

Employee Ownership In Privatization

Report on COG "Employee Ownership in Privatization" Policy Discussion Group
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1. Introduction

An international economic development consultant once described a seminar on privatization which he had attended in Prague. The presenters were from an U.S. consulting firm which had won several USAID contracts to advise governments on privatization policy. The audience were government representatives from several of the states which emerged out of the former Yugoslavia. The presenters explained all of the steps involved in taking an enterprise from state ownership to private ownership and concluded by saying that they could help with each of these steps. When they opened up the floor for questions, one of the visiting officials said that he understood their model perfectly: convert the enterprise into a corporation and seek outside investors to purchase the shares. But in the former Yugoslavia, he continued, workers think *they* own their enterprises. And worst yet, they have official documents from the former communist government which appear to be legal titles. Before his government could begin the process of privatization, they were going to need to regain control over these enterprises. The consultant's response was, "And sir, I can help you overcome that problem too!"

Communism idealized worker ownership of the means of production. The transitional socialist state was supposed to fade away as workers no longer needed its direction. Due to the rhetoric, it was not difficult for certain bureaucrats responsible for privatization to make the dishonest argument that privatization through employee ownership was nothing more than a return to communism. Anatoly Chubais, the principal architect of Russian privatization, once refused to visit what was alleged to be a successful enterprise which had privatized through employee ownership, explaining that he had already been to a collective farm.

Labor union representatives often view privatization simply as a government's way of bypassing its contractual obligations to the workers providing a state-sponsored service. Employee ownership is seen as a token gesture to bribe its membership into accepting a privatization which could eventually lead to the elimination of their jobs.

And yet despite pervasive negative views of employee ownership in privatization, many successful cases have emerged over the years. This paper will argue that, while privatization may not always be the best course of action, where it is inevitable, employee ownership should be considered seriously. A number of different privatization scenarios are reviewed. The paper narrows its focus to those situations where privatization can be a good opportunity for broadening ownership. Only where employee ownership in privatization will lead to this goal should it be recommended.

To successfully privatize an enterprise through employee ownership, the state must be willing to sell, the employees must be interested in buying, the managers must be competent, there must be a market for its products or services, the operation must be competitive, labor-management cooperation must be achievable, and sufficient financing should be available.

The paper goes on to recommend ways in which these necessary components of success can be enhanced in a given privatization situation. The challenges as well as the recommendations are the fruit of a year of discussion facilitated by the Capital Ownership Group and funded by the Ford Foundation. The discussion included both professionals and novices with direct experience in privatization from over twenty countries around the world.

2. Scope and Terms

There are a wide variety of situations which exist under which the use of employee ownership is considered in the process of privatization of state-owned services and enterprises. These include the political-economic context, the origins of state ownership, the position taken by the employees, and the competing interests involved. How employee ownership is used also varies.

Political-economic contexts can be sorted into at least three different groupings: (1) those where government officials are clearly held accountable to a voting population, the rule of law is effective and a competitive market economy exists; (2) those where governmental accountability is weak, cronyism is common, and an elite group play a dominant role in a quasi-market economy; and (3) those where there is no governmental accountability, corruption is widespread, and most fundamental elements of a competitive market economy are absent or ineffective. The dynamics of an isolated sale of a state enterprise in a working market economy is a completely different situation from a sale occurring in the midst of massive privatization, such as what has been going on in Central and Eastern Europe.

The origins of state ownership may fall into one of the following four categories: (1) normal government service; (2) nationalized community asset; (3) state-incubated enterprise; and (4) state-institutionalized enterprise.

A normal government service is one which, in the view of the majority, should be available to all, but requires a taxpayer subsidy. If left to market signals, such a service would only be available to a subgroup with sufficient income to pay a price above or equal to marginal cost. Historical examples have included education, communications and utilities.

The copper industry in Chile is an example of a profit-generating community asset which was nationalized. The production of copper required a combination of an existing national resource and an investment for its mining. The representatives of the Chilean people decided that the return to those making the mining investment was disproportionate to the return to those contributing the national resource.

The Chilean sugar and salmon industries were state-incubated enterprises. The financial power of the state was used to fill an entrepreneurial void and create a profit making activity. The early return to the state came in the form of job creation, import substitution and export revenue. Once these enterprises were capable of operating profitably on their own, the state's goals could be continued without prolonged state ownership.

