Privatisation: Recent Trends

Introduction and Summary[1]

Global privatisation proceeds increased dramatically in 1997 to reach US$153.4 billion, which compared to the 1996 figure of US$98.4 billion, representing a 55 per cent increase. OECD economies still account for the majority of the proceeds or 64 per cent of the total. Privatisation transactions in the OECD area raised US$98.5 billion in 1997 or some 40 per cent more than in 1996, which was itself a record breaking year. An even more robust trend has been developing in non-OECD economies; the volume of privatisation proceeds doubled in 1997 to reach US$55 billion, compared to US$27.9 during the previous year (see Table 1).

Data from the past year confirms the predominant role of public offerings as the preferred privatisation method in OECD economies. In contrast, most non-OECD countries, for a second consecutive year, have raised most of their funds from privatisation through trade sales to strategic investors. The participation of domestic investors in OECD privatisation programmes continued to grow, whereas the role of foreign investors has remained significant, though relatively less important. In the OECD area, the changing attitude of the population at large towards equity investments and the emerging "shareholder" culture have led to an increasing role of retail investors in OECD privatisation-related public offerings. Overall, the distribution of shares at primary offerings remains roughly balanced between retail and institutional investors, while the latter are likely to be much more important in secondary offerings.

As regards future trends, of most governments with privatisation programmes have announced ambitious privatisation targets. On the face of it, this could be another record breaking year. However, the Asian financial crisis remains an important mitigating factor of potentially serious proportions. Asia itself was not expected to generate an important percentage of privatisation transactions in 1998 (with the possible exception of China). But the negative effect of the crisis in other emerging markets can already be felt; important transactions have been cancelled in Russia and Brazil in the first half of the year.

This review of privatisation trends relies on quantitative information, drawn mainly from the recently established OECD Privatisation Database.[2]

Privatisation in 1997

Selected OECD Member countries

The Italian privatisation programme has been one of the largest and most constant through the last four years. Leading the way in 1997 was the sale of nearly 45 per cent of Telecom Italia (formerly Stet), which raised US$14.9 billion and was the largest privatisation transaction of the year. The offering of the third *tranche* of the oil and gas giant ENI was the third largest offer in the world for 1997. Approximately 17.6 per cent of the shares raised L13.3 trillion (US$7.8 billion) and reduced the state share to 51.5 per cent. The next tranche, scheduled for 1998, is expected to bring the state share down further to 39 per cent.

The commitment of the Spanish government to broader and deeper privatisation was continued during its second year in office. Compared to the previous year, in 1997 Spain registered an impressive increase of proceeds to reach US$12.5 billion. The US$4.4 billion offer of Telefonica was nearly three times larger than the third *tranche* of the gas company Repsol, the previous record Spanish privatisation. The offer attracted over 1.2 million buyers and ranked seventh among the ten largest deals in 1997. Nevertheless, the largest sale of the year by Spain was the secondary offering of the power company Endesa, amounting to US$4.5 billion. Finally, at the end of the year, the public offer of approximately 59 per cent of the Spanish steel maker Aceralia raised 341.6 billion pesetas (US$2.27 billion), in what was the largest transaction in the manufacturing sector in the OECD area.

Notwithstanding delays in privatisation transactions following the June 1 elections, French privatisation proceeds in 1997 reached US$7.8 billion from US$5.1 billion in 1996. Approximately 21 per cent of the capital of France Telecom, the fourth largest telecom operator in the world, was sold in October 1997. Over 200 million shares have been sold in retail and institutional *tranches*, of which roughly 105.5 million shares have been allocated to French retail investors. Total proceeds of FF 42 billion (US$7.1 billion) have been raised in the initial public offering (IPO), making the transaction France’s largest public offering to date. In addition, France Telecom has now more than 3.9 million shareholders, more than any other

European telecommunications company. While the sale of France Telecom has proceeded, the long running sale of defence electronics company Thompson-CSF, as well as the sale of up to 47 per cent of Air France, both were postponed.

The largest ever privatisation in Portugal was the IPO of 30 per cent of Electricidade de Portugal, which was held in June 1997 and raised approximately Esc391 billion (US$2.3 billion). The book-building method was used in order to achieve a more flexible pricing of the shares offered for privatisation; the shares were listed on the Lisbon Bolsa and abroad. The third *tranche* of Portugal Telecom was also very successful and totalled US$2 billion.

The second largest privatisation since Deutsche Telecom in Germany was the sale of the state stake in Lufthansa, amounting to 37.45 per cent of the shares. A total of US$2.7 billion were raised on the domestic and international markets. The offer enjoyed high demand as a result of the dramatically improved financial performance of the airline through 1997.

