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**PRIVATISATION POLICY AND  
STRATEGY FOR FIJI**

**Supplement  
to the  
1994 Budget Address**

**MINISTRY OF FINANCE AND ECONOMIC PLANNING**

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# **PRIVATISATION POLICY AND STRATEGY FOR FLII**

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## **PRIVATISATION POLICY AND STRATEGY FOR FIJI**

### **EXECUTIVE SUMMARY**

Since the late 1980s, the Government of Fiji has been pursuing policies aimed at deregulating the economy, and reducing and reforming the role of the public sector. Reform and reduction of the public enterprise sector is a major part of the package of policies, and to this end Cabinet adopted the Fiji Public Enterprise Reform Program in October 1993. The Program incorporates the proposals for increased accountability and managerial autonomy for public enterprises which were outlined in the "Public Enterprise Sector Reform : Supplement to the 1993 Budget Address" and expands upon the competition and privatisation elements of the reforms.

The Fiji Public Enterprise Reform Program is split into three stages. The first stage introduces measures to increase the accountability of public enterprises for performance. The second stage is the increase in competition to which public enterprises are subject. The third and final stage is privatisation. The Fiji Public Enterprise Reform Program is therefore aimed at improving the operation of existing public enterprises, and having introduced competition, then aims to privatise.

The purpose of this supplement is to examine the competition and privatisation elements of the package of reforms to be applied to the public sector, which together make up the Privatisation Policy and Strategy for Fiji which Government has adopted.

In establishing the Privatisation Policy and Strategy, it was necessary to resolve a large number of issues, prior to commencing the privatisation program. The major issues addressed in forming the policy and strategy are discussed below.

#### **1. Operating Environment**

International experience indicates that there are two conditions regarding the environment in which privatisation is undertaken which greatly impact the success of the program. Firstly, the likelihood of a successful program is enhanced if undertaken in a market oriented environment. Secondly, privatisation has a greater chance of success if the enterprise is operating in a competitive market. An increase in competition is often considered to be the single greatest motivation for

increased efficiency and so, as is noted above, the first step will be to enhance competition for the public enterprise as far as possible.

Pursuit of competition will include the removal of the monopoly status of the enterprise where that exists and the removal of any special privileges the enterprise may have enjoyed. It will also be necessary to consider the break-up of the enterprise so as to isolate those activities in which competition is not likely to arise, and to foster competition in all others. Contracting out of services provided by the public enterprise on a non-exclusive basis, prior to full privatisation, is also a way in which competition will be introduced.

#### Policy Adopted

Government has made a continued commitment to the pursuit of market friendly policies. Further, Government has determined that there will be no divestiture of any Government shares in any public enterprise unless that public enterprise is operating in a competitive market environment and there is adequate regulation of any remaining monopoly power.

## 2. Objectives of the Privatisation Program

The Privatisation Policy and Strategy must first identify the objectives of the Privatisation Program. It is essential that Government maintains a clear focus on the objectives of the Program, particularly in light of the difficulties that will inevitably arise during implementation.

The lessons from international experience are that the overriding objective of privatisation must be economic efficiency, since it is the lack of efficiency which has precipitated the need for reforms. Other possible objectives include reducing the burden on taxpayers, stimulating capital market development and widening the local ownership of companies in the economy.

#### Policy Adopted

Government has identified improvements in economic efficiency as the primary objective of the Privatisation Program. Generating Government revenue and stimulating capital market development will be the by-products of the program but are not objectives of the reform.

Widespread share ownership will be pursued as a sub-objective, within the constraints that economic efficiency will impose. For example, in the majority of the cases it will be desirable to sell a controlling interest in the enterprises to a strategic, or core, investor to ensure effective shareholder oversight and provide an injection of managerial expertise. A wide spread of the remaining shares may then be considered, with the benefit that this would represent a safer investment for small investors.

### **3. Institutional Structure**

In managing the process of privatisation international experience has indicated that it is necessary to ensure the process is transparent, consistently applied and pursued as quickly as possible. The institutional structure within which privatisation is pursued should reflect this. The benefits of assigning responsibility to a centralised agency are that this will ensure consistency of application of the approved procedures, provide a greater focus to the program, allow an expertise in the sale of public enterprises to be developed and reduce the likelihood of delay due to vested interests.

#### **Policy Adopted**

The Minister of Finance has been granted the responsibility for privatisation. The implementation of the Privatisation Program will be undertaken by the Public Enterprise Unit (PEU) under the direction of the Privatisation Committee, which will comprise a small number of high level officials.

### **4. Legal Framework**

Whilst a law allowing sale of Government-owned shares may not strictly be necessary, international experience indicates that the effectiveness of the privatisation process is likely to be greatly enhanced by the establishment of a solid legal framework.

#### **Policy Adopted**

The Privatisation Law will establish the authority of the Minister of Finance to sell Government-owned shares, determine the institutional structure, and establish the procedures which must be adhered to in the implementation of the Privatisation Program. The Privatisation Law will build upon the platform provided by the Public Enterprise Act and will be accompanied by a monopoly regulatory law.

## 5. Classification of Candidates

The strategy identifies the mode by which public enterprises will be classified between those which are to be privatised and those which are not. In the case of some enterprises it will be necessary to consider the restructuring of industries in which they operate prior to privatisation, in particular to remove monopolies and allow competitors to enter the market place. This is likely in the electricity and telecommunications industries in particular.

### Policy Adopted

The decision rule which has been adopted with regard to classification is that all public enterprises will be privatised, once appropriately restructured, unless there is a compelling reason to the contrary. The primary example of such a reason is that the activities of the public enterprise are essentially of a public service nature, as opposed to a commercial nature. The decision process is illustrated in annex 1.

