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The effects of changes in corporate governance and restructurings on operating performance: Evidence from privatizations

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Abstract

Using a sample of 161 firms (privatized from 1961 to 1999), our study offers evidence of how restructurings and corporate governance changes affect the firm's post-privatization performance. Prior to privatization, governments may choose to restructure firms through governance changes (i.e., establish relation with strategic foreign investors, implement employee share ownership plans) and/or restructurings (i.e., acquisitions, divestitures, re-capitalizations). We first extend existing privatization research by documenting and describing these restructurings. We then conduct preliminary tests to examine whether such restructurings/governance changes have affected post-privatization operating performance. Our results suggest that both restructuring and changes in corporate governance are important determinants of post-privatization performance.

JEL classification: G15; G28; G38; L33
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1. Introduction

Over the last few decades, privatization – defined as the sale of previously state-owned enterprises to private owners – has transformed the global economic landscape. The extant literature generally

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shows that privatization improves the financial and operating efficiency of divested firms. Megginson and Netter (2001), Djankov and Murrell (2002), López-de-Silanes (2005), Nellis (2005), and Megginson (2005) all provide summaries of this research. In this paper, we empirically analyze reasons why privatization may contribute to these performance improvements. Specifically, we examine how restructurings and changes in corporate governance impact the performance of newly privatized firms. Our methods and results are similar to those of Boubakri, Cosset, and Guedhami (2005), though our focus is more on developed countries.

Prior to privatization, governments may choose to restructure firms through governance changes, such as establishing relationships with strategic foreign investors or implementing employee share ownership plans, and/or through restructurings such as acquisitions, divestitures, or re-capitalizations. We extend the existing privatization research by examining whether such restructurings/governance changes contribute to increased improvements in post-privatization operating performance. This question is important since some governments subject firms to significant changes before privatization while others typically do not. Accordingly, this study will further the search for potential sources of post-privatization performance improvements.

Using a sample of 161 firms privatized between 1961 and 1999, our study offers preliminary evidence regarding how restructurings and governance changes affect the firm's post-privatization performance. Our results confirm that both restructuring and changes in corporate governance are important determinants of post-privatization performance. First, we find that pre-privatization restructuring leads to stronger post-privatization efficiency gains. We also find evidence of stronger profitability gains for firms with lower post-privatization employee ownership and higher state ownership. We also find stronger output gains for firms in competitive (unregulated) industries and for firms in developing nations.

This paper is organized as follows. Section 2 surveys the theoretical and empirical literature to identify potential sources of post-privatization performance improvements. Section 3 describes our data and defines our testable predictions. Section 4 outlines our empirical methodology, and Section 5 presents our findings. Section 6 provides a summary and conclusion.

2. Potential sources of post-privatization performance improvements

The finance and economics literatures suggest reasons why privatization might affect the firm's operating and financial performance. We focus on the impact of changes in corporate governance and restructuring. Specifically, privatization involves changes in corporate governance due to changes in ownership. The act of privatization reduces state ownership. Some privatizations further re-shuffle governance structures by providing ownership to employees and foreigners. As stressed by Boycko, Shleifer, and Vishny (1996), Nellis (1999, 2005), Shirley and Walsh (2000), and Chong and López-de-Silanes (2005), state-owned enterprises have multiple objectives, some of which are inconsistent with the maximization of financial and operating efficiency. The ownership changes from privatization should help to redefine the firm's objectives and the manager's incentives. This should impact post-privatization performance. Second, transferring the firm from government control provides greater entrepreneurial opportunities. One response to this ownership change is the restructuring of the newly privatized firms. Such restructurings include divestitures, acquisitions, and re-capitalizations.

In the following paragraphs, we examine each of these broad changes brought on by privatization and identify specific, testable sources of potential performance improvements. We