UNITED CONSULTING GROUP

Privatization in Healthcare & Education Sectors

January
2018

Executive Summary

Benefits of Privatization

To achieve Vision 2030

- Improve quality of service, reduce costs, attract FDI and improve balance of payments
- Increase private sector contribution in total healthcare spending by 10% by 2020
- Increase private sector contribution to real GDP by 25% by 2030
- Create an attractive environment for both local and international investors and enhance their confidence in Saudi economy.

To help balance the public budget

- The Saudi government has incurred budget deficits for the past 4 years
- 35% (SAR 320 Bn) of public budget in 2017 was comprised of healthcare & social development and education sectors. Historical average has been 36%.

80% privatizations improved efficiency

70% privatizations improved profitability

Based on a research sample

Privatization comes with a host of benefits that reduce financial burden on the public budget, it:

Increases efficiency, improves quality and speeds up decision making.

Leads to the development of capital markets with influx of both domestic and international capital.

Makes industries competitive and promotes effective corporate governance.

Executive Summary

Challenges

Privatizing state-owned enterprises will help in overcoming the following issues:

Contradicting Goals

High Turnover of Labor

The ineffectiveness of Management

Excess Costs

Central Decision Making

Excess Bureaucracy

Fair Book Analysis

Lack of information on operating governmental entities will become a challenge when it comes to valuation

The Rigidity Of Pay Policies

Privatized entities will focus on striking a balance between wages and productivity. Hence wages are expected to decrease in the short run.

Removal of subsidies

Removal of governmental subsidies and increasing price levels might occur as a result of the post privatization resource allocation.

Regulatory Framework

Due to the shift of focus on maximizing profit customer protection and competition framework is in need of scrutiny.

Updating Public Accounts

In order to allow the prospective investors participation public entities needs to alter the accounting updates (audits)

Resources (financial)

The lack of in depth structure of the capital market makes the ownership transfer from public to private difficult.

The inefficiency losses due to regulation distortion and lack of competition implies that privatization yields very minimal efficiency gains for monopolies, and contributes to the minimal yields in the short term.

Executive Summary

Approaches

Following pre-privatization strategies, state owned enterprises can be privatized in 3 ways

Pre-privatization Strategy

- Information preparation
- Management evaluation and strengthening
- Adoption of strategies to maximize enterprise valuation like Public Private Partnership (PPP) model

01 Initial Public offering

The enterprise being privatized has to be of **sufficient size and quality** to justify a public sale of shares.

02 Third Party Sale

A trade sale involves the sale of shares of a state-owned enterprise from the Government usually **to a strategic investor**, a company having similar operations and a strategy in line with their overall expansion strategy

03 Mixed Sale

Trade sales and public offers can be combined. Mostly, the entrance of a strategic investor comes first; **the strategic investor helps the privatized company become more efficient and profitable** and therefore more attractive to retail and institutional investors for an IPO.

% of stake to be sold is decided

Executive Summary

Recommendation

Pre-privatization Public-Private Partnership Model

- Start privatization gradually with a PPP model.
- The management prepares the entity for full privatization.
- Sell the stake when the organization improves financially and operationally, raising its market value.
- Government should maintain controlling power through majority stakes or golden shares.

Privatize Overall Healthcare System with a 4 Level Model

- A four level model that consists of 4 phases of health system: Government sponsored, emerging, intermediate and market driven.
- The 1st level starts with a high degree of government involvement in healthcare delivery, service funding and regulations.
- The final phase, level 4, is a market driven health system that involves a majority participation of private sector across in healthcare delivery, funding and regulations.

Upgrade legal ecosystem

- Regulations must enhance transparency throughout the process.
- Extent of government intervention in post-privatization should be clearly defined.
- Establish a central privatization body represented by concerned ministries and stakeholders.
    - Should report to the Council of Economic Development and Affairs.
    - Responsible for overseeing privatization preparation, regulatory framework, timing, method of sale, winning bids and monitoring.

Address Privatization Challenges

- Government should consider reforming the healthcare financing, auditing, and efficiency.
- Develop policies to ensure good quality healthcare and education to most vulnerable groups while controlling costs for providers.
- Hospitals should move towards activity-based or performance-based budgeting.
- Incentivize management and align their goals with national strategic goals.
- Provide employee training to help them excel in new/changed system.

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01

Driving Factors To Privatize Public Owned Entities

Driving Factors to Privatize Public Owned Entities

Privatization is a key factor for achieving the targets of Vision 2030

National Transformation Program 2020

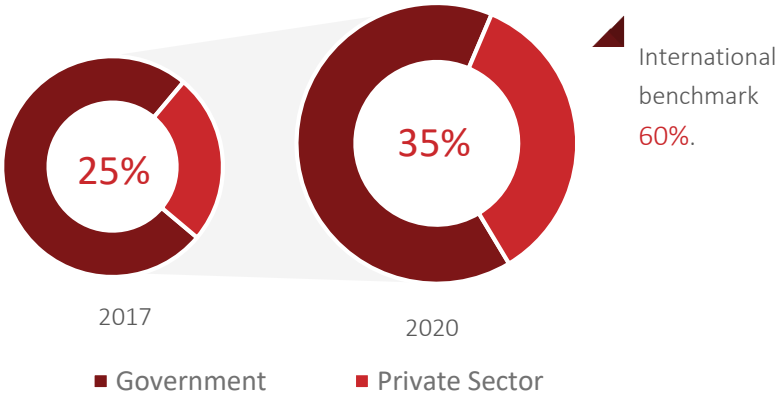
Increase private sector spending through alternative financing methods and service provision.

Create an attractive environment for both local and international investors and enhance their confidence in Saudi economy.

Vision 2030

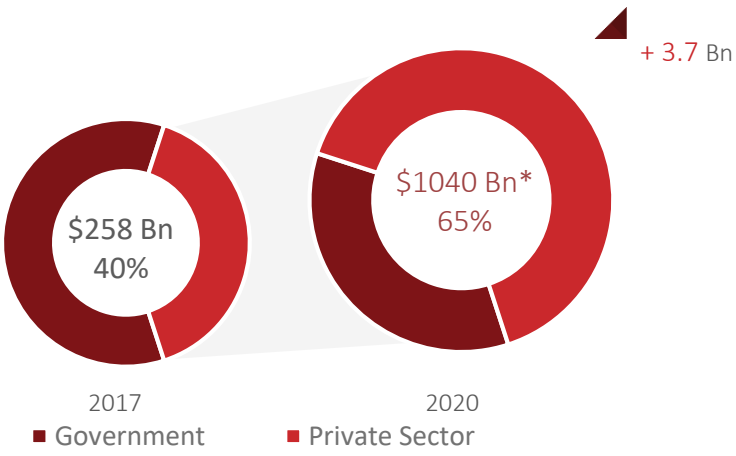
Improve quality of service, reduce costs, attract FDI and improve balance of payments.

Targeted Private Sector Contribution in Total Healthcare Spending by 2020

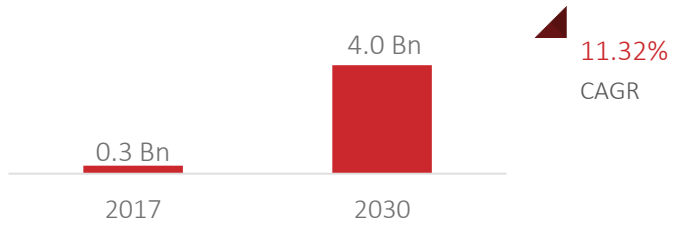


Source: Mckinsey, Vision 2030

Targeted Private Sector Contribution to Forecasted Real GDP by 2030



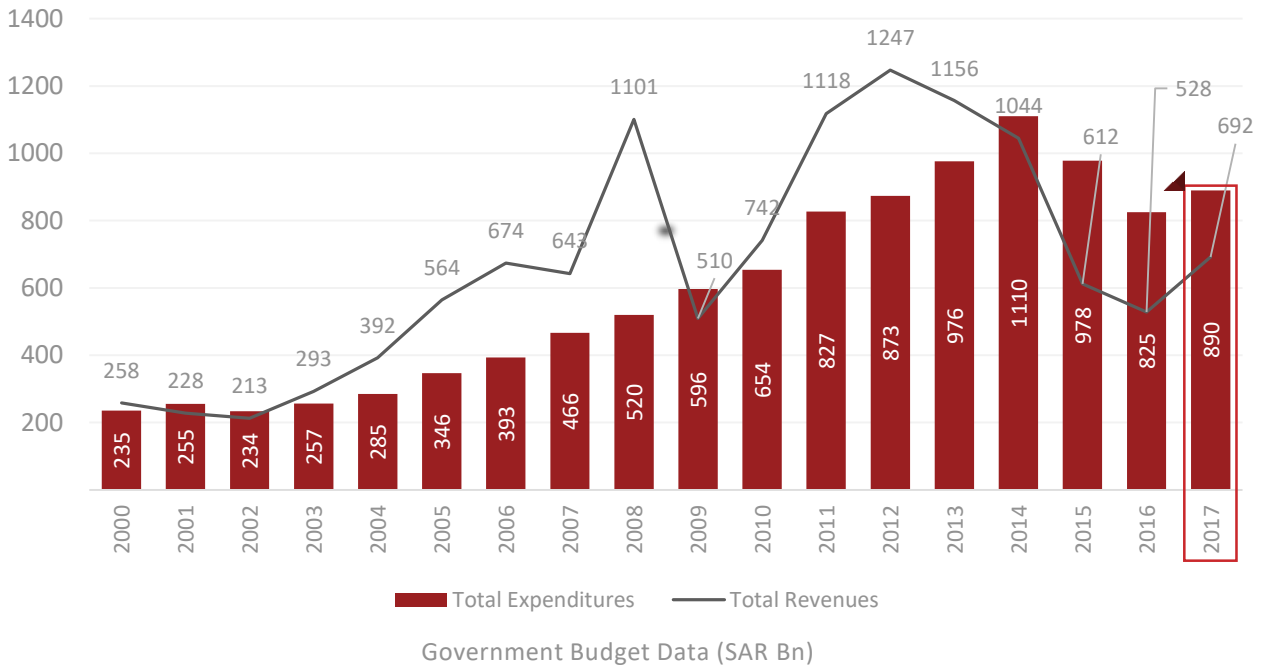
Targeted Revenue from Private Sector for Utilizing Government Health Resources



*Based on target GDP in 2030

The gap between Budget revenue and expenditure

is increasing over the years and the Government is facing a constant fiscal deficit



Government Budget Data (SAR Bn)

According to the national budget of the fiscal year 2017, SAR 200 billion (22% of the total expenditure) has been allocated for the public education, higher education and training. Furthermore, SAR 120 billion (13% of the total expenditure) will be spent on the Health and Social Development sector.

