

## Report by the Privatisation Agency on the implementation of the Bulgaria 2001 Program and of the government programs for privatisation for the period June 1, 1997 - October 30, 2000

The present report traces the implementation of the major objectives in the sphere of privatisation as set out in the Bulgaria 2001 and in other government programs related to privatisation for the period between June 1, 1997 and October 30, 2000. The report was prepared in view of the finalization of a major stage of structural reforms - the privatisation of the state-owned enterprises in the basic sectors of the economy, subject to denationalization - industry, building construction, agriculture, trade and public utilities, and transport (excluding railway transport). The denationalization of the companies in the public utilities sector is a specific task and its implementation requires new approaches and priorities. With the privatisation of the companies in the sphere of public utilities the processes of denationalization and restructuring of the economy emerge into a new stage.

### Major Objectives

The restructuring and the rehabilitation of economy through the privatisation of all industrial and trading state-owned enterprises was highlighted as the priority objective of the government's Bulgaria 2001 program. The program accounts for the slow progress of structural reforms and privatisation during the first years of transition, and initiates measures intended to accelerate the two mainstream trends.

This objective must be accomplished by means of:

- the sale of shares and stakes of enterprises to Bulgarian and foreign buyers at complete transparency of procedures and in a competitive environment;
- the sale of shares and stakes of enterprises to management and employee buy-out teams at preferential terms;
- the sale of detached parts and small enterprises by auctions and competitive tenders;
- the sale of shares and stakes of enterprises at the stock market;
- the sale of the controlling packages of shares in large enterprises to strategic investors by using the assistance of leading foreign consultants and intermediaries;
- the offering of shares and stakes of enterprises in exchange for privatisation vouchers within the framework of the second stage of mass privatisation;
- partial or complete privatisation of the large infrastructure and production monopolies after their restructuring.

The deficiencies and the contradictions in the effective regulatory framework had to be eliminated in order to achieve this objective; moreover, the privatisation procedures had to be streamlined; the options for the employment of the services of intermediaries and consultants for the purposes of privatisation deals had to be regulated; the accelerated disposal of the residual shares and stakes of partially privatized enterprises had to be stimulated; an active and objective-oriented marketing had to be launched in order to attract strategic investors; definitive decisions had to be made on the privatisation of virtually all state-owned enterprises in order to reduce the number of companies in which the state will preserve its majority interests; and to launch structural and personnel changes in all institutions charged with the implementation of the privatisation process.

The major objectives and approaches were described in details in the Strategy for Accelerated Privatisation, which was drafted and approved by the Structural Reforms Council in the autumn of 1997. The speed of denationalization was again highlighted as a strategic priority in view of the delay in privatisation and in the comprehensive restructuring

of the economy.

The requirements related to accelerating privatisation are related also to the commitments assumed by the government within the framework of the three-year agreement with the International Monetary Fund and of the FESAL loan agreement with the World Bank. The privatisation of the enterprises in the state sector is defined as a key element of structural reforms. The matrices to the two agreements contain specific deadlines for the completion of the successive stages of the process of privatisation.

The major objectives of the government programs for the period under consideration are as follows:

- the accelerated and comprehensive privatisation of enterprises in the major sectors of economy subject to privatisation;
- the privatisation of the large state-owned enterprises with the priority placed on enterprises listed for financial rehabilitation;
- the restructuring and the start of the privatisation of the state-owned monopolies in the sphere of public services;
- the attraction of strategic investors for the remaining large, sometimes even structure-defining, enterprises which were not privatized;
- the creation of conditions suitable for the participation of different categories of investors in the process of privatisation - strategic foreign investors, Bulgarian investors, including management-employee buy-out teams and Bulgarian citizens - by employing various denationalization methods and schemes;
- the streamlining of the privatisation procedures with the objective to accelerate the process and to guarantee its transparency.

### **Status of the pool of assets slated for privatisation**

The status of the pool of enterprises, slated for privatisation at the beginning of 1997 was as follows: a total of 7.2% of the assets of the state-owned enterprises had been denationalized by cash methods during the preceding four years. A total of 1050 enterprises, mainly small and medium companies, which represented a total of 14.6% of the state-owned assets and which were relatively attractive, were offered within the framework of the first wave of mass privatisation in 1996 and 1997. The transfer of the shares acquired within this scheme to private owners was completed by the end of 1997. Various amounts of shares in the individual enterprises were offered for privatisation during the first wave of the voucher scheme which indicated that there is still a lot of work to be done for the privatisation of these enterprises.

