

SPECIAL FEATURE

Privatisation: Recent Trends

Introduction and summary¹

During the 1990s, the rolling-back of state ownership in the economy through privatisation gathered considerable pace both in OECD countries and outside the OECD area, (see Chart 1). This process of privatisation is having an impact on economies across the globe, most notably by giving market mechanisms a greater influence over resource allocation.

Obviously, the surge in global privatisation is having a profound impact on capital markets in general, and on equity markets in particular. Indeed, one specific motive behind many privatisation programmes is to assist the development of equity markets by increasing market capitalisation and liquidity.² A closely related motive is to widen share ownership and to create a “shareholder” culture in the population at large. In a broader economic context, the existence of efficient equity markets is likely to prove important, as countries increasingly seek to address the issues of pension system reforms and of ageing populations. At the same time, by replacing public sector decision-making and control with those of the private sector, privatisation is inducing notable changes in the corporate governance structures in important segments of the economy.

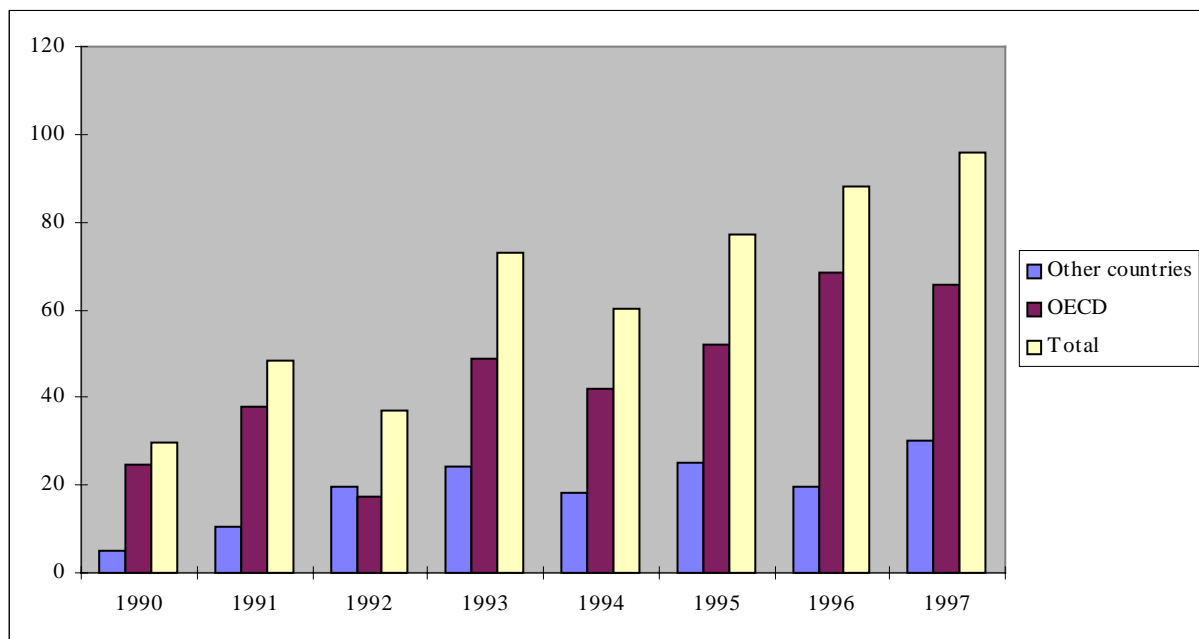
It is not the ambition of this article to cover all these topics. Rather, the article seeks to describe some of the most significant recent trends in privatisation,³ to highlight some key structural aspects of privatisation, and to discuss the impact of privatisation on capital markets, most notably on equity markets. In doing so, information drawn from the recently established OECD Privatisation Database⁴ is presented with a number of detailed breakdowns.

The main conclusions are:

- In 1996, world-wide privatisations amounted to an all-time high of \$88 billion, with a record-breaking \$68 billion raised from privatisations in OECD countries.
- In 1997, global privatisation could reach \$100 billion.