The final category are those enterprises and services which were taken over or created by the state to institutionalize its ability to direct economic activity toward the satisfaction of the majority of the population's consumer needs through central planning.

Employees can find themselves (1) proactively initiating the privatization of their state run enterprise or service; (2) reactively taking advantage of an unsolicited privatization effort initiated by the state; or (3) attempting to stop such a privatization effort. Employee ownership can be a tool for either of the first two options.

Competing interests in the privatization of a state enterprise or service include: (1) the government; (2) the community; (3) the employees; and (4) external profit seekers.

The state's interests could include an effort to transfer the politically difficult task of terminating employment or reducing the standard of living of state employees. It could also be seeking to reduce state expenditures where taxpayers are subsidizing an activity. The state may believe that the quality and cost of the product or service will be improved under private management (without reducing employment and living standards).

The community's interests include continued access to the service or product provided at a lower cost and a higher quality. The community is also interested in protection of the environment, local employment and its tax base.

Employees' interests include the maintenance or improvement in their standard of living, career stability and the opportunity to have greater control over the operations of their workplace.

External profit seekers are interested in gaining a return from their contribution to the enterprise which is greater than what they could gain by redirecting their contribution elsewhere. Employees can take on the dual role of profit seeker as well. Where the opportunity for profit is greater than an employee's other interest in the enterprise, that employee may act no differently than any other external profit seeker. Where such an opportunity does not exist, the employee would act as an internal profit seeker, one who is not indifferent to the reduction or elimination of the enterprise's operations.

How employee ownership is used also influences whether it will be a transitional form of ownership or a lasting one. When the rules of privatization discourage an organized block of employee shareholders from emerging, it is less likely that employees will establish an effective voice in governing their enterprise. Where acquisition of shares comes at below market prices and the resale of shares is not restricted, employees may also succumb to the temptation of a quick windfall. Such practices allow a privatization agency opposed to employee ownership to undermine a politically mandated employee ownership option. Employee ownership is used symbolically to diffuse worker opposition to privatization.

3. Broadening Ownership Through Privatization

Those who support the general mission of COG, broadening ownership of productive capital to those who have little or no capital, can certainly hold differing opinions on the advantages and

disadvantages of privatizing state-owned enterprises and government services. For the scope of this paper, we are more interested in which privatization situations are good opportunities for broadening ownership to employees and others with little or no capital. Where such opportunities exist, what can be done to facilitate this goal?

In the United States, it is estimated that 1% of the population owns 50% of the productive assets, 5% own 90%, and 15% own 100%. This leaves 85% of the population without any productive assets. Similar statistics can be generated for other parts of the world. It is to this final group in each region, that we seek to broaden ownership. We will refer to this group as the *capital-less*, meaning those with little or no productive capital.

The benefits of ownership include a say in how a productive asset is managed and the enjoyment of the benefits produced by that asset. Typically, owners enjoy these benefits in the form of cash, either as dividends or the proceeds of the sale of their ownership interest. To some extent, the entire population can participate in the ownership of a state enterprise or service. As citizens, we have a say in selecting the representatives who appoint the managers who operate state services. We also enjoy the benefits of the state service, whether this is driving on a public road or getting an immunization shot at a public clinic. Our net benefit would be determined by subtracting out the taxes and service fees we paid.

As consumers, our input is expressed through our decision to purchase a service from a private provider at the market price; however, this input is only meaningful if we have the means to pay the market price. We must be able to choose between yes and no. In theory, our net benefit is zero because we either pay a market price equal to the value of the benefit received, or we pay nothing and receive nothing.

By framing the issue this way, we can now ask the question, will the privatization of a specific state service or enterprise broaden or restrict the ownership of the capital-less? Answering this question goes beyond the scope of this paper. The privatization situations we will consider here will be based on the assumption that either (1) the capital-less are not adversely affected by them, or (2) the option of preventing the privatization is not realistic. This leaves us with the question: would the use of employee ownership in a particular privatization situation contribute to the goal of broadening ownership to the capital-less?

