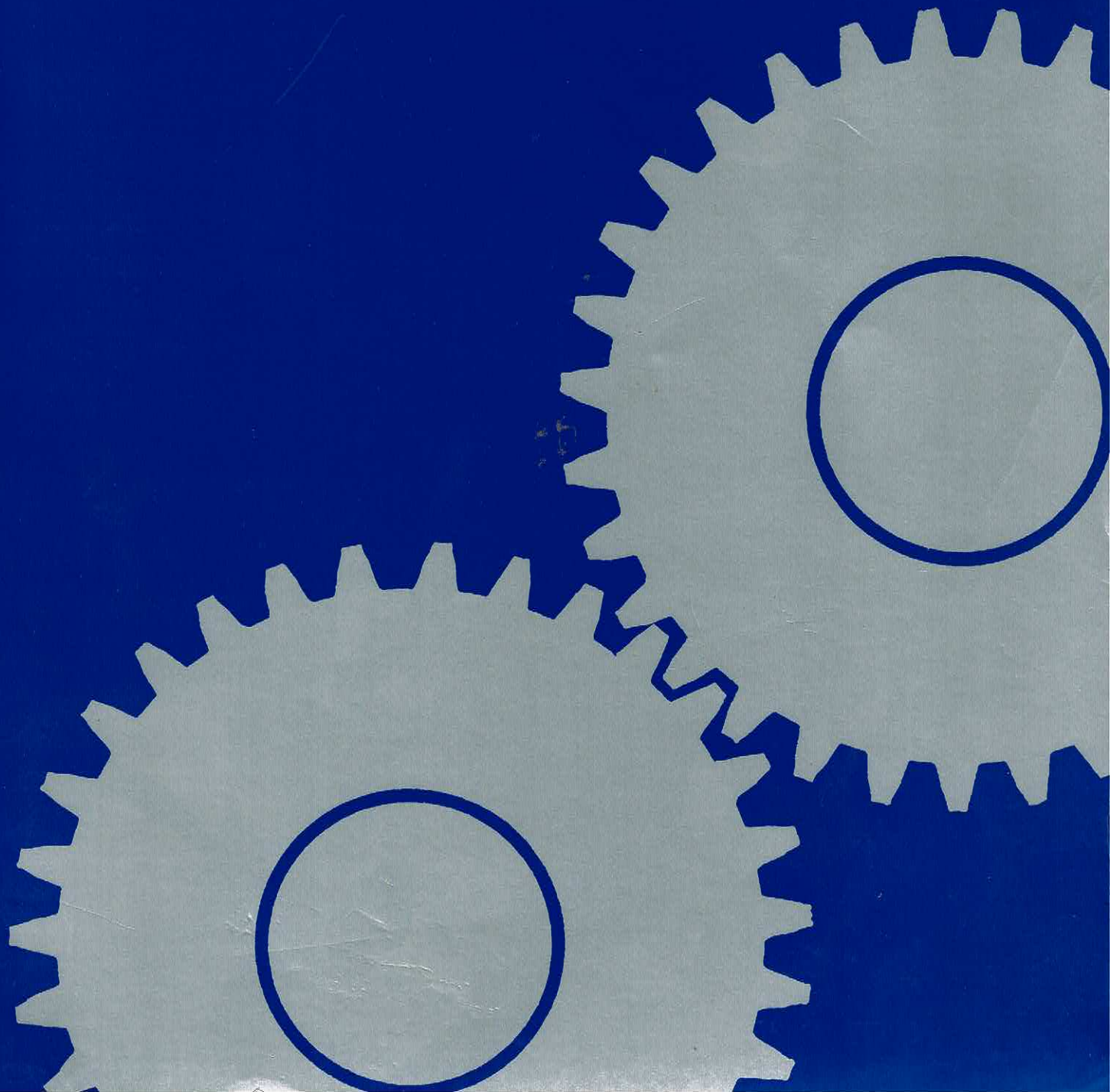
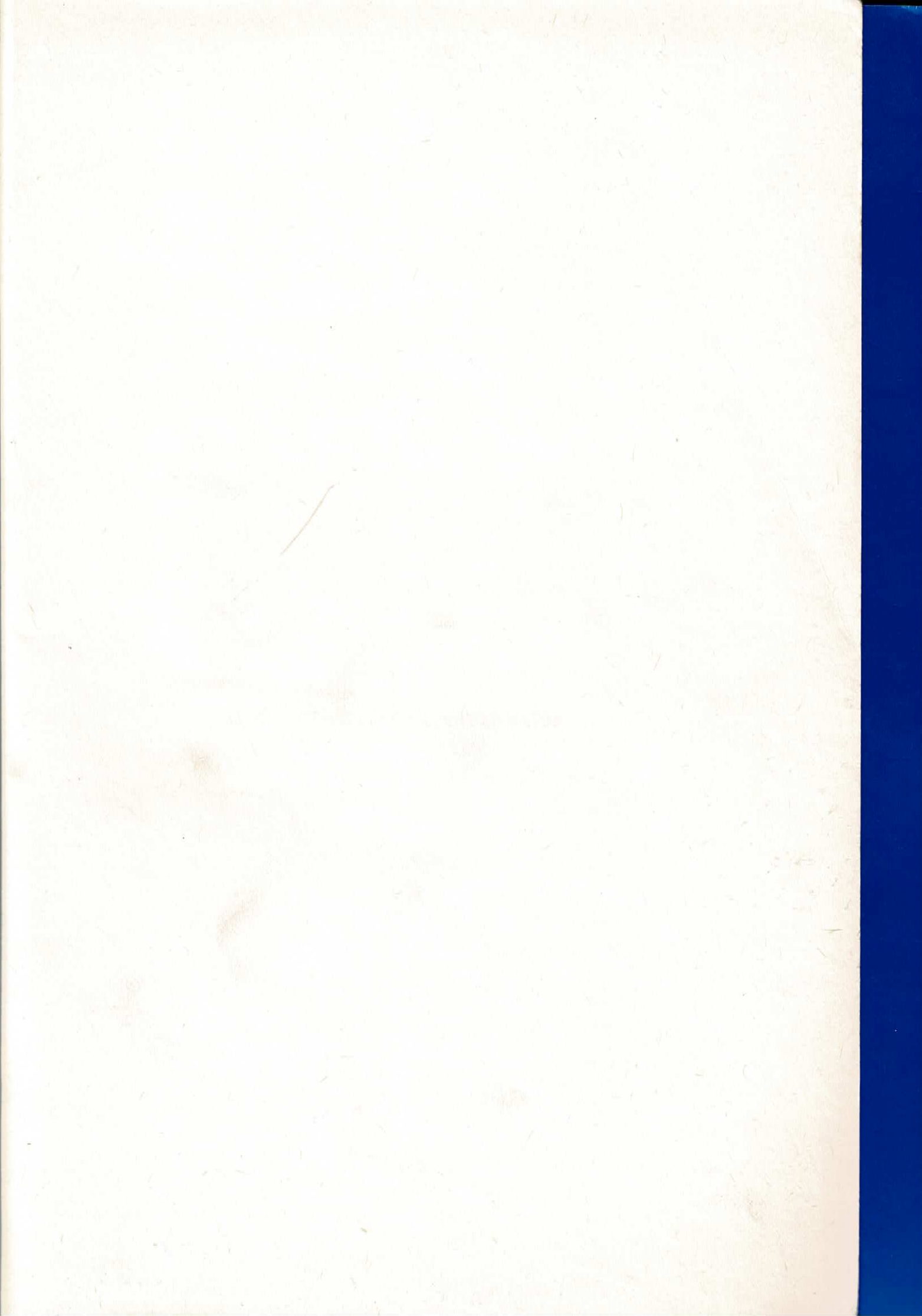


THE MECHANICS OF PRIVATIZATION



Edited by Eamonn Butler





THE MECHANICS OF PRIVATIZATION

THE MECHANICS OF BRIDGE DESIGN

THE MECHANICS OF PRIVATIZATION

Edited by

Dr Eamonn Butler
Director, Adam Smith Institute

From an international conference
sponsored by the

Adam Smith Institute

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'Public services are never better performed than when their reward comes only in consequence of their being performed, and is proportioned to the diligence employed in performing them.'

Adam Smith, *The Wealth of Nations*, p.678



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A note on content

The views expressed in this publication are those of the authors and do not necessarily reflect those of the publisher or copyright owner. They have been selected for their independence and intellectual vigour, and are presented as a contribution to public debate.

With the exception of Chapter 7, these papers were prepared for the London Conference on Privatization in 1987. Some circumstances may have changed, stock prices have altered, and additional services have been privatized.

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Foreword

Nowhere does there exist a greater concentration of expertise on privatization than in the United Kingdom. The privatization programme in the UK started before those of other countries, and has included government companies and services that are larger and more diverse than anywhere else.

Indeed, British merchant banks, marketing agencies, policy analysts, and other institutions now have so much knowledge about how to make privatization work that their advice is one of the UK's most thriving export industries! The whole world, it seems -- whatever the prevailing political colour -- wants to know how to reap the benefits of privatization.

It was to assemble the best of this expertise that in July 1987 the Adam Smith Institute sponsored the first London Conference on Privatization, from which most of the papers in the report derive. Over 100 finance ministers, businesspeople, and other delegates from all over the world came to learn for themselves something of the mechanics of privatization.

