CHAPTER 3

OWNERSHIP AND PERFORMANCE

3.1 Privatization, Ownership and Performance

The common usage of the term `privatization´ refers to a change in the ownership of an enterprise (or activity) from the public to the private sector. In Malaysia, the broad definition of privatization contained in the Privatization Masterplan (PMP) is "the transfer to the private sector of the activities and functions which have traditionally rested with the public sector".

The idea of privatization is derived from `property rights theory´ suggests that a change in ownership will improve the incentives for enhancing productive efficiency. Private enterprises are owned by individuals who have claims to their assets. These assets are used to produce goods and services demanded by consumers, and if they are produced at lower cost, greater profits, and ultimately, income and wealth are created. Private owners have the incentive to monitor the behaviour of managers and employees to ensure production in a cost-effective manner over time, thus suggesting that a change in ownership may have a significant impact on productive efficiency (Vickers and Yarrow, 1988).

Also, a change to partial or complete private ownership is expected to reduce the scope for political intervention in the operations of an enterprise. Therefore, the enterprise's objectives will be simplified, with less bureaucratic controls and arbitrary 'interferences' by the authorities (Cook and Kirkpatrick, 1988).

In Malaysia, the privatization policy has promised increased competition, improved efficiency and increased productivity of the public sector services, which should accelerate the rate of growth of the economy.

One of the most crucial objectives of privatization in Malaysia is that of increasing efficiency. The efficiency objective is generally defined in terms of the two concepts of allocative efficiency and productive efficiency. Briefly, allocative efficiency corresponds to the best allocation of productive resources among different possible uses in the economy, usually enhanced by competition and the price system. As for productive efficiency, this involves the best use by enterprises of resources available to them, and hence the minimisation of costs; the increased productive efficiency of privatized enterprises will have a positive and durable impact on the public purse (Bouin, 1992).

In order to achieve the above, there is a need to have complete divestment of government ownership and control to private owners of hitherto government-owned or run entities (Jones and Fadil, 1992a). At the same time, it is important that such firms be exposed to greater competition as well. According to Jones and Fadil (1992a), divesting ownership alone is insufficient as the entity may still be subject to government control; therefore, it is important that the privatized entity be placed in a competitive environment. Thus, the transfer of property rights must be accompanied by the strengthening of competition in both factor and product markets (Kay and Thompson, 1986). This interaction between private ownership and competition should ultimately enhance efficiency.

There are problems in assessing privatization in Malaysia based on the above criteria as there is limited scope for increased competition in most privatized industries (telecommunications, electricity, postal services and highway construction).

Secondly, divestment of government entities has been partial in most cases; therefore, incentives to lower costs have been limited as they can achieve comfortable profits with no fear of competition (Toh, 1989). Hence, it is important to study whether or not improvements in performance have been a result of privatization per se.

3.2 Privatization in Port Kelang

In line with the government's strategy of bringing about greater competitiveness and efficiency in the economy, the port facilities and services at Port Kelang were among the first to be identified by the Malaysian government for privatization. Port Kelang is located on one of the busiest sea routes in the world and is the largest port in the country. The Klang Port Authority (KPA), which is a government statutory body, had the financial autonomy to manage the entire port facility, including the container terminal.

KPA had never been in the "red" financially and its earnings increased soon after the container terminal went into operations. The container terminal was seen as a good candidate to become Malaysia's first privatized project as it met a number of criteria. It was important for the government to choose an entity that was not politically sensitive while it needed to have a track record of profitability at the same time (Leeds, 1989).

The Port Kelang container terminal met the above criteria. It was functioning at a low level of efficiency by international standards. Pilferage was disturbingly high and security lax. The poor performance of the container terminal was believed to be the result of too rigid bureaucratic control. There was a need for greater flexibility in management and operations if performance was to be improved.

