ZAMBIA
Post-Privatization Study

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Executive Summary

Background and Methodology

The World Bank seeks to assess the effectiveness of the privatization program which was initiated in Zambia in 1992 with significant assistance from The World Bank and other donor agencies. The authors of this paper were asked to review a representative sample of companies in order to assess the effect of privatization on their performance. The twenty largest non-copper mining companies by purchase price, the twenty largest non-copper mining companies by current assets at time of privatization and a remaining sample of smaller companies were chosen for the study. Via a series of sources, performance indicators for 48 companies were gathered and analyzed.

The responding companies were broken down into eight business sectors. The companies were assured confidentiality regarding their individual company responses. The data analysis was predicated on presenting results for groups of companies with a sample size of at least five. The indicator most consistently reported by companies was turnover. This indicator was chosen as the most reliable available gauge for analysis of performance.

Raw turnover data for each company was requested for the period from 1992 through 2001. Most companies have a fiscal year that runs from April 1 to March 31. The raw local currency data was adjusted for inflation and, in a separate exercise, was converted to US dollars. The sample was split into larger companies (the twenty largest by purchase price) and smaller companies. The data were analyzed with respect to industrial sector, mode of sale, dependence on the Zambia Consolidated Copper Mines (ZCCM), nationality of the purchaser (indigenous or foreign) and percentage of income derived from exports. The data were also indexed to both the year privatized for each company and to the year 1998, the year for which the highest percentage of companies reported data. In addition to turnover, statistics on employment levels, profit and losses, capital investment and sales volume were gathered.

Chronological Trends in Company Performance

- Based on turnover data deflated by the CPI, almost two-thirds of the companies declined within the 1992-2000 period. However, a majority of large companies showed a positive growth rate, while the majority of smaller companies experienced negative growth;

- In the aggregate, real turnover results indicate a steady decline prior to 1998 and virtual stagnation since. However, larger companies showed turnover improvement since 1998, while smaller companies showed steady decline through 2000;

- All companies show a drop in employment levels since 1996, with larger companies showing a steeper drop than smaller companies. Overall, real turnover per employee declined through 1998, but has recovered since to 1996 levels, the median year for privatizations. For the largest companies, real turnover per employee has rebounded to levels of the early 1990s. For smaller companies, productivity has stagnated in recent years;
• Larger companies show operating losses in the 1998 and 1999, with a small profit in 2000, while smaller companies show sustained losses from 1996 to 2000. However, the manipulation of profit/loss data for tax purposes must be taken into consideration in evaluating these trends;

• Larger companies account for the majority of capital investment;

• A sharp drop in small company sales volume prior to 1996 suggests gross under-reporting of performance data in the run-up to privatization.

Pre- and Post-Privatization Trends in Company Performance

• Indexing real turnover to the year of privatization of each company reveals an aggregate “privatization curve” for these companies: a steep decline to the year of privatization, a slight rebound in the following two years, and a modest decline in years three and four of the post-privatization period. Despite the initial rebound, most companies have not recovered to real turnover levels of the early 1990s;

• Larger companies follow the standard privatization curve, but show a more moderate decline before privatization and a stronger rebound after privatization than smaller companies;

• The standard privatization curve does not hold for mining supply companies, which continued to do poorly after their own privatization due to the drag effect of delayed mining privatization;

• All other sectors follow the standard privatization curve, with the agriculture sector and the food and beverage sector showing the sharpest initial decline and strongest post-privatization rebound;

• Performance by companies purchased through competitive bid sales follow the standard curve. Performance by companies purchased through pre-emptive rights sales (usually to foreign investors holding minority shares and a management contract) was unaffected by privatization. Performance by companies purchased through management buy-outs show a continuous and steep decline;

• Companies with low inter-dependence with copper mining follow the standard privatization curve. Companies with medium inter-dependence follow the standard curve, but show a sharper recent decline that may reflect efforts by the new mining owners to diversify supply sources. Companies with high inter-dependence with copper mining did not follow the standard curve, showing no post-privatization rebound until four years later, coinciding with privatization of the mines;

• Companies purchased by Zambian investors showed a sharper decline in performance prior to privatization. It is possible that Zambian investors were attracted to firms with a strong track record within a highly protected environment, that declined rapidly in a liberalized environment. However, little difference exists in post-privatization performance between companies with indigenous or foreign owners;
Companies that are not export-oriented follow the standard privatization curve most closely. Heavily export-oriented firms began their recovery prior to privatization—undoubtedly responding to the liberalized environment—and have rebounded to turnover levels of the early 1990s.

**Conclusion**

In the early 1990s, parastatals in the manufacturing and commercial sectors operated in a highly protected environment. With economic liberalization in the 1992-94 period and impending privatization, non-mining parastatal performance, as measured by real trends in turnover, declined dramatically, especially for smaller enterprises. This decline probably reflects a combination of factors—including insufficient competitiveness in a liberalized trade environment, and increased inefficiency or deliberate under-reporting of performance in the run-up to privatization. The data indicate that privatization was successful in stemming the decline in turnover, except in companies heavily dependent on the mining sector, where delays in mining privatization impeded recovery through the end of the decade. Turnover for most companies increased in the two years immediately following privatization. The rebound following privatization has been strongest and best sustained for the larger, export-oriented companies, contributing to the strategic goal of promoting export-led growth.