## 6. Methods of Privatisation

The primary methods of privatisation are the private sale of shares in the enterprise by competitive tender, and the public offering of shares through the stock exchange or directly to the public.

### Policy Adopted

Government has determined that where possible it will combine the two methods, such that a strategic investor provides shareholder oversight, and a wide spread of the remainder of the shares is undertaken through public offering.

## 7. Labour Issues

International experience shows that labour does not necessarily have to lose out in privatisation, and that governments can ease the social cost of unemployment through adequate severance pay and providing retraining opportunities. Short term redundancy costs must be weighed against the immense gains to be derived from economic growth. This will include increased employment of a genuinely productive nature.

#### Policy Adopted

Significant overmanning will be addressed through redundancy prior to privatisation.

#### 8. Debt Restructuring

International experience indicates that where a public enterprise is heavily encumbered by debt, private investors are unlikely to take those debts, even when the price is discounted by the amount of the debt. Private investors will typically prefer to pay a higher price for a company which has a lower risk of failure. A high level of debt may make the investment too risky. In many countries therefore, governments have taken over part or all of the debt of those public enterprises which are heavily indebted, prior to privatising them. The Government would be required, therefore, to make funds available upfront to allow debt write-off prior to the sale of particular enterprises.

#### Policy Adopted

For overly indebted public enterprises, Government will write-off all or part of the debt prior to privatisation to ensure an appropriate balance with the productive value of the assets. No significant investment will be undertaken prior to privatisation as it is highly unlikely that Government will receive a positive return on its investment.

#### 9. Foreign Ownership

Foreign investors in privatised enterprises are a source of managerial and technical expertise, and provide an injection of funds for Fiji as a whole. Concerns may exist, however, as to the desirability of having foreign controlling investors in some privatised enterprises. Mechanisms such as a golden share may, however, be used to address these concerns. A golden share may be held by Government which grants them the power of veto in certain specific and limited circumstances such as subsequent transfer of shares. In addition, the sale of a controlling interest to a foreign investor may be combined with a wide spread of the remaining shares to local investors.

#### Policy Adopted

Foreign investors will be viewed in a similar light to large local investors. Where concerns exist regarding strategic assets and services, Government will consider



the use of a golden share be the large investor foreign or local. However, no special inducements will be granted to overseas investors, or to any large local investor.

#### 10. Monopoly Regulation

As noted above, the competitiveness of the market in which privatised enterprises will be operating is of primary importance in achieving efficiency gains through privatisation. Where monopoly powers remain, despite the removal of barriers to entry, it will be necessary to regulate to ensure those powers are not abused and to simulate a competitive environment as far as possible.

##### Policy Adopted

Government has approved the establishment of one regulatory board to undertake regulation of all privatised monopolies, and will examine the possibility of utilizing the PIB to advise the regulatory board. Monopoly regulation will be governed by a regulatory law.

## **PRIVATISATION POLICY AND STRATEGY FOR FIJI**

### **1.0 INTRODUCTION**

- 1.1 The "Privatisation Policy and Strategy for Fiji : Supplement to the 1994 Budget Address" presents Government's policy of privatisation in the context of the Fiji Public Enterprise Reform Program, and in the wider context of Government's deregulatory policies. The Fiji Public Enterprise Reform Program received Cabinet's endorsement in October 1993. The Program incorporates the proposals for increased accountability and managerial autonomy for public enterprises which were outlined in the "Public Enterprises Sector Reform : Supplement to the 1993 Budget Address", and enlarges on the competition and privatisation elements of the reforms laid out in the 1993 supplement.
- 1.2 The first stage of the Fiji Public Enterprise Reform Program is the introduction of measures to increase the accountability of public enterprises for performance and increase managerial autonomy. The second stage of the Program, which runs concurrently with the first, is increasing the competition to which public enterprises are subject. Privatisation is the third and final stage. Achieving the right sequence of steps, that is competition first followed only then by privatisation, is highlighted as being fundamental to the Fiji Public Enterprise Reform Program.
- 1.3 The purpose of this supplement is to explain more fully the competition and privatisation elements of the Fiji Public Enterprise Reform Program, which together make up the Privatisation Policy and Strategy.
- 1.4 The supplement provides a discussion of each of the major issues which were addressed in the formulation of the Privatisation Policy and Strategy, and identifies the policy which Government has adopted in each case. Experience in Fiji to date, and overseas, indicates the importance of establishing the policy and strategy prior to commencing privatisation.

## **2.0 RATIONALE FOR PRIVATISATION**

- 2.1 Since the late 1980s, the Government of Fiji has been pursuing policies aimed at deregulating the economy and reducing the role of the public sector. An important part of the reform package is the reform of the public enterprise sector. The public enterprise sector has been typified by enterprises that have been insufficiently accountable for their activities and results, have tended to be economically inefficient, have sometimes incurred heavy losses, have absorbed disproportionate shares of domestic credit, and have been a burden on the taxpayer.
- 2.2 The underlying rationale for privatisation is that the public sector environment is not one which is most likely to bring about efficient and profitable enterprise performance. Rather it is the private sector which provides the right environment for enterprise to be pursued. The continued Government assistance required by a number of the public enterprises supports the conclusions that the public sector environment does not provide the right incentives, disciplines (from shareholders, competitors or financial markets) or freedom to managers to carry out commercial operations efficiently.
- 2.3 The deficiencies of the public sector environment in respect of commercial operations stem in part from the fact that the enterprises are required to fulfil a range of commercial, social and government policy objectives which are not necessarily consistent with each other. The requirement by Government that a public enterprise fulfil a non-commercial function makes it very difficult to then hold the organisation wholly accountable for financial performance.
- 2.4 The lack of accountability for performance that results will lead to a lack of incentive for efficient performance on the part of the organisation and its managers. A lack of incentive for efficient performance, and a lack of financial discipline is also caused by the shelter given by Government from the realities of doing business in the commercial private sector. Protection comes in the form of financial support (eg. grants, loan guarantees) and further, in the form of prevention of any competition through the granting of monopoly status.
- 2.5 Whilst many public enterprises operate with a large degree of freedom there is still a tendency for Government to intervene at the operational decision-making level on

occasion. This reduces the ability of the enterprise to be responsive to its changing market conditions which is essential for the successful management of commercial enterprise.