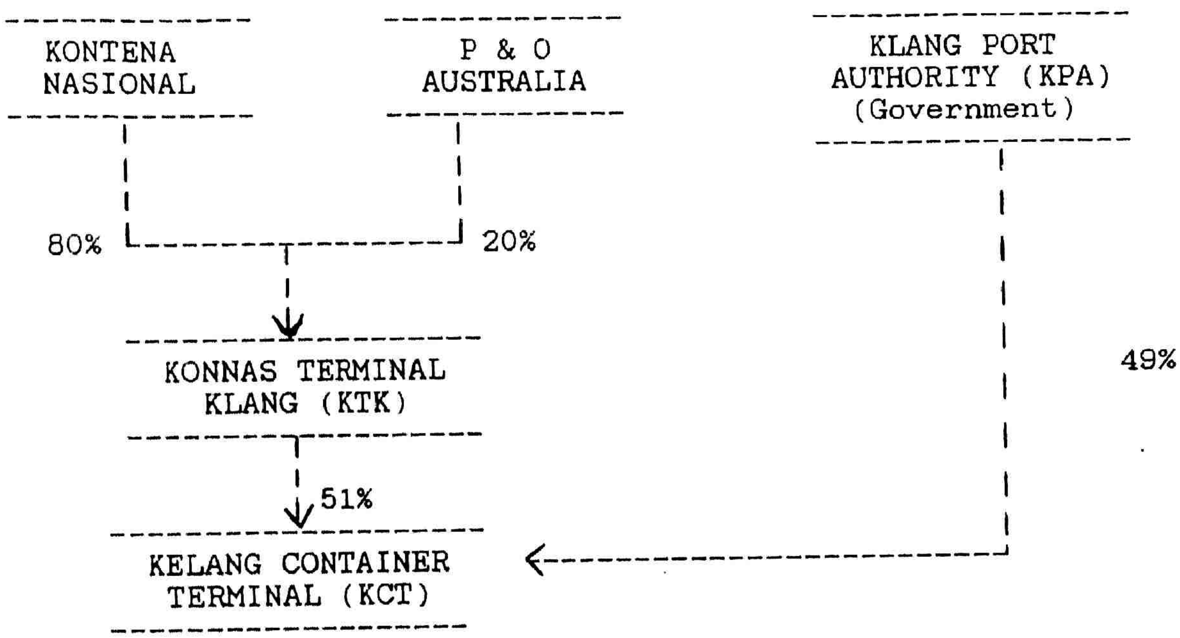
Kelang Container Terminal Bhd.

Kelang Container Terminal, or KCT as it is often referred to, was incorporated as a company in October 1985 and took over management and operations of the container terminal from the Klang Port Authority under an exclusive 21-year licence in March 1986. The company is a joint venture between Klang Port Authority (49%) and Konnas Terminal Klang, or KTK (51%), a joint venture between Kontena Nasional and P & O (Australia) Ltd.

All container operations previously operated by KPA were taken over lock, stock and barrel by KCT. The terms involved outright sale of business and moveable assets for US$44 million, US$6.7 million annual lease rental to be increased by 10% every three years, and supplementary lease rental based on a pre-determined throughput threshold payment (to expire after 1995) (Lloyd's List Maritime Asia, November 1993).

KCT PRIVATIZATION - OWNERSHIP

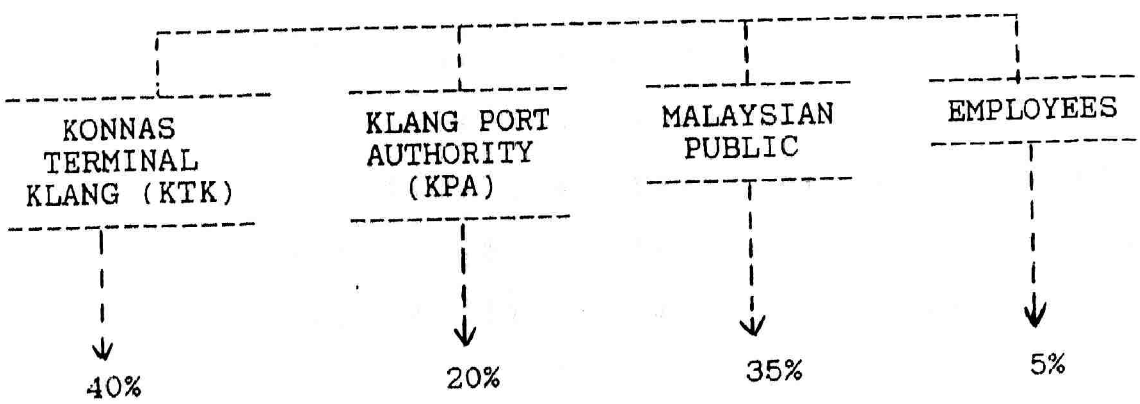
PHASE 1 (1986)



KCT PRIVATISATION - OWNERSHIP

PHASE 2 (1992)

After Public Listing on 23 November 1992



In line with the government's mandate, which stipulated that the public should enjoy the benefits of privatization, 40 percent of the shares in KCT were divested to the public under a share flotation exercise. The flotation led to KCT's shares being listed on the Kuala Lumpur Stock Exchange (KLSE) in November 1992. As a result, both KPA and KTK saw their holdings in KCT shrink proportionately.

One important outcome of the privatization of Port Kelang is to provide a private port environment, which has resulted in greater commercial flexibility and freedom from government procedures. Privatization seeks to overcome slow decision-making as well as the bureaucratic style of management which hampers the progress of the company, which is required to meet current demands on the port.

Since privatization, KCT has introduced a series of major changes to increase efficiency and productivity. To spur the changes, the company recruited several managers with vast private sector experiences. These 'outsiders' stimulated the newly privatized organization and helped accelerate change in the work culture. The new management recognises that in order to be 'customer focused' the company must have fewer layers and a 'matrix' management approach introduced. Thus, with a more 'flattened and interactive' organization, faster decision-making and greater responsiveness to problems were undertaken. At the same time, managers were encouraged to have more direct communications with employees to portray a 'hands-on' management style (Basheer, 1994). Computerization and mechanization were emphasised to minimise manual and routine jobs, as well as to improve cycle-time and to minimise paper transactions. Thus, procedures developed in the operations were "customer driven" rather than just "operations driven".

