Corporate Governance & Responsibility Development Center

PICG Pakistan Institute of Corporate Governance

kurumsal sosyal sorumluluk derneği corporate social responsibility association

PRIVATIZATION, CORPORATE GOVERNANCE AND BUSINESS ENVIRONMENT:

A COMPARATIVE STUDY OF PRIVATE SECTOR DEVELOPMENT IN IRAN, PAKISTAN AND TURKEY

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Privatization, Corporate Governance and the Business Environment: A Comparative Study of Private Sector Development in Iran, Pakistan and Turkey

This paper is a comparative analysis of the problems of private sector development in Iran, Pakistan and Turkey. Using international and national surveys, it reviews the progress of privatization, business environment conditions and the development of corporate governance as factors directly influencing private sector development. The paper focuses on the perceptions of the private sector on business environment and privatization and their awareness of corporate governance principles. The paper is based on surveys specifically commissioned for this project by the three organizations participating in this research project:

Corporate Governance and Responsibility Development Centre, Tehran, Iran (CGRDC)

Pakistan Institute of Corporate Governance (PICG)

Corporate Social Responsibility, Turkey (CSR Turkey)

Abbreviations

CGRDC – Corporate Governance and Responsibility Development Centre

CPI – Corruption Perceptions Index

CSR Turkey – Corporate Social Responsibility, Turkey

EBRD – European Bank for Reconstruction and Development

GCI – Global Competitiveness Index

IFC – International Finance Corporation

IIF – Institute of International Finance

ILO – International Labour Organization

IMF – International Monetary Fund

IPO – Iranian Privatization Organization

OECD – Organization for Economic Co-operation and Development

PCGP – Pakistan Corporate Governance Project

PIC – Provincial Investment Company

PICG – Pakistan Institute of Corporate Governance.

PIDC – Pakistan Industrial Development Corporation

SECP – Securities and Exchange Commission of Pakistan

SOE – State Owned Enterprises

THE – Tehran Stock Exchange

TJSC – Township Justice Share Cooperative

TKYD - The Corporate Governance Association of Turkey

UNDP – United Nations Development Program

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EXECUTIVE SUMMARY

This study is a comparative analysis of the challenges of private sector development in Iran, Pakistan and Turkey. Using international and national surveys, it reviews the progress of privatization, business environment conditions and the development of the corporate governance framework as factors directly influencing private sector development.

The three countries under consideration have recognised, particularly over the past decade, that their economic policies based on the centrality of the state sector has reached its limitations and further economic development has to be based on the expansion of the private sector. The private sector has been developing at varying rates in the three countries despite their difficult conditions. Its growth has been due to both its natural expansion and the privatization of state owned, or socially owned, enterprises. The privatization process itself was embraced by the governments of these countries as a concept and as an important element of their overall economic and social policy – even though the main aims of privatization may have changed over time.

In Iran, the privatization process has been the largest (with some 315 companies and over $72 billion worth of assets) and implemented most rapidly in the last six years. The largest single method of privatization (accounting for $34 billion of the transferred assets) was through the '*Justice Share Program',* the Iranian version of mass voucher privatization in which the minority shares of 56 very large state owned companies have been transferred, through a multitude of investment companies and township cooperatives, to the lowest six deciles of the population on preferential terms. The privatization program, however, suffers from several important shortcomings. There is no mechanism to ensure that the new owners can influence and help improve the performance of privatized companies. This is because in many cases the new owners are either semi-government organizations (such as the investment companies of state owned banks or the government controlled Social Security Organization or Pension Funds), or the newly developed holding companies belonging to military and religious foundations with close connections to certain sections of the government and the religious establishments. There is also every indication that the privatized companies would suffer from weak corporate governance. This is particularly true for companies in the '*Justice Share Program*' and the financial intermediaries involved in this program.

Turkey and Pakistan, too, have experienced fairly successful privatization programs, though smaller in size compared to Iran, but with genuine transfers to the private sector. In Turkey 201 companies and in Pakistan 167 companies have gone through the privatization process, generating revenues of approximately 42 and 8.7 billion dollars respectively (until 2010). Although the number of companies privatised looks rather modest in Pakistan, it covers a considerable number of large entities with a significant number of employees. In Turkey, although privatization became an official state policy in the mid-1980s, its implementation did not gain momentum until the end of 2002 when the AK party gained power. The privatization process in Turkey has been accompanied by a variety of social support projects in order to ameliorate the social impact of the program, particularly targeting the individuals who were made redundant in the process of preparing companies for privatization.

Findings from the international surveys demonstrate that, in all three countries, the quality of business environment is not conducive to the establishment and conduct of business, and urgent reforms are needed. The regulatory aspects of the environment, those based on laws and regulations, are impediments to new businesses and discourage, rather than encourage, entrepreneurship in the formal sector of the economy. There are too many restrictions on foreign trade activities, labour and land market transactions, and the financial systems. The latter, therefore, cannot provide businesses with the levels of credit and other services they need and prevents them reaching their full potential. Levels of corruption and informal activities are high and pose a serious burden on companies. Reforms in all these areas are essential for the private sector in these countries to grow faster and to provide their citizens with greater employment opportunities and higher standards of living.

The findings from secondary sources were augmented by project-specific surveys conducted by the three organizations. The aims of these surveys were to identify the perceptions of the private sector about the business environment; their views on the privatization process, its impediments and benefits; and finally their awareness of the corporate governance principles and the level of compliance with these principles. The surveys show that the biggest obstacles in doing business in all three countries are factors external to the companies, i.e. not under companies' control. These obstacles, which are rooted in business-unfriendly regulatory environment and weak institutional and infrastructural development, particularly affect the companies' competitiveness on domestic and international markets.

As for the privatization process, our survey results seem to suggest that in none of the countries was privatization fully supported by all political factions while there seems to be a mild agreement amongst the respondents that the valuation of companies in the privatization process was carried out professionally. There is less agreement on the fairness and transparency of the procedures adopted for privatization, as well as on the importance of privatization for attracting foreign investment. Concerning the impediments to privatization, respondents identified some of the obstacles relevant in each country. While in Iran, the biggest identified impediment to privatization has been the lack of transparency about the identity of the new owners and the commitment of the government to genuine transfer to the private sector, in Pakistan it has been the social opposition to the privatization itself. In Turkey, however, the respondents did not consider any of the identified factors to be a serious impediment to privatization.

Lastly, the corporate governance framework is in need of serious attention and improvement in all three countries. The survey of companies in this research project confirms that the level of awareness of the corporate governance principles is rather low in all three countries, even in Pakistan and Turkey where the codes of corporate governance have been discussed and adopted in 2002 and 2003 respectively. Of course, companies traded on the Stock Exchange in these two countries comply with their respective codes but these are only a small number of companies. In order to develop the interest of the business community, it is essential to publicise the business case for corporate governance widely. In Iran, although a code of corporate governance was adopted by the Securities and Exchange Organization in 2010, it has not become compulsory for listed companies yet and the knowledge has not gone beyond the Stock Exchange Company and the Securities and Exchange Organization. The level of compliance with the corporate governance principles in the surveyed companies was extremely poor. Further work in promoting good corporate governance and publicising its benefits for companies and their owners and for private sector development is essential in all three countries, particularly in Iran.

To sum up, all three countries have accepted the importance of private sector development for their future economic growth and prosperity. But they have not always pursued policies that facilitate this development. There is a need to develop a business-friendly environment by eliminating regulations that restrict the operation of labor, land and capital markets and raise the costs of doing business to private sector firms. At the same time, the privatization programs, subscribed to by all three countries, should be pursued until all SOEs are transferred in a fair and transparent manner to the genuine private sector. To complement these policies, the corporate governance principles should be institutionalized in all countries and all public joint stock companies be required to comply with these principles. This would help the privatized as well as private companies to improve their corporate governance framework with a view to creating an environment in which firms can raise finance easier and at lower costs from both domestic and foreign sources.

The three organizations conducting this research are committed to play an active role in publicizing the importance of a conducive business environment, transparent privatization and good governance in order to encourage and support their governments to promote private sector development by concrete measures.

INTRODUCTION

This study compares the business environment, private sector development and the perceptions of company managers about the business environment, privatization process and corporate governance in Iran, Pakistan and Turkey. It is based on surveys of focus groups conducted by members of the research team in the three countries and on large scale enterprise surveys conducted by international organisations.

The three countries under consideration were selected for a variety of reasons. All three have (or have had) large state owned sectors. All three have recognised that economic development and citizens' well-being based on the continued expansion of the state sector has reached its limits and, therefore, have decided to reduce the size of this sector. They all have embarked on privatization programs with varying degrees of progress and success and there is plenty of room to learn from each other and improve the effectiveness of their privatization processes. Despite these similarities, there are differences between these countries and their pattern of development. While Pakistan is much poorer with a much larger rural population, many of the institutions of a market economy are more developed there. Turkey is aspiring to become an EU member and therefore has changed much of its legislation to facilitate the development of institutions compatible with EU membership. Iran, on the other hand, despite its well-developed industry and commerce and a long tradition of a market system, has not been able to develop the institutions of a market economy commensurate with its level of development and, as a result, has been overtaken by Turkey -despite its progress over the years.[1]

We believe that these differences allow us to see how different approaches to private sector development (ownership transformation, institution building, good governance and business friendly policies) can help to create a sustainable and progressive business environment in which entrepreneurship can flourish. The experience of transition economies in Central and Eastern Europe suggests that the success of economic reforms (including privatization and private sector development) largely depends on the nature of business environment and the presence of appropriate institutional framework. This study attempts to address the present state of business environment and its impact on the development of the private sector in Iran, Pakistan and Turkey. It also investigates the present corporate governance framework in these countries, the firms' awareness of this framework, its importance for the firms' business strategy and the level of compliance. It is clear from national surveys that a large section of the business community, and therefore the society as a whole, are not aware of the benefits of good governance for companies. The study therefore highlights the business case for good corporate governance with a view to demonstrating that the adoption of corporate governance codes is, above all, in the interest of companies and their owners.

This study is organized as follows. The next section describes the methodology used in preparing this report. Section 2 discusses the general macroeconomic background and profile of the three countries, providing the context for later sections of the study. Section 3 discusses the privatization process in all three countries, emphasising the variety of methods employed in these countries and highlighting the particularly unique 'Justice Share Program' in Iran. Section 4

[1] Iran's GDP per capita at current prices was $1998 in 1978, against Turkey's $1475 (and Pakistan's $229). By 2010, Iran's GDP per capita had fallen to less than half of Turkey's (see Section 2).

analyses the business environment in these counties using surveys conducted by international organization. Section 5 presents the business case for good corporate governance, highlighting the importance of good governance for companies, their owners and their creditors, and provides a summary of the state of corporate governance regulations in the three countries. Section 6 discusses the perceptions of the private sector about business environment, privatization and corporate governance using surveys conducted by the project teams in each country. Section 7 provides the conclusions of the study and offers a number of policy recommendations for each country.

1

METHODOLOGY

This comparative study aims to analyse the main factors influencing private sector development in Iran, Pakistan and Turkey. It focuses on three specific areas: business environment, privatization and corporate governance. The study is based on both published data (reported by national and international sources) and primary data collected through small scale surveys (the 'focus group' method) in the three countries using similar methodology and a largely similar set of questions. The surveys aimed at identifying the perceptions of company managers and other informed stakeholders about the broad features of the impediments to private sector development. The results are only indicative of the main trends and dominant features and can be used to corroborate the evidence from other sources.

The data was gathered during 2010 in face-to-face interviews with key people in firms, informed observers and specialist institutions (such as banks and privatization agencies) with a good knowledge of the economic situation in each country and the conditions of its business environment. Respondents were carefully selected to ensure the inclusion of relevant stakeholders. The sample size in the three countries was as follows: Iran (28); Pakistan (34); and Turkey (21). The sample included private companies, privatized companies and some quasi-public companies[2] as well as journalists, academics, parliamentarians, banks and business associations. The questionnaire was designed to be used in all three countries though it was slightly modified in each country to reflect the local conditions. The surveys were conducted by senior staff of the research teams in each country so as to minimize the risk of inconsistent interpretation. The questionnaire consisted of two groups of questions: one group required the respondents to rank the extent of their agreement or disagreement with various statements on a five-point Likert scale. The other group consisted of open ended questions which aimed at soliciting more qualitative responses on the topics under consideration.

Apart from the primary data collected by the research teams, this study also uses data obtained from national or international institutions such as the national statistical offices, the World Bank, EBRD, World Economic Forum, Transparency International, etc.

[2] These companies have been developing over the last decade in Iran and are becoming the dominant companies in many sectors of the economy. Their dominant position was particularly established during the privatization process. They are private in legal terms but have close links to the public sector and to government institutions. For more details, see Section 3.

2

MAIN ECONOMIC INDICATORS

In order to have a better understanding of the background and the framework in which private sector development takes place, it is essential to analyse and compare the main economic characteristics of the three countries under consideration. This section aims to provide this background.

Population

The three countries have large population with Pakistan reaching almost 170 million. A large proportion of the population live in rural areas (see Figure 1 for the total and rural population in 2010[3]). The proportion is particularly high in Pakistan (with over 60%) and also significant in Turkey and Iran - around 30 percent. Rural areas in these countries have serious problems with their basic infrastructure, obstructing the development of entrepreneurial activity that can supplement self-employment in agricultural activities.

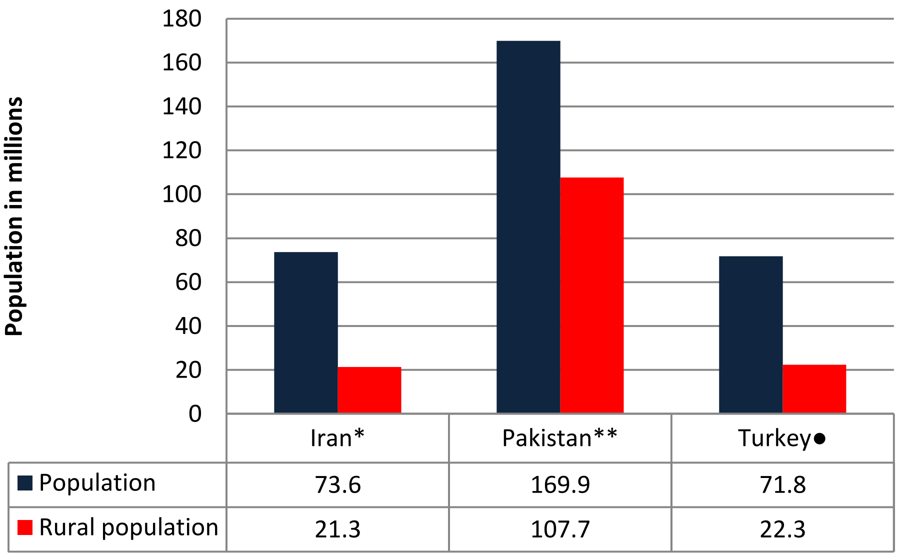
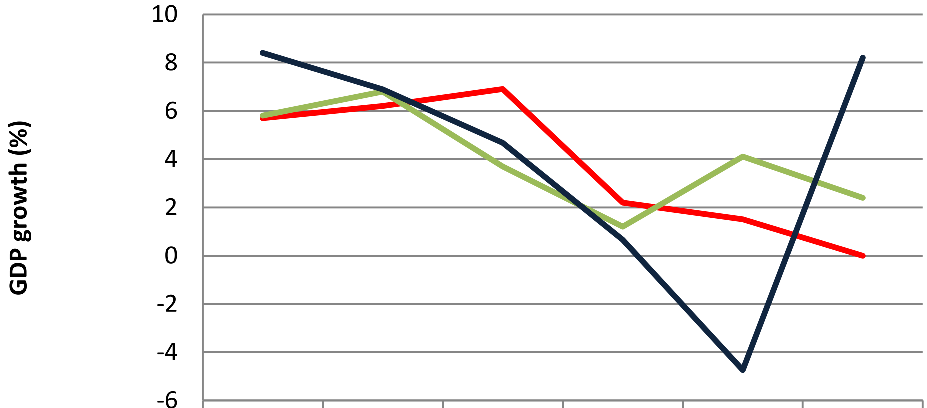


Figure 1. Population and the share of rural population (2010)
*Source: *Iran Stat Centre; **Government of Pakistan; •State Planning Organization*

[3] The Iranian year runs from 21 March of each Christian calendar year to 20 March of the following year, i.e., covering nine months of one year and three months of the following year. For the purpose of brevity, in several places in this study, we have converted the Iranian calendar year, which are the basis of all official Iranian publications and data, to its nearest Christian calendar year by allocating the data for each Iranian year to the Christian year covering the first nine months – thus the data for the Iranian year 1389 (21 March 2010 to 20 March 2011) appears under 2010. This is the practice for data obtained from Iranian sources, unless both years are specified. Data from international sources are usually already adjusted.

GDP Growth and GDP per capita

The countries under consideration all suffer from high unemployment, and growing population and require high rates of economic growth in order to achieve a decline, or at least prevent further rises, in unemployment. However, as Figure 2 shows, despite differences across years and countries, all have exhibited relatively slow and sometimes faltering growth rates in the last six years, averaging around 4.2%. Turkey had a growth rate of over 8% in 2005 before plummeting into recession in 2009 and picking up with 8.2% growth again. Other countries maintaid roughfly similar declining growth rates (averaging at 4.0% in Pakistan and 3.75% in Iran). Unlike Turkey, growth continued to decline in the other two, reaching zero in Iran. Except for Turkey, the other countries have experienced unfavourable external conditions that have impeded faster rates of economic growth. Pakistan has experienced catastrofic floods and frequent terrorist atacks; and Iran has faced isolation and internatonal sanctions with serious impact on her economy. The financial crisis in the latter years of the decade resulted in the slow down of growth in all countries.

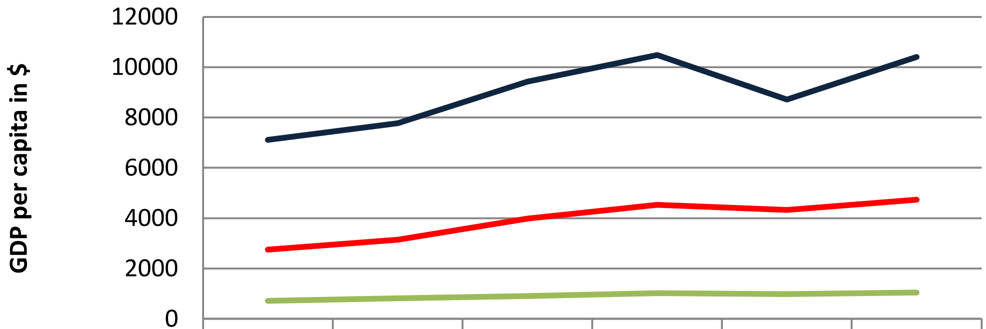


	2005	2006	2007	2008	2009	2010 (est)
Iran*	5.70	6.20	6.90	2.20	1.50	0.00
Pakistan**	5.80	6.80	3.70	1.20	4.10	2.40
Turkey•	8.40	6.89	4.67	0.66	-4.74	8.20

Figure 2. GDP growth rates

*Source: *,•IMF; **Pakistani Federal Bureau of Statistics, Government of Pakistan (2010)*

To be meaningful, these growth rates have to be considered together with income per capita in each country. Here, as Figure 3 shows, there are substantial differences between the three countries.[4] Turkey with GDP per capita of over ten thousand dollars is the richest of these countries; followed by Iran as a distant second with GDP per capita of less than half of Turkey's.[5] Pakistan is low income country with much lower per capita GDP, around one thousand dollars.



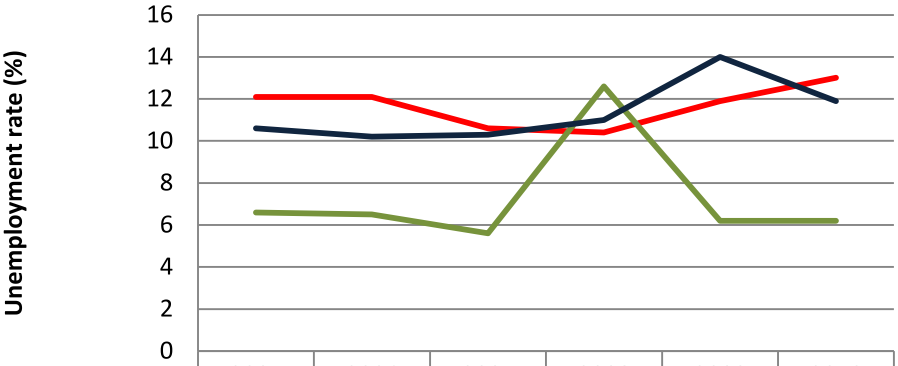
	2005	2006	2007	2008	2009	2010 (est.)
Iran*	2746	3152	3990	4537	4334	4741
Pakistan**	719	821	905	1018	989	1050
Turkey●	7108	7767	9422	10484	8711	10399

Figure 3. Per capita GDP (at current exchange rates)
*Source: *,● IMF; **State Planning Organization, Government of Pakistan (2010)*

Unemployment

All three countries have two digit levels of employment (see Figure 4). What is more the trend of unemployment is rising in all countries except in Iran where there has been a drop in unemployment in recent years. However, Iran faces a particular challenge in creating employment opportunities for the rapidly rising labour force. Despite the fact that job creation has accelerated in recent years, the labour force participation has also risen with the increased desire especially among the educated females to enter the labour market (ILO, 2005). In Pakistan, unemployment was relatively low until recent years. But the growth of the labour force and the financial crisis have led to a rapid reversal of the trend. In Turkey, despite the slow-down in growth, unemployment remained stable but the sustained decline, especially in the wake of the recent financial crisis, is expected to manifest itself in increasing unemployment. This poses a challenge to the Turkish government facing the problem of absorbing almost one million young people entering the workforce each year.