- Since 1993, OECD privatisations have predominantly been made through public offerings in the capital markets as opposed to trade sales to strategic investors.
- Despite a substantial role for international investors, domestic investors have become increasingly important buyers in OECD privatisations.
- In the past three years, privatisation-related public offerings have been evenly balanced between private and institutional investors.
- Privatisation will play an important role in the ongoing transformation of capital markets in the OECD – due to its high profile, privatisation may facilitate a switch from investment in bonds to investments in equities.

**Chart 1. Global amount raised from privatisation
(US\$ billion)**



Sources: National statistics, OECD, World Bank and SBC Warburg.

Trends and Prospects

Privatisation in 1996

Recorded privatisations in the OECD area surged from \$53.1 billion in 1995 to \$68.3 billion in 1996, and last year's was the highest amount raised from privatisations ever recorded for the OECD area. However, the recorded amount raised from privatisations in non-OECD countries fell from \$25.1 billion in 1995 to around \$19.5 billion last year.⁵ Nevertheless, with a record-breaking \$87.7 billion, global privatisations increased some 12 per cent when compared with the \$78.2 billion raised from privatisations in 1995 (see Table 1).

Selected OECD privatisations

Within the OECD area, several large-scale privatisations took place in 1996. Among European OECD countries, by far the largest transaction was the initial public offering (IPO) of Deutsche Telekom, the German telecommunications company, in November. The offering, which was heavily oversubscribed, was the largest single privatisation offering ever, with a total of DM 20.1 billion (some \$13.3 billion) raised from the market. The offering was technically a new share issue by the company in which the state did not participate. As a consequence, the proceeds of the offering went to the company, while the stake of the government dropped to 74 per cent.

The second-largest privatisation offering last year was the November secondary offering in the Italian oil and gas company, ENI, which raised L 8 872 billion (\$5.9 billion). After the offering, the stake of the state in the company dropped to just under 70 per cent. With more than \$6 billion per year in the last three years, the Italian government has been running one of the largest and most constant privatisation programmes in terms of overall funds raised.

In spite of the fact that the United Kingdom privatisation programme is drawing closer to the end, several large privatisations emerged again in 1996, most notably the two IPOs in Railtrack and in British Energy. The Railtrack offering raised £1.9 billion (some \$2.9 billion) from the market. British Energy (a nuclear electricity generator) raised £1.5 billion (some \$2.2 billion). The United Kingdom's Private Finance Initiative (PFI), under which private companies provide public infrastructure services, has now delivered agreed deals with a capital value of over £7 billion. In 1996, there were three PFI bond issues raising some £400 million for transport and light rail projects. Additionally, five equity funds for investing in PFI deals have already been launched.

Over the past several years, the government of Portugal has undertaken a vast privatisation programme. Last year, privatisations amounted to \$3.8 billion, up some 65 per cent from the \$2.3 billion recorded for 1995. The major transactions included

the Esc 146 billion (\$0.9 billion) offering in Portugal Telecom and the Esc 116 billion (some \$0.7 billion) offering in the cement company, Cimpor.

In France, the privatisation programme sprang back into life in June with the secondary offering in AGF, the large insurance company. Including the equity sold to employees, this offerings raised over FF 9.7 billion (\$1.9 billion) and it was very well received in the market. At the end of January 1997, the share price of AGF had risen substantially over both the retail and institutional offer price, and it had out-performed the general market index. Following the disappointing post-launch share price performance of some previous offerings, the AGF privatisation could prove important in re-vitalising French privatisations.

In Spain, the government continued its wide-ranging privatisation efforts through secondary offerings in the banking group, Argentaria, and in the oil and gas company, Repsol. The Argentaria offering raised Ptas 154 billion (some \$1.3 billion) while the sale in of Repsol raised Ptas 77 billion (\$0.6 billion).