- 2.6 The proposals in the 1993 supplement for changes to the public enterprise sector are intended to address these issues as far as possible. International experience indicates however that even when improvements to public enterprise management by governments has been implemented, this has been almost impossible to sustain.
- 2.7 The emphasis of the reforms is, therefore, to limit as far as possible Government's direct involvement in commercial activities and to concentrate Government's attention on providing an environment which encourages the private sector to grow. In this way the private sector will be the sector which leads the growth of the Fiji economy rather than the Government. Consequently, it is the aim of the Government to divest itself of the ownership of public enterprises.
- 2.8 The rule to be applied to the individual public enterprises is therefore that each should be privatised as soon as the market in which it operates is competitive, unless there is a compelling reason to the contrary. By applying this rule to all public enterprises we will identify a residual of public enterprises which cannot (or should not) be privatised; these should be enterprises providing essential public services of a non-commercial nature.

#### SEQUENCE OF REFORMS : COMPETITION FOLLOWED BY PRIVATISATION

- 2.9 As is noted above, privatisation is adopted as the third stage in the Fiji Public Enterprise Reform Program. The ultimate aim of Government to divest itself of ownership of public enterprises will only be pursued within the framework of the Fiji Public Enterprise Reform Program.
- 2.10 The first stage of the Program is the introduction of measures to improve accountability for performance as outlined in the 1993 supplement. The second stage of the Program is to increase the competition to which the public enterprises are subject. The motivation for choosing policies to create a market-driven economy is that the market will deliver goods and services at the best price and quality for consumers. Consumers signal what they want by buying in a free market and

suppliers respond to those demand signals. However, markets will only deliver consumer choice and incentives for improved efficiency if there is competition. Competition is the key factor in providing incentives for improved efficiency in a market-based economy.

- 2.11 The first and second stages of the Fiji Public Enterprise Reform Program are to be encompassed in the Public Enterprise Act. The implementation of the Act is to be the responsibility of the Minister of Finance. As noted above the third stage of the Program is privatisation which will be covered by the Privatisation Law.
- 2.12 The Public Enterprise Act will give the Minister of Finance the responsibility for commercial activities of public enterprises and will introduce the accountability and autonomy provisions discussed in the 1993 supplement. The Act will require the Minister to issue directives and regulations to enhance the competition for public enterprises. In so doing, Government will take due consideration of contracts held with companies which have private shareholders.
- 2.13 Measures to enhance competition would include the removal of the statutory monopoly status of public enterprises in respect of their commercial activities. Where this is insufficient to introduce competition, it will be necessary to consider breaking up the enterprise. Those areas of activity which can be competitive would be separated from those where competition will be harder to introduce. Another measure to increase competition is to contract out the provision of services currently provided by public enterprises, on a non-exclusive basis. As a general rule, any private operator able to meet the minimum criteria would be granted a licence. Contracting out of services will be encouraged wherever feasible.
- 2.14 The adoption of this framework in which privatisation is to be pursued in Fiji is in accord with the international experience, which indicates that there are two primary factors which greatly affect the success of a privatisation program. Firstly, the likelihood of the successful privatisation program is enhanced if undertaken in a market oriented environment. Secondly, privatisation has a greater chance of success if enterprises are operating in a competitive market. This is why enhancement of competition must first be pursued as far as possible, as competition is the single most important factor in determining the success of privatisation in achieving efficiency gains. In considering the privatisation of monopolies it will therefore first be

necessary as far as possible to introduce competition, and to ensure an adequate legal and regulatory system is in place.

- 2.15 Accordingly, there will be no divestiture of any Government shares in any public enterprise unless that public enterprise is operating in a competitive market environment, and there is adequate regulation of any monopoly power that remains.

### **3.0 OBJECTIVES OF PRIVATISATION**

- 3.1 The Privatisation Strategy first identifies the objectives of the Privatisation Program. In large part the objectives will determine the methods of sale to be adopted. It is essential that Government maintains a clear focus on the objectives of the program, particularly in light of the difficulties that will inevitably arise during implementation.
- 3.2 A list of possible objectives is as follows:
- (i) to improve the efficiency with which the privatized enterprises provide goods and services to the private sector and private consumers;
  - (ii) to allow more resources to be released to other enterprises and sectors of the economy in which they will be used more productively;
  - (iii) to reduce the burden on taxpayers and in addition generate Government revenue;
  - (iv) to stimulate capital market development; and
  - (v) to widen the ownership of shares in the productive assets of the economy.
- 3.3 Objectives (i) and (ii) are complementary and together represent the pursuit of improvements to economic efficiency. This is of primary importance as economic growth, led by the private sector, can only be achieved if the services currently provided by the public enterprises improve in efficiency by delivering better services at lower prices. Efficient services of an infrastructural nature are absolutely essential for the development of an efficient and competitive economy.
- 3.4 Therefore, the focus of all public enterprise reforms including privatisation is now to increase the efficiency of the enterprises, and at the same time to reduce the size of

the sector. In the past, public enterprise may have been regarded as being desirable in their own right rather than as a means of providing efficient goods and services.