4 Although Figure 3 is based on current exchange rates, substantial differences remain even when the data is expressed in PPP terms.
5 This is a credit to Turkey's economic policy and a sad verdict on Iran's. In 1978, Iran's GDP per capita was $1998 against Turkey's $1475. Iran, of course, has gone through a revolution and a long war but it also has had the benefit of huge oil revenues. Turkey has had none of these.



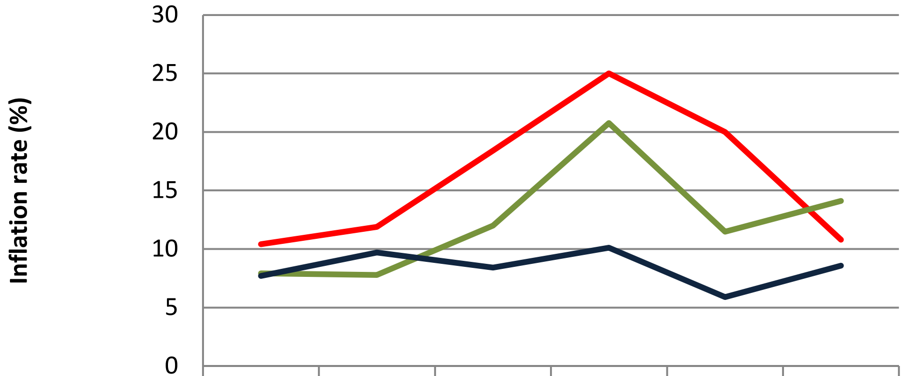
	2005	2006	2007	2008	2009	2010
Iran*	12.1	12.1	10.6	10.4	11.9	13
Pakistan**	6.6	6.5	5.6	12.6	6.2	6.2
Turkey●	10.6	10.2	10.3	11	14	11.9

Figure 4. Unemployment
*Source: *Unofficial; **Government of Pakistan, IMF (2009, 2010 EST.); ●State Planning Organization*

The development of the private sector can play an important role in resolving the unemployment problem in all three countries. This sector may absorb not only the natural growth of the labour force but also the workers laid off in the process of privatization of state owned enterprises. Without a competitive private sector it will not be possible to accelerate job creation, which is badly needed in all three countries.

Inflation

Price stability is an important element of a conducive business environment, reducing the level of uncertainty and facilitating entrepreneurial decision making. As Figure 5 shows, the three countries have had a diverse inflationary experience. Turkey had single digit inflation in most years. On the other hand, Iran and Pakistan had consistantly high inflation, mostly in two digits. In Iran, inflation has been rampant for most of the decade, reflecting poor economic policies (such as an expansionary monetary policy, increasing subsidies, lowering of interest rates, etc.). Pakistan, on the other hand, has experienced double digit inflation which may be attributed to excessive increase in money supply, fiscal imbalances, and exchange rate depreciations (Mukhtar and Zakaria, 2010). Moreover, inflation is expected to be aggravated due to the recent catastrophic floods which had serious implications for macroeconomic stability and growth prospects. Turkey succeeded in bringing down inflation from around 70% in the 1993-2002 periods to single digit (7.7%) by 2005, the lowest inflation for three decades. This was mainly achieved by a tight fiscal policy and monetary policy. In all countries, inflation rates dropped in 2009 due to the economic downturn and, possibly, the decline in demand.

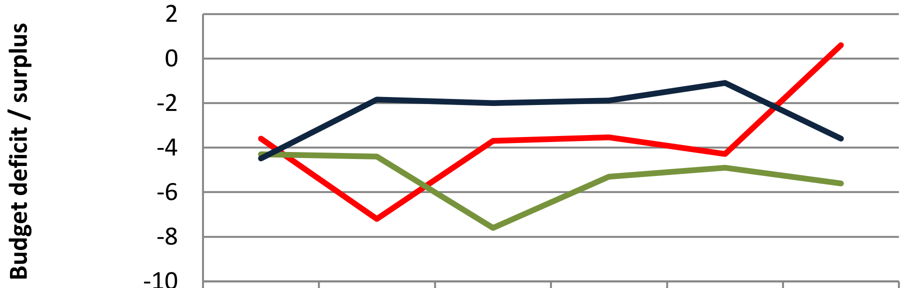


	2005	2006	2007	2008	2009	2010
Iran*	10.4	11.9	18.4	25	20	10.8
Pakistan**	7.92	7.77	12	20.77	11.49	14.1
Turkey●	7.7	9.7	8.4	10.1	5.9	8.57

Figure 5. Inflation
*Source: *IMF; **Government of Pakistan; ●State Planning Organization, IMF(2010)*

Budget Deficit

Budget deficits have been in the single digits in the three countries under consideration (see Figure 6). The low budget deficit reflects the dominant thinking underlying government policies. In Iran the government budget is closely linked to oil revenue and the fluctuating oil prices have a direct effect on the ability of the government to maintain its expenditure program but the existence of a large Foreign Exchange Reserve Fund on which the government can draw freely has cushioned the effect of such fluctuations.[6]



	2005	2006	2007	2008	2009	2010
Iran*	-3.6	-7.2	-3.7	-3.54	-4.29	0.6
Pakistan**	-4.3	-4.4	-7.6	-5.3	-4.9	-5.6
Turkey●	-4.49	-1.85	-2	-1.89	-1.09	-3.6

Figure 6. Budget deficit (percentage of GDP)
*Source: *, ● IMF; **Government of Pakistan; Trading Economics (2010)*

[6] This Fund was set up originally to cushion the effect of fluctuating oil prices and its use was strictly controlled by the Parliament. It was to be used for private sector development and long term investment projects – but not for short term projects or for the government's current expenditure. A Parliamentary Commission investigating the financing of budget deficit reported to the Parliament in March 2011 that the whole of government deficit in 2009-2010 had been financed from this Fund (generally in contravention of Parliamentary rules) (*Hamshahri*, 17 March 2011).

Import coverage

Except for Turkey, the two other countries have relatively low import coverage rates (see Figure 7), with Iran covering some 32% of its imports (if oil exports are excluded). While there have been some improvements in export performance in all three countries, trade deficits remains high. The main exports consist of basic material. There is a strong need for exporting companies to engage in producing high value added products and services. But that is possible only if the economy becomes more competitive through measures such as reducing the size of the informal sector and sources of unfair competition. An effective privatization program may also contribute to the revitalization of the export sector and reduction in trade deficit.

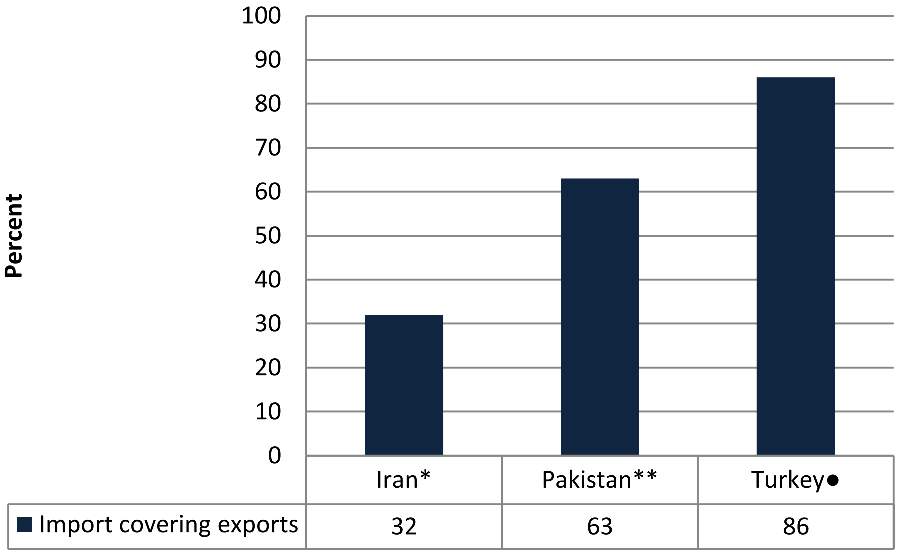
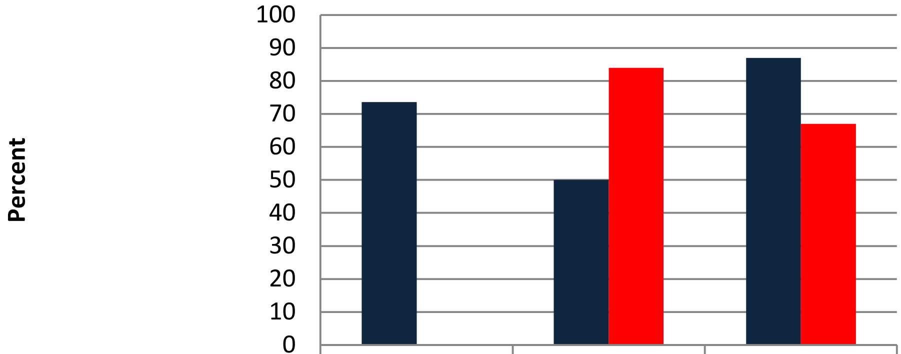


Figure 7. Import coverage (2010)
*Source: *Iran Stat Centre (excluding oil exports); **Asian Development Bank; •Turkish Statistical Institute*

Private sector development

All three countries have a long history of private sector despite the disruptions caused by the Islamic Revolution in Iran. In recent years the share of private sector in employment and output has increased considerably in all countries. By 2010, the share of private sector employment ranged from 50 percent in Pakistan to 75 percent in Iran and 87 percent in Turkey (see Figure 8). In terms of output, the private sector accounted for a higher share in Pakistan (84 percent) compared to Turkey (67 percent).[7]

[7] Data for the shares of privates sector in total output was not available for Iran.



	Iran*	Pakistan**	Turkey●
Share of private sector in employment	73.6	50	87
Share of private sector in output		84	67

Figure 8. Share of private sector in employment and output (2010)
*Source: *Iran Stat Centre; **Asian Development Bank; •Turkish Statistical Institute; ••Authors' estimation*

3
PRIVATIZATION

Theoretical background

The spread of privatization around the world over the last four decades has been motivated by the poor performance of state owned enterprises (SOEs) and a desire to improve the performance of these enterprises. The theoretical basis for privatization has been well developed and policy makers around the world, from a wide spectrum of political inclinations, have adopted policies based on these theories.

The earliest comprehensive criticism of public ownership was formulated by the Austrian school (Hayek, 1935; 1948) focusing on the inability of the government (the *'collectivist state'*) to allocate resources efficiently because of the '*impossibility of economic calculation'* due to a lack of necessary information. Although Hayek's view was marginalised in the economics literature (Littlechild, 1978; Shand, 1984; Hodge, 2006), the debate on the impossibility of efficient allocation of resources under socialism survived.

In the following decades, other criticisms of public ownership were developed. The 'property rights' theorists like Alchian and Demsetz (1972) and Furubotn and Pejovich (1972) argued that managers in state-owned enterprises have weaker incentives to allocate resources effectively than managers in privately owned enterprises. While managers in the private sector face pressure from the competitors and shareholders, their counterparts in the state sector operate under 'soft budget constraint' and are not subject to competitive pressure or bankruptcy and takeover mechanisms (Kornai, 1980; Hodge, 2006). The theory pointed out that the 'agency problem' is more extensive under public ownership as the public sector companies are not subject to monitoring by their ultimate beneficiaries (Jensen and Meckling, 1976; Mohan, 2001).

A different strand of criticism was developed by the 'public choice' theorists who argued that public sector enterprises are more likely to be run in the interest of politicians and civil servants than in the interest of the ultimate owners - society as a whole (Buchanan, 1972; Tullock, 1976; Boycko et al., 1996). As rational economic agents, politicians and state enterprise managers pursue their own interests, or maximize their own utility, rather than the public interest. Utility-maximizing politicians are likely to concentrate on promoting policies that maximize votes and political funding to enable them to retain office, while civil servants will be primarily interested in maximizing their budgets (Niskanen, 1971).

The privatization policy was embraced by both developed and developing countries and large scale ownership transformations took place around the world. Most importantly, the transition to the market system in former socialist countries of Central and Eastern Europe and the former Soviet Union resulted in the privatization of almost all enterprises in these countries. New methods of privatization (mass voucher privatization, management-employee buyouts, international tenders, etc.), motivated by economic, social and distributional considerations characterising the conditions of early transition, had to be devised in order to complete this task in these countries. In the course of the privatization process, these countries had to also develop and improve their financial system and institutions, corporate governance framework, company laws, bankruptcy laws and other institutions of a market economy over a relatively short period of time.

There is a large body of empirical literature analyzing the impact of privatization on company performance particularly in the former socialist countries. Although the empirical work in this field is beset with potential problems such as the availability of appropriate and comparable data sets and econometric problems (omitted variables, selection bias, endogeneity, etc.), this literature is both extensive and rich. A number of survey papers have reviewed and synthesized this literature succinctly (Frydman et al., 1999; Megginson and Netter, 2001; Estrin, et al., 2009). The majority of papers surveyed report improvements in performance associated with privatization. Estrin et al. (2009) suggest that when privatization was accompanied by complementary reforms, it had a positive effect on economic growth. However, the performance improvements vary significantly depending on the type of dominant owners emerging after privatization and the corporate governance framework in each country. Privatization to foreign investors has been identified as the method leading to highest improvement in company performance.

The three countries under consideration have all embraced privatization as a concept and as an important element of their overall economic and social policy – even though the main aims of privatization may have changed over time. Iran and Turkey have not clearly formulated an overall ownership strategy (or privatization strategy) identifying the activities and companies which they wish to transfer to the private sector and activities which they wish to retain within the public sector (as well as those which a joint approach may be considered). Pakistan has a Privatization Strategy but its implementation has recently slowed down. Despite these shortcomings, however, they all have made significant progress in the privatization of their state owned enterprises. The progress of privatization in each country will be discussed below.

Privatization in Iran

Before the 1979 Islamic Revolution, although state owned enterprises constituted the bulk of the industrial sector in Iran (with oil, petrochemical, steel and much of other minerals industries belonging to the state), the private sector had also developed significantly in the manufacturing sector (automobile production, textiles, food and beverages, etc.), banking, construction, trade and services. But the Islamic Revolution led to a reversal of this trend with much of the private property belonging to those close to the old regime, the newly developing capitalist class and foreign investors (particularly Western) confiscated. The confiscated property were transferred to one of the ministries or one of the many 'revolutionary foundations' set up in the wake of the Revolution.

The expanded state sector was sanctioned by Article 44 of the new Constitution, adopted in 1980, which explicitly defined the state sector to include "all large-scale and 'mother' industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like- all these will be publicly owned and administered by the State". The other two types of ownership identified in Article 44 were '*cooperative*' and '*private*' sectors which were expected to undertake other economic activities – with the cooperative sector receiving particular attention and earmarked to become a major form of ownership in future[8], and the private sector which was meant to fill in the gaps left, and serve the needs of, the state and cooperative sectors.

The state sector grew rapidly in the post-1979 period, particularly during the Iran-Iraq War through the expansion of the industrial activities concentrated in several ministries[9], as well as banking and financial institutions, relying on five-year plans to direct long term investment resources, the strict control of international trade, foreign exchange transactions, a multiple exchange rate regime, a wide range of subsidies, and an extensive welfare system. Along the state sector, the private sector also developed rapidly – in trade, services, construction and other industrial activities – to meet the needs of a developing economy and a fast growing population.[10]

In the post-war period, the government embarked on a series of economic reforms, including the adoption of a unified foreign exchange, the liberalization of foreign trade, and an initial debate of privatization. As in former socialist countries, the society had recognised the limits of state ownership and the inefficiencies associated with it. It was clear that any future growth potential had to be based on future private sector development. The discussion of privatization received extensive attention during the 1990s, with almost all political factions, different governments, private sector organisations, and the academia expressing their support. It has been a feature of the five-year development plans since the first plan (1990-95).

It had also become clear that the main obstacle to privatization was Article 44 of the Constitution which explicitly referred to the state sector and its boundaries. The final boost to the privatization debate was provided by a new interpretation of Article 44 and a law on this interpretation[11] which enabled the government and successive parliaments to embark on the transformation of state property to the private sector – a policy which has continued to date. According to the new interpretation, the government could satisfy the constitutional requirement as long as it retained control (even through a golden share) over the main company in a sector – and privatizing the remainder of the property. This has allowed the government to convert its portfolio companies into joint stock companies and dispose the bulk of shares – in all sectors of the economy (steel, automobiles, power, petrochemicals, refineries, mines, telecommunications, banking, etc.). The licensing of private banks and insurance companies – and the privatization of some of the publicly owned banks – complemented the process.

[8] There is even a 'Ministry of Cooperation' which has been charged with developing the 'cooperative sector' through supporting cooperative economic activities and devising policies aimed at expanding the cooperative ownership form.

[9] The bulk of expansion took place in Ministries of Industries and Mines, Defence, Reconstruction Jihad and Oil. The Islamic Revolutionary Guards Corps oversaw the development of the industrial sector, including the military, space and nuclear industries. Specialist organizations such as the Industrial Development and Restructuring Organization and Bank of Industry and Mine were established to oversee and finance this development.

[10] The population of Iran has doubled in the thirty years since the Revolution; for some of this period, it grew at over 3% per year, making Iran one of the fastest growing societies in the world.

[11] The Expediency Council (the Council responsible for resolving disputes between the Parliament, the Government and the Guardian Council) offered the new interpretation on the basis of its analysis of the development needs of the country in 2004. The Supreme Leader approved this interpretation and asked the government to speed up the privatization program. However, privatization faced another delay with the election of the new president in 2005 (Ahmadinejad was critical of the privatization program in its previous form) and wanted to change the program in line with his policy of wealth redistribution. The Supreme Leader issued another Decree on the 'General Policies of Article 44' in 2005 urging the government to speed up the process. A Law on the general policies of the Implementation of Article 44 was also passed, further facilitating the restarting and acceleration of the privatization process.

According to the new interpretation of Article 44, the aims of the ownership transformation program were: improvements in efficiency, facilitating economic growth, and the expansion of share ownership amongst a wide section of the population. The new interpretation led to a rapid growth of the privatization program. Figure 9 illustrates the slow pace of privatization in its first decade and its dramatic expansion in the last five to six years, coinciding with the assumption of office by Ahmadinejad.

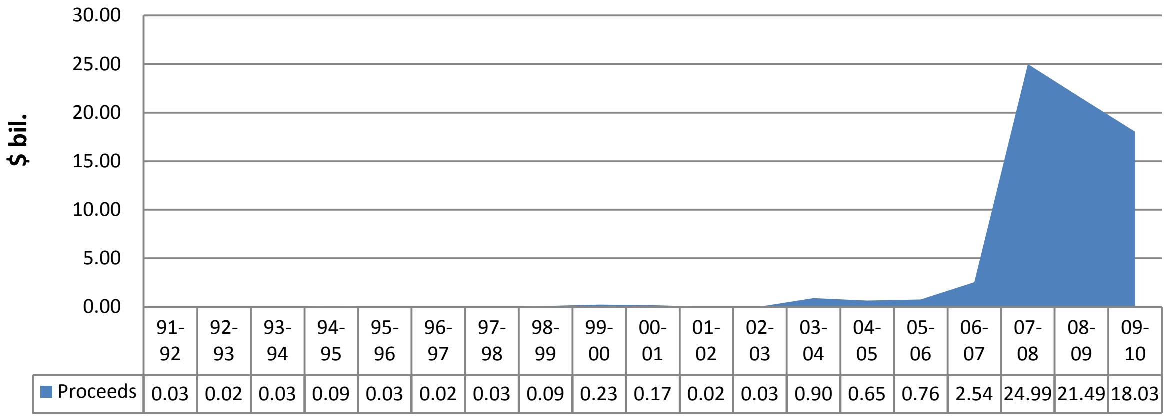


Figure 9. Progress of privatization in Iran 1991-2010 (values of privatized companies in $ bil.)
Source: IPO

The rapid expansion of the privatization activities from 2006 was due to the introduction of the so-called '*Justice Share'* Program - the vehicle for the free or preferential distribution of company shares to the poorer section of the population on preferential terms which was also expected to expand the 'cooperative sector' of the economy. The Justice Share Program heralded a change in the objective of privatization - the concern for social justice became the dominant objective, overshadowing the concern for efficiency. Indeed the operation of this Program has created significant corporate governance problems and weakened the mechanisms through which private owners can monitor and put pressure on the management to improve a company' performance (see below and Appendix 1).