With US$16.8 billion last year, Australia almost doubled its privatisation proceeds from 1996. Nearly two-thirds of these proceeds were raised from the IPO of 33.3 per cent of the national telecom operator Telstra for A$14.3 billion (US$10.9 billion). This transaction was the second largest in 1997 after Telecom Italia and among the ten biggest privatisations ever. Telstra was aimed at local investors, of which institutions acquired 21 per cent of the offer and retail investors 60 per cent. The purchase of Australia's Loy Yang A power station by the Horizon Energy consortium for US$3.8 billion, was among the largest sales in the energy sector in 1997.

The largest Japanese privatisation in 1997 was the sale of JR Tokai (the Central Japan Railway Company), which operates the "bullet train service" from Tokyo to Osaka. This transaction, the largest in Asia, was completed on 8 October, just before the financial market crisis. It was the third rail privatisation of Japan and it raised ¥485.9 billion (US$4 billion approximately). The offer was targeted to institutional and retail investors; the latter purchased approximately 90 per cent of the shares allotted to them. The state holding company JNR will retain the shares left unsold to individual investors plus a residual share of approximately 35 per cent of the shares.

Selected Non-OECD countries

Privatisation proceeds in Latin America reportedly reached US$27.5 billion, of which the major part was generated in Brazil. The country's privatisation programme, initiated in the early 1990s, has entered its second stage, which includes the sale of large state-owned companies and the award of concessions in various areas of infrastructure. The 1997 proceeds totalled over US$17 billion, amounting to 60 per cent of the recorded privatisation proceeds in the region. The majority of these proceeds came from the power sector; the largest sale was that of São Paulo utility CPFL for US$2.7 billion. It is worth noting that investors in the Brazilian power sector were prepared to pay large *premia* over base prices, which in the case of Energipe reached 97 per cent. The largest Brazilian transaction in 1997 -- the sale of a 41.7 per cent stake in the mining giant Companía Vale do Rio Doce(CVRD) -- totalled US$3.15 billion. Large privatisation transactions also took place in Argentina, Colombia, and Venezuela, respectively with the sale of the postal firm Encotesa for US$3.1 billion, EEB Condesa Emgesa for US$2.2 billion and the steel company Sidor for US$1.2 billion.

Privatisation in Asia has suffered in the wake of the 1997 financial crisis, which resulted in delayed transactions or reduced privatisation proceeds. These negative trends might be expected to continue in 1998. Despite the market turmoil, however, certain transactions from the region succeeded in raising significant proceeds. China Telecom was one of the major listings in the area; it raised US$3.9 billion. The share price was affected by the serious fall of the Hong Kong stock exchange index, which occurred on the same day the shares were listed. Major transactions also have been prepared in Taiwan, including sales of insurance companies and the so called "Big Three" banks. The first of these, the sale of Chiao Tung Bank, was completed in 1997 and raised US$1.1 billion.

Large privatisation transactions in Russia raised an estimated US$3.2 billion. The most important transaction was the sale of 25 per cent of the telecom operator Svyazinvest, which was bought by a group led by the local Unexim bank for US$1.8 billion. However, the largest sale reported in transition economies was the privatisation of the Kazakhi Oil Company Aktyubinskneft for US$4 billion.

Privatisation activity in Africa was relatively subdued in 1997. In South Africa, the government's commitment to privatisation resulted in a number of deals. The largest was the sale of approximately 30 per cent of the national telecom operator, Telkom, for proceeds totalling US$1.3 billion.

Ttrends and prospects

In light of the plans currently reported by governments, privatisation proceeds in 1998 are expected to be significant. Among the major factors that could result in lesser amounts being raised are changes in governments' priorities, delays in the preparation of transactions and, most importantly, market conditions. The Asian financial turmoil has already rendered most emerging markets considerably volatile. In certain cases, in Asia and elsewhere, it has caused severe and prolonged drops in share values. Repercussions from the crisis are beginning to be felt by large corporations, banks and financial intermediaries in the OECD area, who have credit exposures to Asian concerns or other significant business dealings. Should the situation worsen, the incentive for governments, companies and their financial advisors/underwriters to bring transactions to the market could weaken, directly affecting OECD privatisation programmes.