2017 budget figures are forecasted
Source: Ministry of Finance

The Kingdom's revenues

were impacted by fluctuations in the price of oil.

The financial strategy in the medium term aims to achieve a balanced budget by 2020 by increasing non-oil revenues, benefiting from efficiency savings on expenditures and ensuring greater fiscal discipline.

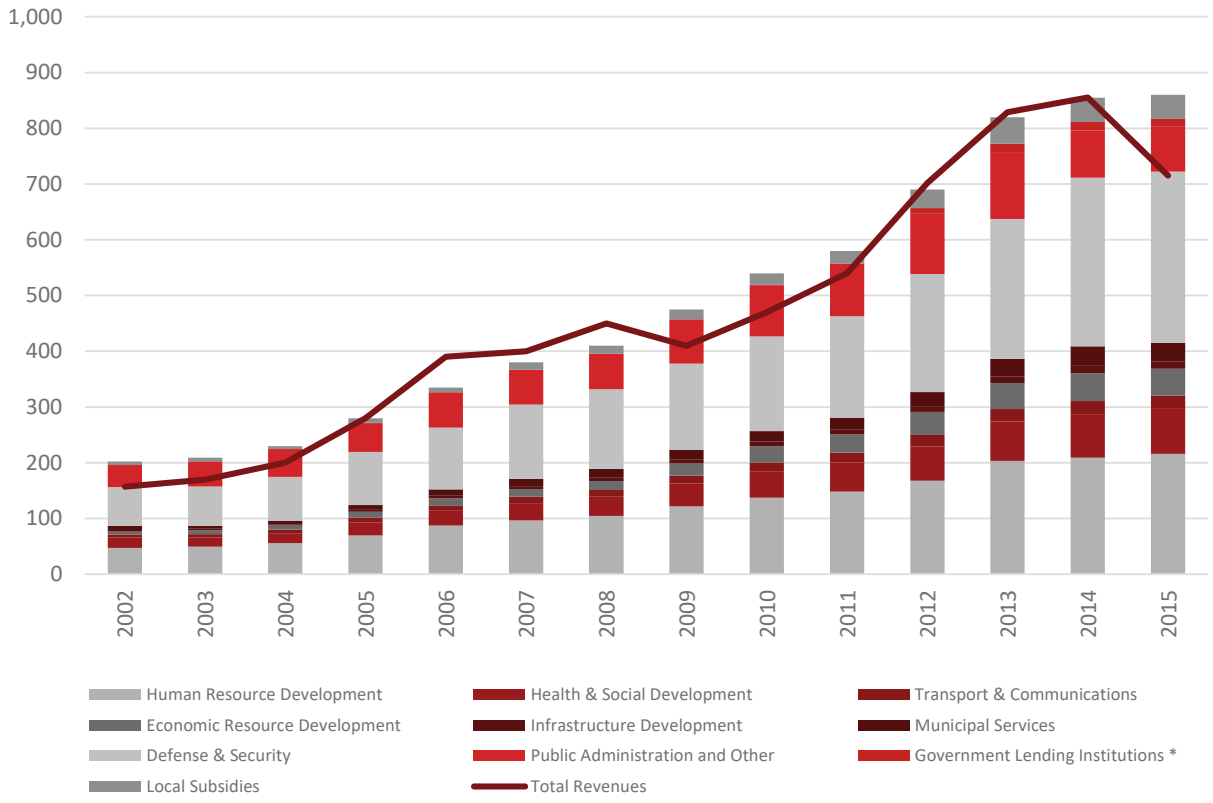
A key objective of Vision 2030 is to reduce government spending and increase non-oil revenues to establish financial stability, diversify revenue sources, increase spending efficiency, focus on projects that have high returns and apply effective systems for performance monitoring and evaluation.

Therefore, identifying economic sectors and activities for privatization, such as the education and health sector will facilitate the structural reform of the Kingdom's finances and reduce the dependence on oil.

Driving Factors to Privatize Public Owned Entities

Privatizing some government services and assets

to achieve budgetary balance is one of the strategic initiatives of Vision 2030



Government Budget Data by Sector (SAR Bn)

Historically, the Saudi government spent about 36% of the national budget on the human resource development and health & social development sectors.

Source: MOF, UCG analysis

Past privatization transactions in Saudi Arabia achieved mixed results

Privatization and the opening of sectors for foreign investors also correlated with a substantial increase in FDI inflows during the 2000s.

At the firm level, some empirical work has shown that the performance of the Saudi Telecom Company and the Company for Cooperative Insurance improved after their IPOs as compared to the pre-IPO financial performance

Compared to other countries in the region, Saudi Arabia's privatization program was limited

	Company Name	Sector	Share Sold
1984	Saudi Arabia Basic Industrial Corporation	Industrial	30%
2003	Saudi Telecom Company	Telecommunication	30%
2004	The Company for Cooperative Insurance	Financial Services	70%
2005	Bank AlBilad	Financial Services	50%
2007	Saudi Kayan Petrochemical Company	Oil and Gas	45%
2008	Saudi Airlines Catering Company	Transportation	49%
	Alinma Bank	Financial Services	30%
	Saudi Arabian Mining Company	Mining and Metals	30%
	Rabigh Refining and Petrochemical Company	Oil and Gas	25%
2012	Saudi Airlines Catering Company	Transport	30%
2015	Saudi Ground Services	Transport	30%
2017	National Commercial Bank	Financial Services	25%

Source: UCG, Bloomberg, IMF, SAMA Annual Reports

Full privatization transfers the financial burden on the private sector

while Semi-privatization reduces the costs incurred by the government significantly.

80% Resulted in improved efficiency

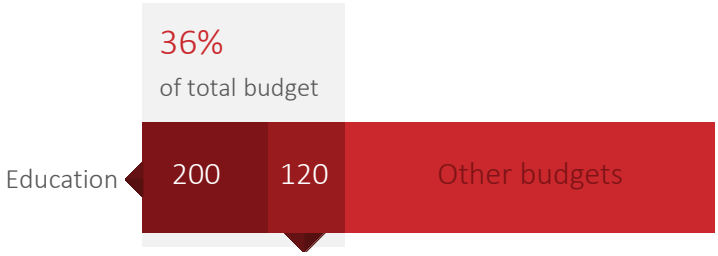
70% Resulted in improved profitability

Based on a sample of 110+ post-privatizations across a variety of countries and industries

There is a symbiotic link between privatization and capital markets development:

faster rates of privatization are associated with **broadening and deepening** the supply of domestic and international capital

01 Lessens burden on government's budget



Saudi Government Budget 2017 (SAR, Bn)

02 Increases efficiency

Private companies have a **greater incentive and capability** to be more productive, more efficient and hence increase their performance. **Private sector runs at a much smaller cost.**

03 Results in higher quality

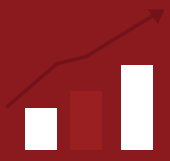
Private sector **competition drives quality** and innovation.

04 Speeds up decision making

Faster decision making due to decreased bureaucracy and speedy implementation of key decisions

Source: UCG, MOF, Economica

The economic benefits of privatization are widely accepted, and can include:



Improving enterprise efficiency and performance

Accessing the capital, know-how and markets which permit growth

Developing competitive industry which serves consumers well

Achieving effective corporate governance

Broadening and deepening capital markets

Securing the best price possible for the sale

02

Privatization Of Healthcare

Introduction

Privatization in the Nordic countries can refer to:

- Selling a public building and equipment to a private company (to be run by a private operating organization, or by a public organization)
- Contracting-out (or 'outsourcing') to a private organization a service which was previously managed by the public sector (e.g. cleaning services in a hospital)
- Contracting a private organization to run a public service in publicly owned buildings with publicly owned equipment
- Contracting a management service to manage a public service (e.g. management of a division of medicine by a private management service company)
- Transferring collection from a public insurance or tax based system to a private insurance system
- Increasing the amount of personal out-of-pocket expenditure for healthcare services or products
- Previously publicly employed professional practitioners offering their services as self-employed or employed by a private organization
- Private companies financing the building of a new facility (e.g. One element in the UK PFI scheme)

Categorization of the public-private mix in the Healthcare sector

	Publicly Financed	Privately Financed
Public Provider	Public hospital financed by public finance, providing care according to need	Private payment to public provider for care for specific patients or groups (e.g. 'pay-beds' or occupational services to an employer)
Self-employed practitioner	Physician paid by public national health insurance contracted or funded by public finance	Physician paid wholly by patients or insurers
Not for profit provider	Hospital or clinic only	Hospital or clinic service paid for wholly by patients, insurers or employers
For profit provider	Hospital or clinic only contracted by a public authority	Hospital or clinic service paid for wholly by patients, insurers or employers

Source: Øvretveit J. 2003 "Nordic privatization and private healthcare"

Case Study

Germany

The German federal states financed infrastructure investments of hospitals in exchange for control over planning.