The unique feature of private sector development in Iran is the growing role and importance of the semi-private and semi-public organizations and institutions (sometimes referred to as *'quasi-governmental'*) to which the state property has been transferred. This sector consists of three different types of organisations: *revolutionary* or *religious foundations; cooperative foundations* usually linked to one of the military or paramilitary institutions; and a variety of *pension funds*. At one level, and in some cases, these organizations are private but, at another level, they receive subsidies and preferential treatments (such as licenses for the import of various goods, tax exemptions and government contracts without going through the normal tender process) from the government, and in some cases they are fully under government control. The private sector often has to compete with these organizations – a major factor impeding private sector development.

In the aftermath of the 1979 Revolution much of the confiscated property was transferred to the newly established the *Mostazafan Foundation* (Foundation for the Deprived), set up t to improve the economic conditions of the 'deprived' section of the population, and later, *the 15th of Kohrdad*

(*5th of June) Foundation*, established to spread the message of Khomeini's movement in the early 1960s to potential supporters at home and abroad). Later, in the course of the Iran-Iraq War, *the Martyrs Foundation* was established to look after the families of those killed and injured in the War. Over the years, a large number of these foundations have been established – often for various religious affairs but always conducting some economic activities.

In the post-war period, the Army and the Revolutionary Guards (with the agreement of the government) decided to use their extensive experience in engineering and infrastructural services for commercial purposes. For this reason, they established a range of 'cooperative foundations' through which they could engage in economic activities.[12] The *Cooperative Foundation of the Guards, the Cooperative Foundation of the Baseej, the Cooperative Foundation of the Armed Forces, the Cooperative Foundation of the Employees of various Ministries,* and many other 'cooperative foundations'.[13] From a purely legal point of view, these are private cooperatives, belonging to their members (the revolutionary guards, members of the *Baseej*, the armed forces, etc.), being managed by their members on the basis of one-person-one-vote, and expected to transfer their profits to their members. In practice, these cooperatives have gone far beyond the scope of previously known cooperatives.[14] In no case have the members been formally asked if they wish to join cooperatives, and they certainly do not take part in their management. Their main purpose is to engage in economic and business activities in all sectors of the economy, including participation in the privatization program. These cooperatives are considered '*private'* companies even though they are closely linked to the military and paramilitary establishments with the heads of these establishments named as the founding members of the cooperatives and also acting as members of the Boards of Trustees. In practice, they are under the control and supervision of, at least a part of, the government.

Each cooperative foundation has established a large number of companies in different branches of the economy with inter-related ownership structures, sometime jointly with other cooperatives. They have also established banks and other financial institutions to finance their activities and to provide financial services to their companies and to the general public.[15] These companies have actively participated in the privatization process and emerged as major owners of privatized companies irrespective of the method of privatization selected by the government. They have been the selected bidders in many privatization tenders.[16] There is no information on the actual size of these cooperatives and their subsidiaries or their assets. There is also no information on any distribution of dividends to members of these cooperatives. The terms '*quasi-*

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12 In 1994, the Parliament passed a law to sanction the formation of 'Developmental and Technical Services' companies (Omrani va Khadamat e Fanni) by the armed forces. The operation of these companies is therefore entirely legal.

13 For the list of major religious and military institutions and foundations, see Appendix 2.

14 Cooperatives were not new organizations in Iran. Many public sector organizations (including ministries, schools and universities) had established 'cooperatives' for their employees during the War in order to facilitate their members' access to consumer goods in short supply through their official links with the distribution networks. But the new 'cooperatives' were of different type and scale- they established a large number of interlinked companies and became active in large scale production of goods and services.

15 Examples are: Mehr, Ansar and Samen ol Aemme Financial and Credit Institutions. These three institutions did not have the official permission of the Central Bank to operate as banks but could operate as 'financial institutions' under the existing laws and perform virtually all the functions of banks.

16 The most spectacular of these tenders was the $8 bil. sale of a 51% stake in the Iran Telecommunication Co in 2009 to a consortium of companies ultimately owned by the Guards and Baseej cooperative foundations. The consortium was selected in a 'tender process' widely criticised by the press and members of the Parliament. A recent new development has been awarding a $1 bil. contract without the tender process by the Central District Oil Company (a company under the Ministry of Oil) to '*Gharargah e Khatom ol Anbia' (Khatam ol Anbia Base)* (a company controlled by the Cooperative Foundation of the Revolutionary Guards) for the development of two natural gas fields. See Mehr Press Agency report, 30 April 2011. This company has been involved in the privatization of large infrastructural projects and service contracts, and is now one of the largest contractors in these fields.

government' or '*semi-governmental' organizations/companies* have been widely used by the press and critics to describe this sector. It is estimated that these cooperatives control, or have large shareholdings in some 1300 large financial and industrial companies in all sectors of the Iranian economy.

In addition to these cooperative foundations, there are also a number of other organisations, officially referred to as *'public, non-governmental organizations'*, which have, actively or passively, participated in the privatization process as private entities. These are the '*Social Security Organization'*, the '*National Retirement Organization',* the *'Teachers' Savings Fund',* etc. These organizations have been separated from the government and organised as independent 'agencies' which are responsible for their own budgets and activities (even though their management is appointed by government ministers). These organizations have participated in the privatization process either actively on their own initiative or passively by being given shares in lieu of the government debt. The government has large outstanding debts to these organizations arising from the non-payment of the employer's contribution to the pension and social security organisations. The use of privatization asset for debt liquidation is of course not new and has been used in many countries. But in other countries, the state uses the revenue from privatization to repay its debt (in Pakistan, for example, a portion of privatization revenues have been used for the liquidation of foreign debt). But in Iran, shares were directly transferred to the '*public, non-government sector'* in order to repay the state's debt accumulated over the years. For the purpose of privatization transactions, the government regards these organizations as non-governmental and the shares owned by them as shares which have been privatized.[17]

The official privatization literature in Iran refers to various types of organizations discussed above as 'private' and makes no distinction between these and the true private sector (individuals and companies who are subject to bankruptcy and takeover mechanisms and participate in the privatization process in their own capacity using their own resources). There is no official data on the breakdown of the private sector and their share in the privatization program.[18]

Apart from the distribution of shares to companies and institutions associated with the two groups mentioned above, Iran has also developed its own unique version of mass privatization – *the Justice Share Program* – devised with the explicit aim of transferring state ownership to the poorer section of the population. Briefly, the Program involves, on the one hand, the allocation of a proportion of shares of 56 large state owned companies (in manufacturing, telecommunication, banking, shipping, oil and petrochemicals, and other sectors) and, on the other hand, a mechanism for their distribution to the lower six deciles of the population. The eligible citizens (over 40 million of them) have become members of their local Township Justice Share Cooperatives (TJSCs) (of which there are 337). The shares allocated to the Program are

[17] The government's position is of course criticized by most observers. An interesting example is the study by the Majlis Research Centre (2009a), investigating the extent to which privatized companies have remained under state control after their formal transfer. The study focuses on companies privatized through block sales between 2007 and 2009. The shares (some or all) of 82 very large companies went through the block sale method (sometimes through a tender and sometimes through the stock exchange) in this period. Three groups of buyers (identified as 'quasi-governmental) purchased 46% of these shares (by value). These were: the investment company of the Social Security Organization (17.6%), the Mehr Investment Company, belonging to Baseej Cooperative Foundation (10.2%), and three retirement funds (18.0%) (p. 6). The Report warns of the "formation of ever expanding quasi-governmental powers parallel to the government" (p. 2).

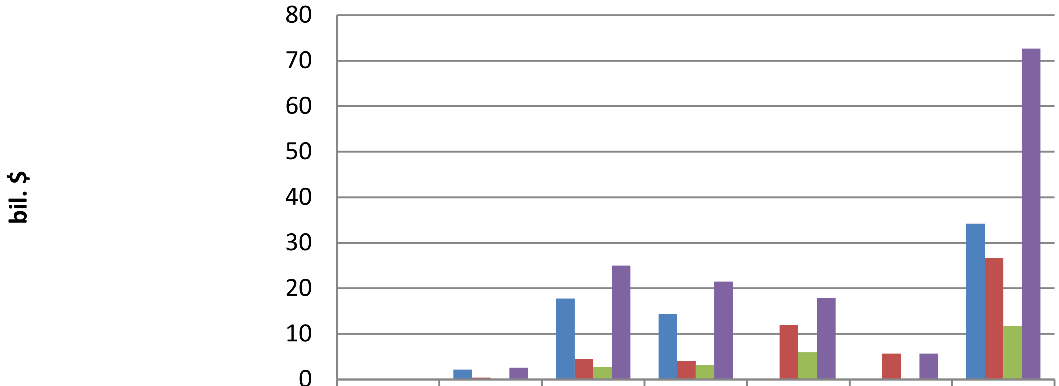
[18] An exception is a study by two academics of the 30 largest companies privatized between 2003 and 2007, puts the share of the true private sector in these companies at 5%, and the change in the share of private sector in these companies at 0.3% (Nassiri Aghdam and Fatehi Zadeh, no date). With large privatizations in the following years in which the semi-government organizations have taken large stakes, the share of the true private sector would be even lower.

repackaged and converted to about 42 million shares (or units), one for each citizen. These shares will be transferred to 30 newly established Provincial Investment Companies (PICs) on the basis of the number of eligible citizens in each of the 30 provinces. The management and policies of each PIC will be decided not directly by its members (the eligible citizens) but through their representatives, the Justice Share Cooperatives of that province (i.e., the TJSCs of each province will attend the General Assembly of the province's PIC and decide on the issues put in front of the Assembly).[19] Appendix 1 provides a more detailed analysis of the Program and its developments in recent years.

It is important to note that unlike other privatization methods, the Justice Shares allocated to citizens *have not been paid for* and the government *has not collected the proceeds* of these transfers yet. The values stated in the following tables and graphs are the estimated book value of companies transferred to the new owners. The payments will be made in future, from the dividends of the companies in the scheme. In the meantime, until shares are paid for, the Privatization Organization will retain the shares.

The relative importance of the size of assets transferred to different recipient groups in Iran is illustrated in Figure 10. Here the recipients are grouped into 'ownership types'. The Justice Shares are treated as the 'cooperative sector' since these shares are controlled by the Township Justice Share Cooperatives (even though the ownership is in the hands of individual coop members). The shares transferred in settlement of the government debt are classed under the 'public non-government sector' (which is in reality a part of the public sector and the transfer is from a state owned enterprise to a state organization). The remaining assets have been transferred to the private sector companies and individuals – and only here there is some possibility of the owners being able to exercise influence and improve the performance of companies.

[19] There are clear similarities between the Iranian Justice Share Program and the Polish Mass Privatization Program where a *majority* (60%) of shares of 512 companies in the scheme was transferred to 14 National Investment Funds (NIFs) which were set up by the government but were managed by management companies composed of experienced foreign and Polish financial institutions. The shares of these investment companies were transferred to Polish citizens on the basis of each citizen receiving one share in each of the 14 NIFs. The funds were remunerated on the basis of the value of companies in their portfolio. Therefore, they were motivated to change the management and force through restructuring changes in their portfolio companies that would increase their value (or reduce their losses). Although the 60% share of funds was divided between 14 funds, they did act together to utilize the voting rights of their 60% holding and have a majority on the Board of each and every company in order to be able to force through the necessary changes in the company. For details see Hashi (2000).



	2005	2006	2007	2008	2009	2010	Total
Cooperative (Justice Share Program)	0	2.174	17.744	14.294	0	0	34.212
Private	0.076	0.366	4.502	4.076	11.988	5.666	26.674
Public, Non-Govermnet (Settlment of government debt)	0	0	2.748	3.124	5.914	0	11.786
Total in each year	0.076	2.54	24.994	21.494	17.902	5.666	72.672

Figure 10. Values of privatized companies and their recipients by sector in Iran 2005-10 (in $ bil.)
Source: Iranian Privatization Organization (2011)

The diagram clearly shows that the justice share program accounts for almost one half of the value of privatized assets. The private sector (which is largely made up of the religious and military foundations) constitutes only about one-third of the total, with the rest being the debt liquidation program of the government.

Privatization in Pakistan

The concept of privatization in Pakistan has existed since the creation of the country. In 1952, Pakistan Industrial Development Corporation (PIDC) was established to boost the industrial development of the country. This corporation established over 50 industrial undertakings in the country with a view to transferring these entities from the public to the private sector (Syed , 1998). After these sporadic initiatives, the privatization process received a new impetus with the creation of the Privatization Commission in 1991. Although the Commission's initial mandate was restricted to industrial transactions, by 1993 its remit was extended to power, oil and gas, transport, telecommunications and banking and insurance sectors.

Pakistan has experienced a fairly successful privatization program in comparison with the countries of South Asia and the Middle East. In all, about 170 SOEs have been privatized. Although this number looks rather modest, it covers a considerable number of large entities with a significant number of employees. Each of the privatized companies was a so-called 'national company' which had been formed at the time of nationalization by the amalgamation of many firms in a particular sector. Thus the number of firms after privatization could not be matched against the number of firms before privatization. The predominant method of privatization in Pakistan was the sale of assets and businesses through a bidding process. The number of transactions under employee buy-out and public offer through the stock exchanges has been the same but the proceeds of privatization through employee buy outs is dwarfed by that through the stock market (see below). There has been no transaction under the lease or concession contracts (which is one of the legal methods of privatization) but the current government is exploring such options under the PPP privatization policy. Other methods of privatization in Pakistan include: total disinvestment through competitive bidding; partial disinvestment with management control; partial disinvestment without management control; sale/lease of assets and property (Husain, 2004).

Privatization in Turkey

Privatization of public assets in Turkey emerged as an official state ideology in the mid-1980s. It was based on the belief that private sector will improve the efficiency of production and will reduce excessive employment and waste in the state enterprise system. The program started with divesting unfinished state-owned plants, small-sized companies and some other factories. Later, initial public offerings of government-owned companies took place. Although Turkey started to implement privatization process long before many other developing countries, the process did not gain momentum until the end of 2002. As Atiyas (2009) points out, this was due to several reasons such as a weak commitment by the coalition governments which displayed internal disagreement about the desirability and scope of privatization, the concern over the loss of patronage opportunities amongst politicians and a feeling that the general public was not yet altogether ready to embrace the concept of privatization. Also, many of the privatization cases had been challenged and reversed at the Constitutional Court on the basis of their conflict with the nationalization law embedded in the Constitution. Total proceeds generated between 1986 and 2002 were only eight billion dollars.

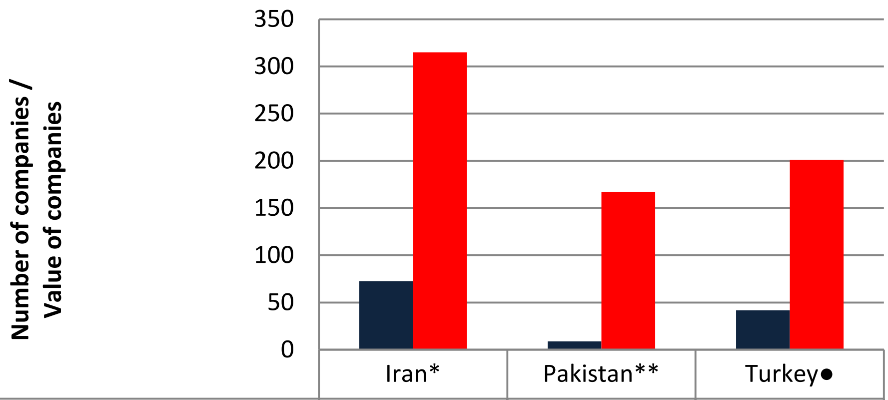
After the newly elected government of the AK (Justice and Development) Party, which supported the privatization policy, came to power in 2002, the process started to accelerate. Major transactions including those of Turk Telekom (Telecommunication), Tupras (Petroleum), Erdemir (Iron-Steel), Petkim (Petrochemical), Tekel (Alcohol) were carried out and the proceeds increased considerably. While the initial aim of privatization was to minimize state involvement in the industrial and commercial activities in the economy, there is a growing feeling that this aim has shifted towards revenue generation and financing of the public debt (Yeldan, 2008). This is identified by the survey respondents of this study in Turkey as well.

The privatization process in Turkey was accompanied by a variety of social support projects. These projects targeted individuals who were made redundant in the process of preparing companies for privatization. While these projects helped in alleviating the problem of redundancies, serious difficulties related to labour shedding still remain.[20]

[20] This is because the redundancies have been particularly high in the relatively underdeveloped regions in the country where SOEs provided job and income for the local communities. Ertuna (1998) points out that in less developed regions, financial compensation can hardly make up for the damage caused by job losses because other employment opportunities may not be available and the loss of jobs may be the beginning of permanent unemployment.

Progress of Privatization

The overall progress of privatization in each of the three countries, in terms of both the number of companies and the volume of assets transferred, is shown in Figure 11.



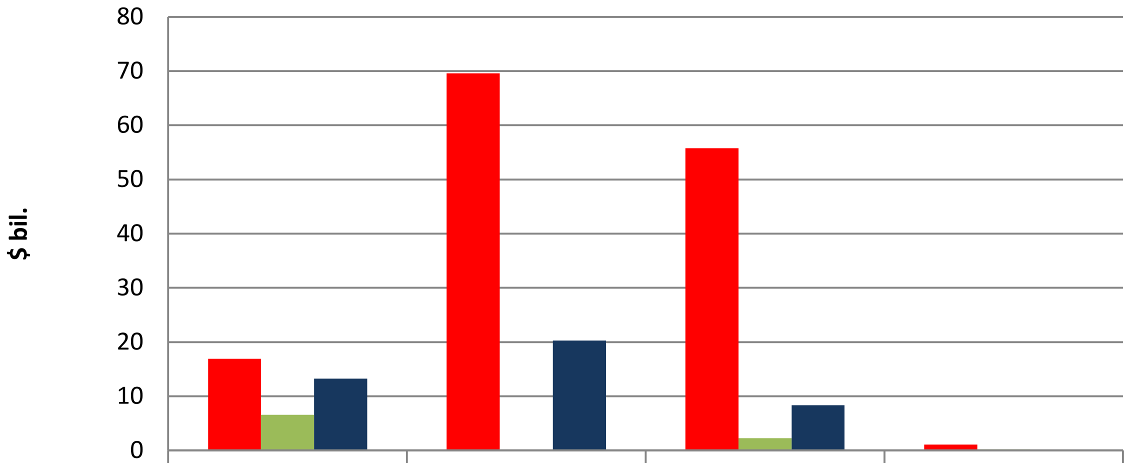
	Iran*	Pakistan**	Turkey•
■ Value of privatized assets (proceeds) $ bil.	72.67	8.69	41.85
■ Number of companies fully or partially privatized	315	167	201

Figure 11. Number and the value of companies fully or partially privatized by 2010 ($ bil.)
*Source: *Iranian Privatization Organization; **Privatization Commission of Pakistan; •Privatization Agency of Turkey*

Iran is the country with the most extensive privatization program, disposing of some 315 companies (fully or partially), worth over $72 billion. Turkey and Pakistan follow with smaller number of companies and lower proceeds. It is important to highlight the fact that although the value of privatized companies is highest in Iran, this does not imply the proceeds of privatization are also the highest. The transfer of assets to various recipients has not always been accompanied by the payment of the value of these assets to the Treasury; in many cases the payment will take place over an extended period. Furthermore, some of the shares have been transferred to recipients in order to liquidate the government's debt to these organizations. In both Turkey and Pakistan, the bulk of privatization proceeds have been received by the government.

Methods of privatization

In addition to the overall progress of privatization in the three countries, we can also demonstrate the progress in terms of different methods of privatization. As mentioned in the preceding sections, a variety of privatization methods have been employed in the three countries, though the dominant method in each country has been different. The main methods used have been: sale of assets or business through tender (sale to the highest bidder); block sale (in which a fixed proportion of a company's equity is put up for sale, usually through the stock market, tender or negotiation); public auctions; initial public offering; and sale (or transfer) of shares through the stock exchange. In some cases, a small amount of shares are sold through the stock exchange for the purpose of 'price discovery', followed by a larger amount at more realistic prices. Other methods, sale to employees, public-private partnership (PPP) and concessions has also been discussed and approved in the legislation in some countries (Pakistan for example) but they either constitute a very small proportion of activities or have not been used at all. Figure 12 shows the value of assets privatized through different methods of privatization.



	Sale of asset through tender and public auction	Block sale	Sale of shares through stock exchange	Management and or employee buyouts
Iran*	16.906	69.604	55.763	1.084
Pakistan**	6.5404	0	2.229	0.186
Turkey•	13.241	20.257	8.352	0

Figure 12. Value of privatized companies through various methods by 2010 ($ bil.)
*Source: *Iranian Privatization Organization; **Privatization commission of Pakistan; •Privatization Agency of Turkey;*
Note: In Iran, most of the 'block sale' privatization was transferred through the stock exchange. The Justice Shares, e.g., are included both in 'block sale' and 'stock exchange' groups. The total, therefore, is well in excess of $72 billion.

