (Australia) won the bid for US\$ 295 million, and over the next year increased its equity to a little over 50%. In 1991, the Bond Corporation sold its stock to a subsidiary of Telefónica de España called Telefónica Internacional de Chile for \$392 million. Some controversy surrounds this sale because Telefónica de España also owns 20% of the shares in another national telecommunication company (ENTEL)⁴ implying possible monopolization within the

³In 1985 and 1986, some small tranches of shares totaling to about 2.5% of CTC's equity were sold in the local stock market.

⁴ENTEL, another subsidiary of CORFO, is a Chilean long distance carrier that was privatized in 1989. 30% of its shares were sold to Telefónica de España (20%) and to Banco de Santander (10%).

sector.

Between 1987 and 1990, CORFO sold the rest of its shares through public offers to other domestic investors (such as public sector employees) and foreign investors. Public sector employees bought CTC shares at lower-than-market prices and received subsidized credit for their purchase.

Pension funds (AFPs) have become a significant source of revenue for privatizing companies and have helped deepen Chilean capital markets. In the case of CTC, AFPs owned nearly 12% of its stock by the end of 1990. The following table presents CTC's ownership in 1990:

DOMESTIC		FOREIGN	
AFPs	11.6%	Telefónica Internl. Chile	43.4%
CTC Employees	3.2%	ADRs ⁵	14.9%
Others	25.8%	Others	1.1%

(Source: Galal et al, 1992)

Total proceeds from the sale of CTC shares between 1985-1990 reached Ch\$⁶ 58 billion. By 1990, CTC had installed over 860,000 lines (Petrazzini, 1993 edited by Boeker) and had invested an estimated Ch\$ 100 billion **in real terms** between 1987-90. A major source of financing was from the creation of new equity. "In fact, between 1986 and 1990, the company issued 477 million new shares which represents 132 percent of the company's shares in 1986." (Galal, 1992, Chapter 10, page 29).

⁵American Depository Receipts, mainly acquired by the Bank of New York

⁶Ch\$ signifies Chilean pesos.

TELÉFONOS DE MÉXICO (TELMEX)

Telmex, the largest telecommunications company in Mexico was privatized in 1990 with the twin objectives of improving the quality of its services and raising revenue. It should be noted that before privatization, the government owned 56% of the company's stock. 44% was in the hand of private shareholders.

The TELMEX sale was a combined sale, wherein the controlling stock was placed through a private sale in the hands of a core investor, and the balance shares were put up as public offerings in domestic and international stock exchanges. In order to ensure that the controlling stock was held by Mexicans, all shares were restructured in the following manner:

- 20.4% — 'AA' shares which were limited to Mexican nationals;
- 19.6% — 'A' shares which were open to both Mexicans & foreigners; and
- 60% — 'L' shares with limited voting rights which were open Mexicans & foreigners.

Since 'L' shares had limited voting capacity, the 'AA' shares essentially carried 51% of the voting stock and was adequate for control. The winning bid for the sale of these shares went to a consortium of Grupo Carso, Southwestern Bell, and France Cable & Radio for US\$ 1.8 billion. Grupo Carso has effective control with just over 10% of the equity.

The sale was conditional on meeting certain commitments that were agreed to by the buyer such as: a 12% growth rate in the number of phone lines between 1990 and 1994; reduction in the waiting period for installation to one month by 2000; and an investment program. The buyers were given a six-year exclusivity period conditional upon targets being met and an adjustable tax rate on profits according to the company's investment performance.

Employees of TELMEX purchased 4.4% of the 'A' shares (worth US\$ 325 million) through a loan from *Nacional Financiera* that matures in eight years using the shares as

collateral. Two more public sales in mid-1991 and 1992 of 'L' shares in Mexico and abroad (predominantly in the US) raised an additional US\$ 3.8 billion. The government of Mexico retained 5% equity.

Telmex is the most actively traded stock and represents 20% of market capitalization in the Mexican stock exchange. The sale of Telmex generated over \$5 billion in capital inflow to Mexico. (Tandon in Galal et al., 1992) Notably, the share price of Telmex increased by an incredible 106% between 1991 and 1992 from US\$ 1.36 per share to US\$ 2.81 per share⁷. In addition to achieving defined goals such as growth in number of lines installed, and expansion of services provided, the buyers of Telmex are committed to investing \$10 billion over the next five years.

CHILGENER

Prior to its privatization, CHILGENER was a subsidiary of CHILECTRA (a government holding company). CHILGENER is an electricity generating company with an installed generating capacity of about 750 MW produced by 17 thermal and hydro-electric units. During the eighties, its market share in gross electricity generation was between 8%-26%. (Galal, 1992) In seeking increased private participation in the electricity sector, the Chilean government earmarked CHILGENER for privatization in 1985.

The first tranche of CHILGENER's shares (30% of the company's stock) was put up for sale in October 1985 through a public offer to AFPs and individual domestic investors. As in the case of CTC, CHILGENER workers were also given a portion of their severance payment to be used towards the purchase company stock which was sold to them directly. By the end of 1986, 35% of CHILGENER's shares had been transferred to private hands with AFPs acquiring 13.2%, company employees 5.2%, and other domestic investors 16.3%.

⁷"Mexico Economic Trends Report," August 1992, American Embassy, Mexico.

In April 1986 CHILECTRA was liquidated and the residual shares (65%) were transferred to CORFO. These shares were sold over the next two years through various public offerings. The following table provides the ownership structure of CHILGENER in 1988 after its divestiture was completed:

Distribution of ownership	Percent of shares owned
Domestic	65.1%
AFPs	26.2%
Employees	4.9%
Others	27.7%
Foreign	41.3%

Source: Galal, 1992

No core investors were solicited in the case of CHILGENER. A new board of directors was appointed soon after divestiture who made a number of managerial and operations changes. One of these changes was to give workers a share in the company's profits thereby providing an incentive for improved work performance.

Total proceeds from the sale of CHILGENER shares between 1985-1988 reached Ch\$ 11.4 billion. In the period following divestiture, there has been an increase in productivity mainly because of an increase in capacity utilization⁸. While there have been fluctuations in the CHILGENER's share price, it has increased from Ch\$ 760 per share in January 1990 to roughly Ch\$ 1100 by the end of 1992⁹.

⁸Galal's study found that CHILGENER's use of coal per gigawatt hour dropped dramatically from 395 tons in 1986 to a little under 370 tons in 1990. This in turn led to decreasing variable costs, which was one of the factors responsible for increased capacity utilization without additional investments.

⁹IFC Emerging Stock Markets Database - Stock Data.

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