Unfortunately, for most companies—typically smaller and less export-oriented—the initial benefits of privatization have been difficult to sustain, and performance has faltered after the initial two years. Although recent performance has been better than in the immediate pre-privatization period, turnover among most companies has never recovered in real terms to early 1990 levels. In some cases, this probably reflects a lack of economic viability of the firm, which should have been liquidated instead of subject to lingering death through internal privatization. In all cases, however, the economy-wide impact of delayed mining privatization—which was sufficient to keep economic growth negative throughout the decade—served to lower investment, investor confidence and aggregate demand, with negative consequences for post-privatization performance of most companies. Privatization of the major mines in 2000 has spurred investment and consumption, already accelerating aggregate growth, and likely contributing positively to performance of many of these companies in 2001 and beyond.

Difficulty in sustaining the net benefits of privatization can also be attributed to a suboptimal domestic and regional environment for private sector growth. Qualitative assessment of these constraints through interviews with company management highlighted: a) fiscal distortions that disfavor local production, marketing and exporting; b) weak regional economies; c) continued regional trade barriers and unfair trade practices; d) lack of long-term financing and working capital, especially for smaller firms; e) unpredictable and frequent changes to fiscal and exchange rate policies; f) labor market rigidities and excessive statutory employment benefits; g) cumbersome judicial processes; g) excessive bureaucratic interference and corruption. Greater attention to these constraints within the domestic and regional environment is warranted in future World Bank assistance strategies, in order to enhance the benefits of privatization and maximize new private sector growth.
1. Study Parameters

Selection of Companies

Fifty-six companies were selected from a database compiled by the Zambian Privatization Agency (ZPA) that included data for 218 privatized companies.

Companies were sorted according to U.S. dollar purchase price. Not all company transactions were in U.S. dollars, so purchase price information was converted from Kwacha purchase price and Rand purchase price to US dollars at the average annual exchange rate.

Companies were also sorted according to the value of their fixed assets at the year of privatization. The twenty largest companies according to this sorting included four companies that were not in the first list of largest twenty companies according to purchase price.

The union of these two lists resulted in twenty-four companies. These companies operated in the following sectors: agriculture, chemicals, construction, energy, engineering, manufacturing, mining (non-copper), tourism, trading, and transport.

A further thirty-two companies were chosen within these sectors to provide a larger sample size per sector. In selecting these companies, consideration was given both to the size of the company and to geographical constraints.

Response Rate

Of the fifty-six companies originally identified, eight were associated with bundled purchases and represent three currently operating companies. This resulted in a group of fifty-one companies able to provide data.

There are two companies for which there is no data: one, a small manufacturing company, could not be contacted by phone or located physically. The other, a hotel, was unable to complete the company information form before the deadline.

One company has no post-privatization turnover data as of yet, having opened a new hotel only in April 2001. The new hotel represents an investment of over $40 million and employment for approximately 1000 people.

The date set therefore includes information for 48 companies.

Sector Breakdown

The companies were reclassified into 9 sectors, as the original ZPA sector classifications were not always clear. The sector breakdown for the companies is as per the table below.

Due to the low number of energy and finance companies, a combined energy/finance sector is used in conducting sector analyses. Many companies were concerned that while no individual company data would be released, confidential information could be deduced if there were too few companies operating in a given sector.
in Zambia. For all data manipulation, we sought to ensure that data for at least five companies existed in any sector.

<table>
<thead>
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<th>Total No. Companies</th>
<th>Total with No Data</th>
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<td></td>
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<tr>
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<td>2</td>
</tr>
<tr>
<td>Trading</td>
<td>5</td>
<td></td>
</tr>
</tbody>
</table>

**Size of Companies Responding**

The range of the dollar purchase price of the 56 companies selected for this study was $14,800,000 to $9,276. The range for the 218 companies in the ZPA database was $14,800,000 to $7,000, with 63 companies registering a zero purchase price because they were either handed back to the original owner or liquidated. The total purchase price of the 218 companies in the database (not including ZCCM assets) was 184.3 billion Kwacha, converted to 154.6 million dollars, based on conversions performed at the time of each individual sales agreement.

The 218 companies in the ZPA database contributed 66.1 billion Kwacha, or 65.8 million dollars, to the privatization account. The 56 companies in this study contributed the lion’s share of that amount, 60.8 million U.S. dollars, to the privatization account.

**Data Gathered**

Each of the fifty-one companies was asked for turnover, sales volume, profits and losses, export earnings, capital investment, stocks and inventories, indebtedness, employment, retrenchments, and average monthly salary data.

Turnover was chosen as the most reliable available gauge of company performance over time, as profits and losses may be distorted for tax considerations. Turnover also turned out to be the most universally accessible performance indicator for each firm. Sales volume information was difficult to gather, with only 26 companies providing sales volume figures.