In Iran, the majority of privatized share, over 50 billion dollars, appear to have been transferred through the stock exchange (though the bulk of this amount which relates to the Justice Share and debt liquidation programs has only a virtual relationship to the stock exchange at the moment and are not yet traded on the stock exchange). These shares, together with the shares of PICs and portfolio companies will be traded on the Exchange at some point in future. Furthermore, the sale to the private sector referred to as 'block sale', involving the sale of a large block of shares, is also included under the 'sale through the stock exchange' even though the shares may not be traded yet. The second most important privatization method was the sale of assets via the tendering process, raising almost 17 billion dollars. The privatization program in Iran included also the provisions that up to 5% of shares of companies may be sold or transferred to employees (the payment for which could be made in instalments). This is different from management employee buyouts in which a company is fully, often through leverage, bought by its employees and managers. Nearly a billion dollars of shares have been transferred through this method.

In Pakistan, the two most important methods were sale through tendering which raised over six and a half billion dollars, followed by sale through the stock exchange with over two billion dollars in proceeds. The other two methods, management and employee buyouts and sale through public auctions raised over 180 and 0.4 million dollars respectively.

In Turkey, the main method of privatization was the sale of blocks of shares raising over 20 billion dollars. This was followed by sale through tendering which raised over 13 billion dollars while public offering raised over 7 billion dollars. Sale of shares through stock exchange raised over 1.2 billion dollars.

Privatization and Corporatization

The vehicle for many of the privatisation methods has been 'corporatization' – the conversion of a state owned company to a joint stock company with all shares belonging to the government or a government department or agency. These shares are then offered for sale through the stock exchange, gradually or in blocks, or through a tender process. Corporatisation was widely used in the privatization programs of the Central and East European countries (Russia, Poland, the Czech Republic, and others) and prepared the companies for private sector ownership and control. Corporatization involves a change in the legal status of the company, from one subject to a specific ordinance or government regulation, or the law on state owned companies, to one under the commercial code with different legal obligations (such as regular financial reporting for example). A corporatized company will have its management (or supervisory) board appointed by the state institution controlling its share but this board, once appointed, will be independent and will have to run the company on broadly commercial principles. It will be able to introduce a market oriented culture and changes aimed at improving the company's efficiency and profitability.

Corporatization has been used extensively in the privatization programs in Iran, Pakistan and Turkey. In Iran almost all privatised companies have gone through this process though it has not always produced the expected outcomes. In the case of companies in the Justice Share Program, for example, the majority of shares of the companies in the program have been retained by the state and the boards of companies have remained under state control, and almost completely unchanged. The appointments to the boards have not been on the basis of individual merits but political connections. In many cases, privatisation has resulted in the transfer of shares from one state institution to another and the deficiencies associated with state-ownership have not changed. Furthermore, although the control of a company may have been taken away from the ministry or organization to which it was attached, the government (or various interest groups within the government) have retained their influence through their control of other companies and institutional shareholders. An interesting example of this type of indirect state control and influence is the SADRA Corporation – one of the largest privatization projects in the country and a case of very poor post-privatization performance largely attributed to the government and its procurement policies (for details, see SADRA's case study in Appendix 3).

In Pakistan and Turkey, on the other hand, corporatisation has been widely used as a transitional stage, enabling the management and boards to use their independent status to prepare the company for privatization. In Pakistan, the most prominent example of a structured corporatization before privatization is that of Pakistan Telephone and Telegraph Department, which was restructured as a corporate entity belonging to the state in 1991 under Pakistan Telecommunication Corporation Act 1991. A few years later, Pakistan Telecommunication (Re-organization) Act 1996 was promulgated which separated different functions of the government owned company into separate independent entities.[21] Pakistan Telecommunication Company Ltd (PCTL) was one of these entities and was eventually listed at Karachi Stock Exchange. It was this listed PTCL, which was eventually sold through public offering and later to direct investors. Based on its share value, in 2005, 26% of its shares along with management control were bought by the regional giant, Etisalat. Similar forms of corporatization were also used for the privatization of major banks such as Habib Bank, Allied Bank and United Bank.

In Turkey, too, corporatization was widely used to prepared companies for privatization. As in Pakistan, corporatization was the vehicle for the privatization of the Turkish telecommunication company. Appendices 4 summarise the progress of privatization in *Turk Telekom* which is one of Turkey's major corporations.

Corporatization can serve as an important and useful intermediary and transitional stage between public ownership and private ownership. But for it to be effective, it is essential that the government makes a genuine decision to leave the management of corporatized companies to independent boards and allow it to learn to become a truly independent board. If the government does not really wish to surrender control of a company to the true private sector, and will use its ability to appoint the boards to maintain its control, corporatization will not benefit the company at all.

To sum up, the privatization process has progressed rapidly in all countries, though its aims may have changed in the process-efficiency not being the predominant aim in all countries any more. In Iran, the process has been the largest and implemented most rapidly in the last six years (though it has slowed down in the last year) but it suffers from several important shortcomings. There is no mechanism to ensure that the privatized companies will improve their performance under the influence of new owners. There is every indication that they, particularly those involved in the Justice Share Program, would continue to suffer from weak corporate governance. The privatization process has been highly politicised with the bulk of transfers having been made to either the lowest six deciles of the population or the military cooperative foundations with unclear ownership structure, raising the fear that despite its massive size, the privatized companies have not been transferred to the real private sector but to organization closely linked to the Iranian military and religious leaders. Foreign investors, who played a major role in the privatization programs of East European transition economies, and also some role in Turkey and Pakistan, were almost completely absent from the Iranian program because of the poor business environment conditions. The privatization program has recently slowed down in Iran and there is no sign of the continuation or extension of the Justice Share Program. Corporatization as a major vehicle for privatization has been used in all three countries but with different results – especially in Iran where despite corporatization, privatized companies have not been converted into independent value maximising entities.

[21] Pakistan Telecommunication Company Ltd. (PTCL), Pakistan Telecommunication Authority, National Telecommunication Company Ltd. and Frequency Allocation Board.

4

BUSINESS ENVIRONMENT

This section analyses the main findings of surveys conducted by different international organizations on the state of business environment in Iran, Pakistan and Turkey. First, we depict the 'ease of doing business' as described by the World Bank Doing Business Report. Second, we report on the competitiveness of these countries as reported by the World Economic Forum's Global Competitiveness Report which ranks countries according to the Global Competitiveness Index (GCI). Third, we show the perceptions of businesses about their business environment as documented by the Business Environment and Enterprise Performance Survey (BEEPS) survey conducted by the World Bank and the European Bank for Reconstruction and Development (EBRD). Finally, we discuss the Corruption Perceptions Index as reported by Transparency International.

To begin with, using IFC (2008), we define business environment as:

"[A] complex set of policy, legal, institutional, and regulatory conditions that govern business activities. It is a sub-set of the investment climate and includes the administration and enforcement mechanisms established to implement government policy, as well as the institutional arrangements that influence the way key actors operate (e.g. government agencies, regulatory authorities, and business membership organizations including businesswomen associations, civil society organizations, trade unions, etc.)."

The business environment in a country is an essential determinant of the success of privatization and of private sector development, strongly influencing economic growth and, therefore, job creation and standard of living. Therefore reforms that aim at the development of markets by encouraging competition and enhancing the effectiveness and sustainability of companies should be high up in the priority list of governments.

Ease of doing business

We have used the data from the Doing Business Report (World Bank, 2010) to track regulatory reforms for conducting business and to rank these countries on the basis of the 'ease of doing business'.[22] As Table 1 demonstrates, Turkey, ranked as 65th (out of 183 countries), has the most favourable business conditions, followed by Pakistan in 83rd place and Iran –trailing at a long distance behind- at 129th place. In the last year alone, Turkey and Pakistan have both dropped in the overall ranking, by five and eight places respectively but the conditions in Iran have marginally improved, by two places, but it still remain the country with least favourable environment for doing business. Improvements in some areas have been quite significant (e.g., in the component 'Getting Credit', it improved its position by 20 places) but, overall, the ranking did not change very much.

[22] Doing Business Report ranks economies on their ease of doing business, from 1 – 183. A low ranking on this index means the regulatory environment is more conducive to the establishment and operation of a local firm. This index averages the country's percentile rankings in 9 areas (starting a business; dealing with construction permits; registering property; getting credit; protecting investors; paying taxes; trading across borders; enforcing contracts; closing a business), giving equal weight to each area. The rankings for all economies are benchmarked to June 2010.

Table 1. Ease of doing business (ranked out of 183 countries)

Country	Doing Business 2011 Rank	Doing Business 2010 Rank	Change in Rank
Turkey	65	60	**-5**
Pakistan	83	75	**-8**
Iran	129	131	**+2**

Source: World Bank, 2011

The overall 'Doing Business' ranking is based on the average ranking of a large number individual indicators on which countries are assessed. We report the detailed indicators for two major components here: Starting and Conducting Business and Credit and Regulations. Figure 13 shows the ranking for indicators related to 'Starting and Conducting Business'. Each ray of the 'radar diagram' shows the ranking of one indicator amongst 183 countries. In terms of starting a business, Iran is the best performer (42nd place)[23], followed by Turkey (63rd place) and lastly Pakistan (85th place). However, it performs badly on other indicators of this component. Although each country seems to be performing well on one of the indicators, and not so well on others, it is clear that, broadly speaking, Turkey is the best performer on this component.

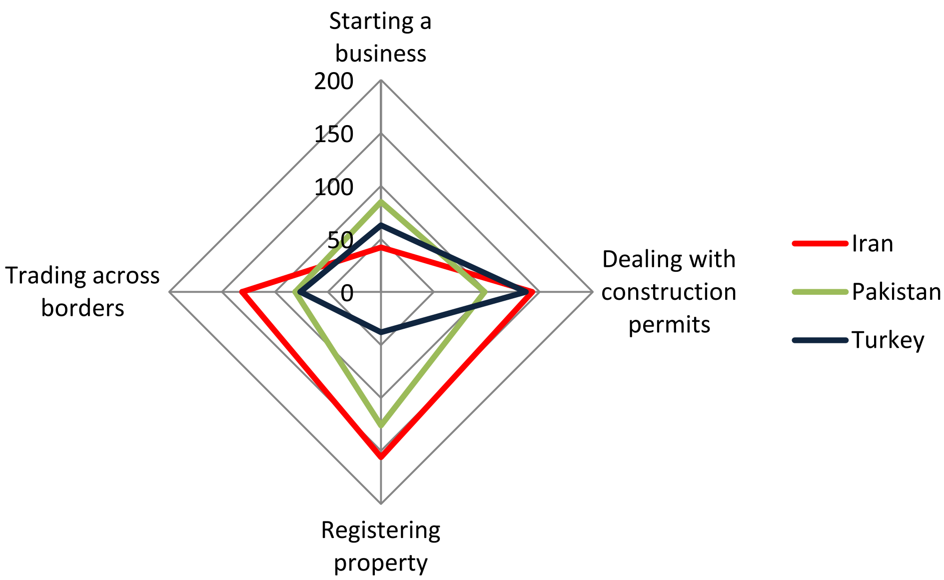


Figure 13. Doing Business: Starting and conducting a business (ranked out of 183 countries)
Source: World Bank, 2010

Figure 14 shows the ranking for indicators related to the 'Credit and Regulations' component. In terms of the ease of obtaining credit, Pakistan has the best ranking (65th place), followed by Turkey (72nd place) and finally Iran (89th place). In terms of protecting investors, clearly Iran perform very badly (167th place) while Turkey and Pakistan performed much better (in 59th and 28th place respectively). In all three countries this indicator has deteriorated during the last two years. In terms of enforcing contracts, we can distinguish between two groups. Turkey and Iran

[23] After the previous year's ranking, the Iranian government embarked on measures to reduce the length of time needed to start a business and succeeded in reducing this significantly (from 96th to 42nd). This success, however, was not extended to other dimensions of this component on which Iran is behind other countries in the study.

are high up in the ranking (in the top 50 places) whereas Pakistan is far behind amongst the bottom 50 countries (at 155th place).

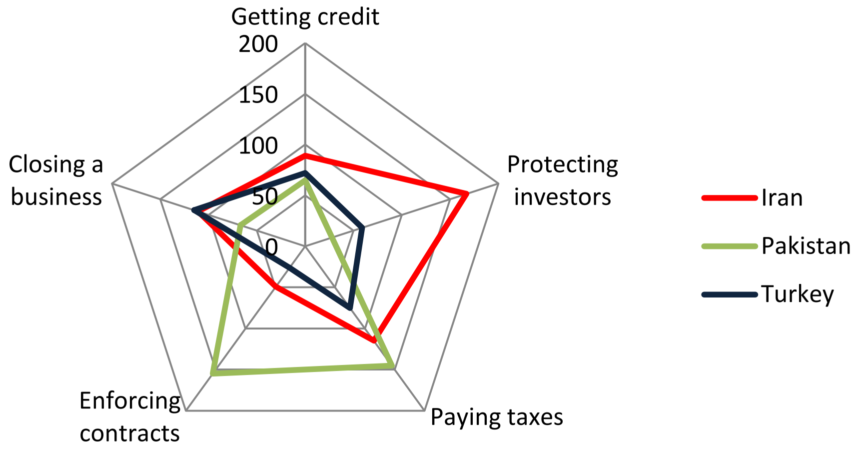


Figure 14. Doing Business: Credit and regulations component (ranked out of 183 countries)
Source: World Bank, 2010

While the Doing Business Survey may have its limitations (mainly related to the small number of respondents) which might lead to errors and biases, it is still one of the most important and commonly used sources of comparable information on the business environment landscape across different countries. Its contribution is important for at least two reasons: first, it sheds light on the regulatory dimensions in different countries and, secondly, it helps generate a debate engaging the business community and governments on the need for reforms. The survey has attracted particular attention in Iran where several governmental and Parliamentary groups have been set up to highlight the importance of business environment and the shortcomings of the present situation, publicise Iran's poor standing compared to neighbouring countries and campaign for improvements in the business environment.[24] The Parliamentary committee has even embarked on its own survey of business environment to obtain a more accurate picture of the situation across the country and to highlight particular areas and sectors in which the business environment is least friendly.[25] Indeed, following these developments and in conjunction with the Iran Chamber of Commerce, the Iranian Parliament recently (Dec 2011) passed the Law on 'Improving the Business Environment'. The Law will establish a 'Private-Public Sector Dialogue Council' made up of the representatives of the private sector and the government to discuss the problems facing the private sector and make proposals to resolve these problems. in which can be discussed. Interestingly, the government has been unhappy about the bill going through the Parliament and declared that it will submit its own proposal for improving the business environment to the Parliament (*Donya ye Eghtesad,* 17 December 2011*)*.

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[24] The Majlis Research Centre has, e.g., set up an Office for the Study of Business Environment which has been very active in publishing research on the topic. A recent report, Majlis Research Centre (2011a) compared the results of five rounds of Doing Business Surveys, highlighting the changes over the five year period and the shortcomings of the business environment in Iran.

[25] The Majlis Research Centre (2011b) reports on the results of the Centre's own quarterly research on changes in the business environment in different parts of the country and in different sectors. The research undertaken in Spring 2011, e.g., identified the *Chahar Mahal and Bakhtiari* Province and the agricultural sector as facing the worst business environment.

Global Competitiveness Index – GCI

We have also considered GCI to examine, from a slightly different perspective, the business environment and its impact on competitiveness in Pakistan, Iran and Turkey in a number of similar areas. CGI is primarily concerned with ranking the countries according to their competitiveness (133 countries are covered by this report). GCI is made up of a large number of factors that influence and contribute to competitiveness.[26] Some of these components (such as regulatory issues, corporate governance and financial sector development) are also important in terms of business environment and will be considered here. Since GCI combines hard data with opinions of business leaders, it provides a good source of information as to what are the priorities that need to be addressed and reformed.

Figure 15 represents the severity of factors contributing to Regulatory Barriers. Iran suffers from poor conditions (positions furthest away from the origin) in two areas related to foreign trade (the prevalence of trade barriers and customs procedures) and a low position in terms of total tax rate. Pakistan, on the other hand, ranks poorly on starting new businesses. Turkey has a more conducive regulatory environment, falling in the centre of diagram along most rays, except the total tax rate. Trade barriers and excessive customs procedures are important obstacles to further development of companies particularly as all these countries are desperately trying to increase their export earnings and participation in international trade.

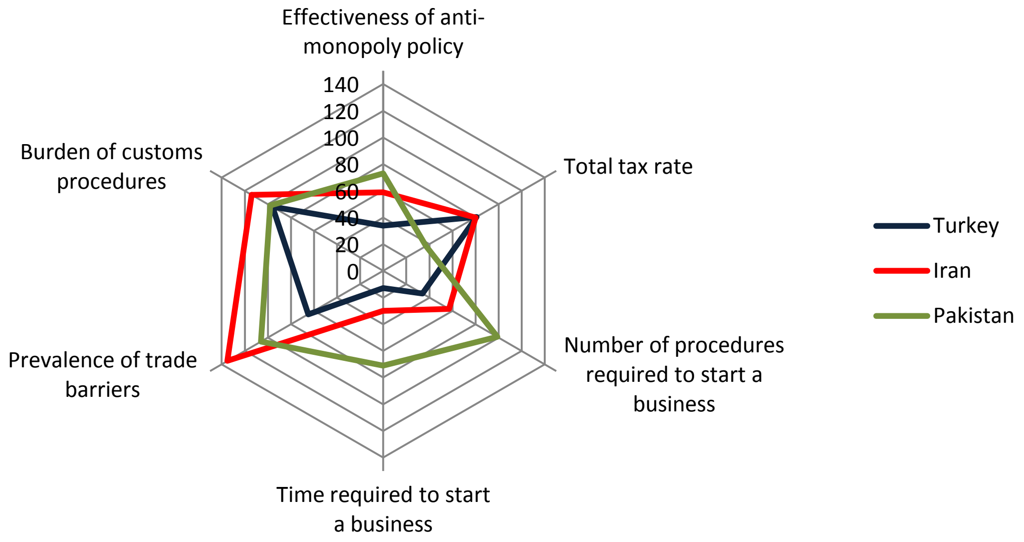

Figure 15. Regulatory barriers (rank out of 133 countries)
Source: GCI, 2010

[26] The GCI is based on 12 'pillars' of competitiveness that are divided into 3 groups: Basic Requirements (Institutions, Infrastructure, Macroeconomic Stability, Health and Primary Education), Efficiency Enhancers (Higher Education and Training, Goods Market Efficiency, Labour Market Efficiency, Financial Market Sophistication, Technological Readiness, Market Size), and Innovation and Sophistication Factors (Business Sophistication, Innovation). These raw data indicators are scored on a scale of 1 to 7, where 7 is the best score, for each country. The pillars are then given a score by averaging the scores for each indicator under that pillar. Similarly, the score for each pillar groups is derived by averaging the scores of the pillars within that group. When creating the overall score for each country, weighting schemes are applied based on GDP per capita. Countries are grouped into three stages of development based on their GDP per capita. Least developed countries are thought to be factor driven, middle income countries are efficiency driven and developed countries are deemed innovation driven. As a country develops, less weight is put on the Basic Requirements and more is placed on Efficiency Enhancers and Innovation and Sophistication.

Figure 16 shows the ranking of factors influencing the state of Corporate Governance. Here Iran is clearly ranked below the majority of countries on all elements (98 and higher) and worse than the other two countries in all but the 'efficiency of corporate board' element where Turkey and Pakistan occupy slightly worse position. On the strength of investor protection, Iran is at 127th place, below almost all countries, while Pakistan is ranked 27th and Turkey 45th. These results clearly indicate that all three countries need considerable improvements in these areas; otherwise the prospect for private sector development will be significantly constrained.

