Failure of Corporate Governance: Privatization of PTCL Pakistan

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Abstract

Purpose: This case study discusses the failure of corporate governance in the perspective of privatization of (PTCL) Pakistan Telecommunication Company Limited.

Introduction: PTCL is the major phone company in Pakistan. It operates about 4.4 million fixed lines and has a cellular arm Ufone that has a second largest share of the cell phone market in Pakistan. It had a monopoly on all phone services, but the telephone industry has been gradually deregulated. PTCL was privatized in 2006.

Methodology: The study is descriptive in nature and uses case study design to present the artifact of one of the biggest financial scam of Pakistan of its time. All the data has been collected from published sources on print media and internet only.

Findings: Financial facts seem to confirm the lack of a serious consideration of corporate governance standards during the privatization process of PTCL. In the case of PTCL, privatization both parties miserably failed to comply with the key standards and structures of corporate governance in Pakistan. The role of auditors and officials responsible for the appraisal of assets of PTCL including Ufone and PakNet was ambiguous and below international standards. The sale of 26% share of PTCL along with the management control is considered as financial blunder in the privatization history of Pakistan. The study clearly elucidate that there was no need for the hasty privatization of PTCL.

Lesson Learned: What PTCL needed was just proper corporate governance through accountability, transparency, integrity, corporate ethics and executive control.

Keywords: Privatization, Corporate Governance, Financial performance, Failure

1. Introduction

There are many rationales for governments of the countries to liberalize the telecommunications sector [1], particularly in developing countries; privatization has emerged as policy tool for managing declining financial conditions [2]. The main reason of privatization of services sector and specifically telecom sector is the technical performance [3]. They further commented that in developing countries, long wait in connecting the call, poor quality of customer services, low productivity and lack of capability and expertise to acquire advanced technology are few of the causes for the deregulation of telecom sector.

In Pakistan the process of privatization and economic liberalization was started in early nineties, where some financial institutions were handed over to public and employees. The main motive of economic liberalization was to minimize the pressure on government and bring investment in the country. During this period most of the privatization attempts were tainted by different allegations.

2. Methodology

The study is descriptive in nature and uses case study design to present one of the biggest privatization of national telecom operator. This case study starts with the introduction of PTCL and provides a brief introduction on its privatization and at the end it provides impact of this failure of corporate governance in offering neat and clean privatization process. All the data has been collected from published sources on print media and internet only. Selected copies of published material are also appended for a quick reference.

3. PTCL – An Introduction

Pakistan Telecommunication Company Limited (PTCL) is considered as one of the most rapidly growing telecommunication companies in Asia [4]. It comprises of cellular company Ufone and internet provider PakNet [5]. In 2005, it was partially privatized to UAE based organization. The major objective of the PTCL privatizations was to bring investment and proficient management that may improve the response towards consumer demands, especially with increase the installation of new lines to meet the escalating needs of information technology. Privatization Commission initially offered 2% shares of PTC through voucher scheme in early 1994. After getting a positive and encouraging response from the people, the government offered another 10% shares to the foreign buyers in September 1994 worth $ 898 million [6].

Table. No1. Historical Background of Telecommunication in Pakistan

1947	Posts & Telegraph Dept. established
1962	Pakistan Telegraph & Telephone Dept.
1990-91	Pakistan Telecom Corporation ALIS: 850,000 Waiting list: 900,000 Expansion Program of 900,000 lines initiated (500,000 lines by Private Sector Participation 400,000 lines PTC/GOVERNMENT own resources).
1995	About 5 % of PTC assets transferred to PTA, FAB & NTC.
1996	PTCL Formed listed on all Stock Exchanges of Pakistan
1998	Mobile & Internet subsidiaries established
2000	Telecom Policy Finalized
2003	Telecom Deregulation Policy Announced
2005	26% shares of PTCL offered
2006	26% shares sold with Management Control

(Source: Pakistan Telecommunication Company Limited)

To protect consumers and abide with the WTO Agreement, the Pakistan Telecommunications Authority committed eliminating PTCL's monopoly on fixed lines after 2002. A private company operating in a competitive market with the oversight of a regulatory authority is likely to provide better service to customers and to keep prices competitively low [7]. The private operators were better providers of universal services than public operators during the early last century [8 & 9].