The capital-less can be divided into two groups: employees of the enterprise in question or non-employees. The issue of direct benefits which the capital-less receive from state enterprises and services was already discussed above. What about the financial interest of the non-employees? Where the operations of a state enterprise or service (meeting the above assumptions) require a continuous taxpayer subsidy, the interest of the non-employees could be summed up as the liquidation value of the assets less the cost of shutting down the operation. From the taxpayer's perspective, these shut down costs include whatever additional costs the government will incur due to the resulting unemployment and loss of tax revenue. Assuming this net value is positive, the taxpayers may be compensated for this positive value either through the proceeds of the privatization transaction, or the future stream of tax revenue coming from the successor enterprise.

Where an enterprise or state service actually contributes a net profit to the taxpayers in addition to the normal tax revenues collected, a value can be assigned to this income stream and the taxpayers can be compensated, again, through the proceeds of the privatization transaction.

The rest of this paper will focus on the use of a privatization situation for broadening ownership to the capital-less employees of the state enterprises or services involved.

4. When Does Employee Ownership Make Sense?

Employee ownership only meets the goal of broadening ownership of productive capital when those employee-owned businesses are operated in a way that maintains and increases their value. As a job preservation strategy, employee ownership can keep a privatized enterprise operating even though the business does not produce a sufficient return to attract an investor. Where employee ownership can make a privatized business no less viable, and perhaps more viable, than the absence of employee ownership, it makes sense. Thus, it is important to examine the factors that determine the feasibility of employees succeeding at privatizing their enterprise as a viable business.

Willingness of the state to sell the enterprise or service to the employees

When those who control the privatization process have eliminated employee ownership as an option, it is a significant challenge for the employees to reverse the policy. In Russia, some employees have had some success by simply taking over their enterprise by force. In countries where the rule of law is more developed, law suits and political campaigns may also succeed; nevertheless, such successes would be the exception, not the rule. Why would a government agency responsible for privatization be unwilling to sell a state enterprise to its employees?

Personnel within the agency may have a vested interest in selling assets cheap, almost at throw away prices, to associates within the private sector. This is likely to happen in countries where cronyism or widespread corruption are common. There also may exist an ideological prejudice against the working class, in countries where an elite group dominates the economy.

In a country that lacks a well-developed market, selling to employees may just result in transferring ownership from a non-market-based government company to a non-market-based private company. If the private company continues to operate inefficiently, covering continuing losses with additional debt or the liquidation of excess assets, privatization will not improve the situation. This was part of the problem in Russia. Where economic reformers are attempting to engineer a market economy, they may also be influenced by the misguided assumption that concentrating ownership into the hands of fewer decision makers will speed economic growth. Some confuse employee ownership with socialism.

Even where governmental accountability and a competitive market economy exist, a privatization agency may resist a sale to employees. It may be interested in quick cash proceeds or it may believe that the employees are not as capable as an alternative buyer to continue making the service available to the public at the highest quality and lowest cost. It may believe that the employees will fail and the state will be drawn back in to the situation.

Employee interest in becoming owners

When employees own a significant piece of their company, have opportunities to contribute proposals for improving its operations, and participate in ownership training that helps them understand their business, such employee-owned companies outperform the traditionally-owned

competition. This may be a crucial factor when the motive for privatization is a state enterprise's inefficient operation. If employees are forced to become owners against their will, the new private enterprise could be handicapped from the start.

Why would employees not be interested in ownership? Where the rule of law and a working market economy are absent, employees, just like other potential entrepreneurs, may not believe ownership has anything to offer them. They may be suspicious of the private market. If there is no effective enforcement of their ownership rights and if operating a business subjects them to pressures from organized crime for payoffs, this belief could be realistic.

Fear of risk is another important factor. In political-economic contexts where either a small elite or the government has always controlled everything, an attitude of dependency and lack of self confidence can permeate the working class.

Realism could be the key factor. It may be clear that the enterprise or service has only survived to date because of taxpayer subsidies. The current level of wages and benefits may not be sustainable without the public funds.

Even where the rule of law and good market conditions exist, employees may not have the resources to effectively explore the option of employee ownership as a response to a privatization opportunity. They may lack the professional support to explore the situation, or the financial means to pay for such support. In some cases, employees may simply lack the knowledge that employee ownership is even an option.

Unions which represent employees may find themselves divided in their view. They may not want to be organizing an employee bid at the same time that they are running a campaign to stop the privatization completely. Or, in the case of unions representing federal employees, they may not have a strong incentive to get involved in an employee buyout, because they cannot represent employees in the private sector.

