



FINANCIAL AND OPERATING PERFORMANCE OF NEWLY PRIVATISED BANKS IN LAOS

(Evidence from Bank pour Commerce External du Lao)

Sompasong Phommasane

Victoria University, Melbourne, Australia

Email: sompasong.phommasane@live.vu.edu.au

Abstract

This paper sheds light on the challenging question of how privatisation affects firms' financial and operating performance in Laos. It attempts to examine whether or not privatisation positively affects newly privatised firms. Due to the lack of data on the financial and operating performance of state-owned enterprises and privatised companies, this paper uses the largest commercial bank in Laos, Bank pour Commerce External du Lao (BCEL), as a case study as it is the only privatised state-owned enterprise (SOE) with pre- and post-privatisation business records available to the public. By comparing the pre- and post-privatisation financial and operating performance of BCEL during the period 2007 to 2015, this paper presents contradictory conclusions. Specifically, although there was a significant increase in output (adjusted for inflation) and employment and a slight decline in leverage following partial privatisation, there was a decline in profitability, operating efficiency and dividend payments. These mixed results can partly be explained by the high level of government ownership (70%) in BCEL. This paper proposes that partial privatisation with the remaining high level of state ownership can have less effects on newly privatised companies of low-middle-income countries like Laos. Since this paper has only investigated a single privatised company - BCEL, further studies of privatised companies need to be conducted.

Keywords: Banks, Business Performance, Privatisation, SOEs

1. Introduction

Laos¹ first introduced a program of structural economic reforms (*so-called New Economic Mechanism*) in 1986, shifting from a centrally-planned economy towards a market-oriented economy. One major component of the economic reform measures was reform of the state-owned enterprises (SOEs), which had been playing a dominant role in the command economy. As the principle objective was to assist in improving the poor economic performance resulting from low productivity and efficiency of obsolete, centrally-planned mechanisms, in 1989, the Lao government introduced a radical program for SOE reform by first privatising small-scale SOEs and then, in 1991 shifted its emphasis toward larger and strategic SOEs such as food processing, telecommunications and transportation.

Given the lack of consistent data on numbers of SOEs, it is difficult to provide a clear picture prior to privatisation situations in Laos. Up to 1997, a majority of some 640 SOEs had

¹ Laos - a landlocked country with a total area of 236,800 km² - is situated at Southeast Asia, sharing borders with Cambodia, Thailand, Myanmar, China, and Vietnam. It has a total population of 6.8 million. The World Bank database states that between 1987 and 2015 in Laos increased from about US\$280 to US\$1810.

become privatised through liquidation, lease arrangements, workforce buyouts and/or direct sales (Bourdet, 1992; ADB, 1997; Livingstone, 1997; Daniel, 2000; Suzuki, 2002; Pham, 2004). The privatisation value aggregate between 1989 and 1997 was about US\$127, 60% of which were contributed by joint ventures. According to those authors, privatisation in Laos served multiple objectives; for example, introducing and promoting private-sector activities in an economy, promoting competition, attracting foreign direct investment, improving productivity and efficiency, resolving budget deficits, and reducing and eliminating state subsidies to SOEs.

In the long process of privatisation in Laos, the year 2010 can be marked as the beginning of a new chapter. Of ten privatisation cases between 2010 and 2015, in 2010 two² significantly differed from the other eight cases in that they supported the establishment of the first-ever stock market. In these two cases, it was the first time that a privatisation process had been conducted with an open, transparent and competitive bidding process using a public share issuance method. It was also the first attempt by the government to implement a privatisation policy, not only to mobilise a large scale domestic private capital, but also to promote the concept of socialising risk. In this way, certain risks were to be shifted away from the government through alternative risk and reward mechanisms.

Nearly thirty years of privatisation efforts in Laos have clearly marked economic achievements, in terms of promoting competition and stimulating private-sector activities. Although the exact numbers of SOEs are not publicly accessible, it cannot be denied that SOEs play a less important role in the Lao economy in terms of economic output and workforce. According to U.S. Bureau of Economic and Business Affairs (2015), in 2015, there were 135 SOEs with US\$5.6 billion in assets, accounting for only one percent of total employment, which according to best estimates was about 30,000 people. For the period 2011-2015, private investments constituted 67% (US\$31 billion) of total investments, or 61% (US\$51 billion) of GDP (Ministry of Planning and Investment - MPI, 2016). The World Bank (2007) reported that in 2007 the private sector accounted for over 80% of GDP and large portions of the total exports. It can; therefore, be concluded that the private sector has now become more important than SOEs in promoting strong economic growth, total employment, exports and investments in Laos.