Looking at OECD countries outside Europe, the Australian Commonwealth and the state governments have in recent years embarked on impressive privatisation programmes. The largest single privatisation in 1996 was the sale of the remaining state participation in the Commonwealth Bank of Australia. The transaction raised a total of A\$ 5.2 billion (\$4.1 billion), including a share buy-back by the company. Privatisation activity at the state level also continued at a strong pace. In particular, several large^e sales in the energy sector took place. More generally, private financing has become an increasingly important way of raising the necessary funds for infrastructure projects with limited strains on government budgets. Reflecting this development, the first Australian infrastructure fund was listed on the stock exchange, raising A\$ 300 million. The fund is already involved in several toll-road projects.

In 1996, the Japanese government re-launched its privatisation programme, raising \$6.4 billion. By contrast, there had been no privatisations in 1995. In June, the government made a secondary offering of Japan Tobacco which raised ¥ 222 billion (\$2 billion). This was the first Japanese privatisation offering to use the more flexible pricing available with the book-building method, which is now widely adopted elsewhere, and it was well received in the market. In October, the government came to the market with an IPO in West Japan Railway Corporation, raising ¥ 488 billion (\$4.3 billion). Although oversubscribed before pricing, the offering was eventually undersubscribed at the time of payment.

Table 1. Country breakdown of global amount raised from privatisation¹ (US\$ million)

	1990	1991	1992	1993	1994	1995	1996 ^p	1997 ^e
Australia	19	1267	1893	2057	2046	7966	9580	7100
Austria ⁵	32	48	49	142	700	1035	1251	1600
Belgium	-	-	-	956	549	2681	1221	900
Canada	1504	808	1249	755	490	3803	1762	2000
Czech Republic ⁷	..	..	..	..	1077	1205	994	700
Denmark	644	-	-	116	2815	12	382	100
Finland ³	-	-	-	229	1166	363	911	100
France ³	-	-	-	12160	5479	4136	5099	5300
Germany ⁵	-	325	-	435	240	-	13273	2600
Greece ^{3,6}	..	..	..	..	..	..	529	1500
Hungary	38	470	720	1842	1017	3813	880	1000
Iceland	..	..	21	10	2	6	-	-
Ireland ³	-	515	70	274	-	157	293	-
Italy ^{3,8}	-	-	-	1943	6493	7434	6265	6600
Japan ⁴	-	-	-	10060	5762	-	6379	8700
Korea	-	-	-	817	2435	480	1849	1700
Luxembourg	-	-	-	-	-	-	-	-
Mexico ³	3124	10754	6866	2503	766	170	72	1900
Netherlands	699	179	17	780	3766	3993	1239	600
New Zealand ³	3895	17	967	630	29	264	1839	-
Norway ³	-	-	-	287	118	510	660	200
Portugal ³	1092	1002	2217	422	1123	2343	3824	3500
Poland ²	62	338	240	734	642	1516	495	3500
Spain ³	228	-	1491	2561	1390	2215	1877	11500
Sweden	-	-	378	252	2313	852	785	1100
Switzerland	-	-	-	-	-	-	-	-
Turkey ³	486	224	423	546	412	515	292	4100
United Kingdom ^{4,9}	12906	21825	604	8523	1341	6691	6695	3300
United States	-	-	-	-	-	-	-	-
Total OECD	24729	37770	17204	49032	42171	52162	68449	69600
<i>of which: EU15</i>	<i>15601</i>	<i>23894</i>	<i>4825</i>	<i>28792</i>	<i>27376</i>	<i>31915</i>	<i>43648</i>	<i>38700</i>
Other countries	5078	10413	19845	23976	18111	25058	19479	30000
Global total	29808	48183	37049	73008	60282	77220	87929	99600

.. Not available

- Nil or insignificant

e: Estimates; p: Preliminary.

1. The amounts shown are gross proceeds from privatisation. These do not necessarily correspond to the net amount available to the government. Also, the figures are on a calendar year basis and they may not add up to published budget figures.

2. OECD estimates, World Bank and SBC Warburg estimates for all years.

3. 1997: OECD and SBC Warburg estimates.

4. 1997 is fiscal year.

5. Information on trade sales not available.

6. 1996: OECD estimate.

7. The cumulative amount for 1991-1993 is 2240 US\$ million.

8. In 1996, there was also a convertible bond issue in the insurance group INA, raising 2130 US\$ million.

9. The United Kingdom government has also sold debt in privatised companies amounting to £1337 million in fiscal year 1992-93, £1617 million in fiscal year 1994-95 and £663 million in fiscal year 1996-97.