Privatization can be a publicly owned body selling off inefficient assets to a person or organization buying those assets in order to gain a return on their investment. The return can come from liquidating property or obtaining concessions from workers on pay and conditions. Receiving a just wage for providing a worthy service to the public, which would otherwise be watered down or canceled for impoverished beneficiaries, is a valid reason to oppose privatization. This would be the more typical privatization situation in countries like the UK.

Looking at the former Soviet Union and its satellites, many traditionally commercial activities, which should depend on consumer demand, are being privatized. In these cases, the state is and perhaps should be no different from any other owner who has to determine whether the consumers are willing to pay a price that sustains a just wage and fair return. The question, then, is not whether investments in non-valued production should be redirected into production valued by consumers, but *when* and *how* this transition should take place.

The community has, in my opinion, a moral obligation to sustain those members who have fallen on hard times, but such charity is more effective through direct support, rather than the subsidizing of unneeded production. Employees, and their representatives, of such activities should accept the inevitable and work in a constructive way with the state to develop a future economic activity which

can sustain just wages. Sometimes, redesigning the operation of the existing enterprise (improved quality and reduced costs) can bring its products back into demand—employee ownership can make a big difference here. Sometimes, additional training and job search assistance is the only realistic avenue. But *never* should the state wash its hands of the fate of a group of employees by simply transferring the ownership of the assets to them in lieu of a well thought out economic development plan which might be more costly to the taxpayers.

Competent management

Employee-owned businesses, like any other, need people capable of selling their product or service, organizing the operation effectively to control costs and ensure quality, and managing their financial affairs to make sure cash is available to pay bills when needed.

Where a market economy was absent previously, few managers have had the opportunity to deal with the kinds of issues they will be faced with when running a private company. The supply of qualified managers is tight and such people will go where they can be highly paid. Where the newly privatized firm is forced to either reduce or cap the wage and benefit package, workers may resent giving their managers a competitive compensation package.

Where the rule of law is weak or non-existent, another difficulty is finding managers who will work on behalf of the interests of the shareholders, both employees and outsiders. Managers do not find themselves being held accountable to anyone and this provides an enormous opportunity to use the enterprise's assets for personal gain.

Even in countries where the rule of law and market economy are well developed, obtaining competent management is a challenge. Those who have been managing a public entity may be resistant to turning over control to others with more experience in the private sector.

Available market for the product or service

The need for a market is probably the biggest challenge faced by employees privatizing their enterprise. No matter how well-managed a company is, if no one is willing or able to buy its products or services at a price that can sustain the standard of living of its employees, it will fail.

If the state's motive for privatizing a service or enterprise is because it is a drain on the budget, it is likely that the private demand at a market price will be lower than what the state was supplying. The newly privatized company will only be selling to that segment of the previous customers who can afford to pay. A smaller market will result in pressure to reduce the level of employment.

Where an entire country is going through a transition to a market economy, general economic conditions could be such that the domestic market for a newly privatized company may have shrunk. Foreign competitors may be taking a significant share of a market which is otherwise declining due to a drop in consumer income. The ability to sell to the export market may be inhibited by the inability, whether real or perceived, to match international quality standards.

Where the rule of law is weak, entry into new and potentially profitable markets may be restricted by gatekeepers such as government bureaucrats with licensing authority or organized crime bosses.

Competitive operation

The state of the equipment, the level of technology, and the efficiency with which these are operated, all influence the ability of a company to produce a product or service at a competitive price and level of quality. Access to quality inputs, whether raw materials, skilled labor or energy, at competitive prices is also important.

Where a centrally-planned economy has been dismantled, established supplier relationships are often in disarray. Higher skilled employees may find they are much freer to change positions and could be attracted away by other companies in more lucrative activities. Years of isolation from the West may have left the equipment and technology unsuitable for producing for the international market. Energy sources may now be controlled by private monopolies that increase prices from a government subsidized level to a premium high.

In countries where state companies were created for the purpose of import substitution, the simultaneous removal of trade protections may not leave enough time for an uncompetitive operation to make the necessary adjustments before being swamped by foreign competition. On the other hand, where the state filled the initial entrepreneurial role of creating a new industry, the newly privatized firm may find itself in a highly competitive position.