**Data Sources**

Companies were asked to provide information from the year before privatization through the last complete fiscal year. Many companies could not provide data for all 10 requested fields in all years. Where there was no data, the data field remained empty, and this was taken into account when calculating index averages in order to exclude false zeros from the calculation.
For the years prior to privatization, information was gathered from several sources: the ZPA database, post-privatization questionnaires distributed in earlier years by the Ministry of Finance and the World Bank, ZPA company files containing tender documents, and company information memoranda, end of year financial statements and correspondence.

Forty-seven interviews were conducted with managing directors and/or finance directors of the selected companies. Of the remaining four companies, two declined to meet, one is in receivership, and one could not be contacted at all.

2. Performance Figures

Methodology

The data requested from the sample of companies represented varying complexity and challenge for each of the companies attempting to respond. Every company that did respond gave us some turnover information, where available, but not necessarily for each of the years requested. The other data was less successfully gathered. Although, we are presenting the employment, profit, capital investment and sales volume data, we focused on turnover data, because that was the most complete set of data available. Sales volume would have been an excellent representative parameter, but with only half the companies providing information in this category, it would have too sparse for concentrated analysis.

Using turnover data, we manipulated the raw data, which was predominantly reported in Zambian Kwacha. US Dollar to Kwacha exchange rates were obtained from the Bank of Zambia (BOZ) from 1992 to the present. All of the turnover data was converted to US Dollar equivalents. Separately, Consumer Price Index (CPI) data was obtained from the Central Statistics Office (CSO) from 1992. The turnover data in Kwacha terms was deflated using this CPI data. Both of these adjusted figures were analyzed and it was determined that the CPI adjusted figures are the better indicator for analysis. Based on this conclusion, the majority of the ensuing analysis was based on CPI adjusted figures.

Growth rates for turnover were calculated using both the US Dollar adjusted figures and the CPI adjusted figures. No other calculations were performed using the US Dollar figures. The CPI figures were normalized in two ways. First, they were indexed to the year 1998, the year for which the most complete data set was available. All other year’s figures are represented relative to 1998. Since all data uses 1998 as an index of 100, the remaining data was additive across companies. The CPI figures were also indexed to the year of privatization of a specific company. This allowed an analysis of companies’ performance relative to their privatization. These data are also additive, and they are a better indicator of the collective effect of privatization.
This chart suggests that the CPI Index is a more conservative measure for performance than a US Dollar analysis. Nonetheless, two-thirds of the companies analyzed show a negative overall growth rate from 1992 to 2000. This is caused by a variety of factors, most predominantly macroeconomic stimuli, but it still does not auger well for these companies that have been privatized. The next two charts split the companies into two groups, the twenty largest companies (by sales price) and the remaining smaller companies.
By splitting data into the two groups of the twenty largest companies and the remaining companies, one finds that the growth rates differ radically in these two groups. Eleven of the 20 largest companies have a positive growth rate using the CPI. (Thirteen have a positive growth rate using conversion to US Dollars) Conversely, only five of the remaining 29 companies show a positive growth rate. This difference highlighted the need to analyze these two groups separately for most subsequent data manipulation.
Indexed to Year of Privatization

Aggregate Data

**Aggregate Performance**

*Chart 4: Relative to Year Privatized*

By indexing real turnover data to the year privatized for each company, the aggregate data show that companies generally declined leading up to privatization. This decline is probably attributable to a loss of protected markets and monopoly positions as the economy liberalized. Another possible reason for the decline in turnover is the intentional under-reporting of company performance in the run-up to privatization. Privatization generally produced a rebound in turnover, but three years after privatization performance weakened again. This is partly attributable to dependence of businesses on ZCCM and the dramatic effect that delays in ZCCM privatization had on the overall economy. Four years after privatization companies are generally better off than at the time of privatization, although recovery has been very weak, falling short of early 1990s levels. Now that ZCCM has been privatized ensuing data is expected to show improved turnover.
Chart Nos. 5 & 6:

The aggregate results once the data is split show that the relative pattern is consistent. The smaller companies show muted results compared to the larger companies, but the pattern relative to the year privatized remains the same. In the aggregate, the data suggest that privatization stopped a declining trend and had a positive impact on performance. However, this impact was blunted by the crippling effect of the delay in the ZCCM privatization and other obstacles to private sector activity.
Industry Sector Data

Chart No. 7 (1):

The eight sectors were split into two groups, charts 7(1) and 7(2). In the first subset, one sees a predictable outcome: mining supplies companies have done poorly in the post-privatization period, due to the failure to simultaneously privatize the mines. The other three sectors have not shown a dramatic improvement, but the steep decline was generally halted at the time of privatization.
Chart No. 7 (2):