Sources: National statistics unless otherwise indicated.

Some observers have pointed to the relatively long period from pricing and allocation to payment and listing as an explanation for the deal ending-up undersubscribed. Reportedly, many investors, who had been allocated stock in the fixed-price tranche, chose not to purchase the stock at the payment date.

Selected non-OECD privatisations

In terms of funds raised, Brazil was the most important non-OECD country in 1996, when privatisations amounted to some \$3.7 billion. The largest deal of the year was the auction in May of the utility company, Light, which raised R\$ 2.2 billion (some \$2.1 billion). At the auction, an international group of three energy companies bought a controlling stake. Also, in a trade sale, an international consortium bought one of Rio de Janeiro's electricity distributors for R\$ 0.6 billion.

Elsewhere in South America, privatisation activity was hectic in Peru in 1996, when the total amount raised from privatisations reached \$2.1 billion. The largest single transaction was the privatisation in July of Telefonica del Peru, the national telecommunications company, which raised some \$1.2 billion. The IPO was met with solid demand, in particular from international investors. By contrast, the other major public offering coming out of Peru last year, Luz del Sur, was less well received by international investors. Consequently, the tranche designated to international investors was reduced, while the tranche allocated to domestic retail and institutional investors was increased. Some \$0.2 billion was raised in this secondary offering.

In Asia, the Indonesian privatisation programme rebounded from the negative experience with the PT Telkom offering in November 1995. International investors had showed limited interest in the issue, which had to be markedly scaled down and the issue price reduced. In October, the government came to the market with an IPO of Bank Negara Indonesia, raising \$0.4 billion from both domestic and international investors. Soon after the Bank Negara Indonesia offering, the Indonesian government sold 388 million shares in a private placement. The shares were priced at a 4.5 per cent discount to the market price, raising a total of \$0.6 billion.

In contrast to the reasonably high level of privatisation activity in South America and in Asia, privatisations in Africa remained of limited significance in 1996 and no major transactions emerged from this region.

Privatisation in 1997

This year, privatisations could raise \$100 billion globally, (see Table 1). Privatisations in OECD countries are estimated to reach \$70 billion, while privatisations in non-OECD countries could total some \$30 billion.

It must be emphasised that the figures for 1997 are best estimates, which may change at short notice as a result of several developments, such as changing market

conditions, the need for more or less restructuring than originally thought of companies to be privatised, or a change in government and political priorities.

This caveat is particularly true for estimated privatisations in non-OECD countries, which generally experience more uncertainty than OECD countries do.

In the OECD area, a particularly high level of privatisation activity is expected in Spain (\$11.5 billion), Japan (\$8.7 billion) and in Australia (\$7.1 billion). It may also be noted that in the period ahead, the amount raised from privatisation in Canada may increase markedly, in particular if the Province of Ontario proceeds with the plans to privatise Ontario Hydro. As was the case last year, the telecommunication sector is likely to be a focal point for privatisations in 1997. The year had hardly begun before the Spanish government sold its remaining 20 per cent in Telefonica, the Spanish telecommunications company. Most market observers expect further large telecommunication privatisations this year, with France Telecom, Stet in Italy and Telstra in Australia among the possible candidates.

Outside the OECD, Brazil is likely to be running the largest privatisation programme. The Brazilian programme encompasses large-scale privatisations both by the federal government and at the state level. Concerning the central government, the largest transaction is expected to be the partial privatisation of Companhia Vale do Rio Doce, a mining conglomerate. Elsewhere, it is expected that the South African privatisation programme could get off the ground, with one possible candidate being the national telecommunications company.