Table No.2. Privatization of PTCL

PTCL (2%)	Aug-94	General Public Through Stock Exchange
PTCL (10%)	Sep-94	Through DR form
26% (1.326 billion) of shares of PTCL	Jul-05	Etisalat-UAE

(Source: Privatization Commission of Pakistan)

During the process and progress of privatization, PTCL’s 26% shares were offered for privatization along with the management control in 2004.Initially three organizations e.g. Etisalat from a UAE consortium, SingTel from Singapore and China Mobile were short listed for the final bidding. PTCL consisted three business units, Ufone, PakNet and country wide landline network. The estimated assets of the company were approximately 10 billion US dollars was one of the major corporate transfer in history of Pakistan. In 2006 the final bid was secured by Etisalat at highest price of $ 1.96 per share whereas, $ 1.16 by SingTel and $ 1.40 by China Mobile respectively. The Etisalat offered $ 2.6 billion with management control of the company. 66% of the shares of the company were retained by Government of Pakistan and remaining shares were offered for public subscription. Subsequently Etisalat took over the control of PTCL along with the control on Ufone and PakNet [10].

4. Privatization of PTCL - Poor Corporate Governance

This case study is conducted with view to describe the non compliance of corporate governance during the hasty transfer of PTCL to new administration. A number of issues have been highlighted in this paper to provide evidence for corporate governance failure at PTCL privatization.

Inappropriate choice for privatization: Normally, the governments around the world offer those organizations for privatization whose performance is considered below standards or they consume huge amount on management and administrative grounds. But the case of PTCL privatization was somewhat unique, that a highly profitable organizational was offered for privatization. It is agreeable that PTCL privatization somehow reduced the Government liability but what the logic to transfer management powers and control to an acquirer who was not familiar with the organizational culture in Pakistan. The 26% of shares were sold to in one of the most ambiguous financial deal ever recorded in the privatization history of Pakistan. The privatization process of PTCL was initiated in 2004 through EOI (expression of interest) in local and international media. 18 local and international companies showed interest in buying the shares of PTCL; however, only three companies were short listed for the final bidding process. The shares price offered by UAE consortium was $1.96, $1.16 by SingTel and $1.40 by China Mobile. Considering the highest per share price the offer by UAE consortium, PTCL was sold with management control.

Under Valued Assets: The independent sources quoted that even Ufone and PakNet had market value of more than US $4 billion, it was also revealed afterwards that the valuation of the company's assets were estimated on the basis of old records instead of current value of the assets. The major officials of the company concealed the factual conditions and information regarding the financial health and prospects of the company. The sale of PTCL is considered one of the major failures of corporate governance in the corporate transfers in Pakistan.

Financial Performance: The pre–privatization performance of PTCL was very strong and commendable in comparison to all other economic sectors in Pakistan. It was contributing large amounts to national exchequer. Before the privatization in 2005, PTCL generated Rs 84 billion with a net profit of Rs 27 billion. The company was also suffering from corruption, nepotism and mismanagement from the officers and staff. The government official, politicians played negative role by politically motivated postings and hiring, the misuse of company's resources like, rest houses and vehicles. In 2004, the government official pressurized PTCL to pay Rs 25 billion as dividend from net profit of Rs 30 billion, being the major shareholder; the large amount was collected by government. Due to these conditions, the company legged behind in acquiring new and latest technologies in comparison to companies of other companies which were making strategic investments. Instead of building the companies strength, capability and making it more competitive in global market, the company was ambiguously sold.

Lower Profit Margins: Under the new administration, the financial performance of PTCL declined considerably. In the four years of pre privatization, the profits grew from Rs 18 billion to Rs 27 billion at an average rate of 11% annually. In the four years of privatization, the profits receded and reached at Rs 11 billion at 21% negative growth rate. The financial growth of PTCL in comparison to regional competitors was discouraging as the growth rate for the peers during 2005 to 2009 was 6% and for 2% PTCL in the same period.