The four sectors in this chart follow the standard privatization curve. To varying degrees, the sectors improvement following the year of privatization, which then falters in later years. The agricultural sector showed particular improvement in the post-privatization period.
When analyzing all the companies on the basis of mode of sale, one finds that companies bought through a competitive bid process follow the standard privatization curve most closely, and rebound more sharply. Those purchased through management buyouts show continuously declining performance, while the companies acquired via preemptive rights show steady performance since privatization. One explanation for the performance of the latter group is that, though these companies were nationalized and majority shares belonged to GRZ, the management of these companies remained in the hands of the original owners. As such, this group of companies would experience less managerial or financial change through privatization. The management buyouts were all smaller companies that probably were unattractive to outside investors, and management never had the resources necessary to stem the decline that had begun earlier in the decade.
Chart Nos. 9 & 10:

The patterns are retained for each of the modes of sale regardless of size of the company. The companies acquired by competitive bid bottom out on turnover in the year privatized and then show improvement following privatization, whereas pre-emptive rights and management buyouts show stagnation or decline.
Chart No. 11:

When the privatized companies are viewed on the basis of their inter-dependence with ZCCM, a clear pattern emerges. Those with low inter-dependence follow the standard privatization curve, but with less tailing off in the later years due to drag from ZCCM privatization. Those with medium inter-dependence also demonstrate the usual privatization curve, but display more pronounced effects of the delay in the last two years. They may also show the effect of new mine owners’ efforts to diversify suppliers since privatization in 2000. Companies that are heavily inter-dependent with ZCCM show no rebound following their own privatization, but show a jump in the last year coinciding in most cases with privatization of ZCCM.
Nationality of Purchaser Data

Chart 12: Turnover Performance
Relative to Year Privatized
by Nationality

The pattern is similar for companies purchased by either Zambians or non-Zambians. However, companies bought by Zambians demonstrate a more precipitous decline prior to privatization. It is possible that indigenous entrepreneurs were more attracted to firms with a successful track record within a more protected environment. Little difference exists in post-privatization performance based on nationality of purchaser.
Chart Nos. 13 & 14:

For the 20 largest companies, the privatization process had little impact on turnover for those purchased by non-Zambians. The number of large companies owned by Zambians is small enough that the pattern in chart 13 reflects the performance of only a few companies. These companies suffered a sharper decline prior to privatization, but are among the few to rebound to earlier levels of turnover in real terms. Smaller companies owned by non-Zambians performed slightly better than those owned by Zambians, but the differences are minimal.
Most of the companies surveyed have no export activities. These companies follow the standard privatization curve: a decline leading to privatization, a modest improvement following privatization, and a marginal decline several years after privatization. Light and heavy exporters showed greater stability in turnover throughout the privatization process. Heavy exporters recovery began prior to privatization—undoubtedly responding to the liberalized environment—and has rebounded to the pre-privatization peaks of the early 1990s.
Most of the privatizations in the sample group occurred between 1995-1997. 1998 was chosen as the index year because it is the year for which turnover data was available for the greatest number of companies. This chart shows a steady decline in company performance through 1997, with stagnation over the next three years. Privatization of the major ZCCM mines in early 2000, which has been accompanied by major capital investments that have spurred employment and strengthened consumer demand, is expected to yield higher economic growth rates in 2001-2002 that would be reflected in the performance of many companies surveyed.
Chart 17: Aggregate Performance  
Relative to Fixed Fiscal Year 1998  
Top 20 Companies by Purchase Price

Chart 18: Aggregate Performance  
Relative to Fixed Fiscal Year 1998  
Non Top 20 Companies by Purchase Price

Chart Nos. 17 & 18:
Small companies showed a far more dramatic decline up to 1997, with continued modest decline thereafter. In contrast, the 20 largest companies experienced a less radical decline and have modestly rebounded in the 1998-2000 period.
Chart 19: Average Employment Levels
Number of Employees per Company

Chart No. 19:
The employment data for the period after 1996 is more reliable, as many companies could not provide employment data prior to 1996. The median year of privatization is 1996, and all companies show a steady drop in employment following that year. The larger companies showed a steeper drop in employment levels since 1996 than the smaller companies which began shedding labor earlier.
Employee Productivity

Chart 20: Average Productivity Levels
Index of Real Turnover to Employee

Chart No. 20:

Overall, real turnover per employee declined through 1998, but has recovered since to 1996 levels, the median year for privatizations. For the largest companies, real turnover per employee has rebounded to levels of the early 1990s. For smaller companies, productivity has stagnated in recent years.
In aggregate, companies reported losses in 1998 and 1999, with larger companies turning around with slight profits in 2000. Smaller companies have sustained a longer period of losses and have yet to recover. The manipulation of profit data for tax purposes must be taken into account when considering these figures. Recently privatized companies have incentive to show losses because they receive tax credits that carry over into the future.
Of the companies that reported capital investment data, larger companies account for 75% of investments over US $10 million and less than 10% of investments under US $1 million. Larger companies have greater access to capital, while smaller companies report difficulties accessing finance.
Sales Volume

Chart 23: Average Sales Volume
Indexed to 1998

Chart No. 23:

Sales volume data follows the familiar privatization curve for turnover data, with larger companies reporting smaller decreases prior to 1998, and a greater upturn after 1998, than the smaller companies. The data for smaller companies indicates a sharp drop in 1995, just prior to the median privatization year. One possible reason for this drop is that there may have been a particularly high level of under-reporting of sales volume in small parastatals, due to looser reporting structures controlled by fewer managers.
Summary of Findings

Chronological Trends in Company Performance

- Based on turnover data deflated by the CPI, almost two-thirds of the companies declined within the 1992-2000 period. However, a majority of large companies showed a positive growth rate, while the majority of smaller companies experienced negative growth;

- In the aggregate, real turnover results indicate a steady decline prior to 1998 and virtual stagnation since. However, larger companies showed turnover improvement since 1998, while smaller companies showed steady decline through 2000;

- All companies show a drop in employment levels since 1996, with larger companies showing a steeper drop than smaller companies. Overall, real turnover per employee declined through 1998, but has recovered since to 1996 levels, the median year for privatizations. For the largest companies, real turnover per employee has rebounded to levels of the early 1990s. For smaller companies, productivity has stagnated in recent years;

- Larger companies show operating losses in the 1996-1999 period, with a small profit in 2000, while smaller companies show sustained losses from 1996 to 2000. However, the manipulation of profit/loss data for tax purposes must be taken into consideration in evaluating these trends;

- Larger companies account for the majority of capital investment;

- A sharp drop in small company sales volume prior to 1996 suggests gross under-reporting of performance data in the run-up to privatization.

Pre- and Post-Privatization Trends in Company Performance

- Indexing real turnover to the year of privatization of each company reveals an aggregate “privatization curve” for these companies: a steep decline to the year of privatization, a slight rebound in the following two years, and a modest decline in years three and four of the post-privatization period. Despite the initial rebound, most companies have not recovered to real turnover levels of the early 1990s;

- Larger companies follow the standard privatization curve, but show a more moderate decline before privatization and a stronger rebound after privatization than smaller companies;

- The standard privatization curve does not hold for mining supply companies, which continued to do poorly after their own privatization due to the drag effect of delayed mining privatization;

- All other sectors follow the standard privatization curve, with the agriculture sector and the food and beverage sector showing the sharpest initial decline and strongest post-privatization rebound;
• Performance by companies purchased through competitive bid sales follow the standard curve. Performance by companies purchases through pre-emptive rights sales (usually to foreign investors holding minority shares and a management contract) was unaffected by privatization. Performance by companies purchased through management buy-outs show a continuous and steep decline;

• Companies with low inter-dependence with copper mining follow the standard privatization curve. Companies with medium inter-dependence follow the standard curve, but show a sharper recent decline that may reflect efforts by the new mining owners to diversify supply sources. Companies with high inter-dependence with copper mining did not follow the standard curve, showing no post-privatization rebound until four years later, coinciding with privatization of the mines;

• Companies purchased by Zambian investors showed a sharper decline in performance prior to privatization. It is possible that Zambian investors purchased firms with a strong track record within a highly protected environment, with less concern for their potential in a liberalized environment. However, little difference exists in post-privatization performance between companies with indigenous or foreign owners;

• Companies that are not export-oriented follow the standard privatization curve most closely. Heavily export-oriented firms began their recovery prior to privatization—undoubtedly responding to the liberalized environment—and have rebounded to turnover levels of the early 1990s.

3. Performance Factors

Donor Support

Many companies feel that donors, as proponents of privatization, should have been able to predict and prevent some of the problems that arose. Such is the degree of expectation that donors are often held indirectly responsible for difficulties. For example, although it is widely acknowledged that many instances of local mismanagement led to company failures, donors are faulted for not having provided management training. Donors were expected to have provided more assistance in transitioning from a public to private enterprise mentality. One company explained that because the civil service was not prepared for liberalization, it viewed private industry as a threat. There is a feeling that public education and information could have created a more favorable business climate in which government supported the growth of industry. An agricultural firm complained that government representatives actively discouraged potential foreign investors in its company by emphasizing the difficulties of operating in Zambia.

Current donor projects are seen as adversely affecting the development of free enterprise in Zambia by providing support such as low-cost loans to specific companies. Such assistance, made on a project-by-project basis, does not consider the effect such actions have on an industry within the country. Several interviewees expressed the
expectation that donors should support and develop entire industries rather than particular
companies.

**Privatization Structure**

Although the Privatization Act allowed Zambians to pay in installments,
preference was given to foreign bidders able to pay in cash, thereby limiting the ability of
Zambians to purchase companies. Few Zambians working for parastatals had sufficient
savings to invest in purchasing companies, although some had funds from retrenchment
packages.

The presence of foreign ownership hurt some industries when these owners
internationally sourced services that had been supplied within Zambia prior to
privatization. For example, a local insurance broker was greatly affected by foreign
ownership, particularly of larger companies such as ZCCM.