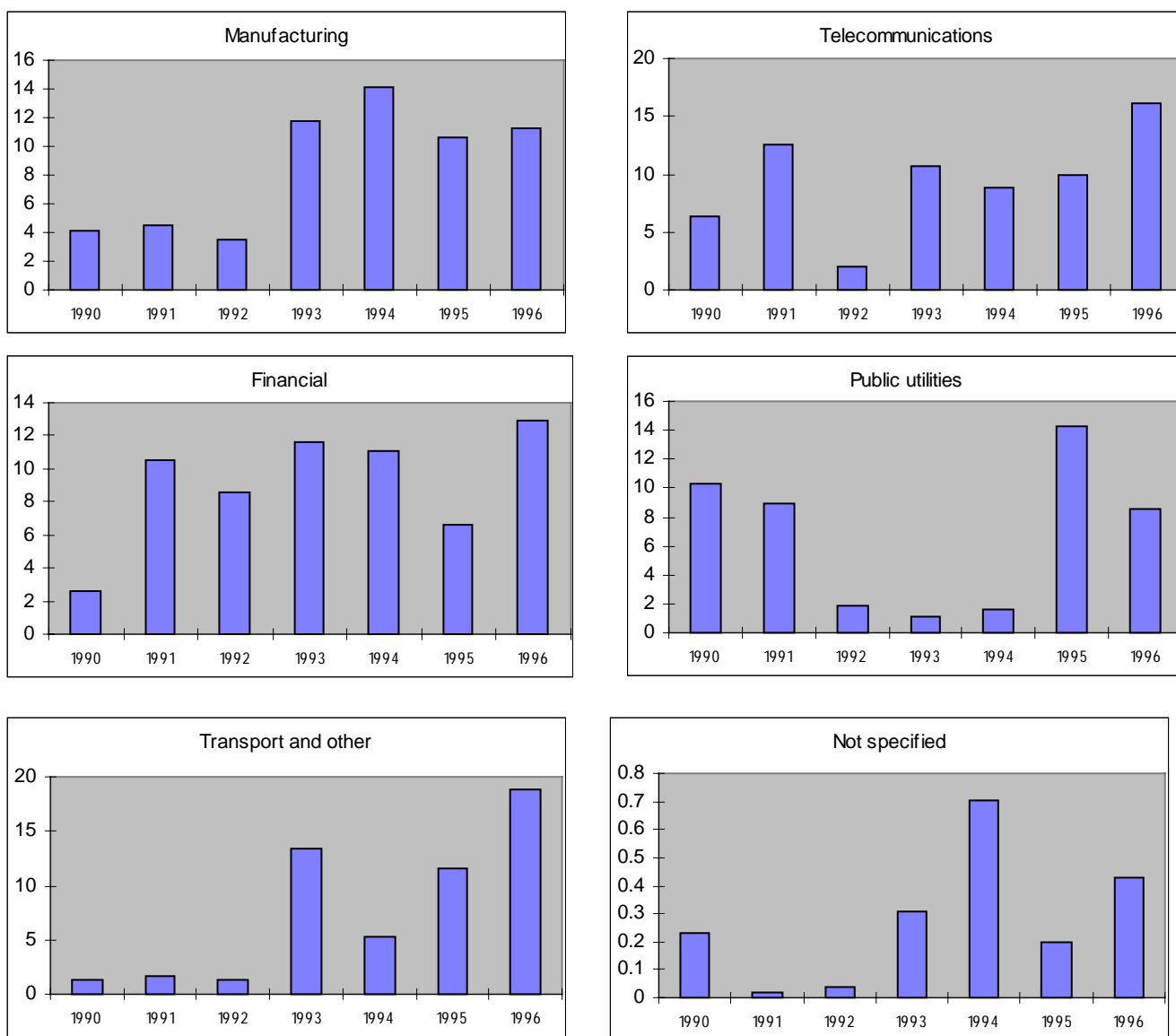
Structural aspects of privatisation

Privatisation by sector

As it might be expected, the sectoral distribution of privatisation in the OECD area varies quite significantly from year to year (see Chart 2), and sectors that were important in a given year may all but disappear the following year.