In the intervening period, the sudden decline and continued nervousness in the international stock exchanges has made some people wonder whether the public's enthusiasm for privatization issues can persist. However, the signs remain good: the shares of privatized companies in the UK are still outperforming the market as their management is nourished by the new disciplines of private ownership; and there remain plenty of techniques that can make the transfer of public services to the private sector without the need for stock market floatations. For example, the paper by Dr Madsen Pirie, written specially for this report in February 1988, explains the 'unsung story' of management buyouts.

It is clear that privatization, using all of the twenty or more different approaches that are available, will continue to sweep the world. If done well, it produces better management, greater efficiency, better service for the customer, a spread of ownership from governments to the people -- and large measure of political popularity into the bargain. This report provides policymakers in all countries with a manual to help them understand the mechanics of this important process.

Dr Eamonn Butler
Director, Adam Smith Institute

THE BENEFITS OF PRIVATIZATION: AN OVERVIEW

Rt Hon Norman Lamont MP
Financial Secretary to the Treasury

It is a very great pleasure to come to an international conference on privatization. Many is the time I have made speeches about how privatization is now sweeping the world from Canada to Spain, from Sri Lanka to Bangladesh; but never did I think I'd speak at a meeting where I think all those countries, or certainly three-quarters of them, are represented.

I should like today to address my remarks principally towards the theme of privatization as a means of widening the ownership of capital.

THE OPPORTUNITY FOR IMPROVEMENT

However, I would like to take as the agreed starting point what I think must be common ground, that all over the world state control of nationalized industries simply hasn't worked out as the proponents had originally hoped. That I think is a very common experience and it is one that is held by developing countries as much as by advanced industrialized countries. The former have learnt that the great hopes held out for state control have not always been achieved and have brought tremendous problems -- budgetary problems and ever-increasing state support. The dead hand of bureaucracy and a complacent insulation from the realities of the marketplace has crushed enterprise and efficiency and led these industries to become a growing burden on the taxpayer.

It is in the face of this insidious decline that we have operated a new policy: a policy to transfer businesses to private sector ownership or, where this is inappropriate, to demand that they become successful businesses within the public sector. But making something a successful business within the public sector is merely a first step towards returning it to the private sector, and certainly as far as the trading public sector in this country is concerned, I can see no reason why, ultimately, everything that is in the trading sector shouldn't be returned to the private sector.

The driving force behind privatization policy is twofold. First, to ensure that the industries themselves are run more efficiently to the benefit of consumers; and second (and this is the point I want to concentrate on) to give individuals a direct stake in the industrial future of their country.

Some achievements

But before I come on to the more theoretical case for transferring capital

ownership of the state industries from the public to the private sector, I should just like to refer to some of the achievements of our privatization programme in this country so far. One thing we notice is that there is a great deal of publicity at the time that companies are privatized and their record and history in the public sector are closely scrutinized, but after they have moved from the public to the private sector, often they fade away. Perhaps this is because good news is no news; perhaps it is because at this stage in the privatization programme we've come to take it for granted that privatized again do better in the private sector.

I'd like just to mention two examples of successful privatized companies. The National Freight Corporation was privatized in 1982. Their profits last year was seven times those achieved in 1982. A rising proportion of the workforce, now no less than two-thirds, own shares. A number of employees now have a capital stake worth probably several hundred thousand pounds. Those who work in the company, with small, large, and medium-size stakes, all have seen very substantial capital appreciation, such has been the performance of the company. The valuation of the shares has gone up a remarkable forty-six times.

Car manufacturing is an industry with a troubled past in this country and one of the companies that has been privatized is of course Jaguar. Although its profits were roughly stable last year compared with 1985, they were still one-third higher than in 1984, the year that privatization took place. Output last year was at record levels and investment was up some 64%. One of the great prizes of Jaguar's turnaround has been an increase in jobs; they have taken on another 2,000 people since privatization. The Chairman recently reported his confidence about the future and how the company was now intending to invest, compared with turnover, much larger percentage sums of money that it believed were going to make it much more competitive in the world marketplace.

In all, since 1979, we have privatized fifteen major businesses which include British Airways, British Telecom, and British Gas. About 650,000 jobs have gone to the private sector and the state-owned sector of industry has been reduced by more than a third since 1979.

Tendering programme

I'd like also to draw attention to another important development which has gone in tandem with the privatization programme and which has particular relevance to the non-trading sector, that is competitive tendering.

In the National Health Service, where competitive tendering has focused on domestic, catering, and laundry services, savings of about £93,000,000 per year have been generated from a budget of about one billion. Some of these savings have come from in-house organizations becoming more efficient and cost-effective. All these savings are kept by health authorities and can be used to provide better services for patients.

We are going to require local authorities in this country to put six services out to competitive tender -- refuse collection, catering, street cleaning, building, cleaning vehicle maintenance, and ground maintenance. There will be powers to require local authorities to put more services out to tender in later years.

The aim of the legislation is to ensure that the taxpayer receives value for

money by allowing private firms to compete for business with in-house organizations. Local authorities will be required to evaluate bids fairly, and if they don't, the Secretary of State has the powers to prevent the services merely being kept in-house. Obviously there would be no point in requiring local authorities out to tender if they could ignore the competitive bids or insert irrelevant clauses into contracts to further political aims. We have designed the legislation very precisely to prevent these manoeuvrings, which can sometimes reach quite ingenious lengths.

POPULAR CAPITALISM

So this is our programme of privatization, liberalization, and competition; but as I said, what I particularly wanted to emphasize is the expansion of capital ownership -- popular capitalism.

Privatization does, in my opinion, make sense in terms of industrial logic returning the companies to the competitive sector, often where they came from originally. But it is not possible to understand the momentum behind privatization or the political attraction that it has in this country, without seeing it in the context of the government's commitment to extending individual ownership. Privatization is only a part, albeit a critical one, of our campaign to create popular capitalism.

Power to the individual

If I had to chose one single belief that has motivated our approach across the whole range of policy, economic and social, it's the belief that we should give back to people the power to make decisions about their own lives. Ordinary people want that responsibility; they want to work to achieve things for themselves rather than to rely upon the state. One of the things that strike politicians most remarkably on the doorstep today, is how this philosophy really is finding an echo among the public of this country and particularly, among sections of the public who in the past might have been expected to support socialist parties. When I go down to some of the poorer council estates of my constituency, there I find a great new enthusiasm for the Conservative Party, a large part of which relates to privatization. People who might be lorry drivers or people working on the road have bought shares in privatized companies and are very enthusiastic about what has been achieved.

Wider home ownership: This policy, of course, was building on something we'd already done with housing, because we gave council-house tenants the opportunity to buy their own homes some years ago. That is a process that has revolutionized home ownership in this country. Over one million council houses have been sold. Over one million people now take pride in their homes and know that their fate as regards maintenance, their responsibility for looking after their houses, is in their hands.

Wider share ownership: Similarly, share ownership, along with the growth in pension ownership through personal pensions, is something that is now happening more and more, all part of the move towards the wider dispersal of wealth and property in this country. We intend now to make share ownership the major part of this advance in the future. Just as home owners take pride and interest in what they own, so a new crop of shareowners will take pride and interest in British industry. Watching the performance of companies gives ordinary investors an insight into how companies work, into the process of

wealth creation, and into the need for efficient and profitable companies if our economic policies are going to succeed and the country prosper. Extending share ownership both gives people a stake in the success of British industry and contributes to that success by helping ordinary investors to understand their own role in the process of wealth creation. Popular capitalism can therefore be a potent force in breaking down artificial barriers between owners and employees, barriers that have dogged this country and industrial relations for many years.

Employee shareholders: The encouragement of employee share ownership is another particular area where we have concentrated a lot of effort. We have taken measures towards this in seven out of the last eight budgets. We have substantially improved the terms of the employee share schemes that we inherited and we have introduced two further schemes. There has been a very considerable response from industry and I am sure that will continue. There are now some 1,300 all-employee schemes (that is, of course, where 100% of the labour force in the company are involved in the share scheme) now in place. When we came to power in 1979 there were only a handful. On top of that, a million and a half employees now have direct interest in the success of their company as a result of these schemes and those numbers are growing.

The results: Taken together, these measures have changed the face of share ownership in this country.

The individual as owner

I would like to turn now from employee share schemes to individual share ownership as a whole. In 1979 individual share ownership stood at three million and seemed to be set for an irreversible decline. By the beginning of 1987 eight and a half million people owned shares -- a threefold increase since 1979. One in five of the adult population now has a direct stake in British industry. If I had to choose a statistic that I think summed up the Thatcher years it is that. The number of people owning shares in British industry is not much less now than the number of people who belong to trade unions.

Over three and a half million first time shareholders have been attracted by privatization and over a million by employee share schemes. Indeed, the level of share ownership in the UK is fast approaching that in the US, where 25% of the total population own shares, or unit trusts.

Are we reaching the limits of individual share ownership in this country? I don't think so. Our aim must be that owning shares should be as common as owning a house or having a bank account or a building society account; and by that standard we have a long way to go. We will continue to use the privatization programme as a means to achieving it. But we don't need just to increase the number of shareholders, we also have to ensure that those people who have become shareholders as a result of the privatization programme now become regular investors in the shares of British companies.

We have introduced a number of schemes to try to bring that about. A year ago the Chancellor introduced a scheme called our Personal Equity Plan. This provides a uniquely simple and attractive way for investors to buy shares in a range of the most successful companies. The Scheme allows investors to build up accumulations of shares on a tax-free basis year by year up to £2,400 a year; and provided they hold those for a minimum period then at the end of

that period their holding is free of all Income Tax and all Capital Gains Tax.

Since the Scheme into effect in January this year, we have had an encouraging response. Personal Equity Plans have been taken out at the rate of a thousand a day in the first five months. I think that this is only the beginning. More and more investors will take out Personal Equity Plans as the message spreads and the message is that investing in shares is for everyone, not just the privileged few.