3.3 Performance

Figure 3.1 reflects the performance of the container terminal before and after privatization. The KPA introduced the container services in 1973, and under its management, container traffic had grown steadily. According to Figure 3.1, annual container throughput was 13,321 TEUs in 1973 and continued to grow steadily to 241,182 TEUs in 1986 (the year of privatization). Unfortunately, even with the steady growth rate of throughput, there was concern about the conditions of operation. In the late 1970s and early 1980s, operating efficiency of the container terminal was rated poor by shipping companies. There was also the danger that Port Kelang would be black-listed by international shippers.

Since privatization of the Kelang Container Terminal in 1986, container throughput has improved tremendously. From Figure 3.1, we can see that, since privatization container throughput rose from 241,182 in 1986 to 494,978 in 1990 and 759,251 in 1993.

At the time of privatization, overall resource utilization was low. This was deemed to be the result of the rigid operating systems and work environment which were seen to be highly regulated and bureaucratic. The highly centralised management structure had a great impact on the work culture and even managers often lacked confidence in making decisions. Poor employee welfare resulted in little support for organizational objectives. Thus, there was lacklustre performance with high absenteeism and irresponsible attitudes towards customers and users of the terminal.

After privatization, one of the most striking manifestations of internal change was in term of labour utilization. The new management provided training and incentives, as well as encouraged staff in participative decision-making. As a result, it brought about accelerated output growth as improved efficiency lowered costs (especially turn-around time) and increased the quality of services. For example, the average turnaround time improved from 13.4 hours in 1985 to 11.3 hours in 1987, while the average length of time that each container remained on the dock declined from 8 to 3.8 days.

The staff strength in 1986 was 805, and by 1993, it was 810. The employee cost per TEU actually declined from RM44.83 in 1986 to RM36.74 in 1993. Figure 3.2 shows that the employee cost per TEU rose initially but subsequently declined. The initial period might have reflected early resistance of employees to the changes (Basheer, 1994). The number of vessels calling at the port has also increased tremendously since 1984 (see Figure 3.3). Table 3.1 gives us a general picture of overall performance from 1984 to 1993.

TABLE 3.1

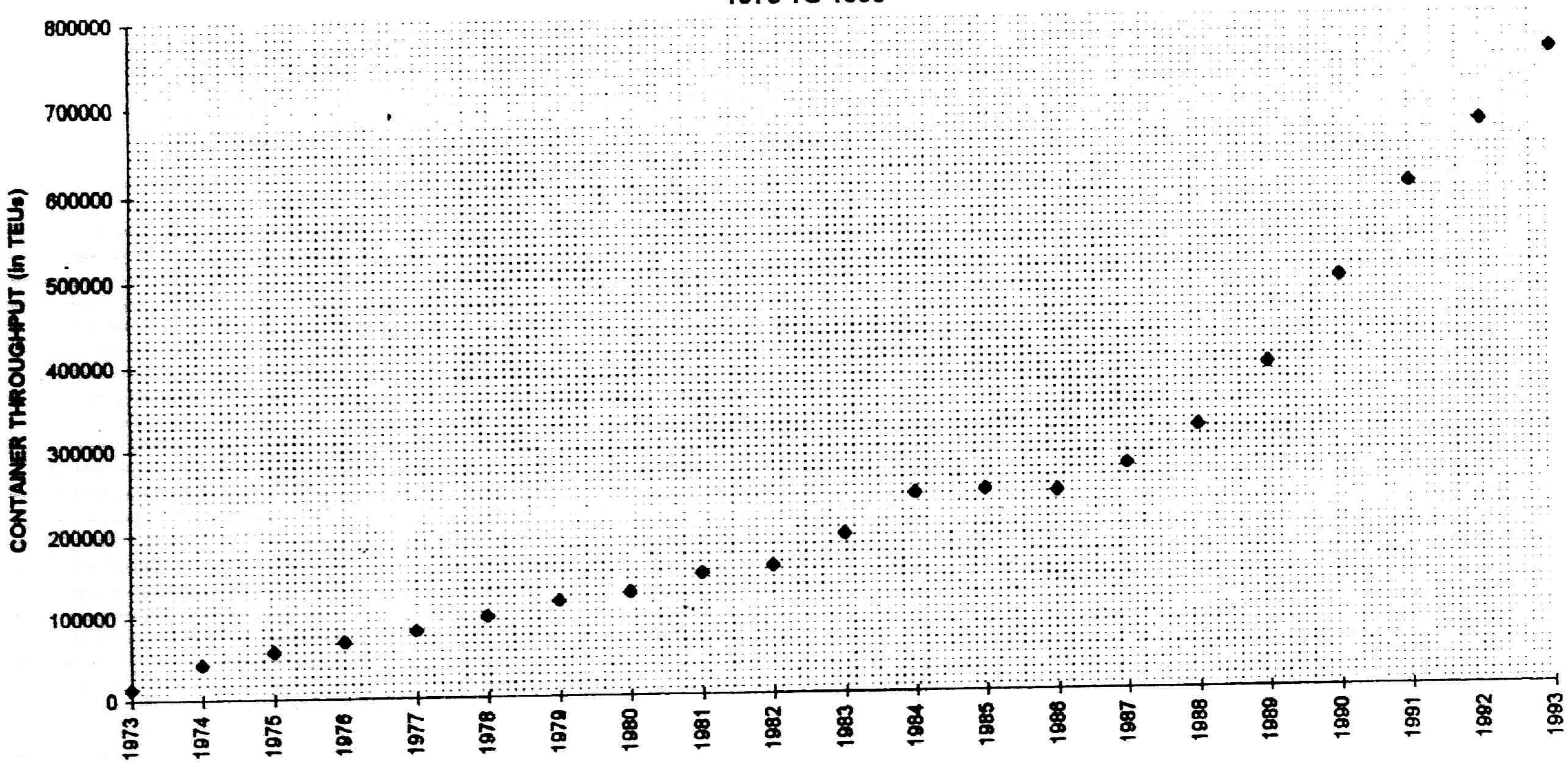
PERFORMANCE OF CONTAINER TERMINAL
IN PORT KELANG, (1984 TO 1993)