Numerous international studies (Megginson, Nash & van Randenborgh, 1994; Boubakri & Cosset, 1998; D'Souza & Megginson, 1999; Dewenter & Malatesta, 2001) provide empirical evidence to support the proposition that post-privatisation companies were more effective than their financial and operating performance at the time they remained under state ownership. Little research however has been found on post-privatisation firms' financial and operating performance in Laos. One of the reasons can be publicly inaccessible data on SOEs' business performance. Out of five listed companies in 2015, only two previous SOEs (EDL-GEN and BCEL) were listed on the Lao stock exchange and had their financial reports available to the public. Unlike EDL-GEN, only BCEL had both pre- and post-privatisation business records. This paper therefore uses BCEL as a case study in order to answer whether or not post-privatisation firms outperformed pre-privatisation firms in terms of profitability, operating efficiency, real sales, investment spending, dividend payments and leverage.

The rest of this paper is organised as follows. Section 2 describes the BCEL, followed by discussing review of the relevant literature on how privatisation affects firms' financial and operating performance in Section 3. Section 4 presents testable predictions and methodology, while Section 5 presents my empirical results, and Section 6 concludes the paper.

² The government publicly sold 25% of state ownership in EDL-Generation Public Company (EDL-GEN) and 20% of state ownership in Bank pour Commerce External du Lao (BCEL) to domestic and foreign investors in 2010.

2. Banque Pour Le Commerce Extérieur Lao (BCEL)

In 1989, the Lao banking sector was transformed from a mono-bank system into a two-tier banking system, with well-defined and separate functions for the central bank and commercial banks. As a result, seven autonomous state-owned commercial banks including Banque Pour Le Commerce Extérieur Lao (BCEL) were established in that year. BCEL remained under full state ownership, until late 2010 when the Lao government publicly offered 20% of its ownership in BCEL to domestic and foreign investors using a share issuance privatisation method. The government then, in 2001, directly sold another 10% in BCEL to a foreign strategic investor, a French-based commercial bank. By 2015, the Lao government holds 70% of ownership while the foreign strategic investor and other public investors hold 10% and 20% in BCEL, respectively.