INDUSTRIAL EFFICIENCY

Perhaps I could turn now to the opportunity for increased efficiency in the companies which have been privatized. We are convinced that companies will prosper in the private sector away from the interference of government. Improved performance comes from freedom from political and bureaucratic interference and the ability to respond flexibly to the needs of customers in the marketplace.

This increased efficiency can come about through competition or in other ways. Privatized companies also have access to capital markets which they don't have when they are in the state sector, which means that funding is available for worthwhile projects; there is the discipline of competition offered by other companies and the test of the marketplace; there are more incentives for both management and employees when they themselves profit by means of increased dividends and share values.

Monopoly or competition?

Perhaps I could say a word about state monopolies because some who favour privatization in general may have reservations about privatizing large companies as monopolies. The privatized utilities, such as British Telecom and British Gas, are exposed to limited, but by no means non-existent, competition. Where competition can exist it is extremely important that one should work hard to create the opportunity for competition to occur.

The extension of privatization to industries which were previously state-run monopolies has been accompanied by the introduction of tough and transparent regulatory arrangements which are designed to give full protection to consumers while allowing and enforcing private-sector standards of efficiency in management. This is in addition to the liberalizing measures which have been introduced. Telecom and Gas operate under licences which contain both explicit and detailed provisions to protect the interests of the consumers. These provisions are enforced by regulatory bodies, respectively OFTEL, the Office of Telecommunications and OFGAS, the Office of Gas Supply, which may back up the provisions with orders that are enforceable in the courts.

The Director Generals of these regulatory agencies are independent of government and where possible, each has a duty to promote or ensure competition. Before we privatized British Telecom, we did a considerable amount to open up the whole telecommunications industry to competition, both at the user end but also at the transmission end as well. There the second major operator, Mercury, has been licensed and can interconnect to BT's network and provide a rival service. In Gas, similar arrangements are available for BGC's grid and storage facilities.

is more important, in handling successful privatizations.

QUESTIONS AND DISCUSSION

George Newfelt (Coopers & Lybrand, Canada): What incentives, if any, are you providing to the state employees affected by the activities being contracted out in the Health Service?

Norman Lamont MP: There are no incentives comparable to the share incentives that we can give to people when a company is floated on the Stock Exchange, and obviously the two situations are very different. This is one of the problems, of course: the privatization of the services is often very strongly opposed by those who sense that there is a threat to their jobs -- which indeed there is, if those jobs are not being done efficiently. Our consideration is to get the best value for money and to get better service, because there is no doubt that there are enormous inefficiencies in some of these services. What we do ensure, however, is that the in-house workforce are always given the chance to tender for the services themselves. It is very important that they should have that opportunity to carry on providing the service, subject to competition.

Wendell Cox (United States): Could you comment on the experience of deregulation of public transport of services outside London, with particular emphasis on the impact of the consumers of those public transport services?

Norman Lamont MP: It is very early days, and we only have a very limited experience of it but I think the experience has been favourable. Certainly, the public reaction has been much better than the critics had expected. What is remarkable about the privatization and deregulation has been the number of management buy-outs that we had. We decided not to privatize the National Bus company as one entity. (Whenever one privatizes a state monopoly the management always tell one you've got to privatize it as one company: it can't be split up, no-one will buy it, the unions won't wear it, it has all sorts of diseconomies if you split it up, and so on.) I think that is an argument that is highly suspect, and with National Bus, we decided that we would split it up. Many of its constituent parts were attractive for management buy-outs, and we have succeeded in selling tens of these individual bus companies. This has been, I think, a very considerable achievement.

Deregulation has also worked well. Again, it is early days but my impression is that bus services now are more tailored to the needs of the consumer. There are fewer large but empty buses going around, and more smaller buses, some of them providing services where before there were no bus services at all. In that sense you have got services that are more tailored to the needs of the consumer.

In London, buses are not deregulated but we have taken a first step whereby some services within London Transport have been put out to tender, though not deregulated in the sense that there are still the old routes and one operator per route. The degree of direct competition is very limited: it's on the old regulatory basis. But even there, putting it out to tender has brought about, in my opinion, improvements in services even within London.

Luis Llubia (Spain): What do you anticipate the reaction of the new shareholders will be when the prices of their shares go down, as sometime they must eventually do?

Norman Lamont MP: All we can do is to emphasize to investors exactly what is emphasized with any mutual fund or any unit trust, the uncertainty of future market conditions and the volatility of share prices. But I think that all the utilities that we have on the launching pad are ones that have a very good future in this country.

Dr Madsen Pirie: Perhaps I could add (not being subject to the same restraints as the Minister) that the privatization issues since 1979 have overwhelmingly outperformed the market.

Question: One of the main arguments against privatization in the developing world is that it leads to substantial increase in prices. In the case of the National Freight Corporation, for instance, where the profitability has increased by sevenfold, was that due to higher prices being charged by the company?

And on a second point, does your policy differentiate between the nationals and foreigners as regards share ownership and maximum holdings?

Norman Lamont MP: On prices, I see no reason why there should be price increases when a company is transferred from the public to the private sector unless these state organizations have been pricing in an uneconomic way. If you wish to maintain uneconomic pricing as an objective of policy, obviously you can't do it in the private sector unless you do it directly by subsidy, but I am not sure that that is a wise policy to follow. Indeed, some would argue that it is due to the realities of the marketplace and real pricing that the proper use of resources is promoted when companies are transferred into the private sector.

It isn't generally the experience that companies that are put to the private sector then put up their prices. That has not been the experience of BT in this country: in some respects, the pressure of competition from Mercury and others has forced it to shave its prices. In gas, we have seen a big reduction in gas prices, partly due to energy market conditions but partly due to privatization. I don't regard pricing as an argument against privatization but that does depend on the policy objective you have.

Your second question was about ownership and restrictions on ownership. Obviously, in companies that have a defence role or a potential defence role, we do take measures to ensure that the control of the company is going to remain within this country. Our warship yards have been privatized, for example, and we have, of course, sold them to British companies and have restrictions on further sales. The Government would be involved in any decision if the existing owners wanted to transfer the assets to another country.

Sometimes we have restricted ownership by means of the Government retaining a Golden Share in the company which gives it a say in any change in the Articles of Association. It is the Articles of Association of the company that can give one some degree of control in those areas. By and large, we don't wish to have such control except where there is a direct defence interest.

Dr Shabrawi (Egypt): There are two critical concepts that you mentioned in the beginning of your speech. The word 'privatization' or the concept of privatization may be appealing or acceptable within a democratic society but in the Third World the word 'privatization' may be associated with denationalization and people may put a bad interpretation on the word.

ORGANIZING A PRIVATIZATION PROGRAMME

Gerry Grimstone

Director, Schroders and former Assistant Secretary, HM Treasury

When the Conservative Government, led by Margaret Thatcher, came to power in 1979, the state-owned industrial sector in Britain accounted for just over 10% of the country's gross domestic product. Nationalized industries employed around one and three-quarter million people and they dominated the transport, energy, communications, steel, and shipbuilding sectors of the British economy.

Eight years later, nearly half of the previously state owned industrial sector has been privatized. More than twenty thousand million pounds has been raised for the Exchequer. Over six hundred thousand workers have been moved to the private sector and the proportion of people in Britain who own shares has more than trebled.

So what is the background to privatization in Britain and its relevance to other countries?. What objectives have been followed? How was the programme organized and implemented and what has been its impact on capital markets?

Whether or not the British approach carries any pointers for your own country is for yourselves to decide. What cannot be denied, however, is that privatization has proved a vastly more popular success in Britain and elsewhere than its originators expected. To date, it has had a startling effect on the performance of the companies which have been privatized, on the capital market, and on the overall economy.

THE HISTORICAL BACKGROUND

In order to understand the development of the British privatization programme and how it is organized, it is important to appreciate the historical background.

The hope of nationalization

The nationalized sector in Britain was largely created forty years ago. If the Cabinet Papers of that period are examined, it will be seen that the industries' founders had very high hopes for their progeny. It was believed that bringing industries into state ownership would imbue management and employees with a sense of the public good. It was thought that productivity and efficiency would increase and that wage demand and price increases would be moderated.

Because of this belief within the United Kingdom, the industries were given a

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Because of this belief within the United Kingdom, the industries were given a

surprisingly light legal framework in which to operate. It was generally thought sufficient to provide for a body of good men and true to run the industries, to place some overall controls on borrowing and investment and to require the industries to break even, taking one year with another. If the theories had worked, it is clear that nationalization would have been a startling success in Britain.

Practical results

However, in practice, the performance of British nationalized industries, like others elsewhere in the world, was generally disappointing. Criticisms were continually voiced about their low return on capital employed; their record on prices, productivity, and manpower costs; and about the low level of customer satisfaction that they provided.

The reasons for these shortcomings are complex. In many cases it can be seen that the fault lay not with the management and the workers of the industry but with the system. The industries were continually open to political and bureaucratic interference. Social and commercial objectives became confused to the detriment of both. The industries' finances were underwritten by the Government and it became clear that success was not necessary for the industries to survive.

As it became apparent during the 1950s and 1960s that the industries could not be left to their own devices, a generally non-political bipartisan approach to control developed. The light legal framework was supplemented stage by stage by an increasingly stringent administrative control framework. By 1978/79 there was a whole panoply of investment approvals, financial targets, performance aims, financing limits and so on. The effect of this framework was to create a set of external stimulæ that tried to provide pressures, similar to that normally provided by market mechanisms.