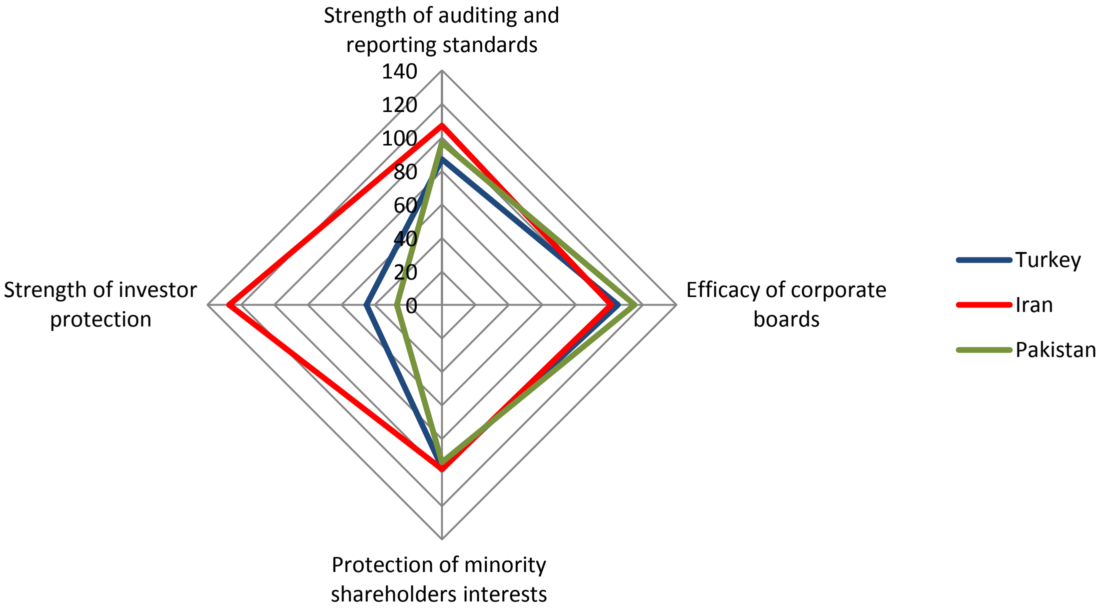

Figure 16. Corporate governance indicators (rank out of 133 countries)
Source: GCI, 2010

Figure 17 shows the state of financial sector development in the three countries. Here, in all four areas shown on the diagram, Iran is clearly ranked below most countries of the world, highlighting the need for policy change in all areas. With the exception of the 'ease of access to capital' element, the Turkish financial system shows very positive rankings (being in the top one-third of countries in the Report). Pakistan also suffers from serious problems in its financial sector development (except in the area of access to capital) and is in need of major policy changes.

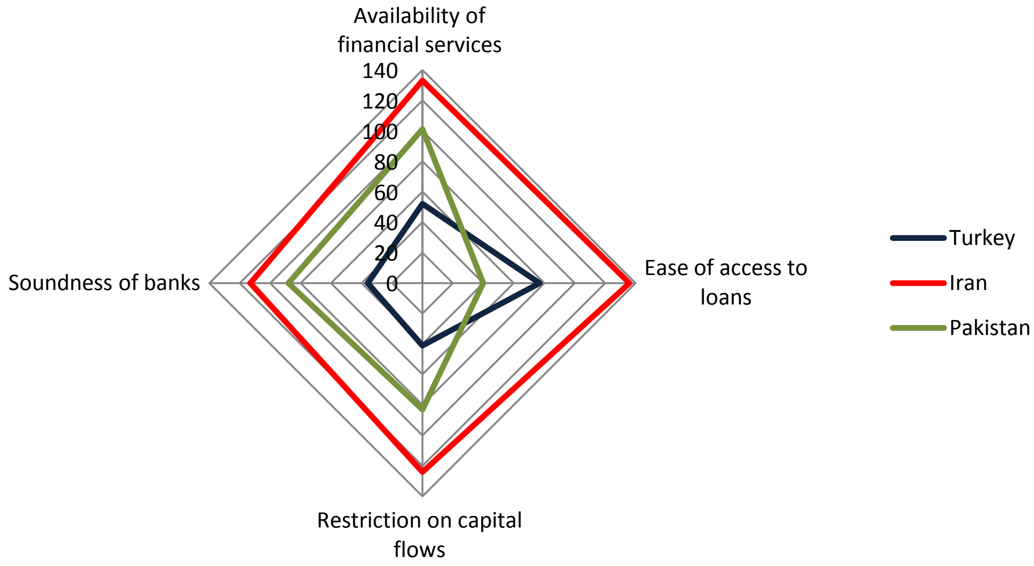

Figure 17. Financial sector development (rank out of 133 countries)
Source: GCI, 2010

Business Environment and Enterprise Performance Survey (BEEPS)
In order to study the views of the business community itself on the business environment in these countries, rather than those of a small selected group, we can use the large scale enterprise survey conducted jointly by the World Bank and European Bank for Reconstruction and Development (EBRD), commonly referred to as BEEPS. The objective of the survey is to collect information from enterprises on their assessment of the quality of business environment and the impact of different dimensions of business environment on their operation. The Surveys have been conducted in many countries, including two of the three countries under consideration, every three years since 1999. Iran has not been included in BEEPS.

Unlike the 'Doing Business' surveys, the BEEPS data do not rank countries but individual aspects of business environment and their impact in each enterprise, on a 1-5 Likert scale. Therefore, in order to be able to compare the severity of different obstacles faced by businesses in different countries, we have calculated the weighted average of the ranking of the severity of each obstacle, using higher weighting for more difficult obstacle. We then normalised these averages to develop a score ranging from 20 to 100 (with 100 showing the most severe obstacle).[27] Here, we consider two groups of obstacles. First, the institutional barriers which include the spread of corruption, quality of courts, practices of formal and informal competitors, and crime, theft and disorder; and second, the regulatory barriers which include tax rates, access to land, customs and trade regulation, labour regulation, tax administration, business licensing and permits. Figure 18 and 19 represent the data on the two groups of barriers.

[27] For each obstacle, the rank given by each enterprise (from 1-5) is multiplied by a weight equal to the rank (also 1 to 5), i.e., the more serious obstacles get a higher weighting). The weighted average is then divided by 5 (the maximum rank) and multiplied by 100 in order to convert the score into a percentage showing how close to the maximum ranking the average rank is. In other words, the score s was calculated as: $s=(\sum w_i x_i/n)*100/5$, with $w_i=x_i$; s is the score for the intensity of each obstacle, w is the weight , x is the ranking given by each respondent and i=1,2,....,n stands for each respondent.

In terms of institutional barriers, shown in Figure 18, Pakistan seems to suffer from the most severe institutional obstacles, in at least four of the five areas, particularly, corruption, courts and crime, theft and disorder. Turkey, on the other hand seems to have a better institutional environment with three of the five indicators falling inside the radar diagram. In both countries, corruption is a serious obstacle to business activity, followed by the prevalence of crime, theft and disorder.

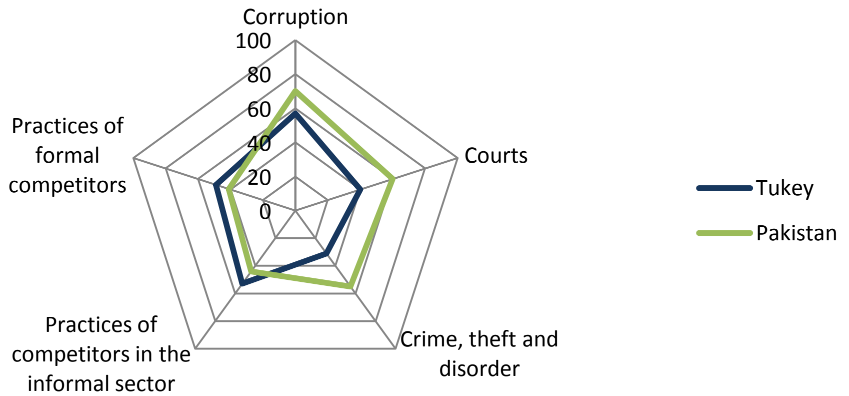

Figure 18. Institutional barriers (score from 20 to 100 – with 100 representing the most severe obstacle)
Source: BEEPS, 2010

In terms of regulatory barriers, shown in Figure 19, the results paint a different picture than institutional barriers with Turkey falling on the outside on three of the six indicators. Pakistan falls in closer to the centre of the radar diagram on several indicators.

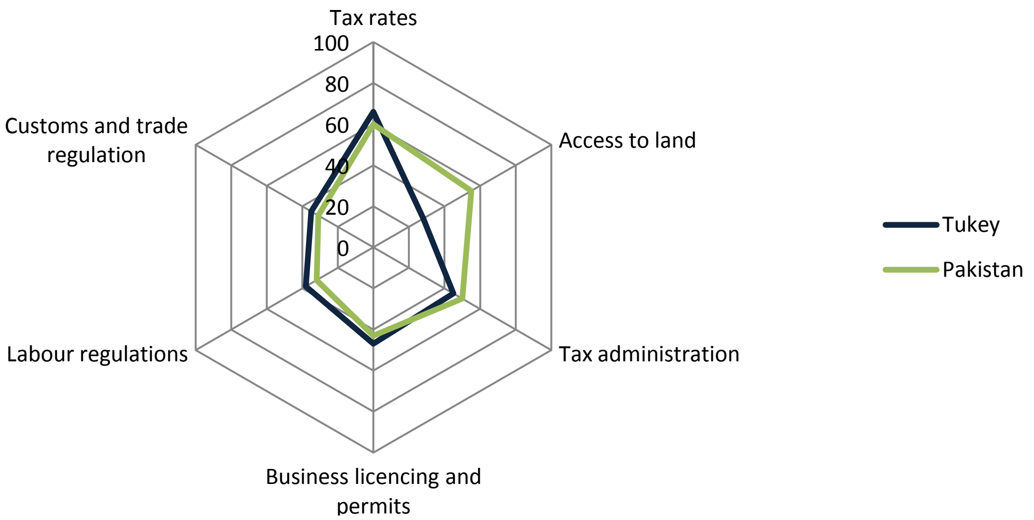

Figure 19. Regulatory barriers (score from 20 to 100 – with 100 representing the most severe obstacle)
Source: BEEPS, 2010

Corruption Perception Index – CPI

Finally, we consider the state of corruption in the three countries as published by Transparency International. The CPI measures the degree to which business people and country analysts perceive the level of corruption in the public sector in different countries around the world. In 2010 it covered 178 countries. CPI assigns scores ranging from 10 (very clean) to 0 (highly corrupt) to different countries. As Figure 20 shows, according to Transparency International, the perceived corruption in Iran and Pakistan (ranking between 2.2 and 2.3) is a very serious problem (especially in Iran). Turkey, too, despite being in a better position than these countries, is not immune from this problem. In terms of ranking, Turkey is in 56th place followed by Pakistan in 143rd and Iran in 146th.

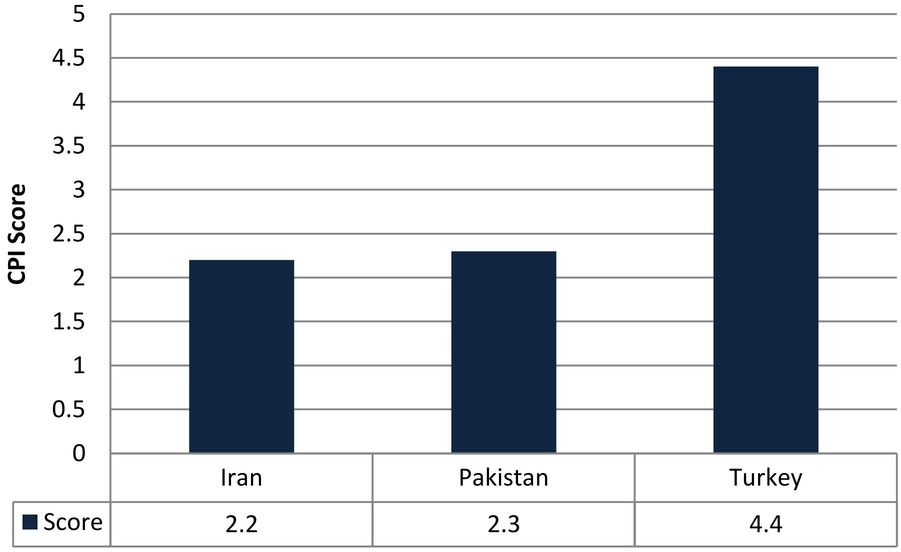

Figure 20. Corruption Perception Index (scores from 0 to 10 – with 0 indicating very corrupt conditions)
Source: Transparency International, 2010

To sum up, the international surveys by reputable organizations and institutions demonstrate that the quality of business environment is poor and in need of urgent reforms in all three countries. The regulatory aspects of the environment, those based on laws and regulations in each country, are not conducive to the establishment and conduct of business. There are too many restrictions on foreign trade activities, labour and land markets, and the financial systems. The latter cannot provide businesses with the levels of credit and other services needed, and thus prevents them reaching their full potential. Levels of corruption and informal activities are high and pose a serious burden on companies. Reforms in all these areas are essential for these countries to grow faster and provide their citizens with higher standards of living.

5

CORPORATE GOVERNANCE

Since the publication of OECD Principles of Corporate Governance, over eighty countries have adopted codes of corporate governance for their companies to follow. Many stock exchanges around the world require the listed companies to observe their codes of good governance and report on their compliance on a regular basis. In this section, we will first discuss the importance of good corporate governance for businesses and then report on the state of the corporate governance framework in the three countries under consideration.

Business Case for Corporate Governance

Corporate governance refers to a set of rules and regulations, and voluntary practices, governing the relationships between the management, directors, shareholders, regulators and other stakeholders. It also refers to structures within which a company's objectives are set, the mechanisms of attaining those objectives and monitoring the progress towards those objectives (OECD, 2004). The corporate governance framework is aimed at protecting the interests of the company as well as its shareholders, creditors and investors. Corporate scandals such as Enron, Worldcom and Parmalat not only caused huge losses for shareholders, investors and employees of these companies but, above all, destroyed companies which were once profitable and respectable establishments. The practices that led to the downfall of these companies were bad for business and undermined investors' confidence and trust in the effectiveness of boards of directors, auditors and regulators. The financial crises following the debacle of sub-prime mortgage market in the US is another example of how excessive risk taking by some financial institutions dragged the US and European economies into the worst recession since the 1930s. All these cases have their roots in poor corporate governance systems in the company or the ignoring of some of the basic provisions of good corporate governance by the managers and board members.

An effective corporate governance framework will ensure that the interests of all shareholders (including minority shareholders), investors and creditors are protected. If investors and creditors are assured that their investment in a company is safe, they will be more willing to hold shares and bonds of the company. The borrowing cost for the company will be lower and its access to external finance will improve. Foreign investors, too, will be happier to invest in companies with better corporate governance. Good corporate governance will ensure that the company produces regular and accurate financial information that will portray the company's real financial position and provide timely information for creditor, investors and the market. A good corporate governance framework will clearly establish the role and responsibilities of the boards and directors, ensure that the company's finances are in order and risks facing the company are properly assessed by professionals and excessive risk taking is avoided. Members of supervisory boards or boards of directors will be appointed on the basis of their expertise, and not their connections, and will be expected to carry out their duties in the long term interest of the company.

Although there are different types of governance systems around the world (different types of board structure, different legal and cultural traditions, rule-based or principle-based, etc.), the underlying principles of good CG remain the same - they aim at improving the confidence of investors in the boards and their effectiveness so that companies can have access to external finance and pursue long term growth policies. This confidence and trust will enable the international capital market to flourish and activate the inactive savings of millions of citizens, thus creating not only wealth for companies and its owners but also jobs, prosperity and growth for the economy as a whole.

Over the past two decades, many academics and professional organizations have studied the relationship between good corporate governance and performance of companies. Although there are many challenges in studying this relationship[28], it is now generally accepted that the most significant and reputable studies show that better governed companies, those with better systems of corporate governance, perform better too.[29] We report briefly on some of these studies.

In the short term, improved corporate governance reduces the company's risk premium which, in turn, improves the valuation of the company immediately. McKinsey's *Global Investor Opinion Survey* (2000, updated 2002) of 200 institutional investors reports that 80% of these investors were prepared to pay a premium for companies with good corporate governance systems (the size of premium depended on the institutional and legal environment –11% in Canada with well-established legal and institutional framework and up to 40% in Egypt and Russia where the regulatory environment is weaker).

But improved CG will have a longer term, and more important, effect on company valuation and performance through its improved decision making process, oversight and accountability. One of the most quoted and most influential academic studies in this area is Gompers, et al. (2003), based on the study of 1500 US companies, using 24 governance indicators developed by Institutional Investors Research Center. They find a positive relationship between the corporate governance ranking and company valuation and profits in the 1990-1999 period. The results were confirmed by another influential study of the same period by Bebchuk, et al. (2004) who used only six of the governance indicators used in the previous study and concluded that there was a positive and significant relation between the governance indicators and company value as well as shareholder return. Drobetz, et al. (2004), replicated Gompers, et al. (2003) for German companies and arrived at the same conclusions.

Similar results were obtained by researchers who used corporate governance measures developed by other ranking organizations. Bauer, et al. (2005), e.g., used the governance indicators provided by Governance Metrics International and found a positive relation these indicators and share prices, company value and profitability. Brown and Cayol (2004 and 2006) used the corporate

[28] These include: measurement problem (how to quantify corporate governance systems, and what measure of company performance to use), cause and effect problem (or endogeneity); the long term nature of the relationship; and the time frame of various studies – just to name a few. The measurement or ranking of corporate governance practices of companies is now a big industry with a number of large professional organizations analyzing different aspects of corporate governance framework of companies and publish regular ranking of these companies. Institutional Investors Research Center, Institutional Shareholder Services, and Governance Metrics International are the best known of these organizations.

[29] It is important to mention that there are a number of studies which do not report any correlation between the corporate governance practices of companies and their performance but (i) these studies constitute a relatively small proportion of all studies, and (ii) their aim is not to argue that corporate governance does not affect the performance of firms but explain the reasons why in some periods and or under certain conditions, the relationship may not be observable. For a good survey of the literature on the topic, see Melvin and Hirt (2008).

governance data from the Institutional Shareholder Services and confirmed the positive relationship between corporate governance and performance (this time measured by Tobin's Q[30]).

But the most extensive study of the impact of good corporate governance has been conducted by Deutsche Bank (2003, 2004a, 2004b, 2005a, 2005b, 2006) covering companies in UK, Europe, America and Asia. These studies have confirmed the positive relation between share prices and the quality of corporate governance and also between the long term governance assessment and the return on equity.

Finally, and from the society's point of view, a good corporate governance system is likely to reduce the level of corruption in a country and benefit the country as a whole. If good corporate governance provisions regarding the appointment of board members, including independent or non-executive members, boards' duty of oversight, transparency, insider trading, clarity of ownership structure, and related party transactions are adhered to, there will be less room for nepotism, self-enrichment of boards and mangers, and siphoning off of company profits for personal gains.

It is sometimes argued that compliance with the requirements of good corporate governance is costly for companies and will be at the expense of their profits. It is essential to emphasize that although there is an initial cost in establishing the structures of good governance and complying with its provisions, the benefits mentioned above, will by far outweigh the initial costs and ensure that the improved profits and valuation of companies accrue to its owners.[31]

We now discuss the development of the corporate governance framework in the three countries.

Iran

Corporate governance and its importance is a relatively new subject in Iran, having come to public attention with the first attempt by the Tehran Stock Exchange to develop the first draft of a code of corporate governance in 2004, the last year of President Khatami's government. With the election of Mr. Ahmadinejad in 2005 and the removal of the Head of the Exchange, the momentum to develop the code was lost. The discussion of corporate governance was kept alive in the capital market institutions and in the academic circles. The OECD Principles of Corporate Governance was translated into Farsi in 2008 and enabled a wider audience to gain knowledge of the principles. In 2010, the Securities and Exchange Organization completed and formally adopted the Code of Corporate Governance but it implementation in the companies is not compulsory yet. The Tehran Stock Exchange is well aware of the importance and relevance of the Code but it has not ratified the Code yet, a decision which would require companies quoted on the stock exchange to observe it. However, the Securities and Exchange Organization, being aware of the resistance of TSE companies to adopt the Code, has used other methods to force the companies into observing some of the principles of good governance. To this end, it has drawn up various directives (or regulations) on Disclosure, Internal Control, Investor Relations,

[30] Tobin's Q is a measure of performance commonly used by economists. It is the ratio of market value of a company divided by the replacement cost of its assets (i.e., it shows the relationship between market value and replacement value of a company).

[31] Although this research is primarily concerned with private sector development, it has to be emphasized that good corporate governance should not be seen as a tool for improving the performance of private companies only. State owned companies, too, can benefit from improving their corporate governance framework. The OECD has published a number of guidelines, initially in 2005 and then in 2011, to highlight the importance of good corporate governance in state owned or mixed ownership enterprises. For more details, see OECD (2005, 2010 and 2011).

etc. which require companies to observe them. These regulations also provide TSE with the power to force companies into observing the provisions of the regulations. Legally, companies are obliged to observe the directives from SEO and the violation of these directives are punishable by fine and even imprisonment. However, the level of compliance with these directives is rather low even though the TSE can fine or even 'delist' the offending companies.

In general, Iranian companies have weak corporate governance practices compared to those in industrialized economies. The capital market is relatively new and undeveloped; the institutional shareholders (pension funds, mutual funds, investment companies and insurance companies) now own more than half of the value of publicly traded stocks on the Tehran Stock Exchange though many of these are directly owned or controlled by state institutions. They and other major shareholders exercise their ownership rights (and supervision and oversight) by controlling management decisions directly. Board members are appointed not on the basis of their expertise and merits but because of their political connections and influence (Mashayekhi and Bazzaz, 2008). The minority shareholders' interests are not well protected and therefore the stock market is not very deep.