	1984	1985	1986[1]	1987	1988	1989	1990	1991	1992	1993
Number of Vessels (Units)	967	1,113	1,202	1,257	1,446	1,680	1,884	2,159	2,581	2,529
Container Throughput ('000 TEUs)	240.7	241.2	244.1	273.3	319.6	394.0	495.0	603.3	672.6	759.3
Employee cost/TEU (RM)	N.A.	N.A.	44.83	53.78	50.97	46.07	41.5	39.4	38.16	36.74

1 Kelang Container Terminal was privatized in 1986.
TEUs - twenty-foot equivalent units
N.A. - not available

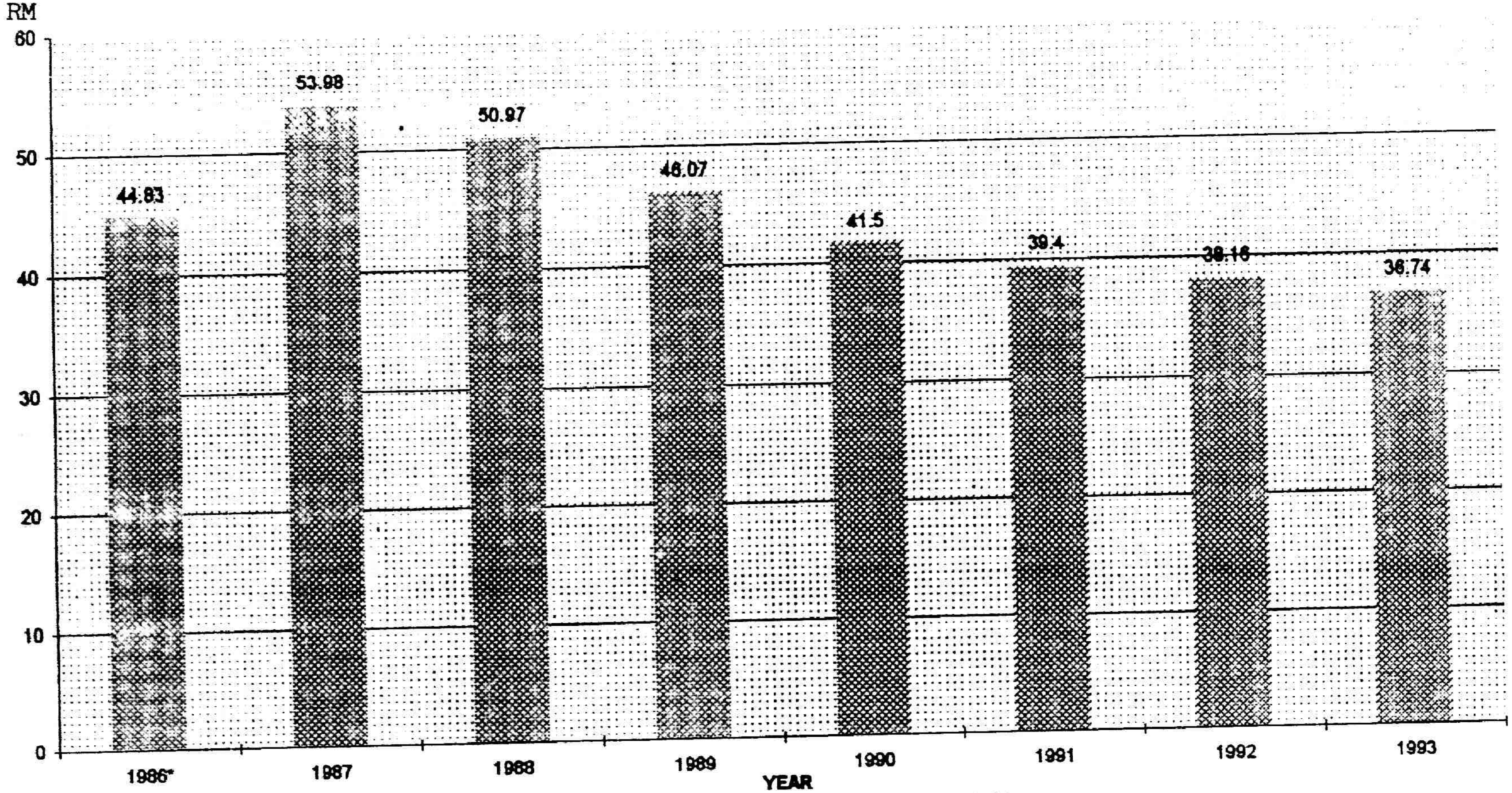
Source: KCT, Annual Reports.