The re-think

When Mrs Thatcher's Government came to power in 1979 their starting point was that no bureaucratically operated market could ever be as effective as the real market when it came to stimulating efficiency. They took the view that the only long-term way to improve the efficiency of the industries was to subject them to the rigours of the marketplace, and this implied privatization, deregulation, reduction of monopoly, and increased competition. The driving force for the programme in its early days was thus basically economic and directed at improving efficiency. I think you have to understand that to realize how the programme has developed subsequently.

There has certainly been some change in objectives since 1979, particularly the greater emphasis on promoting popular capitalism and ownership, but the original rationale for the programme was one of improving efficiency has been maintained.

By July, 1981, having been in power then for two years, the UK Government's position on privatization, like a number of countries elsewhere in the world today, was that it was desirable but very difficult. This is shown rather clearly in a pamphlet written Geoffrey Howe, the then Chancellor of the Exchequer. Its main conclusions read: 'The need for privatization, competition and financial discipline is even greater in nationalized industries than we imagined' and 'Progress in the direction of privatization is often more difficult than it may appear to some of its armchair advocates'. I will be coming to later some of

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When Mrs Thatcher's Government came to power in 1979 their starting point was that no bureaucratically operated market could ever be as effective as the real market when it came to stimulating efficiency. They took the view that the only long-term way to improve the efficiency of the industries was to subject them to the rigours of the marketplace, and this implied privatization, deregulation, reduction of monopoly, and increased competition. The driving force for the programme in its early days was thus basically economic and directed at improving efficiency. I think you have to understand that to realize how the programme has developed subsequently.

There has certainly been some change in objectives since 1979, particularly the greater emphasis on promoting popular capitalism and ownership, but the original rationale for the programme was one of improving efficiency has been maintained.

By July, 1981, having been in power then for two years, the UK Government's position on privatization, like a number of countries elsewhere in the world today, was that it was desirable but very difficult. This is shown rather clearly in a pamphlet written Geoffrey Howe, the then Chancellor of the Exchequer. Its main conclusions read: 'The need for privatization, competition and financial discipline is even greater in nationalized industries than we imagined' and 'Progress in the direction of privatization is often more difficult than it may appear to some of its armchair advocates'. I will be coming to later some of

the lessons that we have learnt in Britain in terms of how to overcome some of these difficulties of organization.

OBJECTIVES AND RESULTS

Improving efficiency might have been a key objective, but it very soon became clear that a properly organized programme could fulfil other objectives than just those of increasing efficiency. And as it is at presently organized, the British programme (in common with a number of programmes elsewhere in the world) has the following aims:

1. To increase efficiency through competition, deregulation, or other means.
2. To raise finance which can be used to fund other expenditure priorities, to reduce borrowing, to reduce taxation or some combination of these.
3. To encourage employees to own shares in the company in which they work.
4. To boost the level of share ownership in the general economy.
5. To strengthen the capital market.
6. To gain domestic and international prestige.

The power of privatization and the extent to which it has been taken up now around the world derives largely from the fact that objectives of this sort can be intertwined into one programme.

The results

Judged by its objectives, the programme in Britain has clearly been successful. Sixteen major sales have been completed and millions of new investors have been introduced to the stock market through the programme.

Worker participation

And there has been a high level of employee participation. Typically, somewhere over 90% of the workforce of the companies which are privatized take up the bonus and other share offers that are given at the point of privatization. That has had a powerful beneficial effect as far as the Government has been concerned, in that the participation by the workforce largely negated the opposition from trade union leaders that was sometimes found nationally. One in five of the adult population of the UK is now a shareholder compared to one in ten in France and one in 20 in Japan.

Performance: The performance of the companies has improved drastically. The profits of British Aerospace have trebled since privatization, Cable and Wireless profits are up sevenfold, Amersham's profits have doubled, Jaguar's are up a third and the National Freight Consortium's have increased sevenfold. The combination of freedom from statutory and bureaucratic constraints, strong balance sheets, progressive elimination of internal inefficiencies and, fortunately, generally favourable economic conditions, has done wonders for the companies concerned.

Tax revenue: It wasn't at all clear in the early days that privatizing profitable

Three requirements

Achieving successful privatizations is a long and complex process. Three separate lines of action can be identified.

The first of these are legal and constitutional changes: changing the legal constitution of the company, setting up a regulatory regime if a natural monopoly is involved, passing the necessary statutory and legal authorities.

The second step is reorientating the company's business systems and management towards the private sector.

The last step, once a commercial entity has been produced, is selling the company.

In our experience, these steps may take anywhere between two and three years to complete. The most critical step in some ways and the longest step is the commercialization. Many obstacles need to be overcome. Commercialization can only be done from within the company, it cannot be imposed from outside. You need good quality top management.

Easy sales first

It is also very important to establish the credibility of a privatization programme early on if momentum is to be sustained and investor interest generated. This points absolutely clearly to doing the easiest sales first.

Now what is an easy sale? An easy sale involves selling a company which has been trading on the fringes of the public sector and which already has the necessary private-sector orientation. To take industries out of the heart of the public sector and to reorient them is a lengthy process. It must never be forgotten, and at times ministers have to be reminded of this in countries around the world, that privatization, unlike nationalization, is a two-way process. Governments may want to sell companies but somebody else has to want to buy them. This is the essential difference between privatization and nationalization.

Choosing the method

Methods of sale in the British privatization programme have been determined by the programme's overall objectives and by practicalities. Because of the desire to spread ownership widely, public offerings of shares have been a preferred choice where this can be achieved. Failing this (and a public offering represents a very severe test for any company), employee and management buyouts have been welcomed, provided that the funds are available and the company's cash flow can support the necessary leverage. The most difficult sales to bring to a popular conclusion are sales to corporate purchasers, particularly, if overseas buyers are involved.

The politics of privatization, and this is the same worldwide, are such that domestic investors normally have to be given preference, although minority sales overseas can be an important factor in bringing an otherwise domestic sale to a successful conclusion.

Market effects: In terms of the capital market effects of privatization, two main positive impacts can be distinguished. First of all, it is quite clear that privatization can lead to a widening of capital markets by bringing in new

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THE TELECOM EXAMPLE

The sale of British Telecom in 1984 was the first privatization anywhere in the world specifically designed to have widespread popular appeal. Prior to British Telecom there were many people within Britain, including some at the highest levels of Government, who doubted that the British general public could be taught to buy shares through privatization. The proportion of shares owned by the general public in Britain was decreasing and attracting even fifty thousand people into a privatization offering was reckoned to be good going.

A new approach

Yet the British Telecom sale attracted around two and a quarter million applications and around half of those people had never before bought a share in their life. The sale was five times larger than any sale that had been previously attempted.

Such success stemmed from a new approach to share issues: British Telecom was the first to be marketed on a wide scale to the general public.

It was clear to all of us who were involved in the sale that traditional methods of selling shares were not capable of creating a new breed of share owners. Stockbrokers were happiest selling shares to their existing clients and therefore if shares were to be sold widely, new distribution channels needed to be created. The vendor would have to go over the heads of the traditional intermediaries, both by motivating a more lively sales force than was found in traditional stockbroking firms and by selling direct to prospective shareholders. No vendor was more suited than the Government to take on this challenge.

Popularity: Why was British Telecom so popular? Well, first of all it combined features of both a utility and a high-technology business which made it ideally suited to inexperienced shareholders. Everybody was very conscious that there were no advantages to the Government in putting inexperienced buyers into a company whose performance might have been depressing afterwards. Small shareholders were, at the Government's expense, given the added attraction of a one-for-ten loyalty bonus if they held their shares for more than three years. Alternatively, they were given discounts off their telephone bills. The sale was advertised widely, in both the press and on television, and generous commissions were paid to the financial intermediaries. A new selling force was effectively developed.

The sale captured the public's imagination, proved (with the benefit of hindsight) to be significantly underpriced, and was both a popular and political success. It marked the emergence of popular capitalism in the UK and showed that the largest privatizations, if properly handled, could be successfully absorbed by the capital market.

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three-year period.

PRIVATIZATION AND THE CAPITAL MARKETS

How can privatization deepen as well as widen a country's capital market? It is often a country's dominant businesses that were previously nationalized and brought into state ownership because of their position in the economy, their strategic importance, or their size and market dominance. And it is these very characteristics which on privatization enables such companies to give depth to a stock market and to provide ballast for what otherwise may be an unduly speculative environment. That is why a number of countries worldwide at the moment are using privatization as an instrument of strengthening and developing their capital markets.

Privatization creates capacity

The experience of Britain and other countries elsewhere shows again, contrary to the original expectations of economists and some market commentators, that privatization can create its own market capacity. There are four reasons for this.

Firstly, the equity that is being sold is normally of good quality and represents an attractive investment opportunity. Purchasers gain comfort from the fact that the vendor is a government and they have learnt by experience that governments are very risk-averse when it comes to handling privatizations. From my own personal experience I can remember a number of times when we have had overseas banks approach us to buy shares in privatized companies. They have said: 'We don't mind what the next privatization is that the British Government will be doing, but if we can have 10% of it, at whatever price it is being offered, we would like to have it'.

Now clearly, if you can develop that kind of stockmarket following worldwide, it eases the process of sales. Success is valued very highly by governments on privatization, and this is no wonder given privatization's invariably high profile.