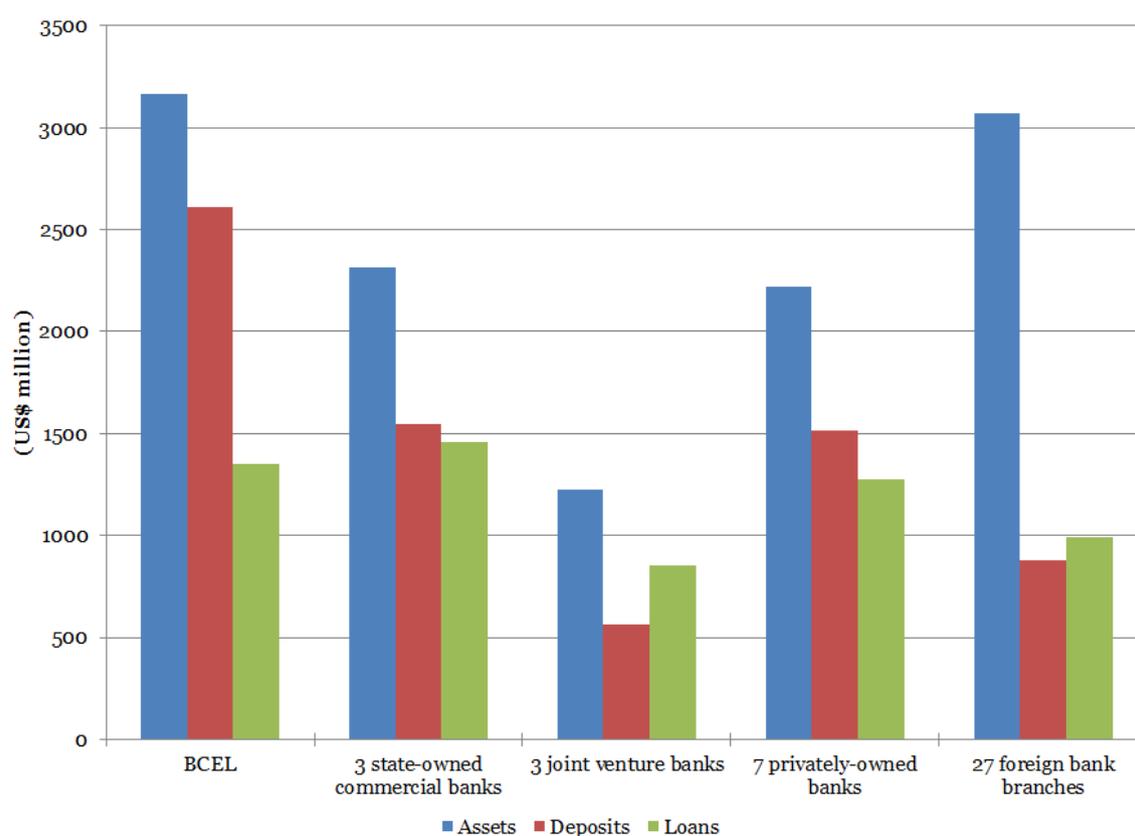


Figure 1: Bank assets, deposits and loans in Laos' banking sector in 2015
Source: BOL (2015) and BCEL (2015)

By 2015, there were 41 commercial banks: four state-owned commercial banks including BCEL, three joint-venture banks, seven private banks, and twenty-seven foreign bank branches. Figure 1 reveals that these state-owned commercial banks dominated the Lao banking system, respectively accounting for 46% (US\$5.5 billion), 58% (US\$4.2 billion) and 47% (US\$2.8 billion) of the entire bank assets, deposits and loans. The sector also appeared to be highly liquid since loans absorbed around 84% of total deposits and loan-to-asset ratio was nearly 50% in that year. Specifically, BCEL was the largest commercial bank in Laos, totalling US\$3.2 billion in assets, US\$2.6 billion in deposits and US\$1.4 billion in loans. The challenging question here is whether or not 'partial' privatisation could lead to better business performance of BCEL.

3. Literature review

This section discusses some empirical studies on pre- and post-privatisation firm performance. The effects of privatisation on the profitability, operational efficiency, output (real sales), capital spending, dividend payments and leverage by the firm are tested by numerous authors (Megginson, Nash & van Randenborgh, 1994; Boubakri & Cosset, 1998; D'Souza & Megginson, 1999; Dewenter & Malatesta, 2001; Wei et al., 2003). Mounting empirical studies have presented evidence of mixed outcomes of privatisation; however, most of these empirical findings document that privatisation generally yields firm performance improvements in regard to either all or some of these pre-determined performance measures and employment in newly privatised companies appears to increase after privatisations. However, a handful of documents have presented the opposite view (Boubakri & Cosset, 2002; Aussenegg & Jelic, 2007), with some concluding that privatisation in low- or lower-middle-income countries produces weaker improvements in performance for privatised firms than that in high-income countries (Megginson, Nash & van Randenborgh, 1994; Boubakri & Cosset, 1998; D'Souza & Megginson, 1999). Let us discuss the very first study in this area by Megginson, Nash and van Randenborgh (1994; henceforth MNR).

The authors compared the pre- and post-privatisation financial and operating performance of 61 firms in 18 countries (12 industrial and 6 developing) and 32 different industries in 1961-1990. The authors provided strong evidence that the sample firms became more profitable, increased their real sales and investment spending, and improved their operating efficiency. Those firms not only significantly reduced their debt levels, but also increased dividend payments and employment. Following the MNR methodology, Boubakri and Cosset (1998)³ and D'Souza and Megginson (1999)⁴ confirmed that their findings were similar to those reported by Megginson, Nash and van Randenborgh (1994) and concluded that privatisation typically transfers both control rights and cash flow rights to the managers, who then show a great emphasis on profits and efficiency than in pleasing the government with high output or employment. Divestiture should, therefore, produce good outcomes by using testable predictions.

4. Testable predictions and research methodology

This paper follows guidelines and testable predictions accordingly to the MNR methodology. Table 1 presents six groups of testable predictions; however, one group (dividend payout) cannot be employed in this paper due to insufficient necessary data. To measure the effects of privatisation on firm performance, all proxies are computed for BCEL for the years before and after privatisation. The mean for each proxy is estimated over the pre-privatisation (years -3 to -1) and post-privatisation (years +1 to +3) period. Specially, the year of privatisation (year 0) includes both the public and private ownership phases of BCEL and financial data for that year are excluded from the mean calculations. In this way, at least two observations are available for the pre-privatisation and post-privatisation windows.