Labor management cooperation

Perhaps the greatest asset which employee ownership can bring to the privatization process is labor management cooperation. The newly privatized company can no longer count on the taxpayers' deep pockets to cover its losses. External profit seekers will seek to eliminate losses by reducing the standard of living of their employees while increasing the productivity demands. This is a certain recipe for labor strife.

Wage concessions may be an unavoidable part of the equation for a newly privatized firm. And yet, without a strong healthy working relationship between the workforce and the company's leadership, many of the necessary changes and improvements may never be completely implemented. Where employee ownership provides workers with a significant enough stake in the company's future value, these wage concessions can be reinterpreted as wage investments. Without successful labor-management cooperation, even where employees are owners, the promise of future wealth will sound hollow.

Financing acquisition, working capital and growth

Privatizing a state enterprise or service requires financing for three key needs. The first is the value of the assets which the taxpayers are turning over to new owners. The second is the cash needed to pay bills during the long period between start up and collection of payments from customers. When the entity was simply a subdivision of the state, it may not have needed to concern itself with working capital. Strategic development is the third financing need. Many newly privatized companies will need to upgrade equipment, acquire more recent technology, develop new products and services, and find new markets. These changes will fuel the growth that increases the value of the productive assets which the employees are acquiring.

In countries where the rule of law is weak and the economy is dominated by an elite group, a monopoly on capital credit generally leaves employees in a poor position to find reasonably-priced financing. Where the government favors employee ownership, it may be able to extend seller

financing to the employees, i.e., accept a note in lieu of cash; however, the government probably lacks the resources to lend the additional cash needed for working capital and growth. The standard of living in less-developed countries also limits the ability of employees to contribute sweat equity in the form of reduced wages and benefits.

5. What Is To Be Done?

While not every state service or enterprise should be privatized, where privatization is inevitable, capital-less employees should have a fair opportunity to create an employee-owned company that allows them to broaden their ownership of capital and gain a greater voice in shaping the destiny of their workplace. The success of such undertaking rests on overcoming a multitude of challenges as described above. Who can play a role in meeting these challenges?

International donor and lending institutions, national governments, regional credit institutions, regional technical assistance organizations, labor organizations and employees themselves, all can make a difference.

Overcoming the unwillingness of the privatization agency to consider an employee bid
Privatization agency decision makers opposed to employee ownership can be categorized as either those using their position for personal gain or those sincerely acting in the public interest. Where the public servants are not serving the public, the options are to (1) remove them, (2) force them to act appropriately, or (3) collaborate with them. Where the decision makers are trying to do the right thing, two possible strategies are education and helping to remove external pressures which control their actions.

The Russians have a saying: *cheloveka nyet, problemy nyet* – remove the troublemaker and the problem disappears. Where a rule of law exists, exposing and prosecuting corruption may be an effective way of dealing with bad public servants. Where democratic elections and a free press exist, the voters themselves may be able to put pressure on elected officials to fire corrupt bureaucrats. More often than not, though, where corruption is wide spread, entrenched bureaucrats may be hard to remove.

Where the players cannot be changed, the next option is to try and create rules of the game which put constraints on their ability to misbehave. Forcing transparency upon the privatization bidding process can help. Also lengthening the time frame of the process of privatizing an enterprise and informing the employees and the public early in the process will allow the proponents of an employee bid to get organized rather than accepting a *fait accompli*. Organized labor can also form coalitions that prepare themselves in general to deal with privatization opportunities in order to be ready when situations emerge.

In some countries, changing the rules of the game may be unrealistic. Then the final option is to build a relationship of trust with the entrenched bureaucrat and identify ways in which employee ownership can be in his or her self interest.

Many people in privatization agencies truly want to do what they believe is best for their community. In some cases, they may not personally be against employee ownership, but they may be under pressure from transnational actors who hold some leverage. For example, the International

Monetary Fund, the World Bank and the US Agency for International Development all provide funds that can facilitate economic development. Employees of these agencies sometimes impose their own views about the “right way” to privatize and make their funding contingent upon conformance. In these cases, convincing these international actors that employee groups can be qualified bidders may help, as well as organizing political pressure on them.

Education can be very important for privatization agency personnel. They need to be made aware of the full process and impact of privatizing an enterprise. Some view their task as narrowly as simply transferring assets out of the state’s hands, without any concern for how those assets are used subsequently. Some have unrealistic expectations of the intentions of buyers to transform the enterprise into an entity that contributes to the economic well-being of their community. They may be ignoring the economic, social and political costs of throwing the fate of thousands of employees into the hands of a profit-seeking investor.