Second, in terms of creating market capacity, a government that is raising finance by selling equities will need to borrow less money to finance a given public sector financial deficit than it would do otherwise. A government's total demand on the capital market may thus be unchanged by a programme of sales. (It is also true that the characteristics of some of the companies that are privatized, particularly utilities operating a natural monopoly, can closely resemble debt in their financial characteristics and thus they may easily be accommodated into that portion of an investor's portfolio previously reserved for sovereign debt.)

Thirdly, and this point is often overlooked, even a single privatization, because of its size, may be a material component of a country's stock market index. Those investors who attempt to match their portfolios to the main constituents of a country's capital market must buy privatized equity if they are to maintain their relative position. Some privatized equity, for example, a national electricity or telecommunications utility, also gives very good exposure to the totality of economic development in a particular country. This is often valued by an investor.

It should also be remembered that governments which are selling equity

become interested in the operations of the equity market and implicitly or explicitly take steps to strengthen the market. Traditionally, governments worldwide only operate in a debt market, whereas the equity market tended to be left to market practitioners. This is now no longer the case and it is also true that the same political philosophy which produces privatization is also likely to encourage market liberalization and deregulation. Privatization and the growth of London as an international financial centre have gone hand in hand.

Secondary benefits

Now in order to capture the capital market benefits, a sophisticated marketing programme must be created to maximize interest from all classes of investors. Such a programme, in terms of its effect on proceeds, will normally be extremely cost-effective. However, not only can such a campaign benefit the proceeds and the commercial image of the company that is being privatized, it can also provide an opportunity to project a country's general development and financial status. The roadshows used to promote privatization can also be used to promote the country and its economy.

Many countries would like to have a privatization programme. Very few countries can assemble sufficient determination, expertise, and credibility to achieve one.

Protecting the national interest

To move on to a rather different subject, the significance of some of the companies which have been sold in the UK and elsewhere is such that privatization would not have been possible if steps had not been taken to protect the national interest. It cannot be ignored that state-owned companies may often have a dominant position in the economy of the country. If steps are not taken to secure the national interest on a case by case basis, privatization will not be possible.

In this country, the Government has wanted to ensure that some companies' continued independence is guaranteed, implying that they cannot be taken over by other companies. We have wanted to require, at times, that the Chief Executive would remain British for some of our companies. We have wanted to restrict foreign ownership in some companies where defence or security interests have been at stake. In the case of natural monopolies, which have been privatized, it has, of course, also been important to ensure that customers' interests are fully protected.

Now it has proved possible, at least in this country, to build in safeguards to protect these important requirements in ways that are fully compatible with United Kingdom and European Community Law. No special legal framework had to be created in order to do this. Where necessary, specific restrictions have been written in to a privatized company's Articles of Association, the company's statutes. And in order to ensure that these restrictions cannot be varied after privatization, the Government has retained a special share, called a Golden Share, which has been created to protect those Articles regarded as essential. It is a technique which has since been copied by many countries worldwide.

I don't intend today to discuss regulatory arrangements in any detail other than to note that much of the conceptual benefit attributed to state ownership of natural monopolies result from an assumption that the State will somehow

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I don't intend today to discuss regulatory arrangements in any detail other than to note that much of the conceptual benefit attributed to state ownership of natural monopolies result from an assumption that the State will somehow

act properly in relation to those monopolies. In fact, anybody who has observed closely the political bargaining associated with the annual expenditure round in countries worldwide, and the outside influences that determine whether or not state industry should invest, would realize the important role of political expediency in regulating monopolies in the state sector and the advantages to be gained from moving to a clear and transparent regulatory framework based on sound economic principles.

LEARNING THE LESSON

Now I said earlier I would review some of the lessons to be learnt from the British privatization programme and some of the mistakes that were made in the early days. Although the programme is a popular success, mistakes were made and lessons were learnt by experience.

New techniques

In the early days of the programme, the sales were treated very much as one-off individual market transactions and no real attempt was made to coordinate the programme nor to capture the public's imagination. Market professionals, in particular, consistently underestimated the power of privatization to attract retail interest and persisted in offering too few shares too cheaply to the British public. Although there had been developments in offer techniques, there was sometimes reluctance in the City of London to introduce innovations, even where these would clearly benefit the vendor.

Because demand for privatization can be an order of magnitude greater than is commonly found in private sector sales, and is sometimes very hard to predict in advance, offer structures are needed which can cope with unexpected demand that materializes in the offer period. The Cable and Wireless sale, in December 1985, which Schroders conducted for the British Government, pioneered a new technique, flexible clawback. When the issue was oversubscribed, shares were brought back from institutional investors and made available to the public. This was a new technique designed to spread ownership in the face of high levels of demand. Subsequent sales have followed suit.

Privatizations differ from all other public offerings, particularly in terms of political sensitivity, size, investor interest, and the complexity of objectives. The luxury of treating them as purely financial transactions is simply not available.

Public relations

If a privatization programme is to be pursued, it is important that the case for doing it is deployed publicly and often. Whether or not increasing efficiency, spreading ownership, or raising finance are the objectives, the intellectual and economic justification for the programme must be coherently presented. If the emphasis of the programme is seen to be primarily political, or is seen to be primarily financial, problems will result. Not enough attention was paid to this in the early days of the British programme.

Identifying the interest groups

It is also most important that the critical participants in the programme are identified early on and dealt with in the most satisfactory fashion. These key

groups normally include the following:

1. The general public, who have a role as taxpayers, customers and voters.
2. The employees of the firms being privatized.
3. The management of the firms being privatized.
4. Prospective investors.
5. Commentators and opponents of privatization.

Pricing

Fair pricing balances the needs of the taxpayer and the investor. Voucher offers for customers offering discounts on bills and free shares for employees help overcome public or trade union doubts. Retaining the privatized company's original corporate structure is of clear benefit to the management concerned. Widespread distribution of shares, full disclosure of information and careful attention to detail, are all necessary if a successful sale is to be achieved.

THE SCALE OF SUCCESS

Now I think it is true to say that the British privatization programme has gone further and faster in the last three years than even its most ardent supporters expected. To raise five thousand million pounds a year from privatization is now seen as unremarkable. The British Gas sale attracted five million applicants and was the world's largest ever equity transaction. In the first half of 1987, three major sales, British Airways, Rolls-Royce and BAA are all following in quick succession.

The Conservative manifesto for the 1987 election pledges that Water Authorities and Electricity Industry will be privatized and says that more state-owned industries will be sold in ways that involve share ownership, both for the employees and the public at large. Your guess is as good as mine what these candidates might be, but clearly British Steel, parts of the Post Office, London Regional Transport and some other companies are all likely candidates.

In political terms, few policies can claim the benefits of privatization. Few can be so attractively presented in terms of privatization's ability to increase industrial efficiency, raise money, boost ownership amongst employees and the wider public, and generate domestic as well as international prestige. Provided the relevant interest groups are clearly identified at an early stage and are kept happy, everybody seems to win. Indeed, if the programme in the UK is pursued to its logical conclusion, UK nationalized industry will soon cease to exist. Within a period of around fifty years, the wheel that Herbert Morrison started turning in 1933, with his book on the socialization of transport, will have come full circle. Herbert Morrison's views on this, unfortunately, will never be known.

QUESTIONS AND DISCUSSION

Fouad K Hussein (Egypt Investment Finance Corp): When you privatize companies, how do you put the price tag on the share? Secondly, what can we do to assure the public in case there might be a change of political wind in the future: that this privatization will not be reversed?

Gerry Grimstone: First of all, I should stress that the objectives for a country's privatization programme must be tailored with reference to local circumstances. The programme will be a complete failure if countries mindlessly copy other country's objectives. Each country has its own priorities and will have its own objectives. What is important however, is that those objectives are worked out in advance and a country knows what kind of privatization programme it wishes to have before it starts. One has to match the objectives to the aspirations of the vendor.

That affects pricing: you have to strike a fair price. It must be a price that, when commentators are looking at it afterwards, shows clearly that neither side, the taxpayer, the investor, the vendor, has been taken undue advantage of. Now it happens that there are valuation techniques, formula techniques, which can be applied to give a starting point for the valuation of the company. Any investment banker could talk eloquently on those. What is important, is to develop a market feel and a feel for what privatized equity will trade at in the aftermarket.

However, it has to be recognized that privatizations produce a very odd class of equity that is sometimes hard to evaluate. Because investors know that governments want these sales to be a success, privatization has developed a following worldwide which transcends some of the actual absolute characteristics of the equity. Pricing can be very difficult. Traditional valuation techniques often don't work. All one can do is to use one's best judgement to fix a price. It is also very true to say that if you are government, looking at a series of sales, it is more advantageous to you to create an aura of success, which runs on from sale to sale, than it is to get the last cent or the last penny out of an individual sale.

I think that this is a lesson which we learnt in the UK. Until the Britoil sale, in November 1982, that tradition was to price the shares to the last penny. It was then realized the proceeds could be maximized over the longer term not by pricing individual sales to the last penny, but getting some enthusiasm going for privatization. That maximizes proceeds over the long term.

If these sales can be made a popular success, if you can involve many, many millions of people in the process, the chances that they will be reversed by subsequent administrations are clearly diminished. And it is also important at the end of the day to isolate, as far as one can, the companies from future government influence, perhaps by declaring in the prospectus (where it becomes part of the contractual terms between the incoming investor and the Government) that the Government will not interfere. It is the case on some of the British privatizations that investors could sue if a future government chose to interfere in the companies. Other techniques, such as passing the right sort of legal framework, or developing the right company articles, can be used to isolate a company from government influence. If privatization can be made a popular success, it will persist; if it is seen as a conspiracy or as a way of selling shares to backers of governments or to favoured financial institutions, it will not last.