#### TRADE-OFF

- 3.5 The adoption of additional objectives to that of enhancing economic efficiency is likely to lead to a trade-off against achieving economic efficiency.
- 3.6 Reducing the burden on taxpayer will be achieved by the dispatching of the enterprise to the private sector. However, if the maximisation of revenue on sale were to be a primary objective, this would directly conflict with the intention to enhance the competitive environment into which enterprises are privatised.
- 3.7 Privatisation and the development of capital market, and the stock market in particular, are complementary processes. However, if capital market development was to be an explicit objective of the privatisation program, then the likelihood is that the privatisation process will be delayed.
- 3.8 Spreading share ownership in privatised enterprises will assist both in increasing the number of citizens with a stake in the commercial activities of the nation, and in building popular support for the Privatisation Program. Care must be taken, however, to ensure that widespread share ownership does not lead to inadequate accountability of management to the shareholders for performance of the company and perhaps lead to reduced efficiency of operations. This may be avoided by combining a strategic, or core, investor who will have a controlling interest and so will be in a position to exercise effective shareholder oversight, with a wide spread of the remaining shares. This will make the investment a safer one for the small investors, and is likely to be attractive to a large overseas investor as a wide local involvement will provide greater local support for the company.

#### POLICY ADOPTED

- 3.9 Following the discussion above, economic efficiency has been adopted as the overarching objective of the Privatisation Program. It is essential that the private sector has the access to efficiently produced goods and services if Fiji-produced goods are to

be able to compete in the world markets. Improved efficiency will necessarily incorporate improvements to the quality of services provided to consumers.

- 3.10 Maximisation of revenue on sale is not a primary objective of the Program. The appropriate process of privatisation for an individual enterprise will be determined based on economic efficiency, and within that process a fair market value will be sought.
- 3.11 As noted above the privatisation and the development of capital market development will proceed hand in hand to some extent. However, capital market development is not an explicit objective of the Privatisation Program as this would inevitably lead to delays in the privatisation process. Speed is identified as being an important factor in the successful pursuit of the Privatisation Program.
- 3.12 Widespread share ownership has been adopted as an explicit objective of privatisation. However, this is a sub-objective, and in pursuing economic efficiency, a mechanism will be put in place to maximise the spread of shares without compromising the need to ensure adequate corporate governance. Such a mechanism might specifically set aside a minority proportion of the shares to be taken up by small investors, or require the subsequent sale of a proportion of the majority shareholder's shares to small investors. Possible techniques are considered further in section 6 below.

#### **4.0 INSTITUTIONAL AND LEGAL MATTERS**

##### **STRUCTURE**

- 4.1 In managing the process of privatisation international experience has indicated that it is necessary to ensure the process is transparent, consistently applied and pursued as quickly as possible. The institutional structure within which privatisation is pursued should reflect this. The benefits of assigning responsibility to a centralised agency are that this will ensure consistency of application of the approved procedures, provide a greater focus to the Program, allow an expertise in the sale of public enterprises to be developed and reduce the likelihood of delay due to vested interests.



#### Policy Adopted

- 4.2 The Minister of Finance has been granted the responsibility for privatisation. The implementation of the Privatisation Program will be undertaken by the Public Enterprise Unit (PEU), under the direction of the Privatisation Committee which comprises high level officials from the Public Service Commission, Prime Minister's Office, Solicitor General's Office and Ministry of Finance and Economic Planning.

#### LEGISLATION

##### (a) The Privatisation Law

- 4.3 International experience indicates that a solid legal framework is an essential prerequisite for the Government's effectiveness in designing and managing the privatisation process, investors' response to it and the long term sustainability and the growth of the private sector. This raises the question as to what is necessary or desirable under the existing governance system in Fiji to carry out a Privatisation Program efficiently and without doubt as to authority or legality.
- 4.4 There is apparently no legal barrier to the sale of publicly owned limited liability companies in Fiji. However, for the reasons noted above, Government has decided that legislation be drafted to provide the mandate, the restrictions, the institutional structure, and the transparent procedures for privatisation.

##### (b) Public Enterprise Act

- 4.5 The Act will cover the introduction of competition for public enterprises, the process of corporatising the commercial activities of Government departments and statutory bodies, and the accountability mechanism for commercial statutory bodies and Government-owned companies. This will provide the platform from which privatisation can be pursued.

##### (c) Regulatory Law

- 4.6 A monopoly regulatory law will be prepared to coincide with the implementation of the first wave of privatisation. The regulatory framework will then be in place when

subsequent stages of privatisation commence, which will include privatisation of Fiji Posts and Telecommunication Limited, Fiji Electricity Authority, Ports Authority of Fiji, Civil Aviation, and the Stock Exchange. Regulation will be required of those activities in respect of which the enterprise retains monopoly power despite the removal of barriers to competition. There is further discussion of monopoly regulation in section 8 and annex 2 below.

## **5.0 CLASSIFICATION OF CANDIDATES**

- 5.1 The strategy identifies the mode by which public enterprises will be classified between those which are to be privatised and those which are not. In the case of some enterprises it will be necessary to consider the restructuring of industries in which they operate prior to privatisation, in particular to remove monopolies and allow competitors to enter the market place. This is likely in the electricity and telecommunications industries in particular.

### **Policy Adopted**

- 5.2 The decision rule which has been adopted with regard to classification is that all public enterprises will be privatised, once appropriately restructured, unless there is a compelling reason to the contrary. The primary example of such a reason is that the activities of the public enterprise are essentially of a public service nature, as opposed to a commercial nature. A suggested decision process is provided in annex 1.

## **6.0 METHODS OF PRIVATISATION**

6.1 Privatisation as is referred to in this document is defined as the transfer of the majority ownership of public enterprises or sale of assets to the private sector.

6.2 The basic methods of privatisation are:

- i. private sale of shares by competitive tender;
- ii. public offering of shares through the stock exchange or directly to the public;
- iii. management/employee buyout; and
- iv. liquidation and sale of assets.