Background

Since 1990s the German hospital sector has been in an ongoing process of restructuring. The privatisation is mainly driven by the large budget deficits of public authorities at regional and municipal level. They do not have to compensate any longer for the budget deficits of public hospitals and could gain money to tackle other financial problems.

Key Design Components

Sale of Public Hospitals

- The state sold public hospitals to private companies. However, it created a Dual Financing System to maintain strategic control.

Dual Financing System

- Under Dual Financing, all operational costs are covered through reimbursement contracts between hospitals and the health insurance companies, while, infrastructure investments are financed by the federal states.
- Hospitals which participate in the federal state's hospital plan are entitled to participate in the dual financing system. This method incentivized hospitals to let the state plan in exchange for financing.
- The federal states produce and regularly update a hospital plan. The ministry responsible within the federal state works out the hospital plan.
- All citizens are required to have a health insurance. Based on income levels, certain individuals qualify for state funded insurance.

Source: UCG, Pique- PSU

Case Study

Cont. Germany

The state could not cope up with financing demand from participating hospitals

Study Sample

- The German healthcare system was largely seen as ineffective. The dual financing system was seen as a failure.
- Post-privatization, the proportion of private hospitals increased **from 14.8% to 25.4%**. At the same time the share of public hospitals decreased **from 46% to 36%.**
- However, the private hospitals were generally small in size. In **2004** more than **82%** of all private hospitals had less than 200 beds and more than 63% even provided less than **100 beds**. Only about 4% of all private hospitals were larger clinics with **500+ beds**.
- **97%** of all clinics and roughly 80% of all private hospitals belong to the hospital planning scheme. This only increased the infrastructure financing burden on the federal state.
- The annual investment needs of hospitals are up to **€5.5 billion** per year. However, the annual investments of the Federal States only amounted to **€2.8 billion**. The country's hospitals currently suffer an investment backlog of **€30-50 billion**. Public funds will not be able to eliminate the investment backlog and the capital needs of hospitals will continue to mount.

Key lessons learnt from Germany's privatization Failure

Weak Financial Model

Although the German federation's strategy of attracting the private hospitals to participate in the national plan in exchange for partial funding was successful, they did not take into account their ability to support the model. It is crucial to have a strong financial model to be able to support the project.

Source: UCG, Pique- PSU

Case Study

USA

Performance of non-profit hospitals post-privatization improved through efficiency

Background

22 hospitals privatized into non-profit hospitals in 90s

- 6 in Florida
- 5 in Massachusetts
- 11 in California

Average number of beds per hospital was 221

Sample selection criteria:

1. The privatization was of a state or local government, short-term general hospital that had had the same ownership status for at least 3 years before the conversion.
2. At least 3 years of data existed both before and after the acquisition.
3. The converted hospital remained privately-owned either non-profit or for-profit) for at least 3 years following the conversion.

Trends Post-Privatization

Profitability	Operating Margin	Price Mark-up Ratio	Non-operating Margin
Before	-8.79%		5.68%
After	-2.71%		1.87%
Difference	+6.08%	+54%	-3.81%

Increase in operating margins, partly due to aggressive mark ups in prices. Non-operating margins could have possibly decreased due to: Loss of public subsidies post-privatization historically recorded as non-operating revenues or change in reporting standards.

Efficiency	Bed Occupancy	Length of Stay (days)	Inpatient Expenses (growth rate)
Before	59%	5.82	4.00%
After	63%	5.10	0.10%
Difference	+4%	-0.72	-3.90%

Efficiency improved and patient expenses increased at a much slower pace.

Source: Villa & Kane (2013)

Case Study

Latin America

Performance of non-profit hospitals post-privatization improved through efficiency

Liberalization and Decentralization Policies

- Latin American countries (Chile, Colombia, and Mexico) implemented market-oriented health care reforms by;

- Liberalization: Opening of a particular industry to economic competition.
- Decentralization: Transfer of power, resources, or responsibilities to deliver public goods from central government structures to substantial governments or administrative entities.

- Liberalization or market competition aimed at making public and private providers more efficient and responsive to patients' needs through the use of market- based incentives.

- Health care reform policies promoted a closer interaction between public and private organizations. The system was a mix of government and private funds paid for health services provided through a mix of public and private providers.

Two Different Approaches

The main distinction between these two approaches is the sequence and timing of privatization policies.

Big-bang	• Transfers assets and responsibilities to private sector in a short period.	• Rapidly "creates the scale needed for privatized firms to be efficient" in addition to shortening the period of time available for privatization opponents to organize against it.
Gradualist policy-driven	• Gradualist approach minimizes social and economic costs by allowing experimentation with different small-scale privatization programs.	• Policy makers can make "midcourse adjustments" based on the experiments.

Source: Bustamante, Mendez (2014)

Case Study

Cont. Latin America

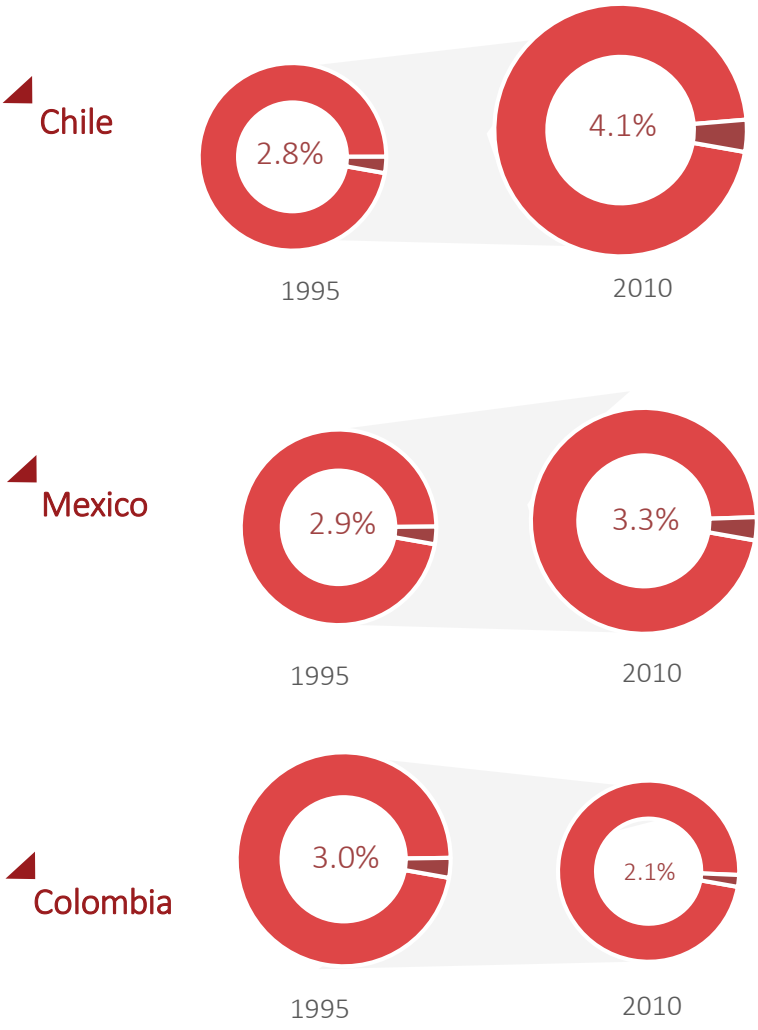
Individuals can opt for either government or private healthcare. Mandatory payroll contributions were appropriately transferred to the chosen sector.

	Approach	Schemes	Healthcare
Chile	Big-bang	• Has mandatory healthcare payroll contributions to public or private health funds • The government transfers all contributions to private payer (ISAPRES) for those who opt out from public payer (FONASA)	Individuals can receive healthcare at both public and private facilities based on their region and level of contribution to the system.
Colombia	Big-bang	• 2 different schemes; a "contributive" system funded through fixed payroll contributions and a "subsidized" system funded through government subsidies; • Individuals receive vouchers from the systems based on their personal characteristics, which can be exchanged with public and private care organizations (EPS) • The government transfers to EPS a share of the contributions	Individuals can receive healthcare with facilities partnering with the subscribed care organization (EPS)
Mexico	Gradualist	• Individuals and their families cannot opt out from payments to social security fund • Individuals who want must additionally pay for private insurance • Public providers receive public funds and private providers receive private funds	Individuals receive healthcare based on their insurance (public or private) from respective providers.

Case Study

Cont. Latin America

Although private expenditures increased as % of GDP, public expenditures increased as well due to increase in financing for universal health policies



Private Sector Healthcare Expenditures as % of GDP

However, privatization in Latin America cannot be characterized as increasing private financing of health care and reducing the growth in public financing as universal health policies increased public spending. Universal health insurance coverage was seen as unrealistic using the social security model.

*Colombia experienced a decline as a consequence of the accounting change of public and private health care resources after health care reform.