Most of the remaining non-denationalized commercial companies were in a relatively poor state, with a low competitive potential, with limited market exposure and with depreciated technological equipment. The state of 47 large enterprises was especially serious - among them the Balkan Airlines EAD, the Kremikovtzi AD, the DZU AD in Stara Zagora, the Arsenal EAD in Kazanlik, the Yambolen AD in Yambol, and others. These enterprises were included in 1996 into a special program for isolation. Special rehabilitation programs were developed for these enterprises, they were efficiently denied access to new credits and their operations were placed under the supervision of the Ministry of Finance.

The large state-owned enterprises in several important economic sectors - chemistry, metallurgy, machine building, electronics, and the military-defense enterprises - remained outside the process of privatisation. Most of these companies had large and unmanageable structures and were engaged in a complex conglomerate of activities, for instance the

chemical and metallurgical enterprises and the holding companies. The delay of their privatisation allowed the emergence of conditions for a persistent destabilization and draining of capitals.

The Privatisation Agency had, under these conditions, a very heavy task as it was charged with the privatisation of these inherently unattractive facilities. The situation was additionally aggravated by the crises in Yugoslavia, Asia and Russia, by the collapse of the prices of synthetic fertilizers, of some chemical products and of ferrous and non-ferrous metals. This situation was conducive for a poor investors' interest in the facilities offered for privatisation, and especially on the part of strategic foreign investors.

In order to provide for a higher-quality performance and transparency in the preparatory stages of the deals for the sale of large structure-defining enterprises, the Cabinet embarked on a new approach and assigned the preparation of the sales to privatisation intermediaries. The Privatisation Agency however assumed the supervision on the progress of the deals and the actual completion of the privatisation contracts. 31 companies were separated into a special group by force of a Council of Minister decision to be offered for denationalization by international consultants. This project was financed by the PHARE program of the European Commission, by the US Agency for International Development and by the World Bank.

A second group of enterprises offered for privatisation with the assistance of intermediaries, included about 70 companies in the sphere of metallurgy, machine building, military-defense industry, tobacco processing, tourism, and others. Privatisation intermediaries were contracted also for the privatisation of the largest-scale enterprises with a crucial importance for Bulgaria's economy. The objective was to improve the quality of the draft projects and to launch a serious international marketing campaign in order to attract strategic investors.

### **Achieved results**

After three years of serious efforts it can be reported that a major portion of the targeted objectives towards an accelerated privatisation, and of the privatisation programs has been achieved.

The privatisation of the companies in the sphere of industry, trade and services, agriculture, building construction and transportation was completed. Currently, about 400 enterprises remain to be denationalized and are included in the 2001 privatisation program.

More than 50% of the assets of the state owned enterprises (estimated at BGL 580 million by December 31.12.1995) have already been nationalized, which amounts to 76% of the assets slated for privatisation (estimated at BGL 383 million by December 21, 1995).

The sale of the large and structure-defining enterprises has been completed, including most of the enterprises included in the financial rehabilitation program.

A series of changes were introduced into the effective regulatory system with the objective to streamline privatisation procedures, which also resulted in the creation of the conditions necessary for the participation of various categories of investors in the process.

The results of the activities of the Privatisation Agency and of the line ministries and institutions between June 1, 1997 and October 31, 2000, are as follows:

A total of 3307 decisions on individual privatisation deals were made.

A total of 3062 privatisation deals were completed, which amounts to 71% of the total number of all deals (4333 deals) completed after the start of the

privatisation process in Bulgaria. Shares and stakes were sold in 1741 enterprises and in 1321 detached parts of enterprises. The contracts for the sale of majority share packages and stakes amount to a total of 1407, which is equivalent to 75% of the whole number of majority-stake sales - 1865.

The Privatisation Agency closed during the period under consideration a total of 534 deals, which amounts to 17% of all deals reported during the same period. Shares and stakes in 331 enterprises were sold (which amounts to 19% of all deals for the period) and in 203 detached parts (15% of all deals involving detached parts during the period under consideration). Of all deals, 212 involved the sale of a majority package, and 119 deals involved the sale of minority share packages.

Between January 1, 1997 and October 31, 2000, the authorities pursuant to Art. 3 of the Transformation and Privatisation of State-Owned and Municipal-Owned Enterprises Act (TPSMEA) denationalized 43.15% of all long-term assets of state-owned companies (estimated at BGL 580 million by December 31.12.1995), and 65.35% of the assets slated for privatisation (estimated at BGL 383 million by December 21, 1995), including the assets denationalized within the framework of the first stage of the mass privatisation program. The Privatisation Agency contributed substantially to achieving this level of performance, by denationalizing 20.09% of the assets of state-owned enterprises and 30.43% of the assets in enterprises slated for privatisation.