In the absence of significant market disruptions in the year ahead, telecommunications, electricity and banking are expected to account for the largest amount of proceeds. OECD privatisation activity in 1998 is expected to be dominated by the sale of the Italian electricity giant ENEL. Proceeds from this privatisation could reach US$15.6 billion. Together with the fourth *tranche* of ENI, other major privatisations expected to come to market include Alitalia, the institutional offering of the country's fifth largest bank in terms of deposits (Banca Nazionale del Lavoro), and Aeroporti di Roma. Spain, which is also planning a large privatisation programme for 1998, completed a major public offering of over 29 per cent of the shares of Argentaria Bank in February, which raised US$2.4 billion, surpassing by almost a half billion dollars the initial optimistic projections. The IPO of up to 75 per cent of Germany's Postbank is expected to raise some US$1.8 billion, while additional bank privatisation transactions are also on the agenda for 1998. Future privatisation plans for Deutsche Telecom (DT) have taken an important turn with the decision to exchange 7.5 per cent of its shares with France Telecom. No public offerings of DT shares are expected in 1998 and 1999. Another important telecom transaction in Europe, the sale of 42 per cent of Tele Danmark to the US company Ameritech for US$3.2 billion, was completed in January 1998.

In 1998 the French government is expected to dispose of up to 47 per cent of its shares in Air France. The sale of 67 per cent of the French bank CIC for US$1.6 billion took place in May 1997 and will be followed by that of its parent, GAN insurance company. At the beginning of 1998, 7.7 million shares (the balance from an earlier 1995 privatisation) of Pechiney, the aluminium and packaging group, were sold for FF 2.3 billion (US$371 million). However, half of the shares will remain in public hands, as they were sold to Electricité de France and the nuclear fuel firm Cogema. The troubled state bank Crédit Lyonnais is to be privatised by 1999, following an agreement between the European Commission and the French government.

The Australian government forecasts sales proceeds of A$15 billion (US$10.5 billion) over the next two years. New assets for sale will likely include Australian Multimedia Enterprise, Australian Defence Industries, broadcasting transmission networks, and commercial property. The government's programme for concessions over the operation of the country's airports has been continued in 1998. In Korea, notwithstanding the ongoing crisis, the government is planning to go ahead with an important privatisation programme in 1998-1999, that will include a secondary offering for Korean Telecom, with expected proceeds of up to US$1.2 billion. Other planned privatisations include the Korean Development Bank and 35 per cent of Pohang Iron and Steel, the world's second largest steelmaker.

In non-OECD countries, Brazil will be a major privatisation player with US$32 billion of proceeds expected in 1998 and US$22 billion expected in 1999. Among the largest privatisation deals under preparation are: The public offering of the residual state share in the partially privatised Compania Vale de Rio Doce, the sale of the telecom giant Telebras, as well as a series of transactions in the power sector. Similarly, Russia has recently drawn new plans for the privatisation of the oil company Rosneft; the first attempt to sell Rosneft in April 1998 fell through as it coincided with a severe stock market crisis in Russia. An important question is whether China will also become a victim of the crisis in Asia. The Chinese government has embarked since mid-1997 on a very ambitious programme of reforms and restructuring of the state-owned enterprise sector. This is leading to the transfer of the ownership of thousands of smaller industrial enterprises; it might also increase considerably the sale of minority stakes in larger industrial concerns.

Structural aspects of privatisation

Privatisation in selected sectors

Since 1981, telecom privatisations have raised more than US$183 billion. In 1997, telecommunications have been the sector which generated the highest proceeds in OECD Member countries. OECD governments raised an astonishing US$40 billion, more than double the 1996 figure. The great majority of OECD members have by now introduced a sizeable amount of private equity in their main carriers' capital. Some of them, such as British telecom (1992) or Spanish Telefonica (1997) have become completely private or have private majority ownership, while others (France Telecom, Deutsche Telecom, Australian Telstra, Greek OTE) have only allowed minority stakes to be sold. Many of the smaller companies, such as Belgian, Irish, Hungarian and Czech telecom carriers, have opted for trade sales of important minority packages to strategic investors and expect to place the remaining equity in the market. This rush to sell can be explained partly by favourable market conditions and budgetary pressures. However, it seems that the most important reason is the realisation by governments of the rapidly changing nature of the telecoms market owing to technological developments. What were previously closed, natural monopolies are quickly becoming competitive markets. Companies need to show investment flexibility and international competitiveness levels that cannot be reached under state ownership. It is likely that markets will be ready to absorb telecom shares at a sustained high rate over the next two years, provided that governments still holding potentially blocking minorities, refrain from intervening in the commercial running of the companies.