Jim Lafferty (US Office of Personnel Management): Sir Colin Marshall, talking about the British Airways' experience, described how a severance package was negotiated with the trade unions, and in that instance, he said, he had to deal with seventeen different trade unions. Are there any reliable generalities to be gleaned from the British experience with privatization in dealing with trade unions? What effect have they had, thus far, in the outcome of some of these privatization efforts?

Gerry Grimstone: The first thing I think that we have found was that the workers were scared of the process because they did not understand it. These were workers who were in the public sector, they were used to the public sector. There had to be a very strong educational effort. The management had to go out to the workforce to explain what privatization was and how it would benefit the companies and employees concerned. There has been a programme of videos, news letters, and corporate roadshows in order to do this. Fear and ignorance were two of the biggest problems that had to be overcome. Perhaps, because of a perceived political stance towards privatization in the UK, I think it would be difficult for any trade union leader to come out formally in favour of privatization. But if you can develop offer techniques which involve the workers of the companies to a very large extent in the process, if you can see a take-up of over 90% among eligible employees of shares (and this has been done in the UK by giving small numbers of free shares, so-called bonus offers, where for every one share an employee buys he is given another share free, and by giving employees some preference in allocation), you can put together attractive incentive packages which make employees want to participate. If the workers are participating, it is quite difficult for the trade union leadership to say that it doesn't wish to support the process.

There is a very amusing story that sometimes is told of how the Labour Party leader, Neil Kinnock, was touring a British Telecom factory in Wales. He held a meeting with the shop stewards and he explained to them Labour's policy on re-nationalizing ('returning to social ownership' as it was called) British Telecom. The shop stewards listened, nodded attentively and applauded at the right times, until one of them asked a question at the end of the presentation: 'But you don't mean you'll take back the shares that we own, do you?'

Dr Hassan Aly Khedr (Ministry of Agriculture, Egypt): I cannot understand how everyone was left happy by privatization. What I have heard is not privatization, but divesting some industries of their Government management and introducing private sector management; but efficiency-wise, this might not necessarily be the most advisable course.

Gerry Grimstone: Within the UK, the policy that went hand-in-hand with privatization was a general policy of commercializing state-owned industries: commercialization as opposed to privatization. The same people within Government were responsible for both those policies.

It is obviously better to do the commercialization within the public sector prior to the sale. The reason for this is that the process can be managed better, a more attractive company is produced, it can be done sensitively by existing employees rather than by new employees.

In British Airways, for example, it was within the public sector that the workforce was reduced from fifty thousand to thirty-five thousand; British Steel, which made large losses in the early 1980s and is still in the public

sector, is on course to make over one hundred and fifty million pounds profit this year. State-owned industries can be commercialized but you tend to need some stability of government policy. The first step, is always to put in good management. We have benefitted in the UK from the fact that the boards of nationalized industries are generally appointed on three to five-year fixed term contracts. That means that if you have a period of stability in political terms, lasting for seven years, eight years, nine years, you have gone through a process of re-appointing people to boards. There was a clear objective in this country to appoint businessmen to the boards of nationalized industries -- and businessmen at the prime of their careers.

Interestingly, once privatization became on the agenda, it was much, much easier to attract good-quality businessmen to join nationalized industries because they realized that the prize was taking those industries into the private sector and then being responsible for managing very large private sector companies. The only way to commercialize an industry, the only way to improve its internal efficiency, is through having good management. That has to be your starting point.

Dr Khaled Sherif (Ministry of Cabinet Affairs, Egypt): What about contracting out management, where you move out the management of an existing firm and replace it with management that is outside the civil service structure, more oriented towards changing the performance or the efficiency of a particular industry. How successful has that been?

Gerry Grimstone: I think the difficulty with that is that within the kind of constitutional framework and the public accountability framework that often surrounds state owned enterprises, there are severe limits on what a manager can achieve. Hand in hand with introducing good management must be this process of liberalization, throwing out the panoply of controls that exist in every country in state-owned enterprises. There is a constant need to refer to the Treasury, to the Government, to ministers for decisions. I am afraid that in most situations, no matter how able the manager is, he cannot manage properly until those constraints are removed. Within the UK, once a company has been launched on the privatization runway, government controls and interference, have been progressively dismantled. It is also true that the strength of character of some of the men now running our nationalized industries is such that they will tell Government officials or ministers that they are not wanted. They have been brought in to make these businesses commercial. They will ignore the owners for the time being, knowing there is going to be privatization.

Unless there can be some real sort of change in relationships, and accountability, no new manager will be able to manage effectively.

Pierre Drion (Peterbroeck, Van Campenhout): How and when are the investment bankers brought in to the privatization process?

Gerry Grimstone: I think that it is very important that the advisors are brought in at a very early stage of the process. This is because many decisions have to be taken on the route to privatization. Some of those decisions may have an impact on the selling process, others may not, but it is very important that the commercial entity that is being created, the management changes that are going on, the new structures, are all structures which are attractive to investors subsequently. Normally people in government are not very good at having a market feel for what they do, so I would appoint advisors very early on.

Advisors should generally be appointed after a competitive search. There are a handful of banks worldwide, which are pre-eminent in this field, but if I were a responsible vendor I think I would always want to compare one bank with another in a structured way before deciding who to appoint.

M H Scalobah (African Development Bank): How far will you go in privatizing, where do you draw the line and do you take into consideration any future changes in government and whether this would not disrupt the whole economy?

Gerry Grimstone: My own personal belief is that commercial activities are better done outside government rather than within government. Commercial activities should be moved to the private sector: the timing of this, and the necessary packaging, clearly have to be sorted out separately in each case.

Once one moves away from commercial activities, from trading activities, the case is far less clear. I think you have to reckon that there are some activities which may need to stay in the public sector. I do not advocate mindlessly privatizing all activities that a government does. All that one can do is to examine activities one by one and say: 'Are these activities which can be done better in the private sector or in the public sector?' If they can be done better in the private sector one should then set up a programme to move them into the private sector. The process does not work if you start from a dogmatic statement that all government activity should be done in the private sector. It has to be a pragmatic market-driven, commonsense-driven, business-driven programme rather than a political programme.

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MARKETING PRIVATIZATION

Tony Carlisle
Director, Dewe Rogerson

I am going to talk about marketing in the context of the large flotations because it's easier to do it that way, but in fact the principles I am talking about apply on any scale. We have used the same general approach to marketing on flotations that have raised twenty-five or forty million pounds as well as flotations that have raised five and a half billion pounds.

THE SPREAD OF OWNERSHIP

Where I would like to start is the self-evident statement that Britain has fast become a nation of shareowners. The main cause of this plainly is flotations. If you go back to pre-Telecom days in this country, then we had about two million share owners. About a third of those were very old, a third of them were not very aware that they had shares (or at least they didn't do very much about them), and so the true share-owning base of this country, the active shareholders, was very small.

After Telecom, which added well over a million long-term new shareholders to this country, we have had a succession of smaller secondary offers: Aerospace, Cable and Wireless Parts II and III, Britoil Part II, and those probably added a half million or so. Then we had TSB which was the second popular offer (not strictly a privatization but a people's share offer in a classic sense). We secured three million enquiries and five million share applications for that company. Even after the scaling down to three million share owners, that added over two million new investors. So did British Gas last year -- and the majority of them is still there.

This year the pot has been kept boiling with the spate of offers that you are fully aware of: Rolls-Royce, British Airways and British Airports.

The new investors

Now before looking at why this explosion has taken place, who are the new investors? I think one of the spectacular successes of privatization here is that the new investors come from right across the country. No longer is share ownership the privileged holding of a few people who have financial connections or historic wealth.

Investor profiles

The new investors actually are characterized much more by a state of mind

than anything else. There tends to be more men among them, but that is because very often share ownership is a household decision and the man most often is the one who fills out the forms. In terms of age, there have been huge shifts, a tumbling of shareownership from being the preserve of the retired 65+ group into the 25-44 groups and even the under 25s. If you look at class there is an enormous drop in the proportion of shareowners owners that are ABs -- the upper socio-economic group -- and an enormous increase in the artisan class, the C2s. That is not to say there isn't a bias still to the wealth groups because there is; but ownership is spreading right down the socio-economic structure. It is also reaching right across the country. There is, of course, some slight bias towards London and the South which still harbours the greater concentration of wealth in this country. But look at the rest and you are looking at a national profile: there is no significant difference in ownership in the rest of England, in Scotland, or in Wales. The new investors are everywhere.

Share ownership may be wide, and I think it is widening further but it isn't yet very deep. Large numbers of people have shares in only one company, whereas traditional share owners might have held ten or more, and many held four or more.

So that is the picture of share ownership in this country. One of the things I think is terribly important to get into one's mind is that share ownership is not about some general desire to own equities for the sake of it; not even in fund managers is that desire prevalent. People are not interested in some vague concept, they can be interested in particular companies which interest them and offer them a good return.

The reasons that we have a spread of share ownership in this country has to do as much as anything with the breaking down of barriers. Before Telecom, people thought that share ownership was extraordinarily complicated: it was by definition for the minority because no one had come to people and invited them to own shares. So naturally enough, they didn't buy any. But the barriers have been broken very substantially. The numbers of people who, surveys reveal, have thought about investing in stocks and shares have grown extraordinarily since Telecom. Secondly, the real competition with share investment in this country is the building society, the traditional place where people put money they want to leave for some while. After Telecom that attitude hardly moved, but now it is beginning to change. Although the shift may not look very large, it is actually a very fundamental one: a small change could mean that very large sums of money want to move.