6.3 The objectives which are identified for privatisation largely determine the appropriate method to be adopted. However, the nature and conditions of each enterprise will determine the range of methods that will be suitable in each case.

### **PRIVATE SALE OF SHARES BY COMPETITIVE TENDER**

6.4 This method involves the sale of all or the major proportion of the shares in a public enterprise to the highest bidder in an open and competitive auction. This method is consistent with the objective of economic efficiency because the potential owner that is willing to pay the most to buy the enterprise is most likely to have the best plan for improving its efficiency and profitability. Because of this investor's superior plan or strategy for managing the enterprise, he can afford to pay the highest price. Such an investor may be referred to as a strategic or core investor.

6.5 As a secondary consideration, this method of privatisation is likely to result in the highest revenue to the Government and thus help to reduce the budget deficit.

### **PUBLIC OFFERING**

6.6 In other countries, various methods of privatisation have been tried. In some cases, shares have been floated on the stock market in an "initial public offering" (IPO). In Great Britain, shares were offered at low prices to small investors to encourage greater share ownership by the general public. In some countries, shares could only be pursued by citizens of the country and foreign investors could not become owners.

6.7 A public offering of shares may be undertaken in two ways.

1. Direct sale of shares to small local investors

6.8 This method would involve the sale of shares in an enterprise to Fiji citizens with a maximum ceiling on the number any individual can buy. Shares may be sold through outlets such as the post office. In order to be attractive to small investor, it will necessary for the shares to be quoted on the stock exchange simultaneously, to allow subsequent sale of shares by the investor.

2. Sale through the stock exchange

6.9 This method would involve the sale of shares in a public enterprise through the stock exchange with no restriction on the number of shares held by individuals or organisations.

COMBINED APPROACH

6.10 The spreading of share ownership was identified in section 3 as the secondary objective of the Privatisation Program. This would require a public offering of the shares. Care must be taken, however, to ensure that this does not lead to ineffective monitoring and control of the company by the shareholders and therefore lead to reduced efficiency and profitability. With a very widely spread ownership the existing managers may be able to operate with little concern for the interests of the owners.

6.11 This may be avoided by combining the sale of a majority of the shares to a core investor through competitive tender, with a wide spread of the remaining shares through public offering. The core investor will have a controlling interest and will therefore be in a position to exercise effective shareholder oversight and provide managerial expertise. Making use of core investors will improve the chances of the enterprise's success and will therefore be a better investment for the small investors.

6.12 A variation of this technique would be to sell 100% of the shares in an enterprise to a core investor but require that a minority proportion be sold on the stock exchange after a fixed period of time. This will allow the core investor the opportunity to bring

about improvements in efficiency and profitability before making shares available to other investors.

- 6.13 Government has indicated that this combined approach would be the preferred method, wherever that is appropriate to the company's situation. In cases where small investors are unable or unwilling to hold shares directly the sale of shares to intermediary institutions such as Unit Trust of Fiji will be considered.

#### MANAGEMENT/EMPLOYEE BUYOUT

- 6.14 This method might be used for those enterprises which are highly labour intensive. The term management buy-out generally refers to the acquisition of a controlling shareholding in a company by a small group of managers. It often also designates a similar transaction where employees or management and employees acquire a controlling interest. The leveraged management/employee buy-out involves the use of credit to finance the acquisition, with the assets of the acquired company generally used as security.
- 6.15 In most cases of buy-outs, a holding company is ~~created~~ through an equity issue subscribed to largely by management and employees. The holding company then acquires the public enterprise which is to be privatised, using equity funds and, in the case of leveraged buy-outs, substantial borrowed funds.
- 6.16 International experience indicates that this can be a very successful method of privatisation, such as in the case of National Freight Consortium in UK. Chile has had more mixed experience, which suggests the need for care in the use of this mechanism. In particular the enterprise will need a steady cashflow and to be reasonably secure.

#### LIQUIDATION AND SALE OF ASSETS

- 6.17 This method would be reserved for non-viable enterprises. The enterprise will be liquidated and the assets auctioned in whole or piecemeal, whichever maximizes revenue.

## **7.0 MAJOR PRIVATISATION ISSUES**

- 7.1 There are three issues which required particularly careful consideration in the formation of the Privatisation Policy and Strategy. These are discussed below.

### **(1) LABOUR REDUNDANCY**

- 7.2 Since economic efficiency is the primary objective of the Privatisation Program, it is necessary that where over-manning exists, it be removed. In some cases therefore, labour redundancy is inevitable. International experience shows that labour does not, and need not, lose in privatisation if governments pay attention to easing the social cost of unemployment. This may be done through adequate severance pay and by providing assistance to those employees made redundant following the contracting out of services, by giving them priority in providing those services as a private enterprise for an initial period. The short term redundancy costs must be weighed against the immense gains deriving from economic growth. This will include increased employment of a genuinely productive nature.
- 7.3 The issue then addressed was whether Government would undertake an examination, and rationalisation where necessary, of staffing in the individual enterprises prior to privatisation. Alternatively, the redundancy process could be left to the new owners. The disadvantages of leaving the rationalisation of staffing to the new owner are that this is likely to deter investors from expressing interest, and forcing the new owner to implement lay-offs is likely to create a negative relationship, and perhaps industrial action, between the new management and employees from the outset. In addition, in attempting to establish a fair value for the company, the sale negotiations are likely to be protracted and costly, and therefore run a high risk of failure.
- 7.4 International experience shows that failure to address the issue of redundancy prior to privatisation is likely to cause significant problems to the sale process and to the newly privatised enterprise, and ultimately may undermine the whole Privatisation Program.

- 7.5 For these reasons Government has decided that the initial examination of an enterprise, when determining the broad method which will be adopted, will also need to determine the need for redundancy. Any significant over-manning will then be addressed pre-privatisation.

