COMPARISON OF FINANCIAL AND OPERATING PERFORMANCE OF PRIVATIZED FIRMS IN ETHIOPIA

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ABSTRACT

This paper assesses and compares the financial and operating performance of privatized firms in Ethiopia. Specifically, study compared, with the use of accounting data, pre- and post-performance of some selected fully privatized firms, using six (three before and three after privatization) years’ data. The study follows the standard methodology of comparison including profitability, operating efficiency, liquidity, leverage, capital expenditure and employment. It also used a before- and-after research design for sample size of thirteen privatized firms, selected using purposive sampling. Data for the study were collected primarily from secondary sources and interview and analyzed through ratio analysis tools. Wilcoxon Z test and the Wilcoxon sign rank test were used as principal methods of testing for significant changes in the variables. The study was found in significant decline in profitability, employment and operating efficiency except sale efficiency and insignificant increment in liquidity, leverage and capital expenditure as well.

KEYWORDS: Financial Performance, Operating Performance, Privatized Firms in Ethiopia.

1. INTRODUCTION

Since the mid-1980s, there has been a global movement away from state ownership towards private ownership of companies. An important aspect of this trend has been the privatization of state-owned enterprises with the goal of improving their unsatisfactory performance. Considerable debates were raged about whether privatization leads to improved firm performance. In the mid-1980s, many governments around the world reached the conclusion that state ownership was not working, and that private ownership improves performance (Abouazoum, 2011).

By the end of the 1980s, privatization had spread rapidly around the world, also to the developing countries of South Asia, Latin America, Africa, and the Middle East. Accordingly, Many African countries have implemented privatization as a major policy of economic reform.
The first African country where privatization was formally supported was Morocco, and it was rapidly followed by Tunisia, and Egypt (Shehadi, 2002).

As the case in developing countries, privatization in Ethiopia is a very recent experience dated back in 1994, which is a result of 1991’s Ethiopian economic policy. Even though the purpose of the privatization policy is to create competition and then to improve performance, and since Ethiopia is less familiar with market economies, obviously, there are undeniable problems. Since the Ethiopian government has given priority to the sale of loss-making enterprises, it hinders the intended goals of privatization, which is improving profitability. Besides, cost of appreciating the enterprises, expanding their functions, and injecting new capital would also be the big challenges to the prospective owners. Therefore, identification of the privatized firms’ problems through financial and operating performance indicators has been the major characteristics indicates competitiveness, potentials of the business, economic interest of the firms’ management, shareholders, the public, the government bodies and the economy as a whole (Surafel, 2012).

Regardless of the increase in the need for privatization in Ethiopia, there has been amazingly little work undertaken to evaluate their performance for instance: Aweke (2011), performance of privatized hotels using profitability and employment variables. Getachew (2003), privatization in Ethiopia: process and performance of privatized manufacturing Firms by assessing labor its fiscal effects. Similarly, Hishe (2005) studied the process of privatization in Ethiopia using transparency, awareness creation, reaching consensus and tough communication campaigns variables. But, the area of comparison of Financial and Operating Performance of privatized firms using profitability, operating efficiency, liquidity, leverage, capital expenditure and employment as variables is not thoroughly researched in Ethiopia.

The paper is organized as follows. The first section deals with introduction. The second section deals with literature review. The third section deals with the methodology. The fourth section is devoted to presentation and analysis and the last section of the study is devoted to present conclusions.

2. LITERATURE REVIEW

Evidences on the financial and operating performances of the privatized enterprises shows two major opposing influences on the performance change of privatized firms: the negative and the positive privatization effect; however some empirical evidences show a mixed result.

The study of Baboukri and Cosset (1998) reveals that significant increase in profitability, operating efficiency, capital investment, and employment. Megginson et al. (1994) indicates that most enterprises experienced increase in profitability, efficiency, capital investment spending, employment and dividends payment. It is also suggest by Mohammed (2004) confirmed that privatization brings a significant improvement on the financial and operating performance of the privatized enterprises.