I think it is also illustrated if you look at the reasons for not investing. Again, surveys show that the barriers that keep people away from share ownership have tumbled.

Less than half the number who said before Telecom they didn't know how to invest in shares still feel that. Some think shareownership too risky, and fair enough, though people are coming to accept the notion of risk in equity ownership. Others say it is too difficult to buy or sell shares though far fewer than three years ago. But what is interesting is that nowhere on the survey response list comes anything to do with political ideology. The marketing man does not have to overcome that barrier.

MARKETING TO THE PUBLIC

One central theme that wider share marketing draws on is the desire in most human beings to want to do something better with their money. Wherever they have got their money, people would love to have a better alternative. Their problem is that they don't know how to go about it, and they don't know whom to trust. If you can actually get their trust and get their confidence and offer them a package which represents something better, then you can shift money very fast indeed. That is exactly what we have been doing in the flotations.

The second feature of wider share marketing is that it taps an additional source of money. This all started back with Telecom, with very simple thinking which acknowledged the huge scale of the deal. It was quite plain that the UK capital markets were not happy to subscribe Telecom in full. It was also plain that overseas markets could only be tapped to a limited degree for political reasons. Therefore more demand was needed. Where can that demand be found? Could it be generated from the retail public?

Wide share ownership, therefore, was a marketing imperative, and not a political one. Our marketing objective, as in all share offers, is to foster the perception of scarcity and the perception of value. If you achieve that, you have over-subscription, if you don't you have a failure.

Extravagant ideas of a wider share ownership campaign have absolutely no relevance to an individual who is asking whether to invest his own, or her own, money in order to get a decent return. People are interested in specific companies, and specific offers. The company has to be a company with which they feel familiar, for which they have regard; and the offer has to be good value. You must start with an attractive company, an attractive offer, an attractive product, otherwise you have problems.

In this country right now you can to some degree tap patriotism for the first time in a long while. That is a consequence of the Thatcher Government and partly the self-promotion of major corporations, British Airways and others, making people aware of success and not hiding their Britishness in the cupboard. But patriotism is unlikely to attract much investment. What investors want is a company with good future prospects, operating in a good industry, a company for the small investor.

The target audience

Who are we addressing this message to? We have three investor audiences: the UK institutions, the UK retail public, and the overseas markets. In the UK markets, the key influences of opinion are the analysts and the media who interact together and who will determine the nature and the quantity of endorsement to be given to an offer. In the middle are the advisors, the stockbrokers, the accountants, the solicitors who can tap the high-wealth band. (Numerically, they don't reach far in this country, half a million people perhaps; but they are important because they are part of the investment community and unless they think it's a good offer, then it counts against you.)

In terms of the investor audiences, the whole of retail marketing, for legislative and other reasons, is directed at the UK. But the scale of it for companies such as Telecom and Gas is such that it certainly creates a backcloth of awareness internationally which helps support overseas marketing.

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The stages of awareness

How do you move people from an awareness of the offer towards being prepared to reach in their wallet? The answer is that you have to issue a very, very clear invitation to come into the deal. It isn't just a question of saying that a certain share offer is on; you have got to tell people that it's for them, that they are being invited to consider investing in this company.

Information: Once people are interested, the next thing that they want is to have more information, a natural instinct. That is one key reason you need a Share Information Office; it's not just an enabling device in law, it is an absolutely critical part of the marketing programmes we have run in this country.

Endorsement: Information on its own is not enough. People move from reading about the company, reading about the share offer to asking whether it is the right thing for them, and the places they are going to turn for that sort of endorsement and reassurance are the places they trust. In the main that means the financial media, the financial journalists. It is that advice that will be echoed by the intermediaries down the line.

The pathfinder: When the public is broadly aware and interested, and the buzz is beginning to go around because the offer looks good, then it is time to ensure people get their money ready, because the narrow window of an offer means that they don't have that long to sign the cheques and post them off.

Finally, on the impact day, the day on which the price is announced and the prospectus published, the communications programme needs to come to a peak and there needs to be a wide perception of a major event taking place.

Psychology and impact: an example

You can map out all of this decision-making process in quite clear detail in the sort of share purchase models we have constructed since Telecom.

If you are running a mass flotation you need to know where you are: who is interested, why they are interested, what information they want, where they want to get that information, and how many people are likely to come in.

Successful marketing needs to understand the quite sophisticated investor psychology. You can actually see it being reflected in the successful share offer advertising. Take the TSB launch commercials.

First commercial: 'At one time or another most people think how nice it would be to own a bank. Well, now is your chance. This September, TSB shares will be offered for sale to the public. If you would like to know how many shares you can buy, how much they will cost, and how to apply for them, phone 0272 2300 300, or come into any TSB branch. We will send you more information and reserve you a prospectus. The TSB now: it's your turn to say "YES".'

Second commercial: 'If you have ever wanted to own a bank, we bring you good news. This September, TSB shares will be offered for sale to the public. How many can you buy, how much will they cost, how and when can you apply? Phone 0272 300 300 or call in at any TSB branch. We will put you in the picture and reserve your prospectus. The TSB: now it's your turn to say "YES".'

Pathfinder commercial: 'It won't be long now. Next month TSB shares will be offered for sale to the public. So if you would like to own a bank, here is your chance. Everyone can apply. You don't have to bank with the TSB. How much can you invest? Can you pay by instalments? Phone 0272 300 300 and we will give you more information and reserve a prospectus for you. Call in at any TSB Branch. The TSB: now it is your turn to say "YES",'

Pre-offer commercial: 'It isn't every day you get a chance to buy a bank. From September 15th prospectuses for the TSB share offer will be available to everyone. The offer is then open for only ten days. From September 15th until 10.00 am on September 24th. You have still got time to phone 0272 300 300 to get more information and reserve a prospectus. Or call in at any TSB Branch. The TSB: don't leave it too late to say "YES".'

Two and a half million enquiries had come into the office by this time.

Offer period commercial: 'The TSB share offer lasts only another few days. It closes at 10.00 am on September 24th. For a prospectus and application form call at a TSB Branch or any other bank. The TSB share offer: it's on now.'

That campaign was a very soft sell, but it was an extraordinarily powerful campaign. Even though it wasn't on the same scale of spend as some of the others, it gained awareness ratings of 85%. That is higher advertising recall than for the general advertising campaign the TSB had been running for the eight years previously. It triggered an unprecedented number of enquiries and applications. It was a very elegant campaign and it more than achieved TSB's objectives, not just of wide ownership, but in terms of altering the image of the TSB.

A complete package

The sort of programmes needed in a share offer involve far more than just advertising. Flotation marketing works because you run an integrated programme. I have talked about research. Design is important: you need a symbol for the float. For the Telecom campaign we produced, with The Stock Exchange, a booklet on *Buying and Selling Shares*. (Remarkably they didn't have one at that time, and when asked the question of how many copies would they like, they said five thousand. When we told them we were printing one-million initial run, that put into perspective the marketing hitting the City for the first time.)

Spreading information

We need the share information office as a physical focus to handle enquiries and to act as the press office to the flotation. It is an office that releases and distributes material that has been legally cleared in advance; it helps orchestrate and organize prior agreed activities. (One of the keys to a flotation is the central control, the marketing committee that make sure that these programmes work together, and that all materials are thought through, are legally cleared and work.)

The sort of questions that people were asking about the TSB were very similar to the sort of questions people ask about any offer: Will I get all the shares? How much do they cost? How do I do it?

We can now anticipate most of the questions people ask and have the answers set up. The Share Information Office therefore divides into two sides.

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One is a mass enquiry arm, which on a major sale is maybe able to handle the eight and half million enquiries we took on Gas, and the other is a much smaller office in London which is a control centre dealing with the press, with the intermediaries, and with difficult enquiries. (Of those eight and half million enquiries that went to the mass enquiry centre, very few could not be answered just by sending the information. At peak, two hundred a day couldn't be answered that way, a very small proportion.)

Branch display is part of helping make an offer a national event, getting it out into the public. Of course, it is not always possible. With TSB, we were fortunate to have sixteen hundred bank branches. With Telecom we didn't; we had to put the literature and leaflet dispensers in post offices and banks because it was all that one could do.

Mailing is likely to produce the highest response of all. A simple customer leaflet went out with account bills in British Gas at a rate of a quarter of a million a day from August 1st. We also followed up with another mailing, a letter from the Chairman to the sixteen million gas customers. Those two exercises were highly cost-effective and produced around five million enquiries. In TSB, mailings achieved a 34% response rate from customers. That is far and away beyond the junk mail levels of response that you get in other areas and it's because you are dealing with people who are interested in something, you are talking directly to them, and you are being simple and adult about it.

Intermediary marketing I have touched on, but there is now in this country, a network of brokers who are skilled at coordinating communications in their territory and bringing people to the roadshows. The latter are supported by central marketing of a direct mailing type which tells people exactly what is happening and shows them the scale on which it was happening.

City communications are critical, revolving around the institutional briefings conducted by the issuing house and the brokers; broker reports; and exhibitions or events that invite the key institutional and intermediary audiences to see in one place the scale of events.

Employee communications are vital. If you don't take your people along with you, particularly when you are asking them to do new things and accept a higher workload, you will not succeed. For TSB for example, we produced a set of briefings that were backed by videos and an extensive staff training programme to make sure they knew what was happening and knew what they were expected to do and what they were allowed to do, and that they felt good about it.

Media relations are complex, since in a mass flotation we are typically dealing with over a thousand journalists, though the core journalist audience is probably about thirty-five strong. Those are the ones who will determine the tenor of the public reaction; and you want a programme of briefings and lunches, to give them the research findings and show them the weight of demand and interest, to give them enquiry figures. The advertising works alongside.