Many privatization agents simply have not been exposed to the real world of employee ownership. Well-targeted study tours to visit successful employee owned companies, both abroad and in their own country, can help to dispel unwarranted prejudices.

Building employee interest

It is not surprising that many workers are resistant to the idea of seeing their company move from state ownership to employee ownership. Part of this resistance can be attributed to objections they may have about private ownership in general, but some may also be simple disbelief. To build employee interest, one must overcome both ideological objections and personal fears. In turn, to overcome personal fears, tools and resources must be available to make a successful outcome realistic.

One ideological objection to privatization is the belief that the nation’s patrimonial assets are being taken away from the community. Workers who are comfortable with a socialist way of thinking may feel strongly that the means of production should be controlled by the community, not distant investors. Employee ownership, to the contrary, anchors the national industrial jewels in local communities. While outside buyers may plan to move the economic activity away, employee owners are part of the local community.

Organized labor may object to privatization because it is often done in a way that weakens their ability to protect the rights of their membership. Laws that govern labor relations in state enterprises may not apply to private companies and past promises of job security and benefits may not be honored by the ownership successors. Showing union leaders models of employee owned enterprises where labor leaders continue to play an important role can help deal with the question: how do we bargain with ourselves? Labor leaders can benefit from understanding the advantages and disadvantages of a broader set of scenarios than simple status quo or sale to an outsider. Building a contingency plan around an employee bid can help them prevent a worse outcome if the fight to stop the privatization fails. Unions need to figure out ways to simultaneously prepare for an employee purchase at the same time that they are campaigning to stop any sale.

In addition to the discussions about whether privatization is good or bad, individual workers have fears about what will happen to them personally. Proponents of employee ownership in privatization need to listen to workers express these fears early on before pushing the privatization

process forward. Upon identifying these fears, strategies for dealing with them need to be included in the plan. Educating employees about where employee ownership has worked in privatization can go a long way. Someone typically sees a capital gain after the sale of government assets; employee ownership can allow workers to share in this gain. Also making them aware of the assistance and structures available to help them succeed will reduce some concerns.

Technical assistance programs designed to educate employees and organize them as proactive agents in the buyout process are important. Funding must be made available for prefeasibility studies which explore legitimate concerns and explain how their firm will succeed as a private employee-owned enterprise.

Employee fears of failure without the deep pockets of the state can be softened if they know there is a fund set up to guarantee no first year layoffs. Procurement contracts from the state to guarantee a minimal level of production can help. And the establishment of a national credit agency specifically for enterprises which were previously on the state budget can ease concerns about not having a deep pocket.

Finally, helping employees build connections to the political powers responsible for their future can open up lines of communication and build trust. Employees must sense that the government is sincere in its willingness to accept the long term challenge of seeing that they have income security.

Developing competent management

A large part of the rationale for privatizing a state enterprise is the conviction that the state does not manage it as well as private owners would. The logical conclusion, then, is that original management is inadequate and either needs to be replaced or assisted. If poor management is the problem and better management can be obtained, then this may be a poor rationale for privatization. Where an entire economy is moving from state planning to market conditions, the management challenge may be much more acute.

While incompetent management may not be the correct rationale for privatization, the principal-agent problem may be. State companies and publicly held companies (ie, traded on the stock market) often share the same problem – the owners are too far removed from the business. If managers can get away with wasteful practices without being held accountable, they sometimes will; especially where the company's waste is their personal gain. Privatization is intended to align the interests of the owners and the managers by making them one and the same, or at least to create up-close owners (as Jeff Gates calls them) who are better able to keep an eye on their managers.

Certainly a possible alternative to privatization would be decentralization into local autonomous units with economic incentives based on local performance, while retaining state ownership.

While the original managers should not be dismissed without review, it seems appropriate that their permanence in their positions not be taken as an *a priori* either. A reasonable amount of time should be dedicated to reviewing a number of management options including that of retaining current management.

In addition to the standard set of management skills (sales, finance, operations), values consistent with the ownership culture of an employee-owned company should be identified and used to screen

candidates. Where corruption is widespread, another criterion may be the personal financial position of the top manager. Some advisors have even joked that one needs to find someone who has already stolen enough previously, that they are now willing to focus on making the company successful.