FIGURE 3.1*
CONTAINER THROUGHPUT (in TEUs)
1973 TO 1993



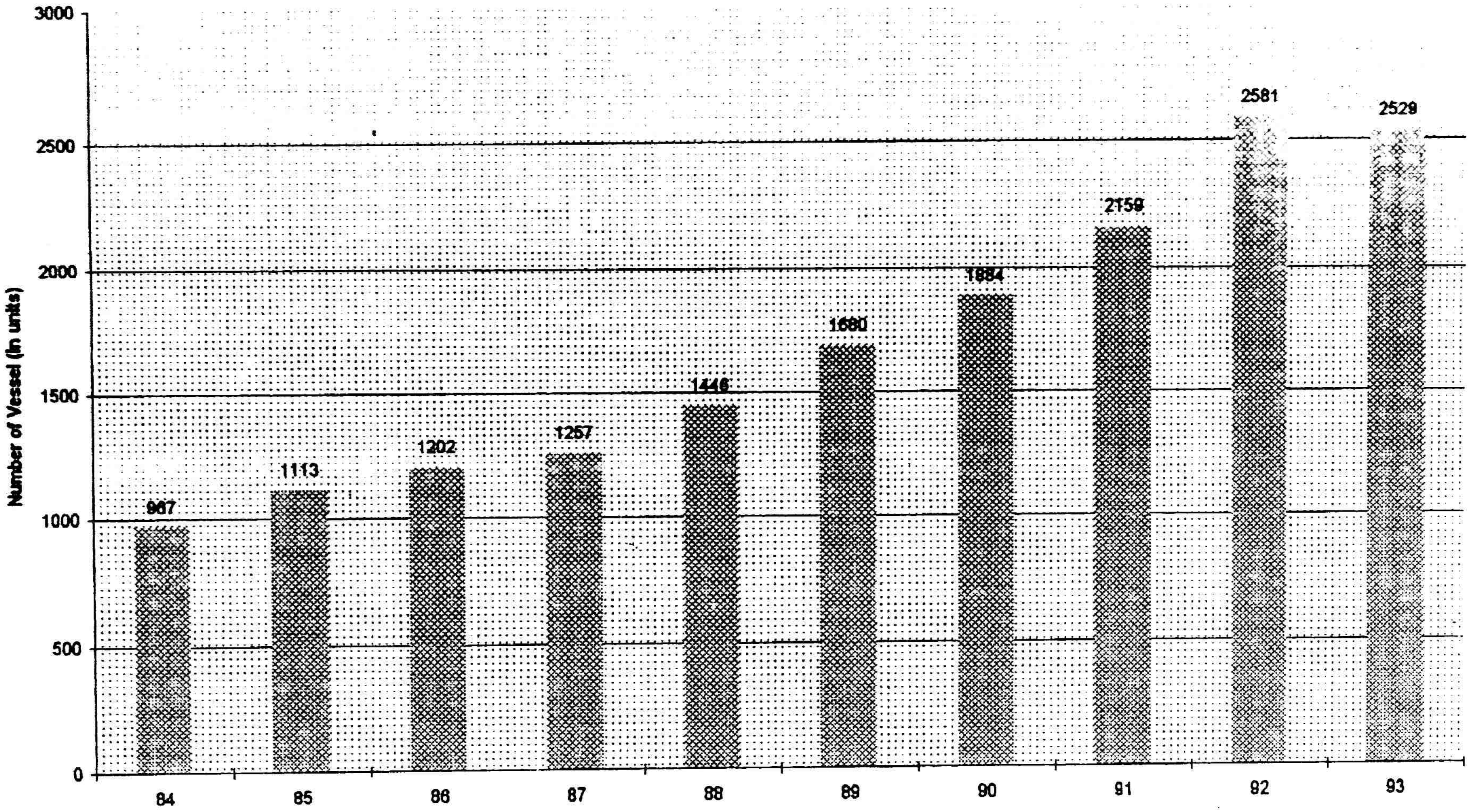
TEUs - Twenty-foot equivalent units
* See appendix 4 for details
SOURCE : KCT, ANNUAL REPORTS