Table 1: Selected indicators of pre- and post-privatisation performance

Proxies	Expected Change
Profitability	
Return on sales (ROS) = net income ÷ sales	Increase
Return on assets (ROA) = net income ÷ total assets	Increase
Return on equity (ROE) = net income ÷ total equity	Increase

³ Boubakri and Cosset (1998) examines the change in the financial and operating performance of 79 firms from 21 developing countries that experienced full or partial privatisation during the period from 1980 to 1992

⁴ D'Souza and Megginson (1999) examines the change in the financial and operating performance of 85 firms from 28 countries that experienced full or partial privatisation during the period from 1990 to 1996

Operating efficiency	
Sales efficiency (SALEFF) = total revenue ÷ # employees	Increase
Net income efficiency (NIEFF) = net income ÷ # employees	Increase
Outputs	
Real sales (SAL) = nominal total incomes ÷ consumer price index	Increase
Real net incomes (RNI) = nominal net incomes ÷ CPI	Increase
Leverage	
Debt to assets (LEV1) = Total debts ÷ total assets	Decrease
Long-term debt to equity (LEV2) = Long-term debts ÷ equity	Decrease
Payout	
Dividends to sales (DIVSAL) = Cash dividends ÷ sales	Increase
Dividends payout (PAYOUT) = Cash dividends ÷ net income	Increase
Employment	
Total employment = total number of employees	Decrease

Source: Adopted from Megginson, Nash and van Randenborgh (1994, p. 422)

5. Data analysis

Data on BCEL's financial data between 2007 and 2013 were mainly collected and compiled from its initial public offering prospectus and multiple annual reports. Therefore, the mean financial proxies for BCEL can be estimated for a seven-year performance timeline: pre-privatisation (2007-2009), post-privatisation (2011-2013) and the year of privatisation (2010). Table 2 presents the mean estimations of BCEL's pre- and post-privatisation financial and operating performance. Let us compare each proxy in turn.

Table 2: Mean proxies of BCEL's pre- and post-privatisation performance

Proxies	Pre-privatisation (2007-2009)	Post-privatisation (2011-2013)
Profitability		
Return on sales (ROS)	0.346	0.215 ↓
Return on assets (ROA)	0.023	0.013 ↓
Operating efficiency (US\$ thousand)		
Sales efficiency (SALEFF)	75	99 ↑
Net income efficiency (NIEFF)	26	21 ↓
Output (US\$ million)		
Real sales (SAL)	48	122 ↑
Real net incomes (RNI)	16	26 ↑
Leverage		
Debt to assets (LEV1)	0.958	0.932 ↓
Debt to equity (LEV2)	27.87	13.65 ↓
Payout		
Dividends to sales (DIVSAL)	not applicable	11%
Dividends payout (PAYOUT)	not applicable	53%
Employment		
Total employment	646	1,228 ↑
Yearly salary per employee (US\$)	6167	9787 ↑

Source: BCEL and author's estimate

6. Profitability change

As companies shift from public to private ownership, their profitability should increase since privatisation brings with it private-sector owners who focus on profit-oriented objectives (Boubakri & Cosset, 1998). The authors point out that the managers of newly privatised firms are expected to focus on profit goals in response to shareholders. This paper's results, however, show a significant decline in BCEL's profitability. As measured by the return on sales (ROS) and assets (ROA), ROS and ROA significantly decreased on average from 34.6% and 2.3% before privatisation to 25.1% and 1.3% after privatisation, respectively. It can be said that BCEL was less profitable after privatisation.

7. Operating efficiency

The great emphasis on profit and the cuts in government subsidies following privatisation should lead firms to use their resources more efficiently (for example, human, financial, and technological capital) (Boubakri & Cosset, 1998). To measure operating efficiency, this paper uses the sales efficiency ratio (real “inflation-adjusted” sales per employee) and net income efficiency (net income per employee). Both ratios show a contradictory result following privatisation. On average, the sales efficiency ratio went up by 32% to about US\$99,000 after privatisation; however, the net income efficiency ratio significantly declined by approximately 19% to US\$21,000. It can be inferred that BCEL used more employees to boost its revenues; and therefore, higher staff expenses are most likely to be unavoidable. This may make BCEL less efficient in this regard.

8. Output

Privatisation can be expected to foster efficiency and thus, stimulate new growth (Boubakri & Cosset, 1998). Using the real “inflation-adjusted” sales and real incomes measures, Megginson, Nash and van Randenborgh (1994) however, point out that these measures cannot be predictable for efficiency due to many possible reasons; for example, higher investment and greater scope of entrepreneurial initiatives. As mentioned above, higher employment can also lead to higher sales and/or higher output. Real sales and net income ratios rose significantly by 155% and 62% on average, to US\$122 million and US\$26 million, respectively. This increase in output reflects the increased productivity (output) of BCEL following privatisation.