## **(2) DEBT RESTRUCTURING AND WRITE-OFF**

- 7.6 International experience indicates that where a public enterprise is heavily encumbered by debt, private investors are unlikely to take on those debts, even when the price is discounted by the amount of the debt. Private investors would typically prefer to pay a higher price for a company which has a lower ~~change~~ of failure. A high level of debt may make the investment too risky. In many countries, therefore, the government has taken over part or all of the debt of those public enterprises which are heavily indebted, prior to privatising them.
- 7.7 Government has therefore decided that the initial examination of an enterprise will include examination of its debt. Consideration will be given as to whether it will be necessary for Government to write-off all or part of the enterprise's debt prior to privatisation, in order to achieve an appropriate balance with the productive value of the assets. In addition it has been decided that no significant investment be undertaken prior to privatisation as it is highly unlikely that Government will receive a positive return on its additional investment when it sells the enterprise.

## **(3) FOREIGN OWNERSHIP**

- 7.8 In a number of countries that have undertaken privatisation restrictions have been placed on foreign ownership. Restrictions may come in the form of placing a maximum limit on the foreign ownership of all privatised enterprises, or on placing a maximum limit on the foreign ownership of particular enterprises.

- 7.9 The benefits which may be expected to arise from foreign ownership in privatised enterprises include an injection of managerial and technical expertise into the organisation, as well as foreign investment for Fiji as a whole. If foreign investors are unable to purchase a controlling interest in the privatised enterprises then this will be a deterrent to being involved at all.
- 7.10 Some concerns may exist over foreign ownership and they may be summarized as concerns regarding :
1. the loss of control by Fiji of the use of strategic assets;
  2. the loss of control by Fiji over the provision of essential services in Fiji;
  3. the danger of selling national assets at below fair value;
  4. the possibility of manipulation of transfer pricing by multinational corporations;  
and
  5. the wish to encourage widespread share ownership in Fiji.
- 7.11 When considering the loss of control to foreign investors over strategic assets it is necessary to consider the arguments made regarding the distinction between ownership and control. Foreign ownership of physical assets does not necessarily mean that these assets can be removed from Fiji. In respect of the essential services such as the utilities, conditions of operation may be imposed by government through the licence.
- 7.12 In general, the operations of a large number of established, foreign-owned companies with sound track records in Fiji would support the conclusion that foreign ownership does not mean that a company's operations are not consistent with the national interest.
- 7.13 In the sale of public enterprises, it will always be necessary to strive for a fair price to be paid, be the purchaser foreign or local. Through the Privatisation Program we would wish to reduce the burden of the public enterprise sector on the taxpayer. The sale price must therefore adequately compensate the taxpayer for lost dividends..



- 7.14 It is acknowledged, however, that public scrutiny is likely to be higher when a foreign investor is involved in the purchase and every care must be taken to ensure that a fair price is obtained, and that the price is seen to be fair.
- 7.15 The possibility of the manipulation of transfer prices between a Fiji resident company and its overseas parent, in order to avoid local taxes, is much easier to prevent if the local company is operating in a competitive market, as comparisons of reported revenues and costs are possible. This is a further reason for ensuring that a company is subject to competition, or adequate economic regulation, prior to privatisation.
- 7.16 In summary, there is no economic reason to fear foreign ownership, as long as adequate control is exercised by the competitive market or by the ~~monopoly~~ regulator. Government has decided, therefore, that rather than restrict the market by excluding foreign ownership, golden shares will be used to retain the power of veto regarding subsequent transfer of shares if it is considered necessary to protect the national interest.
- 7.17 The wish to encourage a wide spread local share ownership, is discussed in section 3 above. Section 6 discusses a number of ways in which this objective may be pursued whilst still securing a core investor (foreign or local) to ensure better corporate governance.