The transport sector has also seen considerable privatisation during 1997. There were three major transactions: the privatisation of the British rail network (Railtrack), the last in a series of UK rail privatisation transactions, and the privatisation of the JR Tokai railway in Japan, another one in a series of railroad privatisations in countries with already advanced rail privatisation programmes. The third major transaction in the transport sector was the partial floatation of Lufthansa. This transaction is part of a clear trend in air transport towards greater competition and private initiative. In Europe, privatisation has been closely related to the restructuring of chronic loss-making, state-owned airlines, and a number of them are expected to look for buyers very soon. Intimately related to airline privatisation has been the privatisation of airports, which also has been taking off recently; airport sales/concessions represented a major slice of Australian privatisations proceeds in 1997. Overall, it seems that the bulk of transport assets in the OECD area have yet to come to the market, which makes this sector a potentially dynamic one for privatisation in the medium term.

Other public utilities, most notably energy generation/distribution and urban waste management, have also been a major source of privatisation activity over the last five years. Interestingly, this is one area where non-OECD members seem to generate a comparable level of proceeds to their OECD counterparts and to show a more consistent upward trend.

Privatisation methods

OECD economies have sophisticated financial markets, a highly developed legal framework and a few large privatisation candidates that have usually been restructured prior to their privatisation. This environment plays a decisive role in the selection of privatisation techniques, procedures, and in general, the design of policies and privatisation programmes. Public offerings in the equity market have been the preferred method for privatisation in the OECD area (see chart 4) . In contrast, trade sales (see Chart 5) play a much more important role in non-OECD countries. This probably reflects the fact that the companies sold are much more in need of fresh investment capital and a better incentive structure than their OECD counterparts; but, in addition, governments perceive that they can only become competitive through the infusion of managerial, technical and marketing know-how and capacity that an already established strategic investor has. Very often, trade sales are combined with a secondary offering in the market.

IPOs are the most transparent privatisation method, in addition to serving broader government objectives such as the development of equities markets and the creation of a broad share-owning class. Transparency of procedures is important because privatisation is a highly political process. In many countries it involves challenging powerful vested interests and long established ways of appropriating financial flows in enterprises. Because it is so political, choosing flexible but secretive arrangements over transparency might have a strong negative impact on many privatisation efforts. Recent experience in a number of OECD countries, amongst them France and Greece, are a proof of the need to publicly explain choices in a transparent way. In addition, greater transparency of sales procedures results in higher returns for the budget. This is also true for privatisation costs. Spain, for example, is reported to have saved up to 75 per cent in its transaction costs as a result of a switch to open competitive procedures for the selection of advisors.

One of the principle goals of privatisation is to improve corporate governance in privatised firms. Various methods of sale will have a different impact on governance. Public offerings will often result in a relatively diverse shareholder base which will tend to provide only weak direct control over management. However, in developed capital markets a capital market discipline, even when the stake sold is relatively small. In most cases, managers are very quick to focus on relations with the shareholders and to improve transparency in the way the business is run. In addition, there is the take-over threat.

In principle, privatisation schemes aiming to raise money for the budget without introducing serious changes in incentives cannot be expected to generate most of the long-term benefits of privatisation. The excessive use of cross-shareholdings, golden shares, and stable shareholders as a means of preventing control from outsiders, have the effect of reducing considerably long-term privatisation gains. Not surprisingly, governments have begun to replace these tactics with new approaches, in which the commitment to long-term ownership by members of the "core" is no longer an explicit requirement. A number of variants have been adopted; most attempt to limit the negative effects of stable shareholders, while preserving some of the stability and long-term engagement that they are supposed to nurture.

Finally, so-called transitional privatisation in several post-communist economies has come to a close, with mass privatisation and other non-traditional schemes having ended or nearing completion. These schemes usually have involved a free (or almost free) transfer of ownership to segments of the population and therefore have generated limited proceeds. The trend is towards traditional methods for the privatisation of the remaining state-owned enterprises. This has led in some cases to an actual increase in proceeds from privatisation (such as in the case of Poland during the last few years) even though the size of the assets under transfer is smaller than before. Moreover, the sectors involved are increasingly the same ones that are the predominant targets of privatisation in the mainstream OECD economies.

The profile of buyers

Recent years have seen a significant increase in the number and value of privatisation equity offerings. An impressive number of European firms were successfully brought to the market.

Government incentives represent an important element of retail demand. Explicit price discounts, free shares, bonus shares, insurance against developments in the after-market, subsidised subscription loans or instalment payment mechanisms have been put in place and are an important reason for a consistently high percentage of retail tranches in privatisation issues. The existence of a strong, non-price sensitive retail demand is forcing institutional investors to compete more actively for shares in the book-building process. This tension between retail and institutional demand may result in higher prices than if institutional investors alone participated. In situations in which initial allocations are scaled back, strong retail demand will also help the immediate after-market as institutional investors buy on the secondary market to reach their targeted holdings. IPOs with strong retail demand have generally been priced close to the top end of the price range.