Some companies felt they had suffered from ZPA management of their accounts.
In one instance verbal agreements with the ZPA regarding former tax liabilities had not
been included in written contracts. Another company claimed that ZPA had not provided
the paperwork necessary for it to use its assets as collateral for loans.

The ZPA sold non-operating assets, such as housing and property, separate from
the companies so companies lost collateral for financing and income to pay liabilities.
The Government of the Republic of Zambia (GRZ) directed that housing be sold to
sitting tenants at reduced prices.

**Regulatory**

**Industry Regulations**

One prominent example illustrates how a lack of industry regulation and
cooperation can affect industry growth in Zambia. A company that wished to offer pre-
financing to its suppliers in order to obtain more raw materials found that it was
subsidizing its competitors. Suppliers that this company had supported sold to
competitors who could offer a slightly higher rate because they had no support costs.
These competitors would not participate in a type of pre-financing cooperative operating
in other countries in the region. The company therefore had no motivation to pre-finance
suppliers and production levels fell. One solution would be legislation that would
distinguish between value-added practices like pre-financing and simply buying product,
but there is no GRZ recognition of the social value of pre-financing.

Concessions given to Konkola Copper Mines (KCM), the primary ZCCM
purchaser, have also had an impact on Zambia’s economy. Everything KCM imports is
duty-free; since suppliers pay similar transport costs that KCM would pay for products,
they are at a disadvantage because they have to pay duty. This has stifled peripheral
mining supply industries.

**Tax Structure**

One of the most common complaints concerned duties for finished goods and raw
materials. While there is sometimes no duty on imported finished goods, duties on
imported raw materials can be relatively high. One manufacturing company successfully argued for its duties to be reduced from 25% to 6%, but it still competes against imported goods with a 0% tariff. Another company interviewed claimed that the taxation of raw materials directly resulted in its parent company’s retreat from production in Zambia. The current Zambian owners have been unable to access working capital, and this manufacturing plant is currently not in production.

There is speculation that donor agencies play a role in the focus of the Zambia Revenue Authority (ZRA) on collecting duty on raw materials. One director felt this was because donor organizations set benchmarks for collecting the reserve. Another felt it was due to pressure from the International Monetary Fund (IMF). The ZRA is seen as an aggressive agency: one director told of individual agents issuing false taxation claims and threatening him with imprisonment if these were not paid. Another company was forced to cease operations by the ZRA.

Rapid and frequent fluctuations in tax rates were also a very common concern. One instance involved an overnight change from a 10% duty to a 95% duty. The timing and degree of such changes are unpredictable. In the example cited, the change was due to lobbying by a local manufacturer interested in competing against imported goods.

**Regional Trade Issues**

There are expectations that donors should have considered inequalities in regional economies before encouraging free trade. Zambian companies feel that South Africa and Zimbabwe profited from periods of closed economic systems and that companies there are currently more competitive because of this.

Historically, Zambia has had lower trade barriers than its neighbors. One explanation for this is that Zambia suffered a lack of skilled trade negotiators.

COMESA and SADC have not contributed to a level playing field. Zimbabwe and South Africa are accused of not complying with regulations. It is felt that South Africa continues to protect its market by not issuing proper trade certificates. South African companies get subsidies in the form of rebates for exporting goods.

The openness of borders through COMESA has allowed for product dumping from Zimbabwe made profitable by parallel exchange rates with a 2 to 1 ratio that has been in effect since the end of 2000. As Zambian manufacturers cannot compete with inexpensive goods brought through Zimbabwe, two manufacturers called for temporary changes in trade agreements with Zimbabwe to block such dumping until the situation is resolved.

Additional factors influencing regional trade involve corruption of border officials, frequent under-valuation of imports for duty, and fake certificates of origin allowing for cheap imports from all over the world.

One company competing beyond the regional market complained that while Zambia is not allowed to have crop subsidies for its product, the United States subsidizes that industry at the rate of $4.6 billion a year.
High Cost of Production

In addition to high duties on raw materials, there are several factors contributing to higher costs of production in Zambia than in neighboring countries that render Zambian companies uncompetitive in the regional market.

Manufacturers are operating at low capacity levels because they are producing for a small domestic market even though their plants have the capacity to supply the entire region. One privatized company lay dormant for several years because its owner did not need the excess capacity.

Some manufacturers cannot produce at higher capacities because they lack raw materials. Agricultural processors are particularly hampered by low yields, approximately half in Zambia what they have historically been in Zimbabwe. Another factor in agriculture is the influence of the Food Reserve Agency (FRA), which offers loans to produce goods such as maize even when that market is saturated. Farmers choose to produce these crops rather than those needed by industries because FRA loans have little pressure to be repaid. One agricultural processing plant has been sold because its owners could not find enough local raw material to keep it in operation. The new owners of the plant have dismantled the machines and brought them to their operations in South Africa.

A food and beverages company operating at 20% capacity finds its cost of production higher due to energy bills. Energy rates are unreliable, subject to increase twice a year without authorization. The energy company, ZESCO, has also created certain double tariff zones that have affected some manufacturers.