The aggregate financial effect of the performance of the authorities pursuant to Art. 3 of the TPSMEA for the period from June 1, 1997 till October 31, 2000, amounts to BGL 8,939,991 thousand (89% of the total financial effect). This amount included the contracted payments on deals - BGL 3,448,347 thousand (or 88% of the negotiated payments), the debts of the privatized enterprises which have been paid up or assumed by the buyers - BGL 1,058,152 thousand (or 92% of the assumed and paid-up liabilities), and the negotiated investments - BGL 4,433,492 thousand (or 88% of all negotiated investments).

The aggregate financial effect from the performance of the Privatisation Agency amounts to BGL 5,834,206 thousand, or to 65% of the financial results achieved by all the deals concluded during the period under consideration. This amount includes BGL 1,596,112 thousand in contracted payments (46% of all payments negotiated for the deals closed during the period under consideration, BGL 885,251 thousand in assumed liabilities (or 89% of all liabilities assumed during the same period), and BGL 3,352,843 thousand in negotiated investments (or 76% of all investments negotiated within the framework of privatisation deals closed during the said period).

As a result of the concluded privatisation contracts, buyers have assumed the commitment to preserve a total of 142,406 existing jobs and to open 24,707 new jobs. In contracts signed with the Privatisation Agency alone, buyers assumed the commitment to preserve 93,960 existing jobs (66% of the total) and to open 5,802 new jobs (23% of the negotiated total).

The number of deals concluded with management-employee buy-out (MEBO) teams amounts to 1224, which is equivalent to 48% of the total number of deals concluded during the period under consideration - 2532. (In order to calculate the percentage of the deals concluded with MEBO teams, the total number of deals was deducted by the number of deals pursuant to Art 35. of the TPSMEA, which excludes the application of the preferences granted to MEBO teams.) The Privatisation Agency signed a total of 172 deals with MEBO teams which used the option of a deferred payment of the negotiated price, which amounts to a total of 44% of the total amount of deals concluded by the Privatisation Agency (namely 387 minus the number of the deals pursuant to Art. 35).

104 deals were signed with foreign buyers (94 deals involved packages of shares and stakes in enterprises, and 10 deals involved the sale of detached parts of enterprise). 52% of these deals were concluded by the Privatisation Agency (54 deals).

48 deals were concluded with the assistance of intermediaries and consultants, including 16 deals (33%) which involved MEBO teams. In all these deals the method of sale was set by the consultants, namely "negotiations with the potential buyers". Despite the fact that a major part of the enterprises, albeit in a difficult situation, were denationalized through privatisation, we cannot consider these deals as being completely successful. The expectations that this approach would attract strategic foreign investors failed to materialize, as did the forecasts for substantial revenues from several of the sales. In many cases the procedures related to the deals had to be completed by the Agency staff.

The competitive tenders are the dominating privatisation technique employed for the sale of enterprises - this approach was used in 873 of the deals (50%), followed by negotiations with the potential investors - in 663 deals (38%) and auctions - in 112 deals (6%). In its deals, the Privatisation Agency used predominantly negotiations with the potential buyers - in 174 of the deals (53%), the auctions - in 64 of the deals (19%) and the competitive tenders - in 59 of the deals (18%). The fact that the Privatisation Agency used predominantly the negotiation approach is explained by the fact that the Agency deals mainly with large enterprises for which the other techniques are hardly applicable. At the same time it must be noted that the line ministries could use auctions and competitive tenders for the sale of smaller enterprises on a larger scope.

Special attention must be attached to the privatisation of enterprises included in the program for isolation which covered a total of 47 companies, some of which are of a structural importance for the economy. These enterprises were threatened by liquidation as a result of their grave financial situation and their privatisation emerged as the only feasible means for survival and rehabilitation. The closure of these enterprises would result in the destabilization of the respective sectors and would have a negative impact on the related smaller enterprises. The expectations were that social tensions will rise dramatically in several regions of the country as these enterprises provided for a substantial number of jobs. 32 of these enterprises were privatized which allowed them to survive and create the conditions necessary for further development. In compliance with the programs for job creation, a total of 38,000 jobs were preserved as a result of the concluded privatisation deals.