Source: Bustamante, Mendez (2014)

Case Study

Apoteket (Sweden)

Apoteket AB is a state owned pharmaceuticals retailer in Sweden which formerly held a monopoly on the retail sale of medicines in Sweden

- In the out-patient pharmacy market, the company provides prescription and non-prescription drugs, merchandise, health services, information and advice to consumers through about **387 pharmacies**
- Apoteket has the largest market share **(33%)** in terms of sales in the pharmacy market with respect to consumer sales
- Ownership is exercised in practice by the Ministry of Enterprise and Innovation through the company management organization. The State's Ownership Policy serves as the basis for governance of Apoteket, along with the Articles of Association, financial targets and owner instructions.

Five-Year Summary	2016	2015	2014	2013	2012
Income Statement (SAR M)					
Net Sales	9,146	8,819	8,355	8,491	9,626
Operating Profit	309	208	154	159	63
Net Earnings	286	206	166	163	104
Key Ratios					
Operating margin	3.4	2.4	1.8	1.9	0.7
Equity/Assets ratio	50.3	60.6	58.4	56.3	37.7
Return on Equity %	14.8	9.2	7.8	10.2	8.8
Return on capital %	29.6	22.7	17.1	16.3	5.0
Average number of employees	3,235	3,318	3,474	3,899	4,540

Source: Apoteket

Case Study

Apotek Produktion & Laboratorier AB (APL)

One of Europe's largest manufacturers of extemporaneous drug formulations

- APL has more than **30 years'** experience of developing and manufacturing pharmaceutical drugs
- APL has an established and close contact with the Swedish healthcare system through manufacturing pharmaceutical drugs
- APL supplies extemporaneous pharmaceuticals to all pharmacy companies operating in the out-patient care market, as well as to inpatient care providers, on equal and non-discriminatory terms.

APL offers services and products in two business areas:

1. **Healthcare & Pharmacies:** Extemporaneous pharmaceuticals - Cytotoxic preparation - Preparation of pharmaceuticals for clinical trials - Development and manufacturing of OTC and branded products - APL branded products
2. **Life science:** Contract manufacturing - Formulation development and manufacturing of clinical trial material (CTM) - Analytical services

Profitability	Return on equity exceeding 8% per year.
Capital structure	Equity/assets ratio of 40–50 per cent.
Dividend	At least 50 per cent of profit after tax for the year.

Source: Apoteket

03

Privatization Of Education

Case Study

Argentina

Private schools deregulation and tax breaks incentivized private sector participation

Background

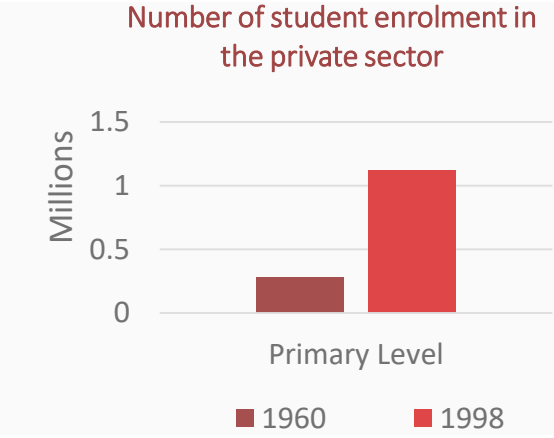
During the first half of the twentieth century, there was inequality between the private and public schools. Students attending private schools were required to be examined by a board composed of public and private school professors in order to be officially recognized and allowed to pursue university studies. Due to regulation changes the enrollment rates in the private sector increased around 1960s

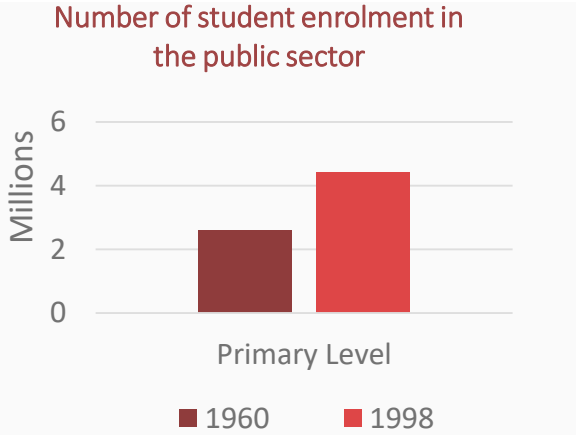
Privatization Process

- Through a direct State aid by means of financial subsidies and an indirect aid by means of tax exemptions for owners of private schools.
- The private sector bears characteristics of a quasi market
- The state allots subsidies to the supply and not to the demand

Governmental Role During Privatization

- Deregulation on private schools
- Hyper regulation on public schools
- The establishment of an independent body called the Servicio Nacional de Ensenanza Privada (SNEP) to supervise private schools





Source: Naradowski, Andrada (2001)

Case Study

Malaysia

The government maintained controlling ownership while private corporations financed takeovers.

Background

In the 80s, a policy shift to the private higher education was established and encouraged in order to actualize the expected growth in higher education system and lift the burden off the state.

Key Design Components

Golden share by Malaysia government During privatization of higher education institutes, the government maintained controlling ownership in the form of Golden Shares. Multimedia and Tenaga Universities are examples.

Financed by corporations: The institutes are financed by large Malaysian corporations in exchange for equity. For example, University Multimedia is owned by Telekom Malaysia, the largest telephone company. Similarly, University Tenaga Nasional is owned by Tenaga Nasional, the national power company.

Fiscal and financial incentives: The government introduced tax incentives to attract private companies to the education sector. It included tax exemption on import duties, sales taxes and excise duties on educational materials.

Partnership with Foreign Universities: The government allowed large Malaysian MNCs to partner with foreign universities to establish their branches in Malaysia. Eg- Sunway Berhad established Monash University, while YTL Corporation established the University of Nottingham. This helped develop private education sector, internationalize education and develop it as an export industry.

Source: G.Sivalingam, FPP

Case Study

Cont. Malaysia

The quality of Malaysian universities improved vastly which helped attract foreign students to Malaysia.

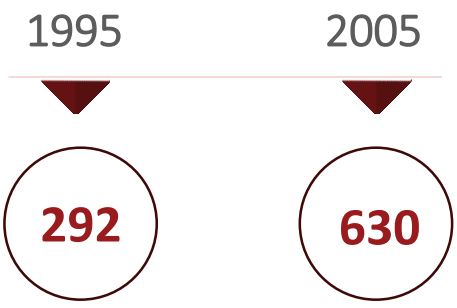
Outcomes

- The Malaysian model was largely successful with **9 Malaysian universities** being ranked in top 300 universities of the world in **2017** as per Times Higher Education.
- The ratio of academic staff to students in private institutions of higher education has been consistently lower than in public institutions. For example in **1997**, when the staff: student ratio in the public institutions was 1:9, it was 1:30 in the private institutions.
- By the end of **2000**, private institutions provided a total of 32,480 places at the degree level, **116,265** at the diploma, **60,840** at certificate levels, comparing favorably to only **47,200 students** in 172 private institutions in **1993**.

TOP 300

UTAR · UPM · Universiti Teknologi MARA · Universiti Kebangsaan Malaysia · Pusat Pendidikan Profesional dan Lanjutan Universiti Utara Malaysia · Universiti Malaya · UTM · UTP · USM Universiti Sains Malaysia

Increase in Private Higher Education Institutes in Malaysia Post-Privatization



Source: G.Sivalingam, FPP

Case Study

Cont. Malaysia

Golden controlling shares and dedicated quality board proved to be key

Key lessons learnt from Malaysia's privatization success

Golden share by Malaysia government

Governments should take control by holding majority or golden shares. This helped the Malaysian government to maintain control of the private universities and keep them aligned to the national strategic objectives.

The Quality Framework

Due to the establishment of a number of universities in a short period, concerns rose regarding the provided educational quality. The government of Malaysia has addressed the issue of quality by setting up the National Accreditation Board (LAN). Both LAN and the Private Education Department in the Ministry of Higher Education, have formulated 56 operational guidelines on the establishment of private institutions of higher learning. These guidelines set standards on equipment supporting facilities and teaching staff to ensure the provision of high quality education.

Exporting Education

The liberalization of the education sector after 1996 has increased the capacity of Malaysia to be an exporter of education. Although Malaysian universities have been open to foreign students before 1996, the numbers of students had not increased until the curriculums were standardized and brought up to the international standards.

