Int. Fin. Markets, Inst. and Money 13 (2003) 19–37

Journal of INTERNATIONAL FINANCIAL MARKETS, INSTITUTIONS & MONEY

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The post-privatization financial performance of former state-owned enterprises

Arthur Comstock [a], Richard J. Kish [b,*], Geraldo M. Vasconcellos [b]

[a] *Marywood University, 2300 Adams Avenue, Scranton, PA 18509-1598, USA*
[b] *Lehigh University, 621 Taylor Street, Bethlehem, PA 18015, USA*

Received 2 June 2001; accepted 25 February 2002

Abstract

We analyze the long-term performance of privatizations, i.e. IPOs of former state-owned enterprises by measuring unadjusted and excess returns in average annual and cumulative terms. The results show negative abnormal price performance during the 1st year after the initial trading day, as well as during subsequent years. On average, privatization offers yield 1st year returns that are over 50% lower than market returns over the same time period. The results for cumulative returns also show, on average, a cumulative negative return of approximately 40% at the end of the 5th year of trading. The overall size of an offer seems to matter—the larger the offer, the better the long-term performance. This conclusion is offered with qualifications. On the other hand, the state of economic development of the privatizing country and the initial return do not appear to have a long-term impact on performance.

Keywords: Privatization; IPO

JEL classification: G15; G14

* Corresponding author. Tel.: +1-610-758-4205; fax: +1-610-758-6429
E-mail addresses: comstock@es.marywood.edu (A. Comstock), rjk7@lehigh.edu (R.J. Kish), gmv0@lehigh.edu (G.M. Vasconcellos).

PII: S1042-4431(02)00024-0

1. Introduction

There have been waves of privatization in the 1980s and 1990s, which will probably continue into the new century. Over the past two decades, many governments have been forced to sell-off previously state-owned enterprises in order to generate revenue and improve efficiency among other reasons.[1] Due to the popularity of such activities, privatization studies are necessary to provide governmental institutions and investors with the background and knowledge to make appropriate decisions. For example, governments need to be aware of the implications of privatizing for the societies that they serve. They must be particularly cognizant of the ramifications of their actions on consumers and workers. As a result, several academic studies have emerged in the literature to examine issues of efficiency and operating performance with respect to these very issues.

However, as shown in Megginson and Netter (2001) only a few studies exist that analyze the *market* performance of such privatization activities. This type of information has tremendous relevance to investors who may be involved with the initial offering or secondary purchases of shares. Such investors are interested in how privatization offers tend to perform in the financial markets. Consequently, the main aspects of this study involve the financial performance of privatization transactions and some of the key characteristics of interest to investors.

2. Literature review

Privatization transactions are expected to be similar to initial offerings of private-sector firms. The long-run (i.e. 1 or more years) performance of IPOs has been well-documented. For example, Ibbotson (1975) demonstrated that IPOs tend to show negative performance during the 2nd through 4th years following the offering. Additional research supports a significant under performance for the long-run returns from IPOs.[2]

Research of initial offerings of state-owned enterprises merges the IPO and privatization literatures. The term privatization refers to the process through which a government transfers ownership of assets and control of commercial activities to the private-sector. Governments often have wide latitude in the design of these sales. For example, all shares of a company may be sold at once or in tranches separated by months or years. Shares may be reserved for employees or institutions, or limits may

[1] These goals are detailed in Megginson and Netter (2001) to include raising revenue for the state; promoting economic efficiency; reducing government interference in the economy; promoting wider share ownership; providing the opportunity to introduce competition; and to subject the state-owned firms to the market discipline.

[2] For example, see Aggarwal and Rivoli (1990), Ritter (1991), Loughran (1993), Hanley (1993), Loughran and Ritter (1995) for an U.S. perspective. Extensions of the underperformance literature to other countries include Levis's (1993) London Stock Exchange IPOs research, Aggarwal et al.'s (1993) research on Brazil, Chile, and Mexico, and Lee et al.'s (1996) research in the Australian IPO market.