Impact of Share value: The post privatization stock value of PTCL depicted a dismal picture. The market value of PTCL share decreased significantly. The value of share in 2005 was Rs 358 billion which reached at Rs 88 billion in 2009. This abnormal recession in the share value of PTCL caused a loss of Rs 200 billion to government and small shareholders.

HR Crisis: After the privatization, the company went through the process of rightsizing and downsizing of employees. 32000 employees from various sections left PTCL through voluntary separation program; the Government has to bear $256 million as the payment to employees. Soon the loss of large number of experienced and trained workers began to hurt the performance of PTCL. The network maintenance, customer care and operations suffered abruptly; consequently, thousands of connections were lost.

Transparency of deal: The sale of PTCL at a loss of Rs 23 billion [11] with reduced share price from original price at $1.96 to $1.66 per share left may question marks on the transparency of the deal. The officials of the company denied any mismanagement during the process of privatization. The successful bidder was given undue concession in the deal which caused loss of billion to national exchequer. PTCL was highest profit earning company in the country with large number of commercial plaza, rest houses, residential colonies and exchanges worth of billions. There is documentary proof that the deal sustained a setback when successful bidder lost interest in the deal due to some technical matters. In order to make the transaction successful, officials of PTCL offered concession to the winner. Simultaneously, SingTel and China Mobile were also contacted for new bidding process but both of the companies refused instantly. Government, the majority share holder with 66% share surrendered the management control in the favor of Etisalat to make transaction successful. The assets of the company were undervalued and Government also shared 50% cost on the payment for golden handshake offered to employees.

Undue concessions: The privatization of PTCL was also exempted from purview of Public Procurement regulatory Authority Ordinance 2002 in the federal budget. With this major constitutional concession, the Etisalat was given free hand for selling and purchasing of assets without considering the ordinance. Following are some of the undue concessions in the privatization transaction.

- The acquirer of the PTCL was allowed to pay amount of transaction in five year easy installments.
- Government was convinced to pay 50% of the layoff charges regarding the employee's voluntary separation program.
- The privatization agreement generally prevent the acquirer from selling the properties of the company but in PTCL case the acquirer want to sale and use the assets of PTCL for the purpose other than these was acquired for.
- The acquirer also received $50 million as technical assistance fees for providing management services and expertise.

Impact of failure: The PTCL privatization was the largest liberalization activity in the economic history of Pakistan. The closely guarded revised privatization agreement with acquirer allegedly inflicted a further loss of billions of rupees to the national exchequer besides unprecedented concessions offered in the long term, in direct conflict with Article 30 of the Public Procurement Rules 2004. The PTCL has been the highest profit earning state-owned company with real estate assets worth billions of rupees across the country including commercial plazas, residential colonies and exchanges. According to the official documents, the Share Purchase Agreement (SPA) of the PTCL with acquirer lapsed in September 2005 after the non-payment of dues by the winning bidder; the government should have also forfeited the earnest money submitted by the defaulting winning bidder. But instead of taking action, after rigorous discussions with the management of acquirer, the government agreed to offer additional concessions and modifications to the transaction structure. The PTCL board of directors, with 62% shares and majority representation, has been made toothless in the privatization process.

5. Conclusions

Being state owned enterprise, it was Government‘s vital liability to determine the scope and feasibility of privatization of PTCL through professional financial analyst and auditors. Before privatization, PTCL was major corporate enterprise and revenue contributor to Government. The key purpose of any enterprise is to generate revenue and create employment opportunities; PTCL was doing excellent job in compliance to revenue earning and providing employment to skilled and non skilled persons. Through various training institutes, PTCL was producing large number of highly skilled telecom engineers and technicians. One wonders, why the privatization commission and BoG of PTCL decided to offer it for privatization. Since the privatization of PTCL, no major change in corporate structure is carried out to improve the services even new management could not lay off 20,000 employees which was one of the major elements of transaction.

The strategies with regard to corporate level, business level and marketing are still not revised and transformed. The study clearly elucidate that there was no need for the hasty privatization of PTCL. What PTCL needed was just proper corporate governance through accountability, transparency, integrity, corporate ethics and executive control.

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