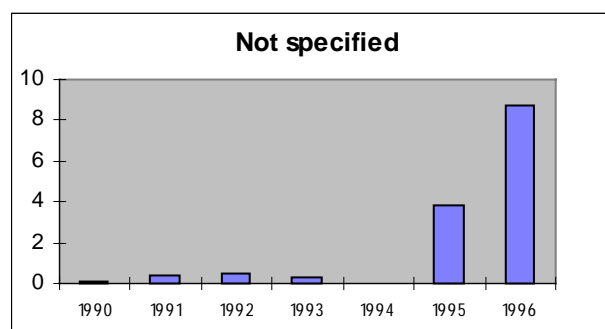
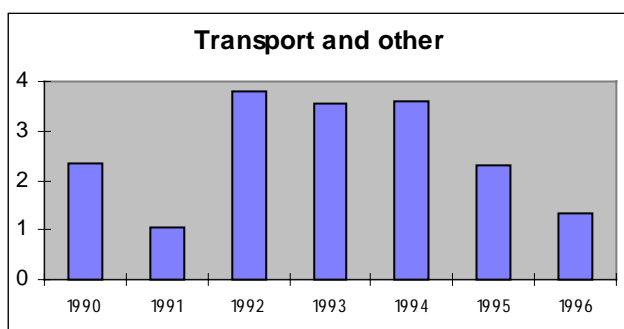
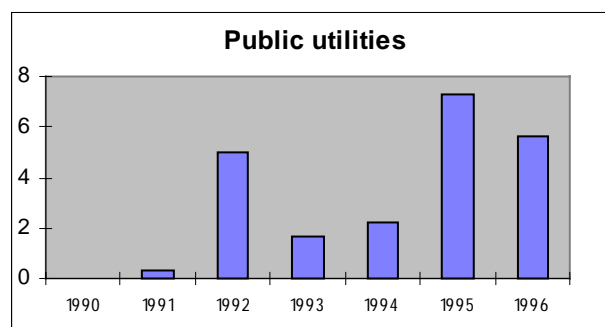
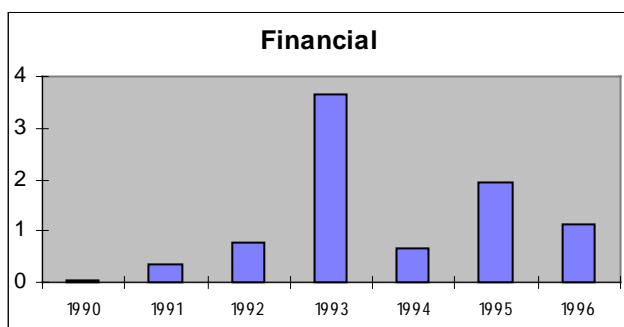
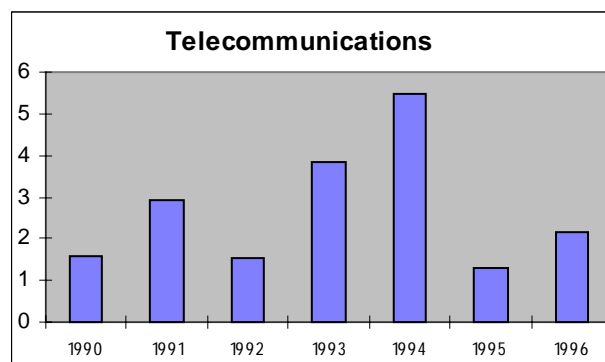
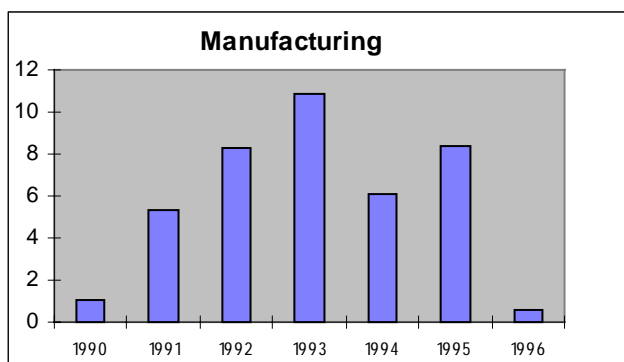
Generally, governments have first sold those companies that least needed restructuring and that were already operating in competitive sectors, most notably, manufacturing companies and financial institutions. Later in the privatisation programmes, governments have typically begun to dispose of companies that required more restructuring and where a regulatory framework needed to be put in place, such as telecommunications and public utilities. Consequently, the overall sector distribution in any one particular year depends critically on which countries are

Chart 2. Privatisations in OECD countries by main sector
(US\$ billion)



Sources: National statistics, OECD, World Bank and SBC Warburg.