FIGURE 3.2
EMPLOYEE COST PER TEU



*Kelang Container Terminal was privatized in 1986
TEU - Twenty-foot equivalent units
SOURCE: Basheer Hassan, KCT 1994

FIGURE 3.3
NUMBER OF VESSELS CALLING AT THE PORT (1984 TO 1993)



*Kelang Container Terminal was privatized in 1986
SOURCE :KCT , Annual Reports

The case of Kelang Container Terminal (KCT) has been frequently highlighted to support the success story of Malaysia's privatization policy, e.g. Nankani (1988), Leeds (1989) and Ismail (1990) have all acclaimed the success of the KCT privatization in their studies.

Jones and Fadil (1992a) have analysed KCT's performance before and after divestiture in greater detail. The objective of Jones and Fadil's analysis was to quantify the degree of achievement. "Efficiency" has been defined by Jones and Fadil, "to include gains to consumers, workers and competitors as well as buyers and government seller". Positive welfare gains have been the result of very impressive performances since privatization.

Public profitability - defined as benefits minus variable costs divided by fixed costs - at constant market prices grew at an annual average compound rate of 4.7 percent in the pre-divestiture period, and at 17.7 percent thereafter.

$$\text{Public Profit} = \frac{\text{Benefits - Variable Costs}}{\text{Fixed Costs}}$$

or $$\text{Public Profits} = \frac{X - II - R - rK^{w} - W}{K^{f}}$$

where X - value of output

II - value of intermediate inputs

W - employee compensation

R - factor rentals

rK^{w} - working capital

K^{f} - fixed costs

According to Jones and Fadil (1992a), the improved performance has been the result of improved output growth. The costs of energy, working capital and rentals did not change significantly after divestiture. The only major change was in wages which increased at an average compound rate of 12 percent after privatization, probably in the form of overtime payments and increased incentive payments, which contributed to increases in labour productivity.

Table 3.2 summarizes the distribution of welfare gains from KCT's privatization. The buyers enjoyed a positive welfare gain. They had paid RM57 million for an income stream worth RM193 million, thereby obtaining a net gain of RM109 million, with RM27 million going to foreign shareholders. Also, workers had chosen to join the new company and were rewarded with higher compensation (sixty percent gains in real hourly compensation from 1985 to 1990) in return for working a little longer and a lot 'harder and smarter'. The government too enjoyed an impressive positive welfare impact. Although it gave-up a profit stream of

RM378 million, it received RM52 million from share sales (less transaction costs of RM5 million) and a substantial tax gain of RM683 million inclusive of the rental payment plus a variable payment based on throughput. The consumers too have not been left out - they had gained by about RM88 million from improved services, as there was significant improvement in terms of reduction of turnaround time as well as crane handling movements, which resulted in more vessels calling at the port. The rate of crane-handling increased from 19.4 containers per hour in 1985 to 27.3 containers per hour in 1987, close to the Singapore figure of 28.0 containers per hour (Ismail, 1990).

The implication is clear: privatize, and efficiency should increase! But is it really true that nationalised industries will definitely perform better when moved to the private sector?

The KPA container terminal satisfied the above criteria, but had previously been functioning at a low level of efficiency by international standards. Pilferage was disturbingly high and terminal security lax. The below par performance of the container terminal was believed to be the result of too many bureaucratic controls. It was felt that if it had the freedom and flexibility to manage and operate its facilities on a more commercial basis, performance would undoubtedly improve.

KELANG CONTAINER TERMINAL DISTRIBUTIONAL IMPACT STATEMENT
(RM million, 1985 present values)

	Operation by		Gain from Privatization
	Private	Public	
Domestic			
Consumers	1539	1481	58
Government	1887	1530	357
Taxes	1650	967	683
Net Quasi-Rents	185	563	-378
Share Sales (less transaction costs)	62	0	52
Debt Subsidy/Take-over	0	0	0
Others	0	0	0
Shareholders	109	0	109
Diversified	0	0	0
Concentrated	109	0	109
Employees	0	0	0
Miscellaneous	284	330	-47
Employees (as inputs)	66	0	66
Competitors	217	330	-113
Providers	0	0	0
Citizens	0	0	0
Domestic Total	3818	3341	477
Foreign			
Consumers	770	740	29
+ Shareholders	27	0	27
+ Competitors	54	83	-28
+ Others	0	0	0
Foreign Total	851	823	28
World Total	4669	4164	505

Source: Jones and Fadil (1992a).

P & O Australia effectively purchased a management contract, through which P & O staff now occupy the posts of Chief Executive Officer, Acting General Manager and Chief Engineer. Thus, the efficiency turnaround in KCT can be attributed to the change in internal management rather than to a change in ownership per se (Adam & Cavendish, 1992).