## **8.0 REGULATORY REQUIREMENTS**

### **ROLE OF REGULATION IN A MARKET ORIENTED ECONOMY**

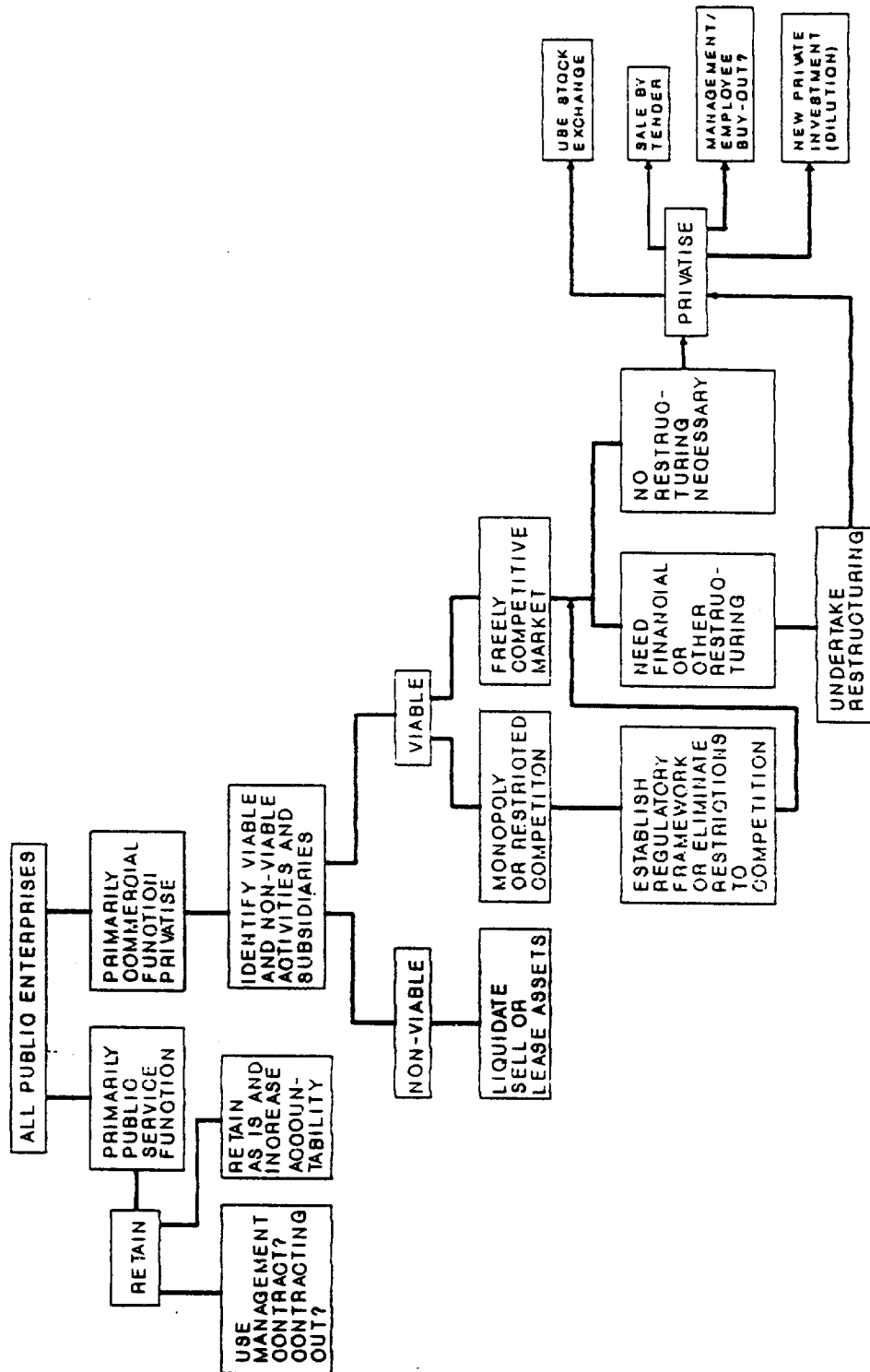
- 8.1 Whilst emphasising the need to encourage the development of competition wherever possible, there will remain a number of enterprises with some degree of monopoly power at least in the short and medium term. A monopoly which is allowed to operate without interference will not lead to economic efficiency, but instead will be in a position to earn monopoly rents through restricted supply. The benefits which may be expected arise from increasing the market orientation of the economy will not be achieved, therefore, if markets are uncompetitive and so do not exercise a

discipline over the participants. Regulation of monopolies is therefore consistent with, and indeed a requirement of a deregulating , market oriented economy.

- 8.2 A number of public enterprises have been protected, by Government regulation, from competition from the private sector. There has, therefore, been inadequate pressures placed on the public enterprises from the environment in which they operate, to require them to achieve economic efficiency. As far as possible, therefore, prior to privatisation it will be necessary to establish a competitive environment for the privatised enterprises, if the intended efficiency gains are to be achieved. This requires barriers to competition in the markets in which public enterprises operate to be removed wherever possible, whether those barriers are currently caused by Government intervention or by other non- competitive forces. This must be of primary focus for the Government, since regulation of monopolies can only ever be a second best solution.
- 8.3 It is undoubtedly the case, however, that some public enterprises will continue to dominate the markets in which they operate for some time because of economies of scale and the limitations of the market size in Fiji. Examples are likely to include FEA and FPTL. Even in those markets which are potentially competitive, dominant positions are likely to remain during a transitional period as it will take time for the public enterprises to adapt, and for new privately-owned competitors to enter previously inaccessible markets. There will therefore be the need for regulation of companies which have a dominant market position, to simulate as far as possible the disciplines of a competitive market.
- 8.4 Without a monopoly regulatory mechanism, the privatisation of a public enterprise which retains monopoly powers may result in increased anti-competitive behaviour and consequently reduced rather than increased efficiency. The lessons of international experience are that the market environment must be competitive, or an adequate monopoly regulatory mechanism must be in place prior to privatising an enterprise.
- 8.5 Some of the issues which must be examined in establishing a monopoly regulatory mechanism, such as the method of regulation and setting of targets are discussed in annex 2.

8.6 As is noted in section 2 above, Government has decided that an explicit rule of the Privatisation Program is that there will be no divestiture of any shares in any public enterprise unless that enterprise is operating in a competitive market environment, and that any remaining monopoly power is adequately regulated. Government has approved the establishment of a single regulatory board, and will examine the possibility of utilizing the PIB to advise the regulatory board. As noted in section 4 above monopoly regulation will be governed by a regulatory law.

## DECISION TREE FOR PRIVATISATION



## MONOPOLY REGULATORY ISSUES

### TYPES OF MONOPOLY REGULATION

1. The first role of a monopoly regulator will always be to encourage competition wherever possible within the industries which are subject to regulation. Whilst a monopoly remains it will, however, be necessary to undertake specific regulation of that monopoly. There are two broad approaches to monopoly regulation which may be differentiated by reference to policies adopted in New Zealand, UK and USA. In the UK and USA restrictions on price increases are the major feature of monopoly regulation. In New Zealand, whilst legislation does allow for prices to be dictated to monopolies the provision to do so has not been used thus far.
2. The New Zealand approach is that companies in dominant market positions be subject to detailed information disclosure requirements. The information will allow potential competitors to be aware of abnormal profit opportunities and enables the New Zealand Ministry of Commerce to monitor the activities to ensure no abuse of monopoly position. The New Zealand approach to regulation is a light-handed one, and appears to be adequate because rigorous deregulation and competition-enhancing measures (including the break up of monopolies) have been introduced at the same time.
3. In the UK, separate regulatory authorities have been established for each of the privatised monopolies. A formula is applied to determine the maximum price increase allowed each year. The formula is of the form "CPI-X" (CPI Consumer price index). X represents the improvement in operating efficiency that the regulator considers would be reasonable to expect in a year if the monopoly were subject to competitive pressures. The USA also employs price controls but the maximum price is a function of a maximum rate of return on assets employed which may be earned by the company.
4. Having acknowledged that monopolies are likely to remain in Fiji for some time, the very light handed approach of New Zealand would probably be inadequate to achieve improvements in economic efficiency. Consequently some sort of price regulation will be required. The rate of return method does not encourage improvements in efficiency as it is essentially a cost-plus method, and in the USA has led to lengthy judicial hearings as companies have challenged the calculation of their rates of return by the regulator. Consequently, the "CPI-X" approach is preferred as it would not be open to