Chart 3. Privatisations in non-OECD countries by main sector (US\$ billion)



Sources: OECD, World Bank and SBC Warburg.

predominant in terms of privatisation transactions, and where in their privatisation programme these countries stand. Obviously, the sector distribution is also a function of which companies governments historically have been left holding.

In the early part of the 1990s, OECD member countries' privatisations were dominated by offerings in the United Kingdom and Mexico. In 1990 and 1991, the United Kingdom privatisation programme, which at that time had already been running for over a decade, was characterised by several large privatisation operations in the utility sector. Also, in 1991, the second tranche in British Telecom was offered. In the case of Mexico, the years 1991 and 1992 were dominated by privatisations in telecommunications (Teléfonos de Mexico, S.A.) and in the financial sector. In fact, the Mexican financial privatisations were a major explanatory factor behind the hike in OECD member countries' privatisations in this sector in 1991 and 1992.

Since 1993, when more and more OECD countries embarked on large-scale privatisation programmes, sectors that would normally be found early in a programme became more visible. Most notably, privatisation operations in manufacturing surged in 1993 and have since stayed at a relatively high level. Likewise, privatisations in the financial sector have remained at a significant level. Other noteworthy developments are the rebounds in public utilities privatisations in the last two years. Last year, there was also a rise in privatisation in transports and other sectors, which was spurred by the offerings in West Japan Railway Corporation and in Railtrack in the United Kingdom. Although telecommunication privatisations have been very much in focus in recent years, it may be worth noticing that significant amounts were raised also in 1991 and 1993.

When comparing the sectoral distribution of OECD privatisations with that found for privatisations by non-OECD countries, a number of differences are worth mentioning. First, privatisations of financial institutions are much less important in non-OECD countries than in OECD countries. With the exception of 1993, the amount raised from privatisation of financial institutions has been fairly modest in non-OECD countries (see Chart 3). Second, privatisation in the manufacturing industry is typically more important for non-OECD countries than for OECD countries. To some extent, this reflects the fact that state ownership of industry in many non-OECD countries was taken to a much higher level than in the OECD area. Finally, the recent rise in privatisation of public utilities is worth noting.

Privatisation methods

Privatisations in the OECD area have predominantly been made through public offerings of equity in the capital markets (see Chart 4). In fact, during the period under consideration, only in 1992 were public offerings not the most important privatisation method.⁷ Since 1993, public offerings have been the most important method by a large margin. The choice of public offerings is not surprising, as the two main requirements

for using this method – namely, a reasonably deep national capital market and relatively little need of restructuring⁸ – are normally met in OECD countries. Furthermore, many OECD governments have regarded an increase in the number of individual shareholders as an explicit objective of their privatisation programme. The other main method of privatisation is a trade sale to strategic investors wishing to exercise managerial control. Although there have been many important privatisations by way of trade sale, this method has been much less common in the OECD area.