Source: G.Sivalingam, FPP

Case Study

Sweden

Reforming education through New Public Management and quasi-markets

- Swedish education reforms in the early 1990s introduced strong elements of privatization and marketization in schools.
- In the early 2000s, the rapidly growing number of students in private (non-fee paying, tax funded) 'free schools', and the restructuring of the free-school sector constitute the most striking aspects of the reforms.
- Privatization and marketization were preceded by a decentralization process starting in the 1970s
- After reforms, the state enforces the legal frameworks that regulate schooling (e.g. adherence to the national curriculum, admission policies etc.), and to set the general goals and aims of education by the Education Act.
- The national curriculum was decided at the central level, and so were the controls of the outcomes and quality of education by the Swedish National Agency for Education, and later the Swedish Schools Inspectorate.
- The direction of marketization points to the creation of a mixed economy of schooling, a quasi-market, where public and private providers funded and controlled by the state, compete over state funding for education, and where there has been a significant transfer of "service production" from the government to the private sector
- Independent schools were by law open to all students who were free to select the school of their choice

Key features of New Public Management in Education in Sweden

Managers

State-run interventions into professional knowledge for managers and school leaders, to some extent connected to marketized ideas around changing identities or roles. They draw on a mix of bureaucratically rooted practices of professional development and new responsibilities around managerial tasks

Managing

- A shift from management by rules to management by objectives.
- Increased focus on outcomes in terms of grades and results on national tests
- Interventions to increase techniques of school visibility through marketing

Management

- A complete and radical reform of the comprehensive state schooling system, to an extensively marketized system where independent (private) and state (municipal) schools compete over student recruitment.
- A highly decentralized system, with a variety of school providers, but central regulation through a national curriculum, syllabi, and legislation

Source: Alexiadou, N., Lundahl, L. 2016. "Reforming Swedish education by introduction of quasimarkets and competition"

Case Study

Cont. Sweden

Education reforms helped in establishing a two-way relationship between the government and commercialized enterprises

- The decentralization reforms, although not necessarily a manifestation of privatization or NPM, were the necessary pre-condition for the introduction of quasi-markets in education
- In 1992 and 1993 the Parliament passed two so-called 'freedom of choice' bills introducing a legal right to parents to select school for their children by introducing a voucher system and generous state subsidies for establishing independent (free) schools
- The rationale behind the school choice reforms was captured by four arguments:

01 To give parents and children maximum freedom of school-choice. This argument was related to international conventions. To ensure such liberty, equal financial conditions between all schools were seen as necessary.

02 To make schools and municipalities more sensitive and accountable to parental wishes.

03 'Stimulating competition' between schools would raise the quality of schools and the whole education system.

04 Market solutions were seen to offer a more effective and efficient allocation of resources.

The education reform facilitated an effective transition to a market economy

- Research studies have reported increasing variations over time in students' performance by socio-economic and gender dimensions, and stronger differentiation between urban and rural schools, as well as between public and private schools having different ethnic and socio-economic intake of students
- By 2010, almost ninety percent of the free schools were run by public limited companies, with possibilities to extract profits for their owners, i.e. without having to re-invest them in the company
- Three of the four largest Swedish companies in the upper secondary sector were purchased by foreign venture capital companies, none of them previously engaged in education
- In the early 2010s, the private school market is dominated by large groups of companies that offer schooling in a 'chain' model.
- In 2015 the largest company, AcadeMedia, has 450 preschools and schools at different levels, 12,000 employees and 90,000 students across the country. In 2013-14 its annual turnover was 679 million Euro, with a profit margin of 7.1%

Source: Alexiadou, N., Lundahl, L. 2016. "Reforming Swedish education by introduction of quasimarkets and competition"

Case Study

Akademiska Hus (Sweden)

Akademiska Hus is a wholly owned Swedish Government enterprise that owns, develops and manages properties for Swedish higher education institutions with its main focus on educational and research activities and student housing.

- The company plays an important role in the objective of strengthening Sweden as a nation of learning and, within that framework, contributing to increasing the supply of researcher and student housing.
- Operations run on a commercial basis and generate a yield that is in line with the market by setting rents that take into account the operating risk. Colleges and universities, which are essentially government agencies, are the source of 90 per cent of the revenue
- The company has contributed to the construction of more than 11,000 student housing units in several cities.

Five-Year Summary	2016	2015	2014	2013	2012
Income Statement (SAR M)					
Property Management income	2,550	2,540	2,556	2,525	2,480
Net operating income	1,650	1,683	1,673	1,578	1,615
Change in value: Properties	1,657	1,195	1,588	104	(131)
Profit before financial items	3,269	2,845	3,240	1,649	1,454
Net financial income (expense)	(247)	(82)	(423)	(176)	(307)
Profit before tax	3,021	2,763	2,817	1,474	1,147
Net Profit	2,317	2,151	2,347	1,156	1,417
Key Figures					
Return on operating capital (%)	6.2	6.9	7.3	7.2	7.8
Yield (%)	5.7	6.4	6.9	6.8	7.1
Net operating income (%)	65	66	65	63	65
Equity/Debt ratio (%)	41.4	40.7	48	46.8	46

In Sweden there are 51 centers of education in 29 towns and cities. Akademiska Hus is by far the largest property owner specializing in Swedish centers of education with a market share of 60 per cent of the total floor space.

Source: Alexiadou, N., Lundahl, L. 2016. "Reforming Swedish education by introduction of quasimarkets and competition"

Case Study

USA

Trends in School Choice and the Privatization of Education

- Privatization of education spurs competition and innovation and produces cost-efficient ways of improving student achievement.
- Since **1990** there has been steady growth in the privatization of education
- Voucher programs can be found **in 6 states** and the District of Columbia and tuition tax credit programs **in 7 states**
- Education management companies (**EMOs**) and charter school organizations (**CMOs**) have franchised school models nationally
- More than **1 million students** are currently home-schooled, up from 300,000 students in **1988**
- More than **1 million students** attend **4,000 charter schools** in **40 states** and the District of Columbia
- Federal law now mandates that students attending schools that fail to make adequate yearly progress (**AYP**) be provided with new schooling options and access to tutoring services

Do the benefits of privatization outweigh the costs?

It depends on three factors:

Finance	How will the program be funded and how will shifting dollars impact students and schools?
Regulation	What are the eligibility requirements and how will education providers be monitored and assessed?
Support Services	What services, such as transportation or information dissemination, are needed to ensure success?

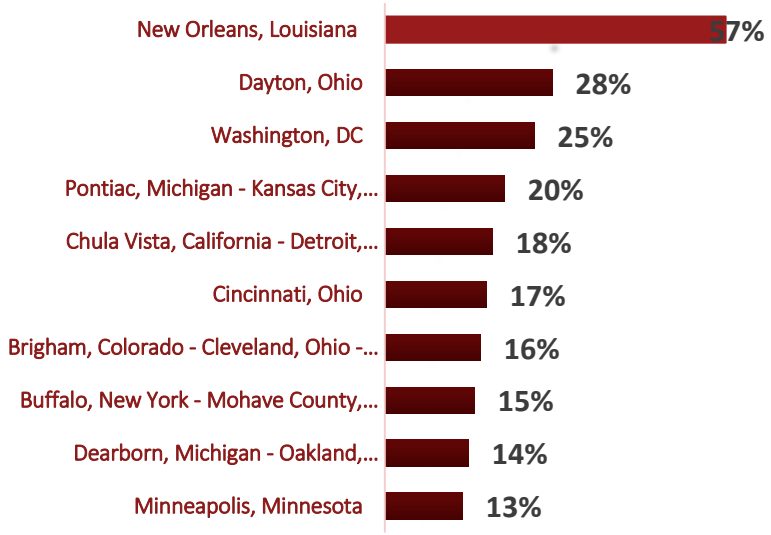
Case Study

Cont. USA

New Orleans has the highest percentage of public school students in charter schools in the united states through the New Orleans publicly funded private school system

- A charter school is an independently run public school granted greater flexibility in its operations, in return for greater accountability for performance. The "charter" is a performance contract detailing the school's mission, program, students served, performance goals, and methods of assessment.
- Charter schools are public schools of choice, meaning that families choose them for their children.
- They operate with freedom from some of the regulations that are imposed upon district schools funded by the federal government. In some states, charter schools serve significantly higher percentages of minority or low-income students than the traditional public schools.
- As public schools, charter schools are tuition-free. They are funded according to enrollment levels and receive public funds on a per pupil basis.
- In some states, such as Alaska, Colorado, Minnesota, and New Jersey, they receive less than **100%** of the funds allocated to their traditional counterparts for school operations. In other states, such as California, additional funds or loans are made available to them. In most states, charters do not receive capital funds to support facility expenses.
- Total number of charter schools is **6,400** compared to **98,236 public schools** and **30,861 private schools**
- In **2014**, the total students enrolled in charter schools was **2,513,634 students**

Students in charter schools across U.S. cities



Case Study

Cont. USA

A strong charter school law is a necessary but insufficient factor in driving positive results for charter schools

There are five primary factors of a successful charter school environment in the United States, as demonstrated by strong student results:

1. Supportive laws and regulations (both what is on the books and how it is implemented)
2. Quality authorizers
3. Effective charter support organizations, such as state charter school associations and resource centers
4. Outstanding school leaders and teachers
5. Engaged parents and community members.

Funding options

01 Funding flows from the state to school districts to charter schools. This option is modeled on the approach in New York with some variations. The advantage of this approach is that it is relatively easy to integrate charter schools into the existing funding system.

02 Funding flows from the state directly to charter schools. This option is modeled on the approach in Minnesota with some variations. The main advantage of this option is that it eliminates the middle man between states and schools.

03 Funding flows from the state to authorizers to charter schools. This option is modeled on the approach in Colorado with some variations.

04

Challenges Of Privatization

Fluctuating economic fortunes influence governments' decision to privatize State Owned Enterprises

Excess Costs

Contradicting Goals

Central Decision Making

High Turnover of Labor

Excess Bureaucracy

The ineffectiveness of Management

Challenges Of Privatization

It is critical to have policies & regulations

to guide the privatization of sectors of the economy where privatization could result in excess market powers

Fair Book Analysis

Critics of the liberalization (diversification of control of state enterprises) argue that there will develop a wider gap between market prices and fair book value, essentially limitations with regards to the availability of necessary Information pertaining to operations of government entities, coupled with the potential risks that will in turn affect the valuation techniques

The Rigidity Of Pay Policies

The pay scales for government employees are higher in comparison to private sectors, and not related to production levels in most cases. So, the adjustment of wages, and in turn a reduction in employment figures as a result of the need by private entities to strike a balance between productivity and wages

Removal of subsidies

Potential removal (elimination) of government subsidies on social amenities (services) utilization, for example, healthcare, etc. Will result in social chaos. Low price levels will on the other hand negatively impact private entities' allocation with respect to resource generation, necessitating alternative income sources for the underprivileged

A broad institution and strategy deficiency

dictate the need for a range of techniques as regards to privatization

Regulatory Framework

Consumer protection is bound to be at risk, and the level of competition also compromised and hence in need of scrutiny

Updating Public Accounts

A majority of public sector/enterprises are in need of accounting updates (audits) to reveal the real value to prospective investors. This has served to slow down the pace or uptake of offers (privatization partnerships) by the government.