Another factor in the cost of production in Zambia is the structure of terminal benefits laws that makes it very expensive to terminate employees.

Judicial

It is felt that there is no judicial framework supporting businesses in Zambia. The Industrial Relations Court consistently finds in favor of employees. Even when employees have been fired, the favorable judicial climate gives them incentive to take companies to court. Numerous and long court cases mean high legal fees for companies. One manufacturer currently has 40 lawsuits pending.

Court cases resulted from employees not understanding the structure of privatization. One company manager claimed that workers did not understand the difference between purchasing assets and purchasing going concerns, and sued for benefits even when not entitled to them. Employees also sued to have all allowances included in calculating retrenchment benefits, rather than simply basic salary, thereby doubling and trebling their benefits. Although it laws defining retrenchment packages in terms of basic salary, late in 2000 the Supreme Court found in favor of this practice in a decision involving the Zambian National Commercial Bank.

Several companies gave examples of judicial inadequacies. One manufacturing company worries that there is no legal brand protection in Zambia after spending five years in court over a simple case of copycat packaging. One company owed money by ZCCM had no recourse to claiming assets after having won their court case. Another company declined to pursue its claim in court for housing sale proceeds to be used to
clear the liabilities of the earlier parastatal company. The company felt that it was faster and cheaper to settle out of court.

Financial

Several managing directors claimed that at the beginning of privatization they had the impression that low-cost financing would be available to them, e.g., through a privatization trust fund from which they could borrow. One manager had expected the Enterprise Development Program (EDP) to be in place by 1995. Such financing would allow them to better manage the liabilities of the companies they were purchasing by paying off high interest debt and retrenching employees earlier rather than later.

Because banks take all the risks in EDP financing, they are not interested in lending. Prominent examples of asset stripping and management misuse of borrowed funds reinforce the perception that risk levels are too high. One company we interviewed failed although it had been able to borrow money from the Development Bank of Zambia (DBZ); this money had not been spent on the company but on perks for management.

Many companies borrow money through overdrafts, at a rate of 46%, while the international cost of capital is approximately 7%. Competitors in Zimbabwe currently have an advantageous lending situation due to parallel exchange rates: they make an instant margin on borrowed money because only one quarter of the loan has to be paid back at official exchange rate.

A lack of financing prevents companies from maintaining equipment. In one case the absence of working capital kept a manufacturer from fulfilling orders that had already been placed or accepting any further orders. A company that closed its Copperbelt branch in 1994 does not have the capital to re-open a branch there now to take advantage of the upturn in the economy.

Expectation of a growth in the economy was not fulfilled, and companies experienced non-payment by customers and the loss of key supply companies.

4. Retrenchment

Prior to privatization, retrenchment was never really an issue in Zambia. During the 1970s and 1980s in the “2nd Republic”, the socialistic structure maintained that employees had a job for life. When the Privatization Act was passed in 1992, managers at parastatals began to get wary and started improving the retrenchment packages allowed for in their Conditions of Service. For example, prior to the Act, the Zambia Industrial and Mining Corporation Limited (ZIMCO), the holding company for the majority of the parastatal entities, had a modest payout in the event of retrenchment. This formula was a table that allowed for increased numbers of months of basic pay to be owed relative to the number of years served. The table was as follows:
<table>
<thead>
<tr>
<th>Years Served</th>
<th>Retrenchment Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 5 years</td>
<td>Nil</td>
</tr>
<tr>
<td>5 to below 10 years completed years of service</td>
<td>6 months basic salary</td>
</tr>
<tr>
<td>10 to below 15 years completed years of service</td>
<td>12 months basic salary</td>
</tr>
<tr>
<td>15 to below 20 years completed years of service</td>
<td>18 months basic salary</td>
</tr>
<tr>
<td>20 to below 25 years completed years of service</td>
<td>24 months basic salary</td>
</tr>
<tr>
<td>25 to below 30 years completed years of service</td>
<td>30 months basic salary</td>
</tr>
<tr>
<td>Above 30 years completed years of service</td>
<td>36 months of basic salary</td>
</tr>
</tbody>
</table>

In addition to the above formula, provisions were made for repatriation (replacing a worker and his family and goods back to his village of origin), notice (one month) and housing for a period of time necessary to leave. The package as outlined above was changed shortly after the Privatization Act was enacted to allow for 24 months basic salary plus one month for every completed year of service. Aside from increasing the retrenchment benefits dramatically, this new formula also skewed the benefits so that employees with relatively little experience received a disproportionate amount of the benefits. Regardless, this provision was still based on basic salary, which specifically represented an employee’s cash pay and usually represented less than 40% of an employee’s total remuneration packages. For tax purposes, the remainder of an employee’s remuneration would be in the form of allowances or fringe benefits and would be calculated separately and paid in cash or in kind. Until 1997, allowances were not included in calculating income taxes.

In 1995, The Minimum Wages and Conditions of Employment Act established the minimum redundancy benefit to be two months basic pay for every completed year of service. This was confirmed in the revision to the Act in 1997. By comparison, the benefits for retirement were established at three months basic pay for every completed year of service with a minimum ten years served subject to a minimum age.