A total of 502 enterprises were involved in the centralized public auctions within the framework of the voucher privatisation (tenders No. 1 to 13). Of the total number, 224 enterprises were proposed for sale against vouchers by the Privatisation Agency. The sale of minority residual packages of shares dominated this privatisation scheme which demonstrated throughout 2000 a persistent tendency towards an improvement of the quality of the offered packages of shares. The success of the voucher privatisation scheme is to a large extent dependent on the emergence of majority packages of shares or residual packages of shares in large and attractive enterprises whose majority packages have already been privatized.

The Bulgarian Stock Exchange closed 53 deals for the sales of shares on enterprises. 16 of the deals involved the sale of minority packages and were floated at the bourse by the Privatisation Agency. The Privatisation Agency used the Bulgarian Stock Exchange to sell another 10 residual packages of shares in privatized enterprises.

As a result of the rapidly growing number of concluded privatisation agreements and of the rising complexity of the deals, the role and the efficiency of the post-privatisation control

over the compliance with the terms of the privatisation agreements emerged as a key factor for the transparency and the integrity of the process.

The objective of the post-privatisation control is to monitor the compliance with the commitments assumed by the buyers within the privatisation agreements, namely the preservation of the main line of business, the implementation of the investment and the employment programs, the settlement and the payment of the outstanding liabilities of the enterprises accrued prior to their privatisation, the obligations to eliminate previous environmental damages and programs for bringing the performance of the enterprises in compliance with the legislative norms related to environment protection.

Judging by the data collected on 106 companies in 1998, and on another 144 companies in 1999, which were all subject to the Privatisation Agency control, the total volume of the released investments amount to BGN 172,769,000 for 1998, and to BGN 183,587,725 for 1999. A small relative volume of defaults on committed investments was established in 1998 - 2.9%, and in 1999 - 4.3%, which was attributed to the increased investment risk in the region as a result of the war in Yugoslavia, and to the complete default on pledged investments in 11 companies, among them OTSM - Iskar, Plama - Pleven, Bulgarska Roza-Sevtopolis in Kazanlik, and others.

In 1999 the largest amount of investments was made in SOMAT AD, Sofia - a total of USD 24,106,600, in Vidima AD, Sevlievo - USD 9,411,000, in Zagorka AD, Stara Zagora - USD 5,314,000, and Riviera AD, Varna - USD 2,035,989.

State-of-the-art technological equipment was installed in Vidima Ideal AD - for a total of BGN 89,295,167, in Assarel Medet AD - for BGN 63,000,000, in Monbat AD - for BGN 5,399,480, and in Trakiya Papier AD - for BGN 1,000,000.

The reports presented by 144 companies in 1998, and by 212 companies in 1999 indicate an over-fulfillment of the commitments assumed for the preservation of an average number of personnel - by 8% in 1998 and by 10.4% in 1999.

The new owners apply their efforts to raise profitability and the efficiency of the acquired enterprises by decommissioning of inefficient production lines and sectors, by optimization of the productions structures and by the separation of the auxiliary and optional businesses into separate companies.

The accelerated privatisation during the last three years contributed to the expansion and the consolidation of the private sector in Bulgaria. Some of the reported performance indicators for 1999 - the high relative share of the gross domestic product generated by the private sector (70%), and the increase of the volume of production in the private sector were a direct result of the rapid denationalization of the enterprises during the period under consideration. The Privatisation Agency admits the failure to implement during the period under consideration the following major elements of the objectives set out in the government's programs:

The approach to the privatisation of the enterprises in the public utilities sphere failed to assume a more decisive character. The improvement of the normative basis regulating the activities of these enterprises as well as their restructuring continued for a longer period of time than expected, and the conditions needed to stimulate a serious progress in this sphere were not established.

The number of the deals concluded with large foreign investors is relatively small. This could be attributed to a number of reasons which could hardly be subjected to an analysis

within the framework of this report. An international marketing campaign was launched by the institutions charged with the prerogatives to privatize, including the privatisation intermediaries, some of them of being consultants of international esteem like Arthur Andersen, Roland Berger & Partners, KPMG, Barents Group, Price Waterhouse - Coopers, Raiffeisen Investment, BC-Atkins, DFC, Deloitte & Touche and Deutsche Morgan Grenfell. Some of the larger enterprises became the target of an initial interest. The fact that no deals were concluded is attributed mainly to the accumulated financial, ecological and social problems at these enterprises.