In opposite to this, Wallsten (2000) on the other hand produced a contradict result in his study in the in Africa and Latin America and found that privatization by itself did not yield financial performance change. In addition to this, Harper (2001) concludes that profitability and efficiency
decreased immediately following privatization. The most recent study by Cagla Okten and et al. (2005), cited in Surafel, 2012 also revealed that privatization by itself does not appear to generate many benefits and is negatively correlated. Further, some empirical evidence on the financial and operating performances of the privatized enterprises shows a mixed result: such as Hakro and Akram (2009) reveal that insignificant results were documented for profitability, efficiency, output and dividend parameters. No significant or convincing evidence is found which suggest significant change in financial and accounting performance indicators of privatization process. In the same, Zuobao Wei, et.al. (2003) confirmed that significant improvements in real output, and sales efficiency, and significant declines in leverage following privatization, but surprisingly, no significant change in profitability. This indicates that there are contradictory results of studies conducted on financial and operating performance of privatized firms.

As Surafel (2012) pointed out privatization in Ethiopia did not seriously affect privatized enterprises operating performance and profitability, it led to liquidity improvement, debt reduction, increased investments, and a decline in overstaffing. Further he has revealed that there were positive improvements in the performance of SOEs after privatization in terms of liquidity and debt ratios compared to its performance before privatization.

According to Getachew (2003), privatization in Ethiopia has not resulted in profitability improvements. Efficiency shows an increase but not significantly, while capital expenditure increased for almost all enterprises in the sample. Output has also shown a marginal increase, while net tax in the sense of generating revenue has drastically declined.

3. METHODOLOGY

RESEARCH DESIGN

A before- and-after research design (pre-test/post- test design), which is two sets of cross section observations on the same events to measure the type and degree of the change in the variable (s) between two points of time.

SOURCE OF DATA

Data were collected from both secondary and primary sources. The secondary data sources were collected from annual financial reports of sample firm, publications, declarations and documentations about privatization in Ethiopia. Primary source was collected using interview, which were conducted with firms’ managers and post and pre privatization team leaders.

DATA ANALYSIS TECHNIQUES

The data were analyzed through ratio analysis tools and then Wilcoxon sign rank test with its respective Wilcoxon Z test were used to test for significant changes in the variables. Research software, Statistical package for social sciences-version-20 (SPSS-20) and Microsoft Excel 2007 were used.
DESCRIPTION OF VARIABLES

The study used twelve different standardized financial and operational performance criteria to compare the financial and operating performance of privatized firms for pre and post privatization periods. In order to clarify the variables used, their respective descriptions along with their proxies have been presented in Appendix Table-1.

PERIOD OF STUDY

This study covers a period of 6 years (three years before privatization and three years after privatization. The period was justified basing similar studies at the same academic level and in countries similar to Ethiopia. Besides, privatization is a recent phenomenon to Africa in general and to Ethiopia in particular and lacks organized data setting specially pre privatization data. Thus, the 6 years of period are considered to be adequate for the study of its kind which aims to assess the financial and operating performance of privatized firms in Ethiopia.

4. PRESENTATION AND ANALYSIS

PROFITABILITY

Theoretically, performance and profitability is expected to improve in the privatized enterprises following privatization new technology, new ownership. However empirical evidences show a mixed result.

In order to compare the performance of privatized firms, the profitability measures have been presented in Appendix Table-2. The table indicates privatization results a negative effect on return on sales, return on asset, and return on equity after privatization was introduced with mean values of -1.39, -6.2, and -26.53, respectively. In other words, all of the stated profitability proxies: return on sales, return on asset and return on equity, showed negative percentage change of 16.74, 234.84 and 80.22 respectively.

The study also pointed out the reasons for the decline in profitability following privatization is due to some policies induced on their product type and degree of processing products. This fact hindered the firms’ competitive advantage and market development with other firms having pre established market. Besides, firms were forced to change their production systems by new machineries, and train their workers and develop the management with the new technology process system without enough preparation and assessment of the market for survival, which increased the cost of production and ultimately results a decline in profitability. Further, shortage of qualified workers and professionals in the market are the major source of declining in profitability.