Resources (financial)

A lack of an in depth structure (capital market) are making it difficult for the public to private transfer as pertains to ownership. Most banks (financial institutions), domestically are averse to the long-term risks associated with privatization policies and hence exists a lack of clarity with respect to legal and commercial frameworks

The inefficiency losses due to regulation distortion and lack of competition implies that privatization yields very minimal efficiency gains for monopolies, and contributes to the minimal yields in the short term.

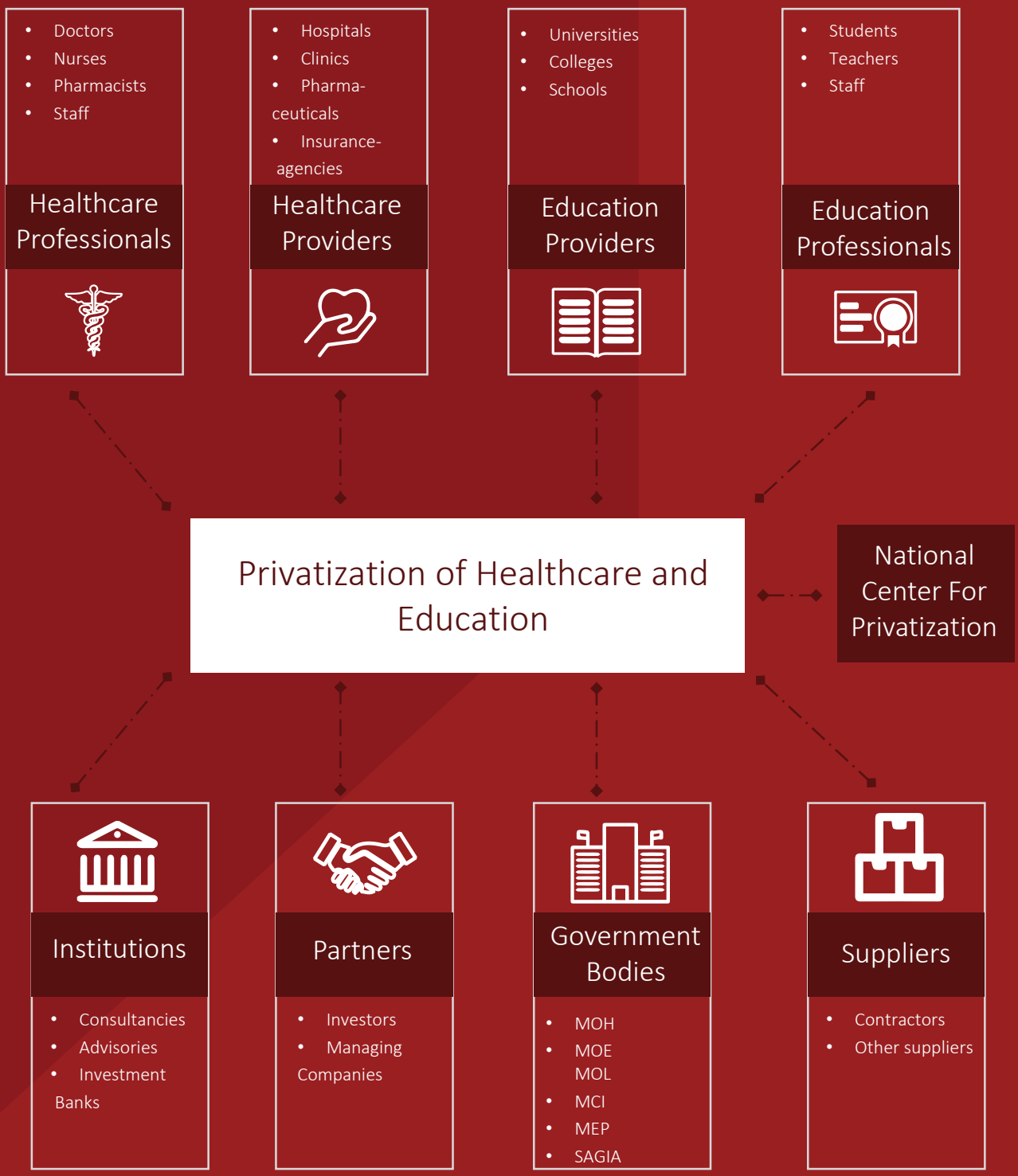
Source: Alhogail, T. (2017). PRIVATIZATION IN SAUDI ARABIA

05

Privatization Approaches

Stakeholder Map

Privatization involves stakeholders from various public and private organizations



Source: UCG

Suggested role of the policy makers in the privatization process

Pre-Privatization

Governance Through Central Body

It is recommended to establish a representative central privatization body that reports to the Council of Economic Development and Affairs.

Privatization transactions can be evaluated on a case to case basis or through a standard framework established by the central privatization body.

Legislative Responsibility

The central body is expected to create the appropriate regulatory framework that promotes transparency and efficient markets and clearly articulates the division of responsibilities among different supervisory, regulatory and enforcement authorities

During Privatization

Oversee Privatization

The central body should oversee the entire process while involving representatives from the concerned ministries.

Regulation Revision

The policy makers must keep revising laws and regulations as necessary to ensure the success of the privatization program.

Post-Privatization

Monitor Post-Privatizations

A monitoring authority should be delegated to respective ministry of the entity's sector. Performance assessments should be developed and practiced.

Developing Institutional Competence and Experience

The teams should study fragilities in established privatization models to strengthen future implementations.

Source: World Bank

Pre-Privatization preparation is key for successful implementations

Central Privatization Body

- Decide if the enterprise should be privatized
- Seek independent advice
- Assess enterprise's privatization readiness

Pre-privatization Strategy

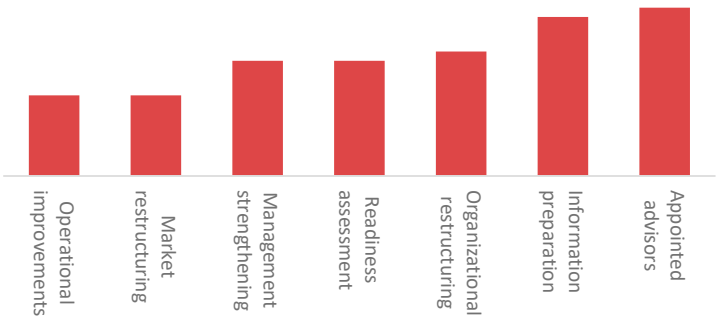
- Prepare information
- Evaluate and strengthen management
- Adopt strategies to maximize enterprise valuation like Public Private Partnership (PPP) model

Based on an E&Y survey of government, management teams and PE who have been involved in privatization transactions from 1995-2010 across Europe

50% **Readiness Assessments**
of **successful** privatization teams did readiness assessments

65% **Information Availability**
of management felt availability of information was vital in preparing for their privatization

47% **Lack of Expertise**
of management and advisors felt expertise in the management team was crucial



Activities undertaken by privatization teams (%)

Source: UCG, EY

Public-Private Partnerships

An Alternative to Immediate Privatization

- PPP method has been used since the 1990s in several European countries in various projects such as highways, schools and hospitals.
- Projects carried out under the PPP approach are a form of cooperation between the public and private sectors in the financing, construction, management and maintenance of a project.
- Under the PPP method, the private sector service provider (contractor) is responsible for asset delivery, financing of the project and the ongoing management/ maintenance of the asset.
- The private sector's returns are linked to service outcomes and performance of the asset over its life cycle.
- When projects generate income during their operation, the contractor receives revenue from the management of these projects as part of a concession agreement.
- An important benefit of PPPs is the risk sharing between the public and private sectors during the design, construction and maintenance of an asset. Moreover, as the contractor does not receive any income before the commencement of operations of a project, there is a strong incentive to successfully run the project within the deadlines.

Public Private Partnership (PPP)

It is an alternative way of the private sector's involvement in sectors of high importance, like healthcare and education sectors which are traditionally managed by the public sector and have large infrastructure projects.

PPP reduces risk for both parties

It replaces immediate privatization by a two stage procedure:

1. An "initial trial" period: A potential investor participates in a (temporarily limited) PPP agreement and operates a state-owned firm/asset to asses "true" risks and "true" profitability without having to make any definite long-term financial commitments.
2. Given that the experiences turn out to be positive, the second phase—regular privatization—then allows the investor to purchase the firm or asset, which are more beneficial for both sides.

Source: IER

Steps of Privatization

Source: PWC, TNI

Privatization Approaches

Steps of Privatization

The enterprise being privatised has to be of sufficient size and quality to justify a public sale of shares. Public offers often raise additional capital for an enterprise through the issue of new shares.