9. Leverage

The switch from public to private ownership can be expected to result in reduced leverage because the government’s removal of debt guarantees will increase firms’ cost of borrowing (Boubakri & Cosset, 1998). To measure the effect of privatisation on the leverage of BCEL, this paper compares the pre-privatisation ratio of total debt to total assets and total equity to those post-privatisation ratios. As predicted, the ratio of debt to assets slightly decreased from 95.8% to 93.2% on average while the ratio of debt to equity significantly declined from somewhat 28 to 14 following privatisation. It can be concluded that privatisation has a slightly positive impact on BCEL’s leverage partly due to equity financing effects.

10. Dividend payments

Dividend payments can be expected to increase since private investors, unlike governments, generally require dividends (Boubakri & Cosset, 1998). As predicted, the dividend payout ratio as a proportion of its net income and the ratio of dividends to sales are expected to increase over time. Owing to a lack of necessary data on pre-privatisation dividend payments, this paper examines only dividend payments following privatisation. It was reported that BCEL paid total dividends of US\$12 million in 2011, US\$14 million in 2012 and US\$13 million in 2013. On average, the ratio of dividends to sales and the dividend payout ratio stood at 11% and 53% during the period 2011 to 2013. However, these ratios gradually declined in two consecutive years (by more than 15% per year) since BCEL first paid dividends in 2011. This can reflect BCEL’s low capacity of generating income and paying dividends following privatisation.

11. Employment and per employee salary

The shift from public to private ownership can be expected to cut employment following privatisation and the reduction of subsidies in order to improve efficiency (Boubakri & Cosset, 1998). This paper’s results show that a number of BCEL’s employees increased by almost 90%, from 646 before privatisation to 1228 after privatisation. This evidence, combined with that Megginson, Nash and van Randenborgh (1994) and Boubakri and Cosset (1998), pinpoints that privatisation does not necessary lead to a decline in

employment. Another finding suggests that privatisation can lead to further benefits to employees since BCEL employees receive higher salaries following privatisation. On average, yearly salary per employee (inflation-adjusted yearly salary per employee) significantly increased by 60%, to about US\$9,800 after privatisation. It can be inferred that privatisation results in higher employment and per employee incomes.

12. Business performance of BCEL after 5-year post-privatisation

This section compares the financial and operating performance of BCEL in a 5-year time horizon from 2011 to 2015 in comparison to pre-privatisation performance 2007-2009. Only differences of two observations for pre- and post-privatisation windows are reported here in this section. The results showed a significant increase in real sales ($\uparrow 155\%$), real net incomes ($\uparrow 25\%$), and employment ($\uparrow 110\%$) and per employee salary ($\uparrow 50\%$), and a significant decline in leverage (debt-to-asset ratio $\downarrow 2\%$ and debt-to-equity ratio $\downarrow 40\%$). The results also revealed a significant decline in BCEL's profitability (return on sales $\downarrow 50\%$ and return on assets $\downarrow 55\%$), operating efficiency (sales efficiency $\uparrow 20\%$ but income efficiency $\downarrow 45\%$), and a gradual decline in dividend payment from about US\$12 million in 2011 to US\$7 million in 2015. It can be concluded that 5-year business performance of BCEL was relatively weaker in terms of profitability and efficiency than its first 3-year performance after privatisation and even much weaker than those under full state ownership.

Conclusion

This paper examines the financial and operating performance of newly-privatised companies in Laos. Due to lack of necessary data on previous privatised firms, it focused on examining business performance of the largest commercial bank in Laos, BCEL as a case study, during the period from 2007 to 2015. The results showed a significant increase in output (adjusted for inflation) and employment, a significant decline in leverage, and a slight decline in profitability, operating efficiency and dividend payments after privatisation. Many authors (Megginson, Nash & van Randenborgh, 1994; Boubakri & Cosset, 1998; D'Souza & Megginson, 1999) suggest that privatisation appeared to produce weaker improvements in performance for privatised firms in either low- or lower-middle-income countries compared to those with high income per capita. This can also be the case in a lower-middle-income country like Laos, by using Laos' largest commercial bank as a case study.