Secondly, it has been noted that output growth was the main source of improved profitability. Again, the question asked by Jones and Fadil is whether such output growth was due to privatization per se or to exogenous demand shifts. Table 3.3 (Jones and Fadil, 1992a: Fig. 13.7) compared growth of output to growth of GNP, exports and imports before and after divestiture. However, improved profitability which is the result of output growth may not be attributable solely to privatization per se. Since 1987, the export-led nature of the economic recovery has involved proportionately greater increases in exports and imports compared to GNP growth. As a result, remarkable increases in throughput and turnover have taken place. Table 3.3 shows that the yearly percentage increases from 1987 to 1992 for throughput and turnover have been very impressive and in line with the growth of exports and imports. Unfortunately, in 1992 and 1993, the absolute figures for throughput and turnover have shown increases, but has declined in percentage terms. From mid-1993, we see the possibility of declining growth in throughput and turnover (in percentage

TABLE 3.3

RELATIONSHIP BETWEEN GROWTH OF OUTPUT TO GNP, EXPORTS AND IMPORTS BEFORE AND AFTER DIVESTITURE

Year Ended 31 Dec	Throughput (TEUs)[a]	Percentage Increase (%)	Turnover ('000)	Percentage Increase (%)	GNP[b] (RM mill)	Percentage Increase (%)	Exports of Goods (RM mill)	Percentage Increase (%)	Imports of Goods (RM mill)	Percentage Increase (%)
1985	244,12[illegible]	-	N.A.	-	72,039	-	37,576	-	28,693	-
1986	241,182	-1.2	N.A.	-	65,851	-8.6	35,373	-5.9	26,592	-7.3
1987	273,335	13.3	75,185	-	74,679	13.4	44,597	26.1	30,041	13.0
1988	319,557	17.0	91,089	21.2	85,796	15.0	54,344	21.9	40,271	34.0
1989	393,954	23.3	107,756	22.2	96,447	12.4	67,824	24.8	60,858	51.0
1990	494,978	25.6	127,221	18.1	110,505	14.6	79,646	17.4	79,119	30.0
1991	603,257	22.0	151,370	19.0	123,530	11.8	92,220	15.8	90,771	14.7
1992	672,642	11.5	160,839	6.3	140,267	13.5	103,657	12.4	101,440	11.8
1993	759,251	13.0	171,640	6.7	157,900	12.6	121,214	16.9	117,423	15.8

a - twenty-foot equivalent units
b - GNP at current prices
N.A. - not available

Sources: Jones and Fadil (1992a).
Bank Negara Report.
Department of Statistics, Malaysia.

terms as the corportization of Kelang Port Management (KPM) may provide some competition to KCT (Mazida, 1992). KPM is expected to offer a wider range of services, including container handling. This should further increase the benefits of consumers as competition should enhance efficiency.

3.4 Regulation and Competition

The effects of privatization, therefore, cannot be properly assessed in isolation just as a change in ownership will directly influence improvements in performance. In the case of KCT, it has been noted that not much change in ownership has taken place since the government still indirectly holds over 88.7 per cent of the enterprise. Equally important has been the environment in which the firm operates. Ownership, competition (hence monitoring) and regulation are three essential elements that have interlocking influences. In the view of Adam and Cavenish (1992)

> "In general, changes in performance can emanate from three sources: changes in demand conditions; changes in market structures as determined by degree and/or regulation; and changes in the internal efficiency of the enterprise brought about by changes in ownership and management."

While changes in ownership may be expected to bring about some gains in productive efficiency, there may be no improvement in allocative efficiency. Allocative efficiency is a function of market structure rather than ownership (Hemming and Mansoor, 1987). Therefore, in the absence of competition, gains in allocative efficiency may be minimal.

Many economists have agreed on the important role which competitive markets play in inducing enterprises to operate efficiently. Such views have been supported by empirical experience which has analysed the introduction of competition into markets where it has previously been prohibited (Millward, 1982; Yarrow, 1989). For example the liberalization of long distance 'express' coach services prompted significant reductions in fares and improvements in the quality and frequency of services (Thompson, 1986).

Unfortunately, there are significant contraints which prevent the introduction of competition in sectors where many public enterprises operate. In most less developed countries (LDCs), the types of industries involving public enterprises are often natural or statutory monopolies. In Malaysia, there is very limited scope for increased competition as the industries already privatized or about to be privatized are statutory monopolies (shipping, telecommunication, electricity, postal services and highway construction) which enjoy economies of scale, with characteristics of lumpiness of capital and capital indivisibilities, that often justify state ownership and control (Toh, 1989).

In developed countries, public enterprises have played very important roles in the manufacturing, mining and service industries. Public enterprises (PEs) are often those firms which have been nationalised due to bad performances. If such PEs are to be put for sale, there is a need to improve their performances in order to make them more attractive. But if the performance of these PEs can be improved under public ownership with a more competitive environment, then there is no reason to sell.