However, since 2008, there have been a number of seminars, conferences and workshops on corporate governance targeting members of boards of directors, the Tehran stock exchange, Stock exchange Organization, banks, etc. to raise the awareness of the people and institutions who should have an interest in good governance. Further activities in this area, particularly training a group of corporate governance specialists to work with boards is essential.[32]

Pakistan

Since 1999, the Securities and Exchange Commission of Pakistan (SECP) has focused its regulatory instruments on encouraging good corporate governance in order to foster investor confidence, resulting in greater transparency and accountability. In March 2002, the first code of corporate governance for Pakistan was finalized and issued by the SECP. It is now applicable to all public listed companies. In 2010, following extensive consultation with various stakeholders, especially private sector organizations, the Code was revised though the final revision has not been published yet but its publication is imminent. Although the code is principle-based and some parts of it is voluntary, in practice it is mandatory given that the Code is part of listing requirements, external auditors are required to verify the Directors' Compliance Statement under the Code, financial institutions are required by the State Bank of Pakistan and non-banking Finance companies by SECP to observe the Code.

In August 2002, the United Nations Development Program along with the SECP and the Economic Affairs Division of the Government of Pakistan implemented a UNDP-SEC program to create awareness of corporate governance among stakeholders in Pakistan and to ensure the implementation of good corporate governance practices.

In 2006, the International Finance Corporation (IFC) launched the Pakistan Corporate Governance Project to improve corporate governance practices of companies in Pakistan. Also, the Institute of Chartered Accountants of Pakistan (ICAP) has been actively involved in arranging seminars and workshops to raise awareness of the best practices in corporate

[32] Notably the Workshop organised by CGRDC and the Tehran Stock Exchange in December 2008 and the inclusion of a number of corporate governance courses in MBA programs at university level.

governance. Furthermore, a survey of corporate governance practices in Pakistan in 2007 was conducted by the Karachi Stock Exchange and Pakistan Institute of Corporate Governance (PICG). The survey aimed to investigate the extent to which financial institutions and companies in Pakistan followed good corporate governance practices and to raise the stakeholders' understanding of these practices. A majority of respondents were aware of the existence of the Code of Corporate Governance 2002 (PICG 2007). The discussion of corporate governance in Pakistan was even extended to family owned businesses with PICG and the Institute of Chartered Accountants of Pakistan (ICAP) publishing the Guidelines for the Corporate Governance of Family Owned Businesses.[33]

Turkey

The level of awareness and the state of corporate governance framework in Turkey is by far higher and more developed than in other countries under consideration. The Capital Market Board of Turkey prepared the Corporate Governance Principles in 2003 (and updated them in 2005), focusing on the rights of shareholders and stakeholders and the duties of the boards of directors.[34] Although these principles are in the form of guidelines, they have had a major effect on Turkish companies.

The Istanbul Stock Exchange established a Corporate Governance Index in 2007 in order to calibrate the compliance of companies with the Corporate Governance Principles and prevent companies with poor corporate governance practices from entering the stock exchange. The Index has a value of 0 to 10 and companies must obtain a score of at least 6 to be quoted on the Istanbul Stock Exchange. The publication of the Index started in 2007 with 5 companies and has since increased to 34 companies, creating a real incentive for companies to improve their corporate governance processes and, with it, their ranking.

The legal and institutional framework for corporate governance in Turkey has particularly improved in the past few years in parallel with the structural reforms carried out in cooperation with the IMF (IIF, 2005) and the attempt to pave the way for Turkey's EU membership aspirations. The Corporate Governance Association of Turkey (TKYD) was established in 2003 and with 15 corporate and 450 individual members, regular annual conferences on corporate governance since 2008 and many seminars and workshops, it has been very active in publicising the importance of good corporate governance in the business community.

However a major problem remains that the majority of listed companies in Turkey are controlled by single families as the controlling shareholder. There is a general belief amongst the managers of TKYD's national studies in 2005, 2006 and 2009 that while these companies are successful under the founding owners, and even the second generation of owners, only around ten percent of them survive to the third generation. The main reason for this is thought to be the poor corporate governance practices of these companies (especially poor transparency). Clearly, there

[33] Available at www.cipe.org/regional/southasia/pdf/CG_Guide_Pakistan_08.pdf.

[34] The principles consist of four areas: *shareholders* (to facilitate the exercise of shareholders' statutory rights, shareholders' right to obtain and evaluate information, and the right to participate in the general shareholders' meeting); *Public Disclosure and Transparency* (to establish the principles and means for public disclosure, public disclosure of relations between the company and its shareholders, the board of directors and executives); *Stakeholders* (to formulate company policy regarding stakeholders, stakeholders' participation in the company management, protection of company assets); and the *Board of Directors* (to identify the fundamental functions of the board of directors, principles of activity and duties and responsibilities of the board of directors, etc.).

is room for much improvement, especially for the development of guidelines for the corporate governance of family owned businesses.

Table 2 summarizes the progress of the Codes of Corporate Governance in the three countries.

Table 2. Development of the Codes of Corporate Governance

	Iran	**Pakistan**	**Turkey**
Code of Corporate Governance	yes	yes	yes
Date of approval	2010	2002 (revised 2010)	2003 (revised 2005, 2010)
Nature of the code	Non-obligatory	Obligatory	Comply or explain until 2011, but obligatory from 2012
Coverage		Listed companies, financial institutions and non-bank finance cos.	Listed companies
Supervising Authority	Securities and Exchange Organization	Securities and Exchange Commission (State Bank of Pakistan for financial institutions)	Securities and Exchange Commission of Turkey

Source: Authors' compilation

6

SURVEYS RESULTS

In this section we analyse the results of surveys conducted amongst the business community in the three countries. The aims of these surveys were to identify the perceptions of the private sector about the business environment; their views on the privatization process, its impediments and benefits; and finally their awareness of the corporate governance principles and the level of compliance.

Country surveys were more akin to focus group studies – a relatively small group of well-informed businessmen from different sectors of the economy and individuals associated with the business community such as the Chamber of Commerce, banks, consultants and journalists.[35] The surveys were conducted by experienced members of the research team in each country through face to face interviews. A detailed questionnaire focusing on the three main areas of the research project was completed during the interviews. The results of this focus group survey highlight the main obstacles to private sector development and the relative importance of different obstacles in the three countries. As the surveys had to take the specific conditions of each country into account, the questions were not always the same in all countries. We therefore report on some aspects of private sector perceptions separately for each country.

The Business Community's Perceptions of the State of Business Environment

The surveys show that the biggest obstacles in doing business in all three countries are external factors, i.e. factors not under companies' control. These obstacles, which are rooted in the weak institutional and infrastructural development in these countries, particularly affect the companies' competitiveness on domestic and international markets. The respondents were asked to rank the relative severity of different obstacles to business development on a Likert scale. The severity of an obstacle is a weighted average of the respondents' answers for that obstacle, with the weights being higher for the more severe obstacles. These were then converted to an intensity score with a maximum of 100 (most severe obstacles).[36] Radar diagrams are again used to show the relative severity of different obstacles in each country – but here each ray does not show the ranking of one country compared to other countries but the severity of an obstacle in different countries. Points furthest away from the centre indicate the more severe obstacles. Figures 21-23 represent the top five obstacles in each country. Given that the main obstacles in each country are different from those in other countries, it is not possible to have the obstacles in the three countries on one diagram, thus the situation in each country is presented separately.

Figure 21 presents the conditions in Turkey. The top five obstacles as reported by respondents are competition from the informal sector (87) followed by corruption (82), access to external

[35] In Iran the survey included only the business community and none of its associates. In Turkey and Pakistan the surveys included business people as well as people from other organisations. The number of respondents in each country was: 28 (Iran), 34 (Pakistan) and 21 (Turkey).

[36] The same method was used for the analysis of BEEPS data in Section 4 (see footnote 27).

finance (73) obtaining subsidizes inputs from the government in specified sectors (68) and legal framework and law enforcement (67).

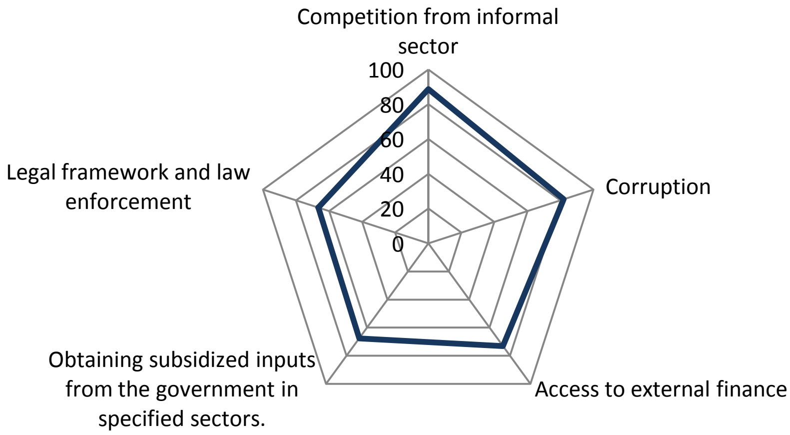

Figure 21. Severity scores for the five main obstacles to doing business in Turkey (maximum score 100, representing the most severe obstacle)
Source: Country survey

On the other hand in Pakistan (Figure 22), the biggest obstacles are obtaining input subsidies and quotas from the government for operating in certain sectors (69 for both), followed by compliance with tax regulation (57), procedures related to obtaining and registering ownership premises (55), and compliance with labour regulations (51).

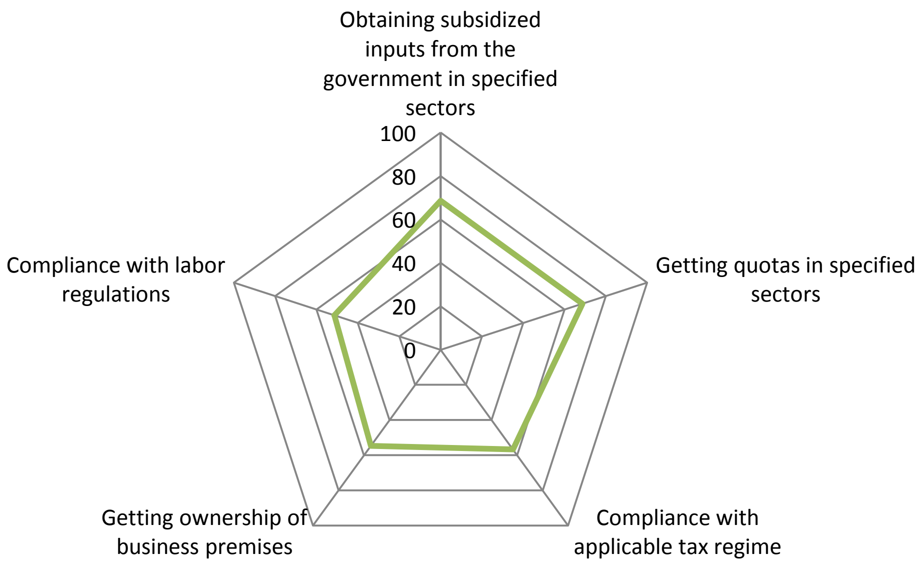

Figure 22. Severity of obstacles to doing business in Pakistan (maximum score 100, representing the most severe obstacle)
Source: Country survey

In Iran (Figure 23), the international sanctions are considered the biggest obstacles to doing business (74) while the uncertainty in economic and regulatory policy is ranked as the second biggest obstacle (73). It is followed by macroeconomic instability (71), fiscal evasion (70) and foreign exchange currency manipulations (54).

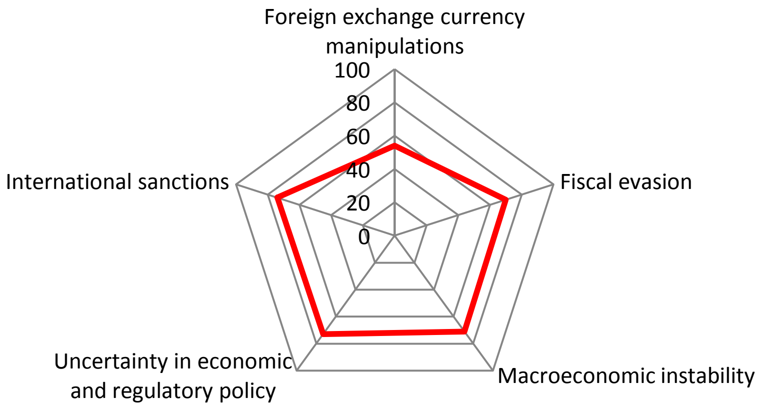

Figure 23. Severity of obstacles to doing business in Iran (maximum score 100, representing the most severe obstacle)
Source: Country survey

The respondents consider the internal obstacles, such as the shortage of skilled employees and managers, as not very important in comparison with external factors – they are ranked at the low end of the list of obstacles. It is not so much that employee and management skills are not important but that in comparison with external obstacles they are ranked lower. Also in countries like Pakistan, companies produce goods at the low technology, low value added end of the spectrum, indicating that their needs for very high skilled employees are limited. Moreover, in an environment characterized by unfair competition from the informal sector and corruption, it is hard to build competitive advantage upon human capital characteristics.

Perceptions of the privatization process

We next present the perceptions of the privatization process and its impediments amongst the respondents. The respondents were asked to express their opinion about different aspects of the process by ranking their response on a Likert scale ranging from 1 to 5. These rankings were averaged for all respondents, using higher weights for opinions expressed more strongly. The averages were then converted to an agreement score ranging, with a maximum of 100, with 100 showing the complete agreement of the respondents with the statement.

The results for a set of statements about the privatization process are shown in Figure 24. In terms of political support for the privatization process, the respondents seem to suggest that in none of the countries was privatization fully supported by politicians. In Iran there is mild agreement with the statement (a score of 61) whereas in the other countries, agreement falls to 45 (Pakistan) and less (41) in Turkey. In terms of a fair and professional valuation for companies in the privatization process, there seems to be a mild agreement amongst the respondents that valuation was carried out professionally. The agreement is stronger in Turkey (61) than in Iran (58) and Pakistan (57). As for the quality of the privatization agency, it seems that the respondents in all three countries agree mildly (but not wholeheartedly) that the staff of these agencies are competent professionals – with scores ranging from 56 in Iran to 65 in Turkey. On the fairness and transparency of the procedures adopted for privatization, there is less agreement in Iran (49) than in others (with a score of around 60). Finally, on the importance of privatization for attracting foreign investment, there was less agreement amongst respondents in Iran (44) and Turkey (42) who are less supportive of the statement compared to Pakistan (64).

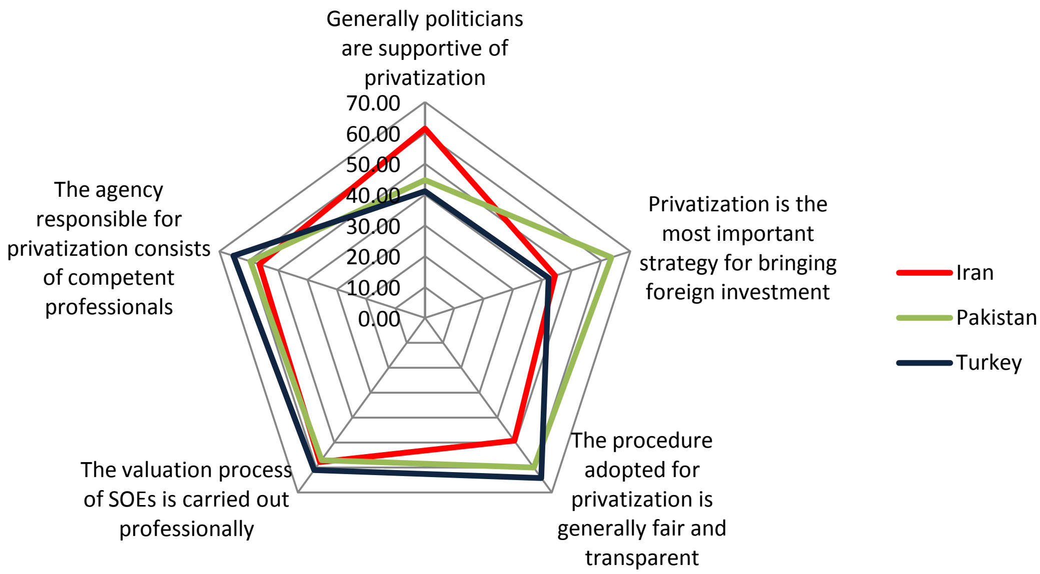

Figure 24. Perceptions of the privatization process (maximum score 100, indicating complete agreement)
Source: Country surveys

The respondents were also asked to rank the impediments to privatization relevant to each country. Here, as in the previous diagrams, the normalised scores show the severity of the obstacle in the statement. Figure 25 represents the extent of agreement with the statement about privatization in Iran. None of the obstacles seem very strong (the ranking shows only mild agreement with the statement).[37] In Iran, the biggest impediments to privatization are the lack of commitment by the government (74), followed by the difficulty of proper valuation of SOEs (72). The third and fourth biggest obstacles are the lack of governmental support to newly privatized companies and the mystification of the privatization process (both 68), followed by the low public awareness of the privatization process (67), and finally the lack of capacity of the private sector (64).

[37] Note that a score of 70 is equivalent to 3.5 on the Likert scale which is not very strong.

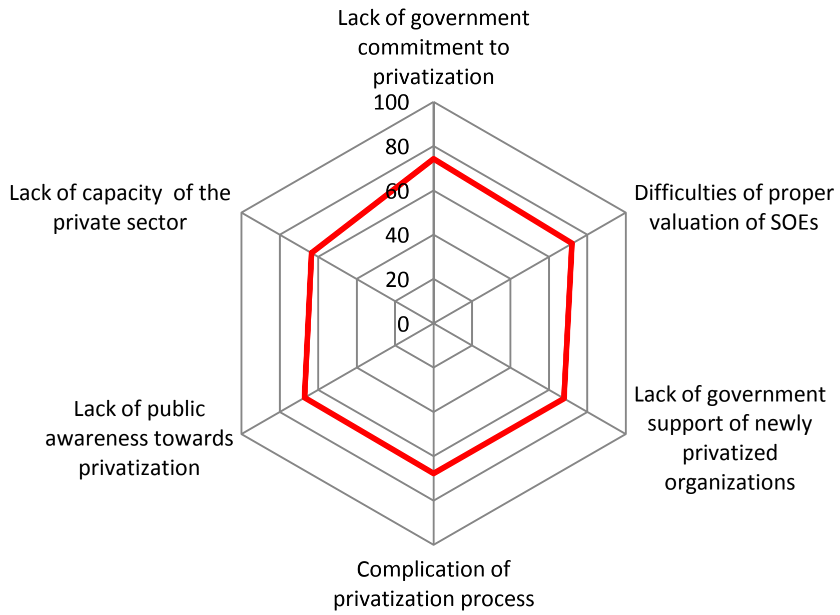

Figure 25. Impediments to privatization in Iran (maximum scores 100, indicating complete agreement)
Source: Country survey

In Pakistan (see Figure 26), the biggest impediments to privatization were the absence of political commitment (78) followed by corruption and vested interests (75), weak public support for the program (58) and a shortage of capital and capacity in the private sector (52). The social opposition (including poverty considerations) (38) is not seen as obstacle to the process.

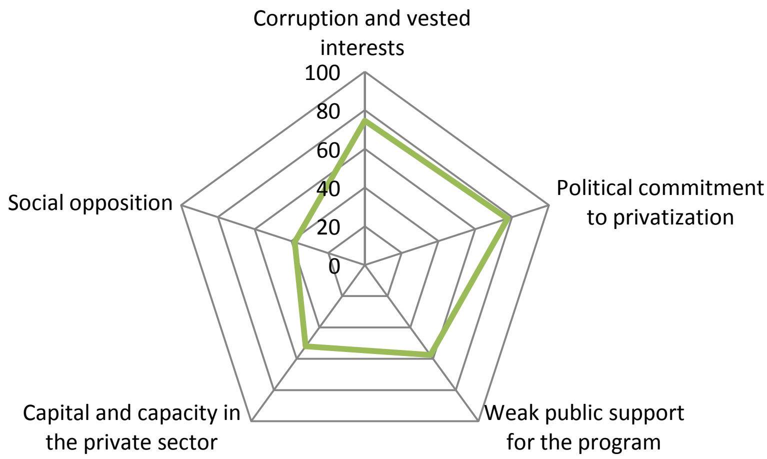

Figure 26. Impediments to privatization in Pakistan (maximum scores 100, indicating complete agreement)
Source: Country survey

In Turkey, however, the respondents did not consider the identified factors to be serious impediments to privatization. As Figure 27 shows, the respondents did not feel strongly about these impediments, the lack of political support for privatization (65), the lack of transparency of the process (64), the shortage of capacity and capital in the private sector (60) and the weak legal regulations (57).