Another challenge for attracting good managers to employee-owned companies is financial incentive. If the managers' stake is not sufficiently large, adding value to the shares of all the stockholders may not be an important enough priority for them. Designing an incentive strategy which is generous to managers who perform well for the benefit of all is superior to high salaries which drain much needed working capital and do not hold top management accountable.

In transition economies with very limited pools of ready-made managers, there will be some developmental needs. One way to address this is to create a matrix of all of the relevant skill sets. Not only can the matrix be used to assist in the selection process, it can also serve as a diagnostic tool to assess management developmental needs. Training resources to strengthen each skill set in the matrix can be systematically identified.

Privatized enterprises struggling to survive under unfamiliar market conditions do not have the luxury of waiting for their managers to gain sufficient market experience. During the first one to two years, these companies would benefit from the assistance of short term experienced managers. To make such people available, the privatization agency could establish a management intervention team which supported several companies at a time, or it could subcontract this task out to a network of employee ownership and turnaround managers. The cost for this could be rolled into the overall long term acquisition financing.

A lower cost alternative would be to bring networks of newly privatized enterprises together on a regular basis for in depth roundtable discussions. The group could share experiences and concerns with each other and also benefit from the input of a few experienced managers. The Internet can also serve as a networking tool; for example, a closed list serv which allows a select group of managers to query each other about periodic challenges.

Oversight of management is another significant challenge. The role of the board of directors is an important check on management. Employee owners are not normally equipped with the typical board member skills needed to review management's operation of their company. Over time, this can change with the proper training. The natural divisions of opinion between management and labor can be more successfully resolved with the assistance of a mutually-selected outside board member with the power to intervene.

Outside board members who have managed in the commercial environment can help a newly privatized employee-owned company get off to a good start by initially assessing and monitoring performance of senior managers.

A transition board can be a good idea as well; one that serves as a guardian of the employee owners' interests until they are ready to play a more active role responsibly. Such a board may also be important for assuring that commitments made to the privatization agency about the continued use of the assets to benefit the local community are met.

Creating a viable market

Enterprises facing privatization sometimes find themselves without sufficient demand for their product or service to support their operations at full capacity. Prior to moving forward with the privatization process, a prefeasibility study should be conducted which includes a realistic forecast in order to measure the size of the problem. The study should also look at alternative services and markets which can fill the gap.

Where a reduction in demand is due to the inability of former consumers to continue their consumption at the market price, this demand can be shored up through either the distribution of vouchers to the consumers or subsidies to the enterprise. Vouchers allow the enterprise to charge market prices and a subsidy would allow the enterprise to lower its price to attract more consumption. A third way to maintain the market is for the government to guarantee a minimum level of procurement for a transitional period.

If the enterprise is expected to lose customers to new competition, one possible method of building customer loyalty is to provide equity in the new enterprise to the consumer group itself through a Consumer Stock Ownership Plan (CSOP).

For the long term, the company's products or services are going to have to compete in the market. This will require that they be made attractive to the consumer. Where management has not had to make products marketable before, some investment in marketing skills training is warranted.

Building a competitive operation

No business can be a source of wealth creation for its employee owners if its revenues do not exceed its costs. The newly privatized enterprise needs an environment in which it can be competitive. Assuming, at least in the beginning, comparatively low levels of quality and high levels of cost, the new company may not be able to enter the international market immediately. It also may have a difficult time competing against imports if no government protections are in place.

The privatization agency should only accept bidders with business plans that include a realistic three to five year plan of operational improvements and capital expenditures which will allow the enterprise to compete unassisted eventually. During the transition period, however, either government subsidies to make competitive prices possible or protective tariffs to make higher prices competitive will be necessary.

Establishing labor management cooperation

Research shows that when employee ownership is combined with employee involvement in decision making, productivity, profitability, and turnover rates improve. Building a relationship of labor-management cooperation can go a long way towards making the newly privatized enterprise competitive by both improving quality and reducing costs.

Experience with open book management and other labor-management cooperation practices is widespread. The transfer of this experience to locally-based technical assistance and training centers can help employee-owned enterprises climb the learning curve much faster.

Networks of enterprises which include companies that have had some success with employee involvement can be very powerful. They allow managers to witness first hand the impact of such programs and to discuss their concerns with their peers.