Privatisation brings with it a percentage of private-sector owners who focus on efficiency and profit-oriented goals; however, they may have little influence on the day-to-day business operations and decision-making processes about material issues since the government remains BCEL's largest shareholder, with a majority shareholding of 70%. In this situation, improvements in business performance, efficiency and profitability are likely to be slow. This paper proposes that partial privatisation with the remaining high level of state ownership can have less effects on newly privatised companies of low-middle-income countries like Laos. Ownership, therefore, seems to matter. Since this paper has only investigated a single privatised company - BCEL, further studies of privatised companies need to be conducted.

References

- i. ADB. 1997. *Lao PDR Public Expenditure Review: Improving Efficiency and Equity in Spending Priorities*. ADB Report No. 16094-LA, Asian Development Bank, Manila, The Philippines.
- ii. Aussenegg, W. & Jelic, R., 2007. The Operating Performance of Newly Privatized Firms in Central European Transition Economies. *European Financial Management*, 13(5), pp. 853-79.
- iii. BCEL. 2015. *Banque Pour Le Commerce Extérieur Lao*. Annual Report 2015, Vientiane, Lao PDR. Available at: <http://www.bcel.com.la/>
- iv. BOL. 2015. *Lao Monetary Statistics - Q4 2015*. Bank of the Lao PDR, Vientiane, Lao PDR. Available at: <http://www.bol.gov.la/laoweb/index.php> [Accessed July 20, 2016]
- v. Boubakri, N. & Cosset, J. C., 1998. The Financial and Operating Performance of Newly Privatized Firms: Evidence From Developing Countries. *Journal of Finance*, 53(3), pp. 1081-110.
- vi. Boubakri, N. & Cosset, J. C., 2002. Does Privatization Meet The Expectations? Evidence From African Countries. *Journal of African Economies*, 11, pp. 111-40.
- vii. Bourdet, Y., 1992. Reforming Laos' Economic System. *Journal of Economic Systems*, 16(1), pp. 63-88.
- viii. D'Souza, J. & Megginson, W. L., 1999. The Financial and Operating Performance of Newly Privatized Firms in the 1990s. *Journal of Finance*, 54(4), pp. 1397-438.
- ix. Daniel, J., 2000. Progress in the Privatization Program in the Lao PDR. In *Economic development in Lao PDR: Horizon 2000*, Pham, D. C. (ed.). Vientiane, Lao PDR: Bank of the Lao PDR.
- x. Dewenter, K. L. & Malatesta, P. H., 2001. State-Owned and Privately-Owned Firms: An Empirical Analysis of Profitability, Leverage, and Labour Intensity. *American Economic Review*, 91(1), pp. 320-34.
- xi. Livingstone, I., 1997. The Experience of Privatization and Private Investment in Lao PDR and Cambodia. *Journal of the Asia Pacific Economy*, 2(2), pp. 225-38.
- xii. Megginson, W. L., Nash, R. C. & van Randenborgh, M., 1994. Financial and Operating Performance of Newly Privatized Firms: An International Empirical Analysis. *Journal of Finance*, 49(2), pp. 403-52.
- xiii. MPI. 2016. *8th Five-Year National Socio-Economic Development Plan (2016-2020)*. Ministry of Planning and Investment, Vientiane, Lao PDR.
- xiv. Pham, D. C., 2004. *The Lao Economy Review of New Economic Mechanism (NEM) and The Challenge of Integration*. Bank of the Lao PDR, Vientiane, Lao PDR. Available at: <http://www.bol.gov.la/english/laoeconomyreview1.html> [Accessed June 05, 2013]
- xv. Suzuki, M., 2002. *Issues of State-Owned Enterprises in the Lao PDR: Interview Survey*. Macroeconomic Policy Support for Socio-Economic Development in The Lao PDR, Lao PDR Committee for the Planning and Investment in Collaboration with Japan International Cooperation Agency, Vientiane, Lao PDR.
- xvi. U.S. Bureau of Economic and Business Affairs. 2015. *2015 Investment Climate Statement*. U.S. Bureau of Economic and Business Affairs, Washington, D.C. Available at: <http://www.state.gov/documents/organization/241836.pdf> [Accessed April 11, 2015]
- xvii. Wei, Z., Varela, O., D'Souza, J. & Hassan, K. M., 2003. Financial and Operating Performance of China's Newly Privatized Firms. *Financial Management*, pp. 107-26.
- xviii. World Bank. 2007. *Lao PDR Investment Climate Assessment 2007: Reducing Investment Climate Constraints To Higher Growth*. World Bank (Laos) Office, Vientiane, Laos.