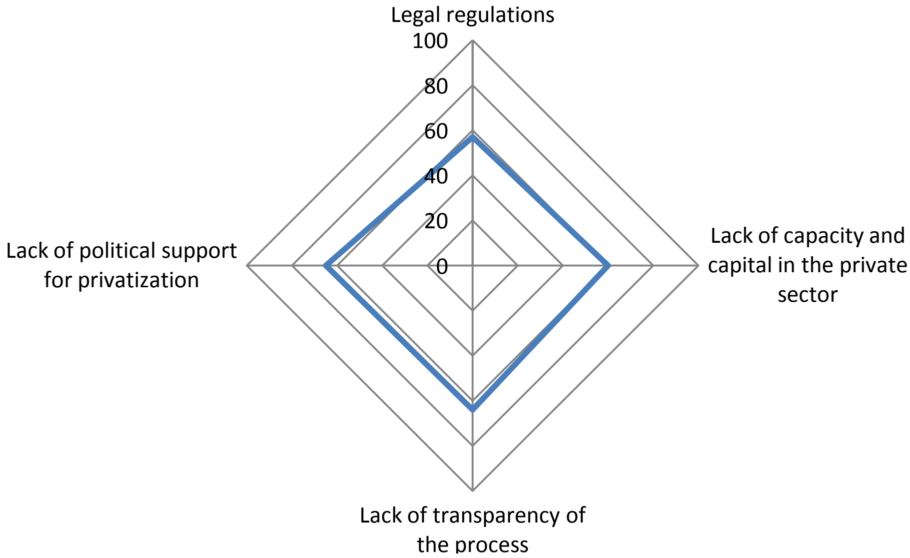

Figure 27. Impediments to privatization in Turkey (maximum scores 100, indicating complete agreement)
Source: Country survey

We have also investigated the perceptions of respondents about the benefits of privatization. Here again, we used a score which expresses the scale of agreement with a particular statement (100 mean that they completely agree). These perceptions are presented in Figure 28.

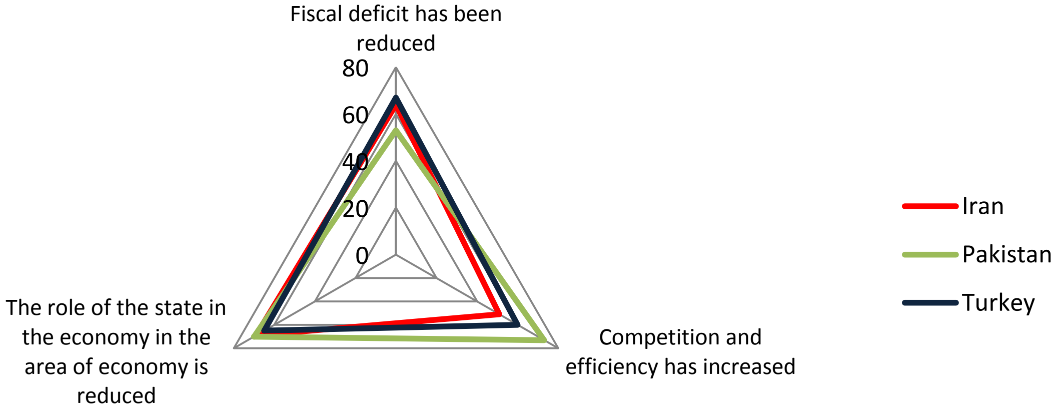

Figure 28. Benefits of privatization (maximum scores 100, indicating complete agreement)
Source: Countries survey

There is a similar pattern response across all countries. Respondents in Turkey tend to agree more (67) when asked whether the privatization process has led to an increase in the state revenue and a reduction in deficit, compared to Iran (64) and Pakistan (53). When asked whether privatization has led to an increase in competition and efficiency, respondents from Pakistan agreed more (73) compared to Turkey (60) where there is only mild agreement and Iran (51) where there is mild disagreement with the statement. Similarly when asked whether the privatization process led to a reduction in the role of the state economic affairs, respondents in Pakistan tend to agree more (70) compared to Iran (69) and Turkey (65).

Corporate governance

The questions related to the corporate governance framework of the questionnaire were different in the three countries and therefore we analyse them separately.

Iran

The survey of companies in this research project confirms that the level of awareness and compliance with the corporate governance code is rather low. Figure 29 summarises the practices of companies in the survey in a number of areas of importance to good corporate governance. This diagram strongly confirms the corporate governance conditions reported by the Global Competitiveness Report and discussed in the previous section. None of the companies in the survey have developed a set of guidelines on corporate governance. None of them have specialized board committees (such as the audit committee or the remuneration committee) either. A large majority (93%) do not have formal procedures and policies to protect minority shareholders' rights. A majority of companies (64%) do not have clear policies on shareholders' rights and a similar proportion (61%) do not have policies that explain the procedures for disclosing audit information and a similar proportion do not publish an annual report. The majority of companies (75%) have independent auditors as this is required by the Commercial Law and 61% of them have formalized codes of conduct and ethics.

One of the main reasons for this poor state of affair is the very basic nature of the Commercial Law in Iran, which was originally passed some 80 years ago and amendment slightly some 40 years ago. Although the Law contains provisions for the establishment of joint stock companies, it is not capable of regulating all the variations in forms of ownership or formulating a suitable governance structure. The idea of a new Commercial Law or Company Law has been on the agenda of successive governments for at least the last ten years and is the subject of discussion in current a Parliamentary Committee but there is no prospect for an early resolution of the issue. The development of a corporate governance culture may also contribute to the enrichment of the discussion of the new Company Law. A Sub-Committee of academics and lawyers is also charged to consider, and prepare proposals for, the corporate governance aspects of the future Commercial Law.

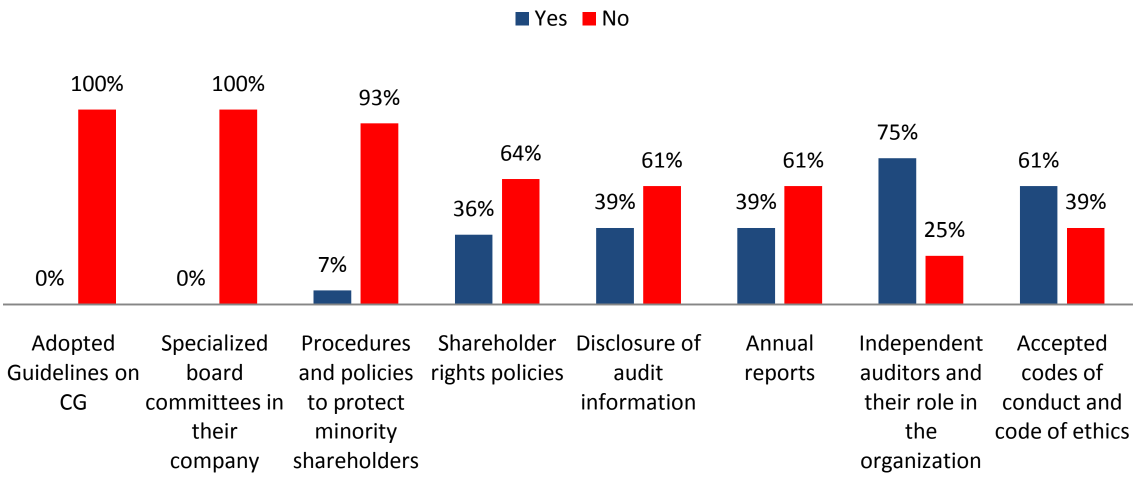

Figure 29. Compliance with various indicators of good corporate governance in Iran (%)
Source: Country survey

Pakistan

There is a greater recognition of the relevance of corporate governance and its importance for economic development in Pakistan. There is also a greater awareness of the concept in the business community. Investors are becoming increasingly interested in the state of corporate governance because the activity of various institutions has raised the knowledge of the relevance of corporate governance for company performance and profitability.

The country survey organised in Pakistan shows that although there is a greater awareness of corporate governance issues in Pakistan (than in Iran), the change from the 2007 survey has been very small. This time, only 59% of the respondents were aware of the existence of the code of corporate governance (even though some of the respondents were well informed consultants and academics). The other 41% either thought that there was no code or that they did not know (Figure 30).

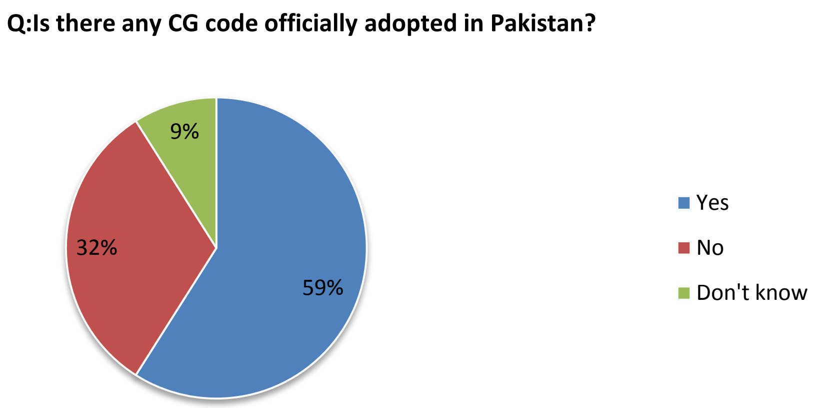

Figure 30. Awareness of the Code of Corporate Governance in Pakistan
Source: Country survey

The respondents were also asked about the impediments to effective corporate governance. The weighted average of their responses, ranked on a Likert scale, was converted to a severity score, ranging from 20 to 100 (with 100 showing very serious obstacles). Figure 31 shows the main obstacles and their severity scores. The biggest obstacle to effective corporate governance is the wide-spread prevalence of family owned enterprises in the corporate sector (92), followed by the low level of shareholder activism and oversight (71). The lack of participation of private sector in the development of the code and the feeling of its ownership was not considered an important obstacle (47). This is not surprising, given that there was extensive consultation with the business sector in the run up to the revision of the Code in 2010. The absence of voluntary private sector associations, with a low score of 36, was not seen as an impediment to effective corporate governance.

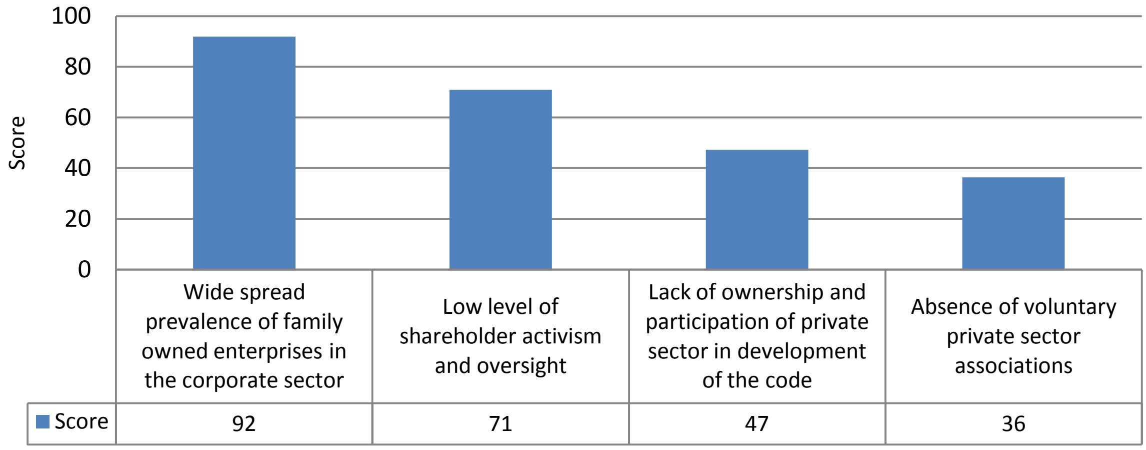

Figure 31. Severity of the impediments to effective corporate governance in Pakistan (maximum scores 100, indicating complete agreement)
Source: Country survey

Turkey

Despite the longer history and more awareness raising activities, the country survey in Turkey shows that the respondents' awareness of the 2003 Corporate Governance Principles prepared by the Capital Market Board is similar to (indeed, slightly worse than) that of the survey respondents in Pakistan. As Figure 32 shows, only 52% of the respondents had some knowledge of the principles of this Code (in Pakistan it was 59%).

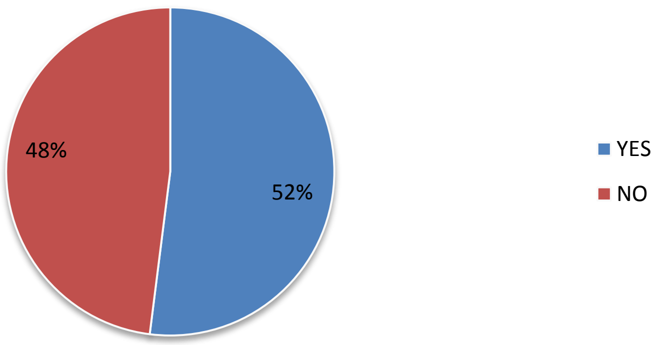

Figure 32. Awareness of the principles of the 2003 Code of Corporate Governance in Turkey (%)
Source: Country survey

7
CONCLUSIONS
and
POLICY RECOMMENDATIONS

The three countries under consideration have recognised, particularly over the past decade, that their economic policies based on the centrality of the state sector have reached their limitations and further economic development has to be based on the expansion of the private sector. The private sector has been developing at varying rates in the three countries despite their difficult conditions. The growth of private sector has been due to both its natural expansion and the privatization of state owned, or socially owned, enterprises.

In Turkey, the private sector has enjoyed a better environment and is more developed than other countries, accounting for 87% of total employment. Iran, despite a long history of private sector and the massive privatization process in recent years, is behind Turkey, followed by Pakistan where the private sector accounts for only 50% of employment. Privatization has been one of the main means of private sector development in all three countries. Here, Iran has had the most impressive privatization program with over $72 billion of state assets transferred out of direct state ownership – mostly in the last six or seven years – ironically, under the present seemingly state oriented regime. But the debate over whether or not these assets have been transferred to the genuine private sector (or remain under government control and influence) continues, with an insider institution such as the Research Centre of the Parliament expressing doubt about the transfer of state owned asset to the private sector. In terms of the scale of privatization, Iran is followed by Turkey with $42 billion and Pakistan with $9 billion. Although in all countries the most important aim of the program was to improve the efficiency of enterprises under the new ownership, over time this aim has changed. Distributional objectives and social justice became the dominant objective in Iran and raising revenue became very important in Turkey.

In Iran, the privatization process has been highly politicised with the bulk of the assets having been transferred on the basis of political considerations, either to make wealth and income distribution more equitable, or to promote the newly developed the so-called 'cooperative sector' (which although is non-governmental, it is not real 'private' either). The recipients of transferred shares have been either the lowest six deciles of the population (through the Justice Share Program) or the religious and military cooperative foundations with unclear and non-transparent ownership structure and with close links to the religious establishment. The transfers to the private sector unconnected to these foundations seem to be very small. More importantly, although the bulk of asset transfer is accounted for by the Justice Share Program, the companies involved have not been truly privatized as the state still holds the majority of their shares and, at least at present, there is no prospect for the Justice Share Cooperatives or their Provincial Investment Companies, as private sector organizations, to take part in the management of these companies. This Iranian privatization program, though seemingly very extensive, is in need of further research before its true dimensions and also its impact on the performance of privatized companies are identified.

Over half of the privatized assets have been transferred to the poorer section of the population under preferential conditions (repayment of the share price through future dividends and 50% discount for the lowest 20% of the population). This is the Iranian version of the mass privatization method widely used in Central and Eastern Europe. However the Justice Share Program and its complicated web of Provincial Investment Companies and Justice Share Cooperatives will leave the privatized shares not under the management of professional investment companies but under the control of the groups constituting or representing the recipients of Justice Shares and not the actual recipients themselves.

The Justice Share Program suffers from serious corporate governance problem as there is no mechanism to ensure that the privatized companies will improve their performance under the influence of new minority owners. There is also every indication that political considerations, and not the performance of privatized companies, will dominate the decision making process in privatized companies.

The Business Environment remains poor in all three countries, in absolute terms and in comparison with other countries. In all international surveys, the three countries fall in lower half or lowest quartile of the distribution. Although the individual countries may have made good progress on one or two aspects of business environment (notably Iran's rapid progress on cutting the time needed to start a business), this has been rather exceptional. The overall conditions remain poor and in need of rapid improvement. In Iran, of course, the importance of the business environment has been the subject of much debate in the last year, leading to the passage of a new law on the subject. The country surveys of this Project, consisting of a small focus group of informed stakeholders, confirmed the findings of international surveys. Turkey is the country with an overall better business environment than the other two. This is largely due to Turkey's desire to join the EU which requires it to make its legal and institutional environment compatible with EU legislation. A conducive business environment is a precondition for private sector development and the governments of all three countries are well advised to concentrate on taking immediate measures to improve their country's business environment in order to build investor confidence and attract the badly needed foreign investment.

The knowledge of Corporate Governance and its implementation is rather mixed in the three countries. In Turkey and Pakistan, many companies (though by no means all) are aware of the principles of corporate governance and its importance for the success of companies. There are institutions such as TKYD and PICG which have made significant progress in raising awareness of corporate governance amongst large firms. The principles of good corporate governance are also enshrined in Codes of Corporate Governance in the two countries with both Karachi and Istanbul Stock Exchanges (especially the latter with its Index of Corporate Governance Compliance) being interested in pursuing and promoting good governance. The situation is different in Iran. While some attempts at publicising and promoting good governance have been made by local think tanks such as the Corporate Governance and Responsibility Development Centre of Iran, the broader society, especially the government has been less aware and concerned about this. While in Turkey and Pakistan there is some knowledge of the importance of corporate governance in government circles and large firms, there is much less knowledge of the corporate governance principles in Iran.

The findings of the present research project clearly indicate the low level of awareness of surveyed businesses about CG. It is therefore essential to strengthen the capacity of the three partner institutions, in particular that of the Iranian partners, to promote good corporate governance and in cooperation with other professional organizations to champion the spread of good corporate governance practices. In Iran, there is a large number of family owned businesses and improvements in their corporate governance systems should be a major focus of activity in order to help these companies to survive the succession problem.

Policy Recommendations

On the basis of the above conclusions, the following brief policy measures are recommended for each country:

Iran

- Improve the business environment, particularly liberalising the goods, labour and capital markets
- Following the passage of the new law on improving the business environment, promote the Private-Public Sector Dialogue Council and its work in order to publicise the need for a more conducive business environment
- Speed up the privatization process which has slowed down since 2010, with the real private sector being given some priority in order to create a competitive environment
- Improve the transparency of the privatization process, especially the ultimate beneficial owners of privatized companies.
- Publicise the business case for corporate governance
- Promote the Iranian Code of Corporate Governance and make it obligatory for listed companies to report on their compliance with the Code annually
- Enforce the directives and regulations passed by SEO
- Publicise the need for corporate governance training in regulatory organizations and boards of companies and provide the relevant training opportunity
- Promote the case for good governance amongst financial institutions and require them to observe the Code of Corporate Governance
- Amend the provisions of the Commercial Law (as in interim measure) in order to improve the corporate governance framework of the organizations associated with the Justice Share Program- Township Justice Share Cooperatives, Provincial Investment Companies and the portfolio companies
- Speed up the preparation of the new Commercial Law

Pakistan

- Improve the business environment by continuing the government's economic policies on a long term basis
- Introduce and enforce Code of Corporate Governance for State Owned Enterprises
- Speed up the transparent privatization process which has halted since 2008
- Publicise the business case for corporate governance, particularly amongst the family owned businesses, particularly those in utilities and other large scale activities

Turkey

- Improve the business environment, particularly pay attention to problems of closing down a business, dealing with construction permits and trading across borders
- Continue and speed up the privatization process, especially in the utilities sector while, at the same time, formulate an overall privatization strategy (or ownership strategy) for the future, identifying the government's strategy for different activities currently performed by the state
- Publicise the business case for corporate governance, particularly amongst the family owned businesses

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APPENDIX 1: The Justice Share Program in Iran

In Iran, in addition to the standard methods (sales through tender and sale to management and employees), a unique method of privatization explicitly aimed at improving social justice by transferring the ownership of companies from the state to the poorer section of the population has been developed. This Iranian version of the mass voucher privatization model is referred to as the Justice Share Program. It involves, on the one hand, the allocation of a proportion of shares of selected state owned companies and a mechanism for their distribution to eligible citizens and, on the other hand, the identification of the relevant section of the population as recipients of these shares. A group of 56 state owned companies (including very large companies in manufacturing, telecommunication, banking, shipping, oil and petrochemicals, amongst others) were selected for the program and the proportion of the shares of each company, almost always less than 50%, was also decided upon.[38] The companies in the scheme are referred to as 'justice share companies'. The poorest sixty percent of the population (about 42 million citizens) were to receive justice shares in equal amounts. They were expected to pay for the shares received over a period of time (up to ten years) out of the profits of companies in the justice share program. The poorest 20% were also entitled to a discount of 50% on the price of shares they would receive. The complex system of distributing the shares to eligible recipients involved layers of organizations, some of which are still not fully operational. The shares of companies in the scheme have been placed in a basket (similar to a unit trust or an investment fund) and converted into units of the unit trust with approximately 42 million units (each being one 'justice share'), and transferred from the Iranian Privatization Organization (IPO) to 30 Provincial Investment Companies (PICs), one in each province, acting as 'investment fund' managers. The amount of units (or justice shares) transferred to each PIC depended on the number of eligible citizens in its jurisdiction. Some PICs are very large organizations (e.g., the Tehran PIC has over 4 million shareholders) and have a larger share of the basket while others are small with smaller share of the basket. Each PIC is expected to manage its allocated shares on the stock exchange on behalf of the eligible citizens in its particular province. They are also expected to be involved in the management of their portfolio companies if their shareholding is large enough to warrant such involvement.[39] It is of course impossible for the nearly 42 million recipients of justice shares to participate directly in the decision making process of the investment companies which manage their justice shares. Indeed the individual citizens are not direct shareholders of PICs; instead, they are members of 337 Township Justice Share Cooperatives (TJSCs) specifically set up for the program, each encompassing all the eligible citizens of its town. Each individual citizen has one share (justice share) of his/her cooperative. Each cooperative will act on behalf of its members and will participate in the election of the board of directors of the PIC of its province on the basis of the number of shares under its control (or the number of its members).These Cooperatives act on behalf of members and manage their justice shares.