But never underestimate how much you have got to drive home the simple points. People still miss the boat.

managers, to the employees, and to the wider public in the privatization programme.

So if you get long-faced bankers, brokers or financial intermediaries, worrying you about market capacity, I have one simple recommendation -- sack them and find somebody who will deliver the goods, because the money is there and it should be their job to find the money for you and act as intermediaries creating a new marketplace.

Personnel

When you are confronted with agonized people saying that the employees and the managers of the enterprise won't let you sell the enterprise from under their feet, remember this little rule. There are very rarely employers, employees, managers of any public enterprise who do not find the freedom that comes from getting away from Government (and the higher salaries that can ensue) anything but liberating and refreshing. It needs explaining, you need to persuade them, you need to carry them with you. Good communications can work a little magic in those who might at first have been hesitant about going on this course.

Bureaucracy

The third rule is if you are faced with a bureaucracy which has high standards, a great deal of probity, honourable traditions of civil administration, but seems a little reluctant to shed some of its prized functions, do not despair. I have met no single bureaucracy in the world that has succeeded in keeping out every person of talent and enterprise that might have applied for a job there. There will be, even within your civil service, a few good people who would love the message of freedom, of privatization, of asset sales, of releasing new energies in your economy. Your challenge, whether as ministers or managers of enterprises seeking sale, is to locate those people and put them into a position where they can have an impact on the process of change and the formulation of policy.

PROCEEDING WITH PRIVATIZATION

Getting on with the job

First of all, when you are setting about your task of privatization, don't go for the two-year slog or the two million pound consultancy job to work out absolutely every detail and have sixty different companies listed in order of preference. If you are seriously interested in privatizing, there is no substitute for doing it.

By all means get some external help to identify the first two or three targets that can be privatized quickly and successfully. They will probably be competitive, profitable businesses, but if you are faced with the problem that you have no profitable businesses, you will have to sell some loss-makers, or you will have to make them profitable first by contractual arrangements, balance sheet re-scheduling and so forth.

If you are in an even worse position, where you have no competitive business, where every one of them is a monopoly, then in order to avoid a political disaster I recommend you break those monopolies very quickly. You must choose the easiest ones to break and you should introduce private capital

into those areas as quickly as you can.

Legal powers

Next, if you do need legal powers, if you find your law will not permit a sale, put a piece of legislation on the fast track to give you all the powers you need. I greatly regret that the British Government was persuaded that it needed a separate piece of legislation for every major privatization that it has carried out. That means by definition, a delay of well over a year for every major privatization target. How much better if you can go the French route and put in enabling legislation which permits you to sell any one or more of a whole list of companies or assets.

Assembling the team

When you have done that, then set up two or three teams of people, one for each of your fast-track early privatizations. As in everything in life, people are the key to success. You don't need hundreds of people, you don't necessarily need the most expensive people, you simply need the best, most highly motivated people who believe in the process and can not only see the problems but are interested in delivering solutions. You need the answers from people who are well aware of the extent and true nature of the difficulties you will face.

THE PROSPECTS

You can do a privatization from a standing start, in fairly difficult conditions, in three months. I say that with confidence because I have been privileged to help a country do just that: in Jamaica, the first major public offer sold into a stock market that previously traded only four hours a week and had a tiny turnover. It was done in less than three months from the first decision to draft a paper for Cabinet to the point at which all the shares had been placed.

In Jamaica, not a single foreigner was allowed to buy a single share, but the share issue was massively over-subscribed and the total size of the issue exceeded the annual turnover of the Jamaican stock exchange in the previous year.

For a relatively small issue in a modestly sized country, you can do it with a team of ten people. If you are in a very sophisticated country and if you have to surmount SEC regulations or difficult stock exchange requirements, or the Byzantine complexities of a national Treasury, then you may need fifty, or a hundred people. Most countries will fit somewhere on that scale.

For most types of privatization, you can now look around the world and see an example of almost every type of case. There is a corpus of experience and expertise that has now been built up worldwide, and there are many people more than willing to share it. It is well worth paying for if you can get the right advisor.

QUESTIONS AND DISCUSSION

Pierre Drion (Peterbroeck, Van Campenhout, Belgium): I would like to know if there is any blueprint for the team of advisors that is needed for a programme of privatization. And what type of fees do they apply for this

service?

John Redwood: Yes there is a rough guide to the kind of advice you would need for a large scale public offer for sale in a sophisticated capital market, or in a group of capital markets.

The most difficult type of privatization you can attempt financially is, of course, privatization with simultaneous launch of shares in all the world's major markets, with all their different listing requirements. That greatly increases the complexity and also therefore, the fees.

I would suggest that you approach HM Treasury; the officials there in the Information Department, can give you a little pack which sets out the range of advice that has been used in the UK privatizations and will give you an idea of the type of people you need. The public relations consultants, the stockbrokers, the advisory bankers, the receiving agents, the lawyers, the clearing banks -- all the people that are needed to deliver a good issue.

I think there is no substitute in your own domestic market for talking to those who are going to bid for this business and finding out from them what they would charge. The fees, typically, amount in a sophisticated issue to somewhere over 5% of the total realization proceeds, split between the bank, the broker, the lawyers, publicity consultants and so on; but the range could be somewhere between one and a half and ten percent of the total proceeds, depending on the degree of sophistication of the sale and the type of market in which you are operating, and the success or failure of the government in persuading people to do it for lower fees.

Alex Tomlinson (Centre for Privatization, Washington): In the case, Mr Redwood, of the Jamaican Bank, I understand that there were a cadre of Jamaicans who were very much involved and that the sale was done solely within Jamaica. Could you explain in a few words the role that Rothschilds performed?

John Redwood: Rothschilds were there to offer advice and support to a Jamaican team of people who were carrying out the sale and I think our skill lay in providing a timetable, a discipline to the sale, and in offering a range of options or solutions to problems we thought were going to come up. The Jamaican team could choose between these and make sure they had a solution in place at the right point in the process. It was quite a light commitment of man-hours involved from this country. We spent a bit of time there with them, but the bulk of the credit (as the bulk of the risk) rested with the Jamaicans, particularly Price Waterhouse Jamaica, and with the civil servants and the officials from the company involved.

In the case of National Commercial Bank of Jamaica, the bank did not retain its own advisors. It was possible to do that because there was goodwill within a very small team of people and everybody had an interest in making sure that a successful operation would transfer to the private sector that would be able to look after its shareholders. I agree with the comment that in many cases, the company will need its own advisors to make sure its interests are truly represented, but you don't have to do it that way.

Question: There are certain government undertakings that require some action far more drastic than merely privatization -- namely, to close them down completely. Do you have such experience?

John Redwood: Yes I think all countries have that difficulty and this is where the question of how many redundancies can you accept is important. Sometimes the question is, whether the company be slimmed down first before privatization, which means that the government gets blamed but privatization does not; or whether the company should be sold to the private sector on a fairly favourable price basis, reflecting the costs and dislocation that will naturally follow from redundancies, which in part shifts the blame directly from the government but opens privatization to the easy charge that it is just a covert way of sacking the workforce.

In my own view it is best to leave privatization out of major redundancy operations. It is better for the government to be honest about those parts of the public trading sector that are no longer trading at anything like a satisfactory level and deal with the bodies where major surgery is needed.

Sir Keith Stuart (Associated British Ports): I think it's just worth adding to what John Redwood has just said that the company to be privatized also needs its advisors, because remember that the company has to live with the investors and the market long after the act of sale has taken place. The Government, as the vendor, needs its advisors as described, but so does the company that is being sold off. For every banker or lawyer acting for the government as the vendor, there is usually a mirror image of them acting for the company, to make sure that the company, once privatized, is in a conditions in which it can live happily with its investors after the act of sale.

HOW BRITISH AIRWAYS WAS PRIVATIZED

Sir Colin Marshall
Chief Executive of British Airways

THE STARTING POINT

I have been asked to talk about British Airways and its change from a rather unhappy and depressed statutory corporation into a company with more than 400,000 shareholders: a company which has turned a substantial profit for more than five years and one which looks forward to competing effectively in the decades ahead in the increasingly integrated world markets of the travel tourism and transport industries.

The spadework

Privatization has become a word with a considerable cachet. One which implies avoiding bloated bureaucracy, achieving profit, and finding better ways to compete. However, I assure you that it is not merely the act of moving from the public to the private arena which may cause these things to happen. It requires long hard work at every level of a company to ensure that they do. Becoming private is in itself no immediate guarantee of improvement. In fact, if unaccompanied by anything else it may well result in additional travail, since quite often the personnel of public corporations find themselves ill-equipped to move efficiently into sections of business that are very different.

At British Airways it took us five years to achieve what we had hoped would happen in eighteen months. Much of this was due to some vicissitudes which almost no one could have anticipated. Even with this lapse of time we still have more work to do internally to get the company to the point where I would like to see it as a cost-effective business, eliminating the last vestiges of a statutory unit.

We are still encouraging changes in attitude, in response mechanisms, and in ways of working, both of the management and the staff level -- which will take some time yet to bring to fruition.

Privatization is something not to be lightly undertaken. The major problems of finance, restructuring and dealing with images in transition, are only the beginning. Beyond these are the uncharted areas of management/staff relationships, customer awareness, and responsiveness, the whole question of accepting risk and chance as part of everyday life rather than something to be avoided at all costs. These are a few of the things which anyone thinking about taking a company private needs to review. Without a top management totally dedicated to the concept and willing to withstand a long hard grind