STEP 1

Financial advisers prepare a privatisation plan

STEP 2

Selection of underwriters

STEP 3

Government and public enterprise approve the privatisation plan

STEP 3

Government and public enterprise approve the privatisation plan

STEP4

Government and public enterprise approve the privatisation plan

STEP 5

Launch of public sales campaign and organisation of road shows

STEP6

Book building:

STEP7

Price set by an agreement between government, enterprise and underwriters on the price per share

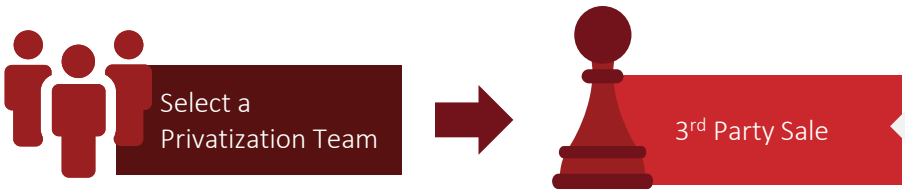
STEP7

Stocks are sold on the market

Source: PWC, TNI

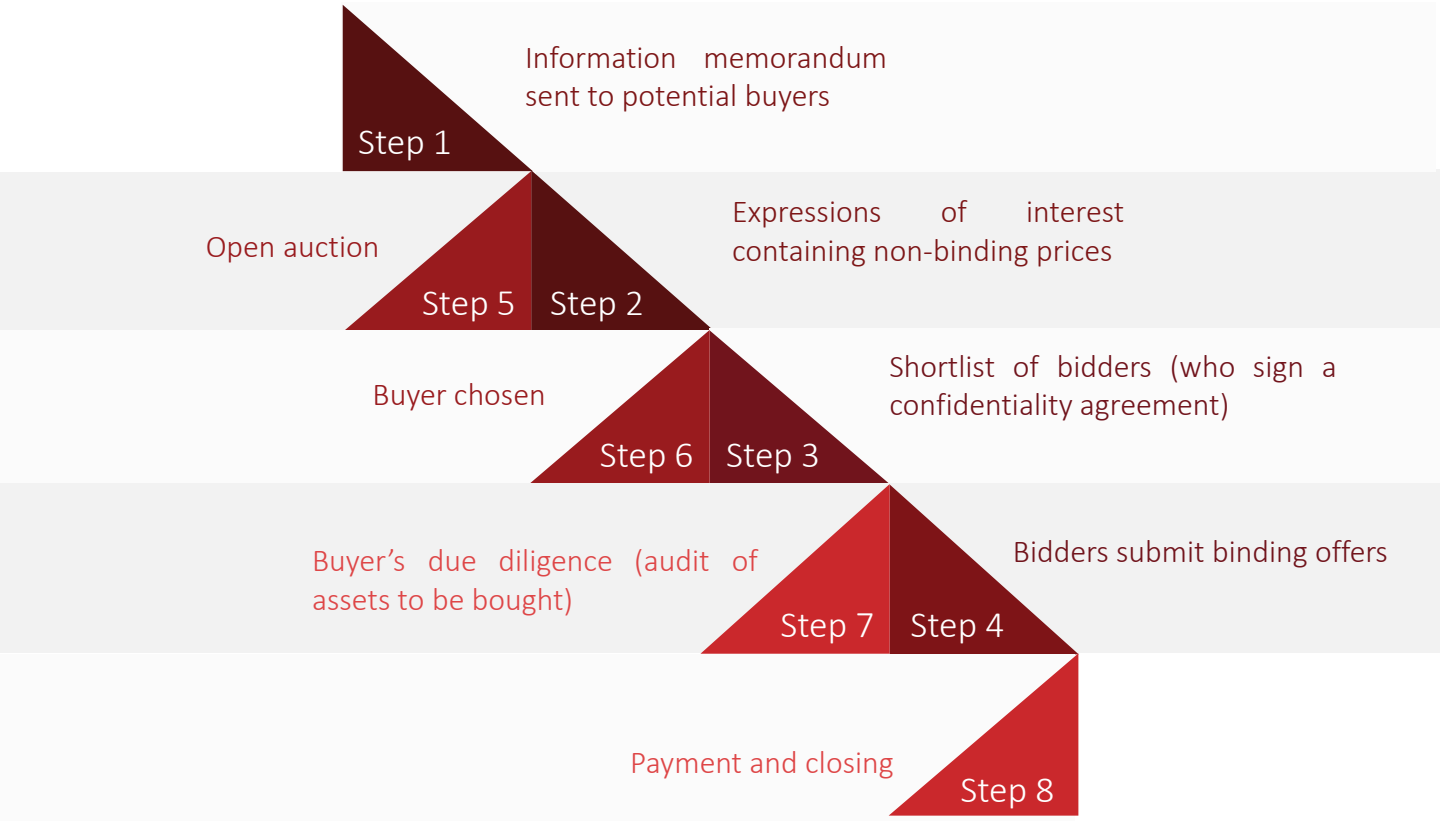
Privatization Approaches

Steps of Privatization



A trade sale involves the sale of shares of a state-owned enterprise from the Government usually to a strategic investor, a company having similar operations and a strategy in line with their overall expansion strategy. It is common for the strategic investor to acquire, as a first step, a minority stake in a privatized entity but with a substantial role in management.

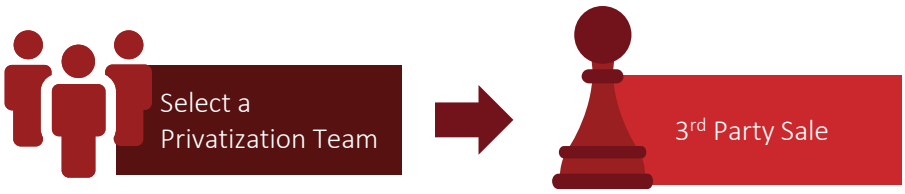
01 Auction



Source: PWC, TNI

Privatization Approaches

Steps of Privatization



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02 Negotiated Sale

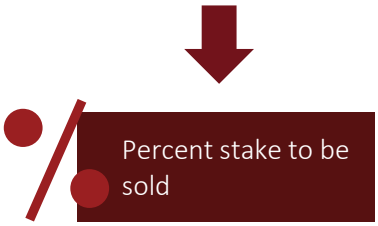
Step 1	Confidentiality agreement signed with buyer
Step 2	Confidential information memorandum sent to buyer
Step 3	Buyer's due diligence
Step 4	Price and terms agreed and approved by Government and enterprise
Step 5	Price and terms negotiated
Step 6	Final buyer's due diligence (Representations and warranties)
Step 7	Payment and closing

Percent stake to be sold %

Source: PWC, TNI

Steps of Privatization

Trade sales and public offers can be combined. Mostly, the entrance of a strategic investor comes first; the strategic investor helps the privatized company become more efficient and profitable and therefore more attractive to retail and institutional investors for an IPO. The Government sells an additional stake of its shares, thereby raising more funds. In some cases, the strategic investor may use the IPO as an opportunity for an exit route for their initial investment.



Source: PWC, TNI

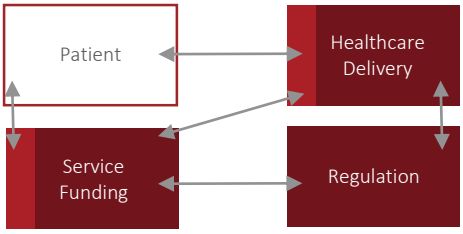
06

Recommendations

Recommendations

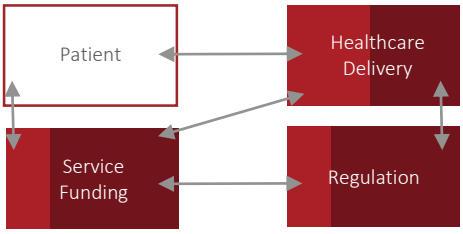
Increased private sector participation in healthcare is essential to increasing the efficacy of Saudi healthcare system while reducing burden on government spending.

Level 1:
"Government-Sponsored" Health System.



- Predominance of public sector activities – Command and Control model.
- Private sector involvement limited to few care providers.

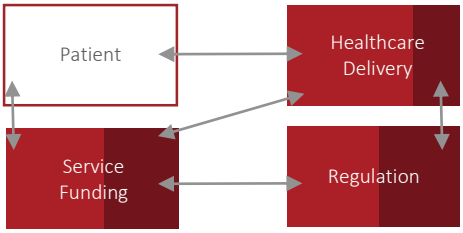
Level 2:
"Emerging" Health System.



- Emergence of private sector involvement in healthcare and increasing private insurance.
- Decreasing burden on government due to private insurance.
- Mounting pressure for establishing a comprehensive regulatory framework.

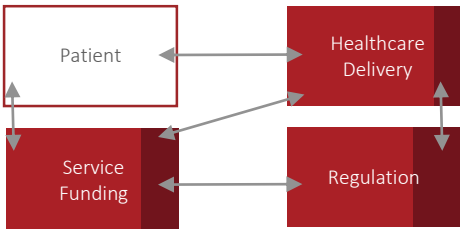
Best-in-class/Desired Health System Position

Level 3:
"Intermediate" Health System.



- Widespread private sector healthcare delivery options.
- Public sector provisioning limited to select patients (e.g., the poor/military).
- Increasing healthcare regulations.

Level 4:
"Market-Driven" Health System.



- Near-absence of public sector healthcare.
- Government role limited to ensuring oversight, with limited subsidies.
- Comprehensive regulations to ensure fair play.