In LDCs, since most PEs are basically monopolies, privatizing them would mean changing them into private monopolies which face little competition. But at the same time, it must be stressed that not all industries or sectors to be privatized have limited scope for competition. In fact, there are instances in Malaysia where privatization could lead to enhanced competition, and therefore greater efficiency, but these were allowed to slip by (Toh, 1989).

Criteria of efficiency and competitive systems of tendering have not been systematically adopted. A good example is the privatization of the North-South Highway. The government called for a system of competitive bidding, presumably where efficiency would be enhanced through granting contracts to the lowest bidder (without sacrificing quality). Unfortunately, the contract was awarded to a company that did not have the lowest bid. This company is in fact owned and controlled by Hatibudi, which is in turn majority-owned and controlled by proxies of UMNO, the dominant party in the ruling coalition. Thus, little attention has been given to ensuring greater competition or public accountability; this is a matter of concern as many privatized entities remain virtual monopolies (Toh, 1989). Similar doubts also arise with regards to the government's professed objective of enhancing the competitive environment through privatization. As with most Malaysian privatizations that have occurred subsequent to Port Kelang, the privatization had no effect on the monopolistic character of the enterprise (Leeds, 1989).

There is indeed widespread concern about the existence of formal and informal collusion, e.g. cartel-like agreements; possible patterns in bidding for contracts, suggesting collusion among bidders; and companies enjoying special influence and privileged information, thus being able to consistently bid successfully for profitable opportunities from privatization (Jomo, 1993).

Kay and Thompson (1986) have also demonstrated that managers of privatized enterprises (previously public enterprises) in Great Britain can successfully lobby for anti-competitive regulatory environment to protect their privileged positions after the reform.

It is therefore very important that the guiding principle must be to ensure that privatization does not take place at the expense of liberalization and thus reduce competition. It should not allow a change in ownership to become the end goal of the process, as this could allow a small group of private owners using their economic position and political influence to ban further competition.

Privatization should be seen as an instrument of competition policy, to be accompanied by other means to promote efficient markets, by attracting new participants into the market and restructuring existing companies into more competitive units (Bishop and Kay, 1989).

Hence, the replacement of a government monopoly (in the case of electricity in Malaysia) by a private monopoly may prove to be tricky for the government as there are very few private electricity companies.

It is without doubt that when a public monopoly is transferred to the private sector, the privatized monopoly will have to accept regulatory surveillance. In Britain, for example, the privatization of British Telecom was accompanied by the creation of a regulatory agency known as OFTEL (Office of Telecommunications). The regulatory agency is not only concerned with anti-competitive practices but also with eradicating other sources of economic inefficiencies, including attempts by politicians to affect economic decisions. It is required that the agency be given sufficient autonomy to limit the possibility of its being dominated by particular interest groups (Hemming and Mansoor, 1987).

In the United States, private natural monopolies have been regulated by commissions for decades. The Federal Communications Commission (FCC) has been a body to regulate the prices charged to consumers even before divestiture (Vernon, 1988).

In Malaysia, The Telecommunications Department or Jabatan Telekom Malaysia (JTM) acts as the regulatory body for Telekom Malaysia. Such regulatory body is essential and according to the PMP, released by the Economic Planning Unit (EPU),

> "In respect of natural monopolies, there is limited scope in increasing competition. In place of competition, an appropriate framework will be established and strengthened to regulate these natural monopolies in order to ensure that consumers' interest are protected in terms of price, quality and availability of services."

The other regulatory bodies are Department of Electricity Supply and the Postal Department. Besides ensuring that consumers' interests are protected, other functions - such as issuing licences and setting tariff rates - are also included.

On the other hand, the government cannot over-regulate or stifle privatized monopolies because they need to operate as commercial entities if they are to be credit-worthy in a competitive market. (Sivalingam, 1991).

3.5 Government Influence Over Privatized Enterprises

In Malaysia, even though the government claims that privatization is `premised on the superiority of market over public control of economic activity to achieve efficiency´, there is very little effort at ensuring that deregulation accompanies privatization. In fact, in most corporatized or privatized public utilities, the government has retained effective control despite some changes in ownership. The issue of `the golden share or special share´ enables governments to retain the ability to exercise control over some privatized state-owned enterprises. However, if the `golden share´ does not exist, through its various government bodies or agencies, the government may still have substantial control over privatized enterprises. In Malaysia, the government has a lingering hand over enterprises such as MAS, MISC, Telekom Malaysia and TNB through its `golden share´. This enables the government to veto any changes it deems undesirable.

Therefore, we cannot conclusively state that improvement in performance was solely the result of privatization per se if privatization is strictly looked at private hands" since a large percentage of ownership in most privatized entities is in government hands, either directly or indirectly. (See Table 2.9).

Since ownership changes and increased competition have not been significant in most privatized enterprises, we can attribute improvement in performance (especially in the case of KCT) to management and technological changes. If managers of enterprises are given full operational autonomy and are motivated to manage and motivate workers to work harder, efficiency should increase.