The MEBO privatisation scheme which is often referred to as one of the negative aspects of the ongoing privatisation process in Bulgaria, was launched with the objective to set off the low level of investors' interest to a large portion of the enterprises offered for privatisation, and to create the conditions for completion of a number of deals in which no other buyers were interested. The scheme aimed also at the creation of a certain level of competition in deals for which a single buyer had emerged. In more than 70% of the cases when the Privatisation Agency concluded a deal with a management-employee buy-out team, MEBOs were the only buyer. In 15 cases the MEBO teams which signed a privatisation contract with the Privatisation Agency refrained to use the deferred payment terms they were eligible to.

Packages of shares of relatively attractive enterprises were not offered for denationalization through the stock exchange. The strategy for the denationalization of the large and relatively attractive enterprises offered the inherent option to float minority packages of shares at the stock exchange after the majority package had been sold. This option remains open for the pending sale of the Bulgarian Telecommunications Company, of the enterprises within the Bulgartabac Holding and of some of the infrastructure companies.

The provisions for the transparency of the process of the negotiations is another aspect of the Agency's activity which is the target of a persistent, often speculative, criticism.

The legal provisions related to the assurance of openness of the privatisation are included in the Transformation and Privatisation of the State-Owned and Municipal-Owned Enterprises Act and in the relevant bylaws dealing with the application of this instrument. In the cases when the privatisation procedures are not regulated by normative instruments, the Privatisation Agency proceeds to regulate the process by means of its own internal acts - the Rules for negotiations with potential partners and the Procedures for processing of claims for supplementary agreements to the effective privatisation contracts.

The contracts concluded by the Privatisation Agency for the sale of structure-defining enterprises are subject to the approval by the Supervisory Board of the Agency and by the Council of Ministers. The indirect parliamentary control over the privatisation procedures is executed by the members of the Supervisory Board of the Agency, who are representatives of the major political factions and of the Council of Ministers.

In compliance with Clause 11 of the Transitional and Final Provisions of the TPSMEA, the authorities charged with privatisation are obliged to publish in the Official Gazette on a monthly basis the relevant data about the completed sales (the facilities subject to the sale, the buyers, the price and the payment terms, the number of the negotiated jobs). These data are related to the most important parameters of the concluded privatisation deals.

The transparency of the privatisation process is guaranteed by the opportunity to execute administrative and judiciary control over the compliance with the requirements related to the publicity of the privatisation process, established by law. The administrative sanctions and the procedures for litigation against the authorities pursuant to Art. 3 of the TPSMEA in case of violations are provided for in the provisions of the legislative instruments listed

herein, and entitles each interested person to claim in court for compensation accrued as a result of a possible infringement of his rights.

A total of 102 court cases have been initiated against decisions made by the Executive Director or by the Supervisory Board, but in two cases only the Supreme Administrative Court prescribed a review by the Supervisory Board and the Executive Director.

The progress in the sphere of privatisation and the further restructuring of the economy over the last three years cannot be challenged. The progress has been recognized by the European Commission, by the international institutions and credit rating agencies and to a major extend contributes to the positive assessment of the Government's performance. The leading role of the Privatisation Agency in the process of denationalization during the period under consideration is unquestionable.

We admit that within the framework of an accelerated privatisation on such a large scale there may be cases of infringed interests, and there may be some debatable decisions made as well. At the same time however we consider the estimates that the privatisation till now is of a poor quality as being somewhat precipitated. The conditions under which the process is developing have to a large extend determined its character. In most of the cases there was no other acceptable solution which would help enterprises survive but their privatisation.

The denationalization of the major portion of the enterprises in the sphere of industry, building construction, agriculture, trade and services marked the end of an important stage within the overall process of economy restructuring through privatisation.

The restructuring and the privatisation of the public utilities enterprises represent a new stage of structural reforms. These deals will have a substantial impact on the country's economy and on the quality of life. That is why this is a very sensitive issue for the society. Most of the companies are operating at a profit. For them, the attraction of strategic investors is of a priority much higher than the speed of denationalization. The legislative and structural changes in the Privatisation Agency create the conditions necessary to support the preparation and the negotiations on these deals by a political consensus in an environment of an enhanced public control.

The success of denationalization is to a major extend the direct result of the political will of the Government to restructure the economy, which implies also the comprehensive privatisation of the state-owned enterprises, of the development and application of a clear denationalization strategy, of the high level of coordination between the institutions engaged in the process of privatisation, and of the intensive efforts of the personnel of the state institutions charged with privatisation.