the detailed dispute over the calculation of a Company's rate of return, and is the most simple and straightforward method of price control available and does not allow prices to be determined on a cost-plus basis. International experience suggests that in the application of any maximum price increase or rate of return, the process should be categorized by rules rather than discretion. This will minimize the possibility of political interference in the setting of prices, for the monopoly utilities in particular, and will provide a greater degree of certainty about the regulatory environment to potential investors in privatised enterprises.

#### TARGET SETTING

5. In practice, there are a number of fundamental questions which must be addressed in the application of "CPI-X" price regulation. Firstly, since the regulation is in respect of price increases, it must be determined whether the current price is the appropriate price from which to start the "CPI-X" process.
6. At the same time, the degree to which different markets, different goods and services and different customers of the monopoly are to be split for the purpose of price regulation must be addressed.
7. If an average price increase for the company is targeted then there remains the possibility of cross-subsidization. Whilst adhering to the average price increase ceiling, the company may still be able to exploit those markets in which it is dominant, and use the abnormal profits to cross-subsidize below-cost pricing in markets in which it has competitors. The degree of heterogeneity of the company's customers and markets will determine the number of price targets required.
8. The arbitration process required for disputes between the regulator and the monopoly must also be examined.
9. It would also be necessary to analyse the need for non-price targets. Price regulation does not address the quality of service provided and indeed in a reaction to price regulation the quality of services may suffer as the company tries to maintain profits without implementing improvements in productive efficiency. In the UK it appears that service criteria are being developed and analysed for possible use by the monopoly regulators in a response to the criticisms of the current price-only targets.

ANNEX 3: BASIC FINANCIAL INFORMATION FOR MAJOR PUBLIC ENTERPRISES (1992)

(\$F 1000)

Company	Government Ownership %	Sales	Total Assets	Employees	Budget Appropriation grants & equity injections Total over 3 years: 1992 to 1994	Government Guarantees as at 31/12/91
<b>Agriculture, Forests and Fisheries</b>						
Fiji Meat Industry Board #	100	537	4,000	*	0	0
Fiji Pine Ltd	100	2,969	75,300	166	2,200	0
Rewa Rice Ltd 1/	100	8,978	7,700	*	0	1,327
Pacific Fishing Co. Ltd #	98	38,872	32,900	*	0	2,052
IKA Corporation Ltd #	100	1,618	4,400	45	1,000	0
National Trading Corp	100	6,570	8,500	65	0	0
Fiji Sugar Corp Ltd 1/	68	274,462	237,400	*	0	0
Yaqara Pastoral Ltd	100	14	2,500	36	0	0
Yalavou Rural Development	100	0	700	*	600	0
<b>Housing &amp; Urban Development</b>						
Housing Authority	100	13,365	107,696	241	3,550	7,530
Public Rental Board	100	719	10,462	*	4,750	24,079

ANNEX 3

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(\$F 1000)

Company	Government Ownership %	Sales	Total Assets	Employees	Budget Appropriation grants & equity injections Total over 3 years: 1992 to 1994	Government Guarantees as at 31/12/91
<b>Infrastructure &amp; Aviation</b>						
Ports Authority of Fiji	100	16,278	50,000	358	0	12,470
Civil Aviation Auth. of Fiji 2/	100	17,476	51,340	797	13,230	0
<b>Air Transportation</b>						
Air Pacific Ltd 1/	78	196,516	88,000	544	0	7,962
Fiji Air Ltd	23	12,254	8,900	122	0	0
<b>Electricity &amp; Telecommunications</b>						
Fiji Electricity Auth.	100	79,961	509,900	1094	9,200	245,338
Fiji Post & Telcom. Ltd	100	49,934	135,829	1580	800	0
Fiji Intern. Telcom. Ltd 1/	51	48,449	41,100	109	0	0



**ANNEX 3: BASIC FINANCIAL INFORMATION OF MAJOR PUBLIC ENTERPRISES (1992)**

(\$F 1000)

Company	Government Ownership %	Sales	Total Assets	Employees	Budget Appropriation grants & equity injections Total over 3 years: 1992 to 1994	Government Guarantees as at 31/12/91
<b>Financial Institutions</b>						
Fiji Development Bank 2/ #	100	23,172	237,000	306	15,780	149,546
National Bank of Fiji 2/	100	32,470	363,100	606	1,500	237,126
Home Finance	25	3,976	36,000	22		7,600
<b>Others</b>						
Fiji Sports Council	100	391	2,501	*	390	0
Fiji Broadcasting Comm. #	100	2,370	2,300	182	2,870	86

**Notes :**

For the financial year 31 December 1992 except,

1/ Financial year ended 31 March 1993

2/ Financial year ended 30 June 1992

\* Unavailable information

# shows provisional amounts for 1992

Italics indicate 1991 data

**Source :** *Annual Reports; Reports of the Accounts & Finances for the year 1991.*