OPERATING EFFICIENCY

Privatization is expected to result in increased operating efficiency in privatized enterprises as a result of new investment, new technology and improved corporate governance. However, study outcome consistent with mixed results.
In order to compare the performance of privatized firms, the operating efficiency measures have been presented in Appendix Table-3. The table shows, asset turnover decreased from an average of 76.29 before privatization to 59.12 after privatization with a negative percentage change of 28.93 while income efficiency decreased from an average of 8.43 before privatization to 7.10 after privatization with a negative percentage change of 18.72.

However, sales efficiency shows positive changes after the privatization with mean value of 0.98 and with a positive percentage change of 14.45. More specifically, sales efficiency increased from an average of 5.8 before privatization to 6.78 in the years after privatization.

From an operational performance perspective, the results partially support the empirical literature that privatization does have a positive effect (defined by sales efficiency) on firm performance. This is resulted from sales efficiency showed a positive change after the period following privatization but negative result is showed in light of income efficiency and asset turnover. Similarly, the improvement in productivity in light of sales efficiency is due to new investment, technology introduced as a result of privatization. However, the introduction of high depreciation cost due to high price of asset evaluation upon privatization exaggerated the enterprise loss. Similarly income efficiency and asset turnover results a negative change due to higher capital investment in the period following privatization in order to cope up with other firms having pre established market force. In addition limited competitive ability within the market due to poor quality of semi and finished products decreased the sales of the companies and hence decreased asset turnover, which in turn has limited their income efficiency relative to pre privatization period.

LIQUIDITY

Notionally it is evidenced that after privatization most of the private owners use their own source for the working capital needs of the organization, which in turn increase their liquidity.

In order to evaluate the performance of privatized firms, the liquidity measure has been presented in Appendix Table-4. The table shows a positive change in current ratio, which rises from an average of 1.31 in the years before privatization to 2.48 in the period after privatization with positive mean value of 1.17 and with a positive percentage change of 47.17 as well. This is resulted from even if privatized firms are advised to improve their current ratio through using short term loans, most of privatized firms failed to do so.

LEVERAGE

State owned enterprises, particularly in developing countries, are typically encumbered by large debts, causing many to have negative net worth. Private buyers often make it clear that they do not want to take on these debts, even when the sale price is discounted by the amount of the debt. They seek an immediate positive cash flow to reduce their risk and help finance new investment. However, the result shows that privatization could lead to debt increment.

In order to evaluate the performance of privatized firms, the leverage measures have been presented in Appendix Table-5. The table shows the ratio of debt to equity was increased from
an average of 1.66 before privatization to 2.91 after privatization. Similarly, the debt to total assets ratio was increased from an average of 0.42 in the period before privatization to 0.67 in the period following privatization. This indicates that the debt to equity and debt to assets ratios have increased as a result of privatization with mean values of 1.25 and 0.25 respectively. Further, the above table indicates the debt to equity and debt to assets ratios have largely increased as a result of privatization with percentage change of 42.96 and 37.31, respectively. This is resulted from even if privatized firms are advised to improve their current ratio through using short term loans, most of privatized firms failed to do so since they feared to use debt financing in the short run. This condition forced owners to use long term financing to finance the operations in the short run. Hence, the results specify that total debt are highly exceeded equity financing after privatization was introduced, which indicates an evident increment in firms leverage position after privatization.

CAPITAL EXPENDITURE

Theoretically, efficiency in privatized enterprise leads to increase in capital investment. Moreover, in a situation where there are old and highly depreciated enterprises, an immediate initiative through investment injection would become imperative to coup up with a market competitive environment.

In order to evaluate the performance of privatized firms, the leverage measures have been presented in Appendix Table-6. The table shows an increase in capital expenditure to sales rises from 0.851 in the years before privatization to 1.093 in the period after privatization with a positive average change of 0.0241. Similarly, an increase in capital expenditure to assets from 0.334 before privatization to 0.1486 after privatization with a positive average change of 0.123. This is due to in situation where there are old and highly depreciated enterprises; an immediate initiative through investment injection would become imperative to coup up with a market competitive environment. Following privatization, often managers are forced to make necessary adjustments that may require change in product mix, improve efficiency and optimal allocation of resources through new capital spending. Besides, privatized firms have been forced to improve their way of doing business and replace the machines and technology feasibility. This fact led firms to adopt new processing machineries as per the existing technology. It can be considered as one of the major source of an increase in capital investment.