Against this backdrop, managers at ZIMCO augmented their initial change by assessing that allowances would now be folded into the basic pay calculation, thus doubling or trebling the effective retrenchment values. These two changes were implemented in the form of memos by the Company Secretary at ZIMCO. ZIMCO Board approval was never fully documented for the latter augmentation. Additionally, few of the subordinate companies incorporated these two changes through their own formal Board of Director processes.

As stated earlier, when the employees of the ZNCB sued to have their allowances included in their retrenchment packages, the Industrial Relations Court found in the employees’ favor. On appeal, the Supreme Court found for the plaintiffs. This has placed ZNCB on the brink of bankruptcy.

Unions traditionally negotiate their Collective Bargaining Agreements separately from the Conditions of Service that is for managers and non-represented employees. Having seen the actions of the non-represented employees, unions began to aggressively negotiate very large returns for retrenchment. Maamba Collieries unionized members negotiated three months basic pay for every completed year of service. Nitrogen Chemicals of Zambia’s union negotiated an astonishing six months basic pay for each completed year of service. Some of the other participants in this exercise had
retrenchment benefits that exceed four months basic pay for each completed year of service.

The average months to be paid for each completed year of service within the companies surveyed in this effort is 2.4, approximately 20% greater than the statutory minimum. This figure does not include lump payments in addition to this monthly calculus.

An alarming consequence of the judicial decisions made in the ZNCB case is that these retrenchment benefits will be increased drastically if precedent allows employees of other companies to fold allowances into their retrenchment pay formula, even if the agreements state that the formulas are based on basic pay.

The most celebrated example of retrenchment benefits being paid by an outside entity is in the privatization of ZCCM. KCM has provisions for retrenchment payments that are being supported by The World Bank. In some of the earlier privatizations, provisions were made in the Sales Agreements for retrenchments to be covered out of the proceeds from the sale of the company. By and large, later agreements and those involving MBOs placed the onus of payment on the buyer. This manifested itself in the form of carried liabilities that would continue forward into future operations, thus hampering efforts to increase real pay. It also stripped money away that would have been better used for working capital and capital investment.

In a few cases, promised retrenchment packages have not yet been paid, leaving employees in limbo: they receive salaries that have not been increased for years, despite the Kwacha depreciation, and yet have nowhere to go. The employees at Maamba Collieries are still waiting for retrenchment packages promised over three years ago, while ZCCM employees have been paid off.

The changes made to the retrenchment benefits since 1992 violate the intent of the Privatization Act. Unfortunately, without judicial support in that vein, employees will continue to pursue seemingly frivolous law suits, win and set precedence for ensuing outrageous suits of a similar nature.

5. Conclusion

In the early 1990s, parastatals in the manufacturing and commercial sectors operated in a highly protected environment. With economic liberalization in the 1992-94 period and impending privatization, non-mining parastatal performance, as measured by real trends in turnover, declined dramatically, especially for smaller enterprises. This decline probably reflects a combination of factors—including insufficient competitiveness in a liberalized trade environment, and increased inefficiency or deliberate under-reporting of performance in the run-up to privatization. The data indicate that privatization was successful in stemming the decline in turnover, except in companies heavily dependent on the mining sector, where delays in mining privatization impeded recovery through the end of the decade. Turnover for most companies increased in the two years immediately following privatization. The rebound following privatization has been strongest and best sustained for the larger, export-oriented companies, contributing to the strategic goal of promoting export-led growth.
Unfortunately, for most companies—typically smaller and less export-oriented—the initial benefits of privatization have been difficult to sustain, and performance has faltered after the initial two years. Although recent performance has been better than in the immediate pre-privatization period, turnover among most companies has never recovered in real terms to early 1990 levels. In some cases, this probably reflects a lack of economic viability of the firm, which should have been liquidated instead of subject to lingering death through internal privatization. In all cases, however, the economy-wide impact of delayed mining privatization—which was sufficient to keep economic growth negative throughout the decade—served to lower investment, investor confidence and aggregate demand, with negative consequences for post-privatization performance of most companies. Privatization of the major mines in 2000 has spurred investment and consumption, already accelerating aggregate growth, and likely contributing positively to performance of many of these companies in 2001 and beyond.

Difficulty in sustaining the net benefits of privatization can also be attributed to a suboptimal domestic and regional environment for private sector growth. Qualitative assessment of these constraints through interviews with company management highlighted: a) fiscal distortions that disfavor local production, marketing and exporting; b) weak regional economies; c) continued regional trade barriers and unfair trade practices; d) lack of long-term financing and working capital, especially for smaller firms; e) unpredictable and frequent changes to fiscal and exchange rate policies; f) labor market rigidities and excessive statutory employment benefits; g) cumbersome judicial processes; g) excessive bureaucratic interference and corruption. Greater attention to these constraints within the domestic and regional environment is warranted in future World Bank assistance strategies, in order to enhance the benefits of privatization and maximize new private sector growth.