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[38] The median proportion of shares of the 56 companies allocated to the justice share program was 35%. The range was from 1% in two car manufacturers Iran Khodro and Saipa to 50% in Darab Cement Co. With the exception of the latter company, the proportion was always less than 50%. The government can increase the proportion of shares of companies allocated to the program or add new companies to the scheme if the need arises.

[39] The PICs may be involved in the management of their portfolio companies only if their shareholding in these companies reaches a minimum of 10-15% or if some of them work with each other to act as one block. In that case they would be entitled to at least one seat on the board of directors of many companies. It remains to be seen if PICs would or could work together as a block.

The actual shares of portfolio companies would remain with the Privatization Organization until their price is fully paid out of the profits of companies.[40] PICs themselves are to be floated on the Tehran Stock Exchange within one year of their formation. Altogether 42.3 million citizens were identified as eligible for receiving justice shares and were invited, over a three-year period, to join their newly founded local TJCs.[41] In December 2006 the government announced that justice shares were distributed to the first group of 4.5 million eligible recipients. In the following two years, other groups of eligible recipients had responded to the invitation and joined the local cooperative, bringing the total number of recipients to 37.7 million people (89.1% of the eligible citizens). By March 2009 some 15 million had even received dividends on their shares. The first group of 7.3 million received 800,000 Rials (about $80) as dividends for two years (2006-07 and 2007-08) while the second and third groups, about 29 million people, received only 400,000 Rials (about $40) as dividend for 2007-08 only.[42] This dividend was meant to come from the profit of the companies in the justice share program with a proportion used to pay for the price of shares. In reality, the information on the profits of the 56 companies and whether they made sufficient profit to make any payment to shareholders remain rather unclear. According to a recent IPO report (IPO, 2011), for years 2006-08, the companies in the scheme were unable to pay the full dividends payable on justice shares (out of total payable dividend of just over $3.9, they could only pay some $1.6 bil. with the remaining $2.3 bil. remaining as outstanding debt of companies to the Justice share Program).[43] For the years 2006 and 2007, some $300 mil of the distributable dividend has been paid to the Treasury as part payment towards the price of justice shares (some 13% of the payable dividends for these two years). The remainder has been distributed to the holders of Justice Shares. For the year 2008, no decision on distribution was made. However, the indications are that dividend distribution will be halted for a while. Indeed, in an interview in December 2010, a member of the Board of Directors of Tehran Provincial Investment Company declared that there will be no more dividend distribution on justice shares until the price of shares are fully paid. He also stated that the companies in the program have not performed well and their profits have not been sufficient to pay any dividend. The justice share 'honeymoon' seems to be eventually over.[44]

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[40] If, after ten years, the company profits were not sufficient to pay for the shares, PICs are expected to pay for the balance or surrender a proportion of shares to the Privatization Organization. The value of shares of PICs would thus decline and so would the value of shares of cooperatives (in which the citizens are members) and the value of the justice shares in citizens' hands.

[41] The government went through several stages in order to identify the eligible groups of citizens and invite them to register in the TJSCs. The first stage consisted of some 8 million low income citizens who were registered under various programs and were in receipt of benefits (the poor rural population covered under a welfare plan known as the *'Shahid Rejaie Plan'*; those receiving support from the Help and Welfare Committee; and the unemployed veterans. The second stage included all low income rural and nomadic population, about 16 million in all. The third group, some 14.5 million, included government employees, retired government and military personnel and employees of municipalities. The fourth group consisted of 1.3 million people who had made sacrifices for the revolution (the families of martyrs, the injured veterans and former prisoners) and another million citizens in miscellaneous activities (including single women heads of families, mosque workers, students of theological schools, journalists, employees of the Justice Share Organizations, independent carpet weavers, taxi and public transport drivers, construction workers, etc.). The large majority of the recipients are already organized into groups (e.g., *Shahid Rejaie Plan', Martyrs Foundation, Association of Mosques, Association of Friday Prayer Imams,* etc.) which helped the process of identification of eligible citizens. These groups were also used to appoint the founding boards of directors of TJSCs and PICs. The bulk of citizens identified as eligible (89.1%) responded to the invitation sent by the program organizers and registered in their local township cooperatives. For details, see IPO Report, 1389 (2010).

[42] Some 1.4 million eligible citizens have not yet received any dividends as they were either selected at a later date or are still in the process of registering in their local cooperatives. It is not clear if they will receive any dividend in near future.

[43] This is of course very unclear. One may ask why have the companies not been able to pay the Justice Share Program's share of profits if they have made profits,. The company management, despite being appointed by the state, can clearly avoid paying dividends to the Program with immunity. The lack of transparency about these issues is obvious.

[44] 'Goodbye to Justice Share Dividends', interview with Mohammad Javad Sheikh in the daily Ayandeh, 1 Azar 1389 (21 November 2010).

It is important to note that unlike other privatization methods, the justice shares distributed to the citizens have been sold on credit and the government has not collected any proceeds yet. The values stated in Figure 10 are the estimated book value of shares of companies in the program. Also, for the purpose of reporting, the distribution of justice shares, and the shares of companies in the Justice Share Program, appear to have been conducted through the stock exchange (see Figure 11) even though the PICs and most of the justice share companies have not been admitted to the Stock Exchange yet, the shares of justice share companies have not been transferred to PICs, and justice shares themselves are not traded on the Stock Exchange either.

By March 2009, the value of shares allocated to the justice program had reached $34.2 bil. (each justice share being valued between $800 and $900, depending on the number of citizens that would eventually take up their entitlement.

Three features of the Justice Share Program have important implications for the future of companies in the scheme and need highlighting. Firstly, given that the procedures for the election of the Board of Directors in TJSCs and PICs have not been established, the government has appointed the first set of directors for these companies from the institutions and groups which constituted the lowest six deciles of the population (referred to in footnote 32). These are highly politicized and political organizations and certainly not independent of the government. They also have an interest in maintaining the present situation. Indeed, the PICs have already formed an Association of Provincial Investment Companies with a very restrictive Articles of Association, giving themselves a long tenure. The absence of regulations on investment companies and their governance has facilitated this type of self-interested behaviour. Although PICs and TJSCs are private companies, the organizations in charge of them are very close to the government and are likely to pursue government edicts rather than the interest of their members.

Second, the precise role of PICs remain unclear: they may act as investment funds aiming at the restructuring of their portfolio companies by influencing the managers (and replacing them if necessary); or they may be purely financial funds engaged in buying and selling of shares – starting with those of portfolio companies but gradually widening their portfolios to other securities. Given the main objective of the Justice Share Program (improving social justice by enabling the lowest 6 deciles of the population to become shareholders and to receive dividends as additional income), the pressure to change the management of the companies and embark on the badly needed restructuring activities aimed at increasing the efficiency of companies will be weak.

Third, and partly as a result of the second point, the program will have little impact on the corporate governance of companies in the scheme. In a large majority of the 56 companies, the recipient PICs are minority shareholders with little influence on management – therefore the companies will remain state owned and continue to face the same problems as all other state owned companies (low efficiency, poor corporate governance, lack of incentive for restructuring, etc.) with a minority of their shares having been privatized. Furthermore, PICs need to act together as a unit (by providing each other with proxy voting rights in their portfolio companies) if they are to have any influence (and potentially a seat on the Board of Directors). But this seems a long way away at the moment. The corporate governance of PICs will be an important problem too as they have a very large number of members (TJSCs). In TJSCs, with millions of members in some cases, it is not clear how they would ever be able to elect their Board of

Directors – given the provisions of the Iranian Commercial Law which requires a 50% +1 quorum on the first two attempts to organize the general assembly of shareholders. For the moment, and until the justice shares are paid for, the government has assumed the responsibility for these shares and the representation process. The holders of justice share certificates have automatically agreed to the government (or government appointed organizations) appointing the management of TJSCs and PICs. The procedure for the election of these management personnel after the shares become the property of real people remains to be resolved at a future date.

APPENDIX 2: List of Selected Quasi-Governmental Organisations in Iran

Selected List of Quasi-Governmental Organisations (the list includes the main foundations and cooperatives but is not exhaustive)

Revolutionary and religious foundations

Bonyad e Mostaz'afan (Foundation for the Deprived);
Bonyad e Shahid (the Martyrs' Foundation);
15th of Khordad Foundation (5th of June Foundation);
Imam Khomeini Relief Committee
Astan e Ghods e Razavi (the foundation managing the property belonging to Imam Reza's Shrine in Mashhad);
Jame'at ol Zahra;
Zeinab e Kobra Foundation;
Bonyad e Tablighat e Eslami (Islamic Promotion Foundation)
Bonyad e Sandoogh e Bozorg (Great Fund Foundation)
Bonyad e Maskan (Housing Foundation)
Fatemiye Foundation, Qom
Al-Hadi Foundation
Devine Mission Foundation
Martyr Na'imi Foundation of
Baqiat al Salehat Foundation

Military cooperative foundations
The Cooperative Foundation of the Guards (*Sepah*) and which includes, among others, the following well known organizations: Khatam ol Anbia Base (*Ghararghah),* Al-Qadir Institute, *Ansar* Financial and Credit Institute, Mehr Financial and Credit Institute, Samen ol Aemme Financial and Credit Institute, Housing Jihad for Veterans.

The Cooperative Foundation of *Baseej* which includes, among others, the following organizations: *Baseejian* Free Credit Institute; *Noor* Cultural Institute, Housing Institute, *Baseej* Consumer Cooperative, Health and Scientific Services, Mehr e Eghtesad e Iranian Investment Co.

The Cooperative Foundation of the Armed Forces

APPENDIX 3: The Rise and Fall of SADRA Corporation[45]

The shares of SADRA Company were transferred to the private sector in 2003 through the stock market. It was the third largest privatization deal on the stock exchange at the time and the third largest in the history of privatization in the country (after the transfer of Khouzestan Steel Company and Iran Telecommunication Company). However, its privatization did not lead to improved performance and growth; it rather resulted in losses and, if the findings of the audit report are confirmed, the imminent bankruptcy of the company.

SADRA Company was registered in 1985 as a subsidiary of the Industrial Development and Regeneration Organization Holdings (the privatization arm of the Ministry of Industry). It was converted to a public joint stock company and listed in TSE in 1996 with the bulk of its shares held by IDRO. In 2003, SADRA was privatized with the Investment Company of Bank Melli Iran (one of the largest state owned banks) and a number of its related companies becoming the controlling shareholders. Effectively, the company was transferred to a different state-owned company with a different structure of power and influence. However, this initial transfer may be considered as the first step in the eventual transfer of the company to the real private sector as institutional investors such as the pension funds or investment companies were less bureaucratic, bound by less unnecessary regulations, and had better access to capital and with greater flexibility to respond to new opportunities. Moreover, financial institutions can better help these companies to restructure themselves and become more market oriented and profitable.

SADRA was a large company with more than 2,500 employees and over 3,000 additional employees working through contractors, owned several notable properties: a 500-hectare industrial island in southern Iran used exclusively for building ships and marine transporters, and a head office in Tehran claimed to be worth over $200 million. SADRA operated in three major fields: oil, gas and petrochemical projects, marine engineering projects and construction projects. It also holds controlling shares in several large companies, including some in the hotel industry.

A closer look at SADRA's work portfolio shows they were mainly large national projects with the government and various ministries as the main contracting authorities (the clients). Therefore, the performance of the company closely depended on the government's actions which led to the rise and the eventual fall of SADRA. In 2003 and 2004, SADRA registered more than $110 million profits which was reduced to $40 million in the following year. In 2007, SADRA registered losses of $38 million and the collapse was imminent. When listed, SADRA's shares were traded at $2 each and soon they rose to $4.30. Subsequently the share price plummeted and is currently trading at 10 cents.

There is general agreement about the reasons that led to this collapse: major governmental projects were taken away from SADRA and given to other companies and, in addition, SADRA was not awarded new contracts. There are two major views about why this happened to

[45] For the longer and more detailed version of this case study, see Majlis Research Centre (2009b) "The Privatization of SADRA - Lessons from the Largest Privatization Project in Iran", *Specialist Bulletin of Iran's Economy,* No. 4, 1388 (2009), pp. 15-24.

SADRA. The first view, as communicated by directors and managers of SADRA, claims unfair and irrational decisions of the government influenced by special interest groups. The second view blames the problem on weaknesses of the management and its inability to manage its projects. These views are briefly examined below.

The first viewpoint belongs to SADRA's managers. They claim that after the 2005presidential elections, most new contracts were awarded through negotiations rather than through competitive tenders. Moreover, SADRA was not awarded a number of contracts despite having offered more competitive prices and conditions. The company's CEO believes that the new government has been 'unkind' to SADRA because of the pressure from interest groups inside and outside the government. Competitors associated with the Ministry of Petroleum and various investment companies and pension funds of the employees of this ministry (in particular the Marine Construction Co.) are the insiders undermining SADRA and taking away its oil and gas projects. Competitors outside the government are associated with the *Khatom-ol-Anbia Base* (a major infrastructure construction company related to the Cooperative Foundation of the Revolutionary Guards). Contracts have been taken away from SADRA and given to this organization because of its closeness to the present Government. There was a third group of competitors who had been interested in buying SADRA at the time of privatization, had asked them to facilitate the sale of SADRA to these companies at a low price, and warned the managers that if they did not cooperate, SADRA will be forced to collapse in the near future and will be bought at even lower prices.

The second view, although rejected by SADRA's managers, blames the inability of SADRA to complete its projects on time and meet its commitments fully. A competitor had claimed that SADRA lacked sufficient expert capacities given that it had expanded quickly into other sectors such as oil and gas, away from its core ship building and marine engineering activities. However, it has also been noted that none of the other domestic competitors was substantially stronger than SADRA and there were no official allegations against SADRA concerning its underperformance. The reasons for SADRA's deteriorating situation, however, have never been officially revealed and there has been no dialogue between SADRA and the authorities to solve the problems. Both explanations of this failure have a common element: the change of government's attitude and behaviour towards the company.

The case of SADRA highlights a number of important issues in the Iranian privatization program:

Firstly, privatization by itself will not necessarily lead to an improvement in a company's fortunes; the appropriate environment is also essential. The most important element of this environment is an impartial government with no self interest establishing a competitive environment. When the government is the major client of a company, privatization may promote the company and may also bring the company down. The transfer of ownership from the government to state-owned or semi-state-owned financial institutions would deprive the company of its privileged position inside a ministry and make it subject to the pressures of various interest groups influencing the government.

Second, the lack of agreement among different political tendencies and decision making bodies about the post-privatization ownership and management structure of major companies in the country has been a major contributory factor to the demise of SADRA. It seems that while one tendency of the political system has been willing to facilitate the growth of companies like SADRA, another tendency which is not the beneficiary of SADRA's success wishes to concentrate major infrastructural projects (including oil and gas) in government-related quasi-public organizations, e.g. companies related to Baseej and the Revolutionary Guards cooperative foundations. SADRA and its shareholders and employees are the losers in this game.

Third, the absence of public debate about the failure of SADRA's privatization should be taken seriously. The failure of one of the biggest privatization projects in Iran has never received the publicity it deserves and has not been discussed as broadly as it should have been. The discussion was rather limited to the narrow circles of the stock market and the 20,000 shareholders who suffered significant losses. Public discussions and comments by the critics can contribute to successful privatization. However, the civil society in Iran does not seem to have been offered this opportunity yet.

Finally, fraud, inefficiency and lack of transparency in the allocation of large government projects, which contributed to the downfall of SADRA, will remain the major obstacles to the development of the economy in Iran.

APPENDIX 4: The Privatization of Türk Telekom[46]

The privatization of Türk Telekom has been a milestone in Turkish privatization history. The objective of the Government was to foster a viable and competitive telecommunications sector, to attract world-class partners for Türk Telekom with a view of increasing efficiency and service quality as well as executing the privatization process on a timely basis and on the basis of market conditions. In order to design the most appropriate privatization strategy for Türk Telekom and in search of an effective process, a market testing study was undertaken during September and October 2003. Turk Telekom was converted to a joint stock company in 1994 with 100 percent of shares owned by the government.

Following the market testing study, the Council of Ministers issued a Decree in November 2003 which encompassed the feedback received from the study. It specified that a minimum of 51 percent of Türk Telekom shares were to be offered as a block sale first, with the remaining shares to be privatized through various privatization methods including the public offering. With the enactment of Law No. 5189, the foreign ownership restrictions were lifted, the scope of the golden share was restructured and the satellite business of Türk Telekom was separated from the company to function as a separate public entity.

The Privatization Administration launched an information dissemination program prior to the official tender announcement to inform the interested parties about the forthcoming process and provided them with the relevant information about Türk Telekom. Eleven national and international companies registered in the process and they were provided with operational, legal and technological data of Türk Telekom as well as the upcoming privatization process.

A subsequent Decree of the Council of Ministers issued in 2004 authorized the sale of 55 percent of Turk Telekom by block sale method and set the deadline of 31 December 2003 for the tender announcement. It also authorized the Türk Telekom Tender Commission to apply pre-qualification criteria during the tender process.

The formal tender for the block sale of 55 percent of Türk Telekom shares was announced on 25 November 2004. Bidders were required to satisfy the pre-qualification criteria determined by the Tender Committee. Applications for pre-qualification were delivered to the Privatization Administration by 11 January 2005 whereby 13 national and international bidders were deemed qualified. The due diligence and data room process was conducted in the period February-April 2005. Four bids were submitted by the bidding deadline. The Tender Committee first evaluated the business plans of the four bidders, all of whom had received satisfactory points on the initial evaluation, and invited them to the opening of the financial bids on 1 July 2005. Oger Telecoms Joint Venture Group (a consortium led by Saudi Oger and Telecom Italia) submitted the highest bid, with $6.55 billion, and the Etisalat Joint Venture Group the second highest bid with $6.5 billion for the block sale of 55 percent of Türk telekom shares. The result of the tender was approved by the Council of Ministers and was published in the Official Gazette on 2 August 2005.

[46] We are grateful to the Investor Relations Office of Türk Telekom for supplying detailed information used in this case study.

The Share Sale Agreement, the Shareholders Agreement, the Share Pledge Agreement and the Concession Agreement (lasting for 21 years) were signed on 14 November 2005. With the signing of these agreements, 55percent of Türk Telekom shares were transferred to Oger Telekomünikasyon A.Ş. and consequently, Türk Telekom ceased to be a state owned company. The Concession Agreement was signed on the same day between Türk Telekom and the Telecommunications Authority. The sale was selected by the "Acquisitions Monthly"; an international prestigious finance journal, as the "Emerging Market Deal of the Year 2005", the first time that a Turkish merger and acquisition transaction has been awarded at this status.

Following the completion of the block sale, and on the basis of the Council of Ministers Decree No. 2003/6403 which had stipulated that the timing of the amount of shares to be sold through public offering would be determined after the block sale, preliminary studies regarding the privatization of the some of the remaining shares owned by the Treasury commenced. Within this framework, the Council of Ministers Decree No. 2007/12973, dated 10 December 2007 stipulated that 15 percent of Türk Telekom shares would be privatized through public offering by 31 December 2008. This would be divided between domestic investors (with some allocation reserved for employees of the company and those of the General Directorate of Postal and Telegram Services) and foreign investors. In practice, the IPO shares were allocated in the following proportions:

- Employees of Türk Telekom and post office: 7.35% PTT
- Foreign investors: 61.05%
- Various groups of local investors: 31.6

The IPO of Türk Telekom constitutes not only the largest IPO ever in the Republic of Turkey, but also the largest telecoms IPO globally in the previous four years. Türk Telekom has been trading on the Istanbul Stock Exchange (ISE) under the symbol TTKOM since 15 May 2008.

Oger Telekomünikasyon remains the largest shareholder of the company with 55.7%, the Treasury still retaining 31.8% of the shares and a free float of 12.5% (of which some 78% are in the hands of foreign investors) being traded on the market.