■ Degree of Government Ownership ■ Degree of Private Sector Ownership

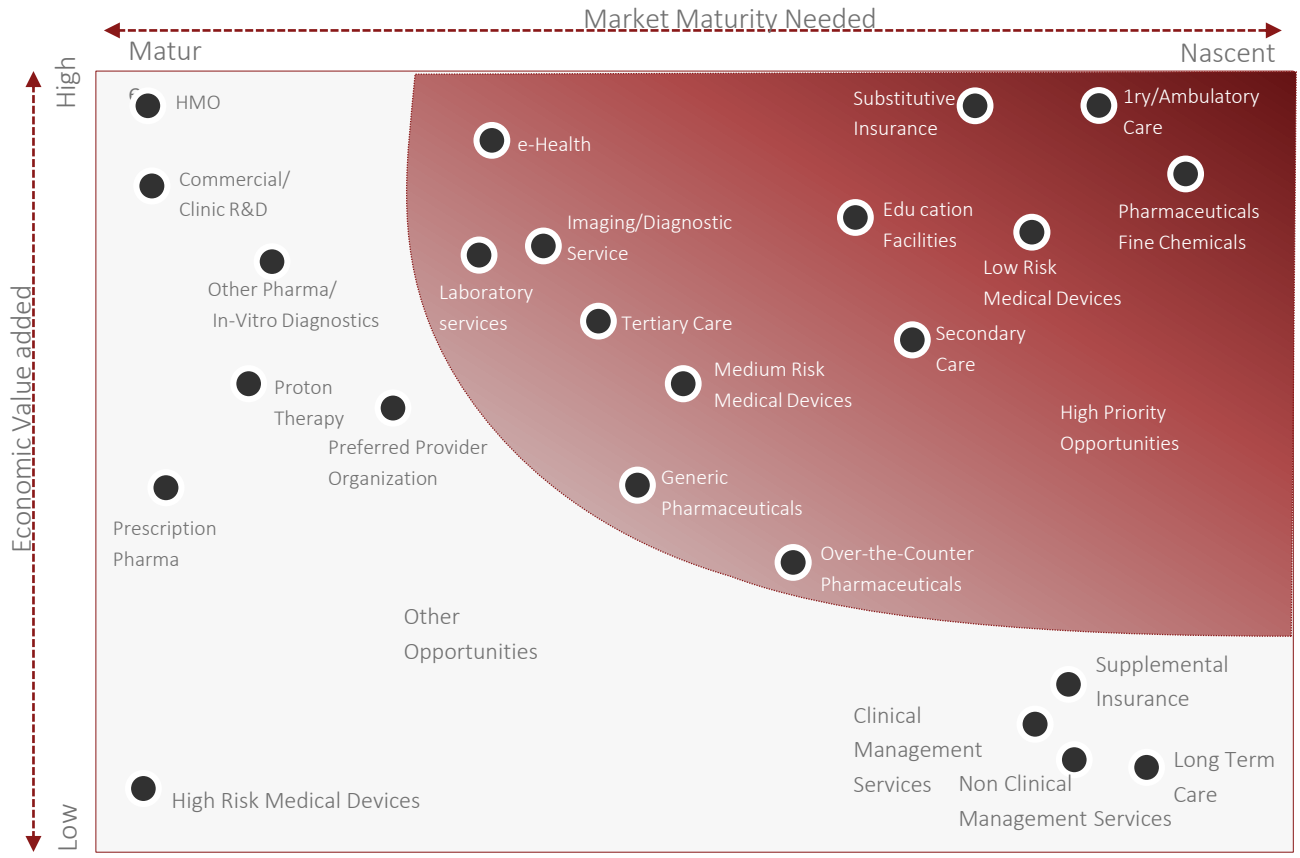
Increasing Private Sector Participation

- The government dominates the healthcare sector in Saudi Arabia. Private sector spending for health care in Saudi Arabia accounts for 25 percent of the total, compared to 55 percent for the U.S. or 76 percent in India.

Source: Booz & Company , 2007

Recommendations

Transition to a market-driven healthcare system will not only be good news for Saudis and the Saudi economy, but also international healthcare providers and investors



- For international healthcare providers and investors, the coming liberalization of the sector will mean increased access to the largest healthcare market in the Middle East, and an exciting opportunity to help millions of Saudis live longer, healthier lives

Source: Booz & Company , 2007

Recommendations

For governments, the first step in delivering a successful program of privatizations is to evaluate and implement the lessons learned from previous exits

- One major concern is that privatization reduces health-care access for low-income individuals, increases the price of services, and leads to cuts in unprofitable services.
- Empirical studies show weal evidence and low scientific validity supporting the argument that privatization could increase access to medical care.

Therefore, prior to privatization, MOH should consider reforming the healthcare financing, auditing, and efficiency.

Also, before hospitals undertake privatization in Saudi Arabia, it is necessary to encourage the move toward activity-based or performance-based budgeting.

After privatization, a policy has to be developed to ensure that the most vulnerable groups have access to good quality healthcare while controlling costs for care providers.

Source: Alkhamis, A. A. (2017). Critical analysis and review of the literature on healthcare privatization and its association with access to medical care in Saudi Arabia. Journal of Infection and Public Health.

Recommendations

Experience shows that success depends largely on the level and depth of the preparatory work carried out ahead of any privatization.

Importance of Regulation

Effective State regulation is important to be in place prior to privatisation and to be further enhanced if needed after a privatisation; privatisations must always be carried out in the context of a strict supervisory and regulatory framework so as to prevent the abuse of a position of monopoly and fully safeguard the interests of consumers.

Strategic Sectors

Loss of State control over businesses operating in sectors of vital and strategic importance is harmful. The State should maintain control of over 50% of the shares or at least maintain a right of veto in strategic decisions ("golden shares"). A study of 110+ businesses privatised showed that approximately 60% had included such provisions in their Articles of Association.

Employee Matters

Terms of employment after privatisation must be analysed to match employee contribution to remuneration, with right motivational elements. Increased profitability will allow improvement of employment terms over time. Employees can be incentivised through their involvement in (i) management of the company, (ii) ownership of a tranche of shares and (iii) changes in their rights and status. Provide employee training to help them excel in new/changed system.

Other Considerations

Governments must educate the public on matters of privatisation. Transparency is critical for economic and political success. Privatisation programs should have clearly defined objectives; Governments should set these out in policy statements or laws before privatisation commences. Timing is crucial; deals depend on the appetite of strategic investors to acquire or the market sentiment in regards to public offerings.

Source: UCG

Recommendations

PPP model ensures a safe and timely approach to eventual full privatization

01 Start with a trial phase of privatization with a Public-Partnership Model

- Select a private entity to run the operations of the enterprise.
- The trial period allows assessing the management partner for the given project.
- Delegate operating & management authority to private partner gradually in phases with a clear articulate plan.
- Use data and KPIs to track performance. Performance and readiness assessment should be done at each phase of the plan.
- The management should be paid fees until the enterprise starts generating significant revenue through student fees. The management can then receive a percentage of the profit.
- The management is incentivized to increase profitability and lower costs through efficiency reducing the financial burden on the state, while the performance assessment ensure their alignment with the national strategic goals of the sector.

02 Sell the stake when the organization improves financially and operationally

- The stake can be sold to
  - The management company itself
  - A large corporation
  - The public through IPO
- The government should have golden or majority shares to ensure they maintain control of the entity.

Key Points

- Create a central body to govern and monitor all privatizations.
- Strengthen the legal framework to improve confidence of the private sector
- Enhance regulations to enable smooth privatizations
- Educate employees and engage all stakeholders including a body that represents the citizens as customers
- Strengthen consumer protection & rights, while increasing transparency to minimize conflict of interest
- Introduce programs to support low income families for health insurance and educational fees
- Time the sale of the equity right to generate maximum proceeds

Source: UCG

Recommendations

Saudi legal environment requires modifications

The legal framework should

- Allow for the financial restructuring of enterprises prior to sale and permit liabilities to be cancelled, deferred or swapped for equity.
- Define regulations and limitations on the operations of the enterprise.
- Clearly define laws governing the extent of government intervention.
- Introduce regulations to enhance transparency during the whole process.
- Define the entitlement of existing employees to severance and other benefits.

Representatives from the government and respective ministries should form a central body

Central Privatization Body

- Recommend to the appropriate political decision-maker the enterprises or classes of enterprise to be included in the privatization program.
- Decide upon any necessary financial restructuring of the enterprise prior to sale.
- Determine the timing and method of sale.
- Control the preparation and issue of bid invitations and the pre-qualification of bidders, if required.
- Require government-appointed members of the governing board of each enterprise to resign at or prior to settlement of the sale.
- Recommend the acceptance of the winning bid.

Source: UCG, World Bank

07

About UCG

United Consulting Group

About

UCG is a management and financial consulting firm that started in 2006, UCG focuses on: providing value added- measurable services to our clients. We support our clients in revenue growth, cost cutting, process improvement and capability building. UCG's culture is built on the notation of providing practical solutions for our clients to achieve sustainable growth.

We bring both strategic and specialized functional expertise: we deliver value to organizations by breaking down silos, assessing the real issues and optimizing their business models.

Our people come from different backgrounds, but they all focus on delivering real results. Some of our specialties, include strategy & transformation, finance & investment advisory, governance, productivity management, and start-up & small business consulting.

Our Focus

UCG offers specialized services to a number of different industry sectors. Among the many covered by the company are the financial, transportation, technology, manufacturing, retail, healthcare, sports and the government sectors.
Since our culture focuses on practical and achievable results, our consultants are hand picked from the industry and all of our senior members have real experience in developing or leading complex businesses in Saudi and abroad

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- Market Research and Feasibility studies
- Business Modelling and Financial Planning
- Boot Camps
- Coaching and Startup programs
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