Notwithstanding the importance of the retail component, institutional participation in offerings has increased significantly during the last 20 years -- and the initially very high retail tranches of 1980s-vintage privatisations (especially in the UK) have been considerably tempered by the growth of financial asset management firms. The phenomenal growth of these institutions has had two effects: they have absorbed part of the retail demand of privatisation; and they have brought about an increase in the role of foreign investors in the institutional tranches of privatisation offerings.[3]

The important role played by foreign institutions in larger IPOs is now widely appreciated. Pension funds, life insurance companies and mutual funds are keen to diversify the geographical distribution of their portfolios as they focus increasingly on equity investment. The importance of international institutions might actually be understated in Chart 6A. As noted, their presence is very important in the immediate after-market in privatisation offerings; and they are very often buyers of residual sales in the context of private placements.

The relative importance of international and domestic investors (see chart 6B) at any given moment results from several factors, including the depth of the domestic equity market and political objectives of placing more assets more or less domestically. One of the goals of privatisation programmes is to widen share ownership among domestic retail investors and to create an "equity culture" in bank-dominated economies, which has translated into increasing participation of domestic investors in privatisation placements. Their relative importance in 1997 was even more pronounced in trade sales. This partly reflects the fact that sales to foreign strategic investors are much more conspicuous and, therefore, more politically sensitive than sales to foreign institutions in the course of public offerings. It is telling that the average percentage of sales to foreign institutions via IPOs has reached 38.5 per cent of proceeds over the last 7 years, as opposed to 27.5 per cent for trade sales to strategic investors.

The impact on capital markets

In most OECD countries, privatisation has been instrumental in the further development of financial markets by boosting total market capitalisation, transaction volumes and liquidity, and by bringing new shareholders to the market. Privatisation in many countries has contributed to a shift from traditional forms of savings to equity investment. This trend has created more demand for privatised assets and has rendered privatisation more popular. In turn, the development of local capital markets has fostered the success of privatisation.

In 1997, the stake of privatisation offerings in international equities reached 28 per cent, or US$24 billion in absolute terms.[4] This was about in line with the average reported share over the past ten years.[5] In general, the share of privatisation-related issues tends to grow in booming stock markets, while, as noted above, declining or volatile stock markets have a negative impact on privatisation. The Spanish Tabacalera privatisation is one example; underwriters involved in that particular transaction actually incurred losses, the first such occurrence with an OECD privatisation offering.

Government privatisation programmes have had a strong impact on the distribution practices and syndicate structures in international equity offerings. Evidence from the past decade shows that both the number of tranches included in large equity offerings and the number of participating banks has decreased over time. Growth of fund flows between domestic and international markets and the consolidation in the investment banking industry have also had an important impact on the way privatisation transactions are carried out. The increasing globalisation of the financial services sector has resulted in greater capacity in global distribution and large block trading for fewer but larger banks.

Moreover, enhanced competition has led to a decline in fees, which in part, accounts for the emergence of smaller syndicate structures. Investment banks engage in fierce price competition to win government privatisation business, a relatively new element in their client strategies. In the mid-1990s, as European governments sold big stakes of their telecom, banking, and utility sectors, underwriters were earning close to 3 per cent of the value of each transaction. It has been reported that average fees in 1997 in Europe amounted to 2.5 per cent; for certain deals, they have even dropped to 1.8-1.7 per cent.[6]

Privatisation of OECD banks has itself led to dramatic efficiency increases in the banking sector: These were effectuated either through internal restructuring or productivity improvements, or through wide-spread mergers and acquisitions to eliminate overcapacity in the previously state-dominated banking sector.

Notes

1. This article has been prepared by Stilpon Nestor and Elena Miteva of the Privatisation and Enterprise Reform Unit, OECD. Ayse Bertrand and Agnes Cimper of the Financial Statistics Section were responsible for putting together the comparative statistical data.

2. This has been less important in the case of privatised companies, due to various devices that governments put in place in order to control the ownership structure after privatisation. Only in the case of the UK have privatised companies been subject to the rigorous discipline of the take-over/corporate control market.

3. The importance of institutional investors has increased spectacularly in international markets during the last 20 years. In 1981 they held assets worth US$3.2 trillion in the OECD area; in 1995 the figure had reached US$24.3 trillion, US$17.5 trillion of which were held by investment companies/funds, pension funds and insurance companies (see OECD 1997c).

4. See OECD (1997a)

5. See, for example, the presentation by Matthew Westerman, director at ABN-AMRO Rothschild, at the Rome meeting of the OECD Privatisation Network, September 1997.

6. See Vincent Boland.

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