EMPLOYMENT

It is generally believed employment is an important and critical issue in privatization because of the possibility that privatization could lead to cutting the current level of employment.

In order to evaluate the performance of privatized firms, the employment measure has been presented in Appendix Table-7. The table shows the average number of employees was found to decline from 517 to 503 employees after privatization with a mean change of -14. However, the proclamation underlines the employment safety associated with privatization. According to proclamation No 146/1998 which states continuity of employees' pension coverage, employees' pension coverage existing before the privatization of any enterprise should continue without any interruption. Besides, the new owner of the enterprise should respect employers' obligations.
imposed by the appropriate laws with regard to employees' pension. As per the privatization agency, there is a mutual agreement in the status of employment. The legal document reveals that the firm has an obligation to maintain existing employees as is otherwise compensate them while layoff.

5. CONCLUSIONS

The Ethiopian privatization program has steadily gained momentum since its inception in 1994 and has evolved and changed in certain perspectives, but still works along the main objective of the Ethiopian Economic Policy launched in the year 1991. It is still designed to support the Ethiopian economy on its long way to sustainable development and growth.

The study found a significant decline/negative change in overall profitability indicators. This is due to increase in the cost of production or doing business following privatization.

The study also found a significant decline in operating efficiency, which was justified by all indicators except sale efficiency due to new investment and technology to compete in the market, which in turn decrease asset turnover. Besides, high depreciation cost due to high price of asset evaluation upon privatization, has limited their income efficiency.

The study also found a significant decline in liquidity following privatization. This is due to failure in using short term loans, which is advised for privatized firms to finance their operations.

The study found a significant increase in leverage position following privatization. This is due to most of privatized firms feared to use debt financing in the short run and forced them to use long term financing to finance the operations in the short run, which results an increment in firms’ long term debt following privatization.

The study also confirmed a significant increase in capital expenditure. This is due to: high depreciation cost due to high price of asset evaluation upon privatization which necessitates investment injection so as to compete with a market competitive environment.

Lastly the study documents a significant decline in employment level following privatization. However, according to proclamation No 146/1998, privatized firm has an obligation to maintain existing employees otherwise compensate them while layoff.

6. REFERENCES


APPENDIX

TABLE 1 DESCRIPTIONS OF VARIABLES USED IN THE STUDY

<table>
<thead>
<tr>
<th>Performance Indicator</th>
<th>Proxies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability</td>
<td>ROS=Net income/Sales, ROA= Net income/Assets, ROE= Net income/Equity</td>
</tr>
<tr>
<td>Operating Efficiency</td>
<td>SALEFF=Sales/No of employees, INEFF =Net income/No of employees, AT= sales/total asset</td>
</tr>
<tr>
<td>Liquidity</td>
<td>CuR=current asset to current liability</td>
</tr>
<tr>
<td>Leverage</td>
<td>D/A= total debt /total assets, D/E=Total debt/equity</td>
</tr>
<tr>
<td>capital expenditure</td>
<td>CAPEXP-S= capital expenditure /sales, CAPEXP-A=capital expenditure/Asset</td>
</tr>
<tr>
<td>Employment</td>
<td>EMPL=Total Number of Employees</td>
</tr>
</tbody>
</table>

Source: Adopted from similar studies.

TABLE 2 PROFITABILITY INDICATORS

<table>
<thead>
<tr>
<th>Profitability Indicators</th>
<th>Mean Before</th>
<th>Mean After</th>
<th>Mean Change</th>
<th>Percentage Of Change</th>
<th>Change Description</th>
<th>Wilcoxon Z statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROS</td>
<td>9.69</td>
<td>8.30</td>
<td>-1.39</td>
<td>-16.74</td>
<td>Negative</td>
<td>0.972*</td>
</tr>
<tr>
<td>ROA</td>
<td>8.84</td>
<td>2.64</td>
<td>-6.2</td>
<td>-234.84</td>
<td>Negative</td>
<td>0.906*</td>
</tr>
<tr>
<td>ROE</td>
<td>59.61</td>
<td>33.07</td>
<td>-26.534</td>
<td>-80.22</td>
<td>Negative</td>
<td>0.625*</td>
</tr>
</tbody>
</table>

*Wilcoxon Z Test is significant at the 0.05 level.