Financing successful employee-owned companies

Financing the acquisition, working capital and development of a newly-privatized employee-owned enterprise faces several challenges. These funds can come from a variety of sources including the seller (the government); traditional private lenders; regional, national and international development banks; equity partners and the employees themselves.

The government should consider seller financing of an acquisition by employees. If the enterprise was a drain on the state budget before, taking a note does not put the state in a worse position. If it was a contributor to the state budget, as long as the debt service and income taxes paid match the previous contribution, it is also not in a worse position. Of course this assumes that the buyer will preserve and enhance the value of the assets. If the buyer intends to strip the assets, the state could find itself holding a note with nothing to back it. Where the workers control the enterprise operations and effective oversight of management is in place, asset stripping is less likely to occur.

Where a portion of the ownership is sold to an outside investor, again the state would be no worse off lending the funds back to the employees of the enterprise for working capital or capital investments. Alternatively, the state could accept a note from the employees for the acquisition and the outside investor could provide the funds for working capital and capital investments in exchange for a portion of the ownership of the new enterprise.

Payments on the note could be adjusted to the profitability of the enterprise. During the early years, payments would be minimal or deferred, and increased once the business is stabilized. Extending loan terms for long periods would have a significant impact, as 30 year mortgages have been made home ownership a reality for millions in the United States.

One viewpoint is that in exchange for the state assistance, the employee owned firm should relinquish rights to any excess profits. Defining excess profits may be problematic. Also, such an agreement could be a disincentive to operating the business profitably. Perhaps the most effective way to carry out such an arrangement would be to give the state stock options at a reasonable future target price.

Where it is realistic, workers should be required to contribute to the necessary financing of their company. Such a contribution can establish a sense of commitment to the endeavor and be a major step towards the transition to a culture of ownership. While the ability to contribute is an asset, the lack of such ability should not be used as a barrier.

In some countries, workers have accumulated retirement assets which can be used. Risking diversified retirement assets to purchase shares in a newly privatized company is a serious matter and is justifiably seen as a means of last resort; however, dedicating a percentage such as 20% is not unreasonable. Where wages and benefits are sufficiently above a comfortable standard of living, the use of a reduction in compensation to be used to service additional debt is another possibility. In some cases, workers may take on personal liability to borrow a portion of the necessary funds, and

then apply future profits to the repayment of this debt. This personal liability should only cover that portion of the funding which cannot be collateralized with the enterprise's own assets.

Another source of funds is an equity partner. Sharing control with an outside investor may be preferable to taking on personal liability and has the potential to bring in needed expertise. At the same time, the pure interests of the workers will be subject to compromise. Side agreements to define the future disposition of the outsider's shares can enhance the workers control over the future evolution of ownership.

Where there are no reasonable methods for financing worker acquisition of a controlling ownership share, non-monetary shares with defined voting rights may also give the workers a level of protection where an outside investor acquires the controlling interest. At a minimum the workers would have the right to veto negative practices such as asset stripping.

6. Conclusion

People who work for themselves do a better job. Research strongly suggests that workers who own a piece of their company, who understand the benefits to be obtained from that ownership, who are given the opportunities to participate in decisions which can enhance the value of their property, and who are given the training and education to make their participation meaningful – such workers transform their enterprises into companies which consistently outperform their competition.

An enterprise can be operated more efficiently by people who clearly understand that their own personal well-being depends on that efficiency. This has been proven time and time again where employee owners have taken over unprofitable corporate divisions, only to turn them around dramatically within the first six months.

Where the bureaucratic structures of the state have proven ineffective in operating a state-owned enterprise, creating up-close owners can often be the best solution for enhancing the value delivered by the enterprise to its customers. Unfortunately, in too many cases, privatization has been watered down from the establishment of owner-operated businesses to the paving of the way for enrichment of the few at the expense of the many through a simple transfer of property followed by systematic asset stripping.

This paper has supported the position that employee ownership is the best form of creating up-close owners through privatization. It has reviewed the necessary conditions under which employee ownership can successfully broaden meaningful capital ownership to the vast majority who remain capital-less. Finally, it has compiled numerous recommendations for increasing the likelihood that an employee owned privatization effort will succeed. May privatization agents of goodwill throughout the world seek to continually enhance privatization as a tool for broadening capital ownership.