Source: Computed from annual reports of the sample firms & test results

TABLE 3 OPERATING EFFICIENCY INDICATORS

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Mean Before</th>
<th>Mean After</th>
<th>Mean Change</th>
<th>Percentage of Change</th>
<th>Change Description</th>
<th>Wilcoxon Z statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT</td>
<td>76.29</td>
<td>59.17</td>
<td>-17.12</td>
<td>-28.93</td>
<td>Negative</td>
<td>0.650*</td>
</tr>
<tr>
<td>SALEFF</td>
<td>5.80</td>
<td>6.78</td>
<td>0.98</td>
<td>14.45</td>
<td>Positive</td>
<td>0.046*</td>
</tr>
<tr>
<td>INEFF</td>
<td>8.43</td>
<td>7.10</td>
<td>-1.33</td>
<td>-18.72</td>
<td>Negative</td>
<td>0.116*</td>
</tr>
</tbody>
</table>

*Wilcoxon Z Test is significant at the 0.05 level.

Source: Computed from annual reports of the sample firms & test results
TABLE 4 LIQUIDITY INDICATOR

<table>
<thead>
<tr>
<th>Liquidity Indicators</th>
<th>Mean Before</th>
<th>Mean After</th>
<th>Mean Change</th>
<th>Percentage Of Change</th>
<th>Change Description</th>
<th>Wilcoxon Z statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current ratio</td>
<td>1.31</td>
<td>2.48</td>
<td>1.17</td>
<td>47.17</td>
<td>Positive</td>
<td>0.807*</td>
</tr>
</tbody>
</table>

*Wilcoxon Z Test is significant at the 0.05 level.

Source: Computed from annual reports of the sample firms & test results

TABLE 5 LEVERAGE INDICATORS

<table>
<thead>
<tr>
<th>Leverage Indicators</th>
<th>Mean Before</th>
<th>Mean After</th>
<th>Mean Change</th>
<th>Percentage Of Change</th>
<th>Change Description</th>
<th>Wilcoxon Z statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>D/E</td>
<td>1.66</td>
<td>2.91</td>
<td>1.25</td>
<td>42.96</td>
<td>Positive</td>
<td>0.162*</td>
</tr>
<tr>
<td>D/A</td>
<td>0.42</td>
<td>0.67</td>
<td>0.25</td>
<td>37.31</td>
<td>Positive</td>
<td>0.552*</td>
</tr>
</tbody>
</table>

*Wilcoxon Z Test is significant at the 0.05 level.

Source: Computed from annual reports of the sample firms & test results

TABLE 6 CAPITAL EXPENDITURE INDICATORS

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Mean Before</th>
<th>Mean After</th>
<th>Mean Change</th>
<th>Percentage Of Change</th>
<th>Change Description</th>
<th>Wilcoxon Z statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>CAPEX -S</td>
<td>0.851</td>
<td>1.093</td>
<td>0.241</td>
<td>22.09</td>
<td>Positive</td>
<td>0.638*</td>
</tr>
<tr>
<td>CAPEX –A</td>
<td>0.344</td>
<td>0.467</td>
<td>0.123</td>
<td>26.38</td>
<td>Positive</td>
<td>0.196*</td>
</tr>
</tbody>
</table>

* Wilcoxon Z Test is significant at the 0.05 level.

Source: Computed from annual reports of the sample firms & test results

TABLE 7 EMPLOYMENT INDICATOR

<table>
<thead>
<tr>
<th>Employment Indicators</th>
<th>Mean Before</th>
<th>Mean After</th>
<th>Mean Change</th>
<th>Percentage Of Change</th>
<th>Change Description</th>
<th>Wilcoxon Z Test statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>EMPL</td>
<td>517</td>
<td>503</td>
<td>-14</td>
<td>-2.78</td>
<td>Negative</td>
<td>0.735*</td>
</tr>
</tbody>
</table>

* Wilcoxon Z Test is significant at the 0.05 level.

Source: Computed from annual reports of the sample firms & test results