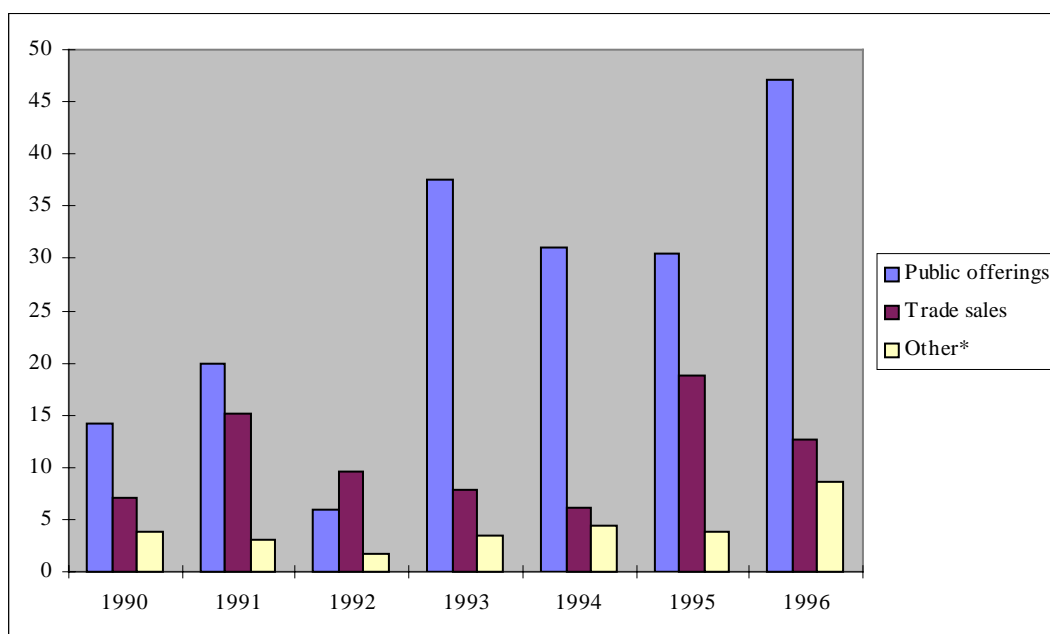
As the privatisation programmes advance, it could be expected that initial public offerings (IPOs) will become less important relative to the sale of residual stakes in already (partly) privatised companies. Indeed, in the period from 1990 to 1992, when OECD member countries' privatisations were dominated by offerings in the United Kingdom and Mexico which both were relatively late in their privatisation programmes at that time, the share of IPOs in total public offerings was on average 14 per cent. Then, in 1993 and 1994, when a large number of OECD countries embarked on a privatisation programme, the average share of IPOs in total public offerings surged to 67 per cent. However, as some of these programmes subsequently moved into a more mature phase, the average share of IPOs fell back to an average of 44 per cent in the years 1995 and 1996. In fact, even last year, which was heavily influenced by the very large IPO in Deutsche Telekom, the share of IPOs in total public offerings was only 54 per cent.

As the process of privatisation progresses, many governments are left with relatively small residual stakes in companies. Although these stakes normally constitute only a modest part of the company's capital, their market value may be quite significant. Nevertheless, disposing of these residual holdings by way of a full-fledged public offering is often not cost-efficient. In response to this, a number of privatisations have, within the last year or so, been done through so-called *block sales* or *bought deals*. Following a competitive bidding process, a block of shares are sold to an intermediary, which subsequently places the shares in the market. The key to a successful block sale is speed, as the offering needs to take the market by surprise. Thus, from the time the bidding process begins to the time shares are placed in the market, only some 12 hours would have passed. This method has been used in the United Kingdom and in France. In December 1995, the United Kingdom government sold its remaining 1.8 per cent stake in British Petroleum in a block trade. Last year, the United Kingdom government sold the residual 2.9 per cent stake in the airports operator, BAA, and its remaining stakes in six water companies and a number of electricity companies through the same method. Also last year, the French government disposed in this way of residual stakes in two oil companies, Total and Elf Aquitaine. Raising a total of FF 5.3 billion (\$1 billion), the sale of the residual stake in Elf Aquitaine was the second-largest block trade ever. Also, the French government disposed of its residual 7.5 per cent stake in Credit Local de France in September.

Another way of disposing of a small residual stake has been by so-called *accelerated bookbuilding*. As the name implies, compared to a normal public offering

with bookbuilding,⁹ the accelerated bookbuilding method has a much simpler structure which permits the offering to close faster and at a lower cost. One recent example was the Spanish government's sale of a residual stake in Gas Natural. In contrast to a normal bookbuilding, the roadshows only lasted a few days, and the book closed within a week. Furthermore, there was no retail tranche, nor was there any tranche targeted at United States investors.

Chart 4. Privatisations in OECD countries by type of transaction
(US\$ billion)



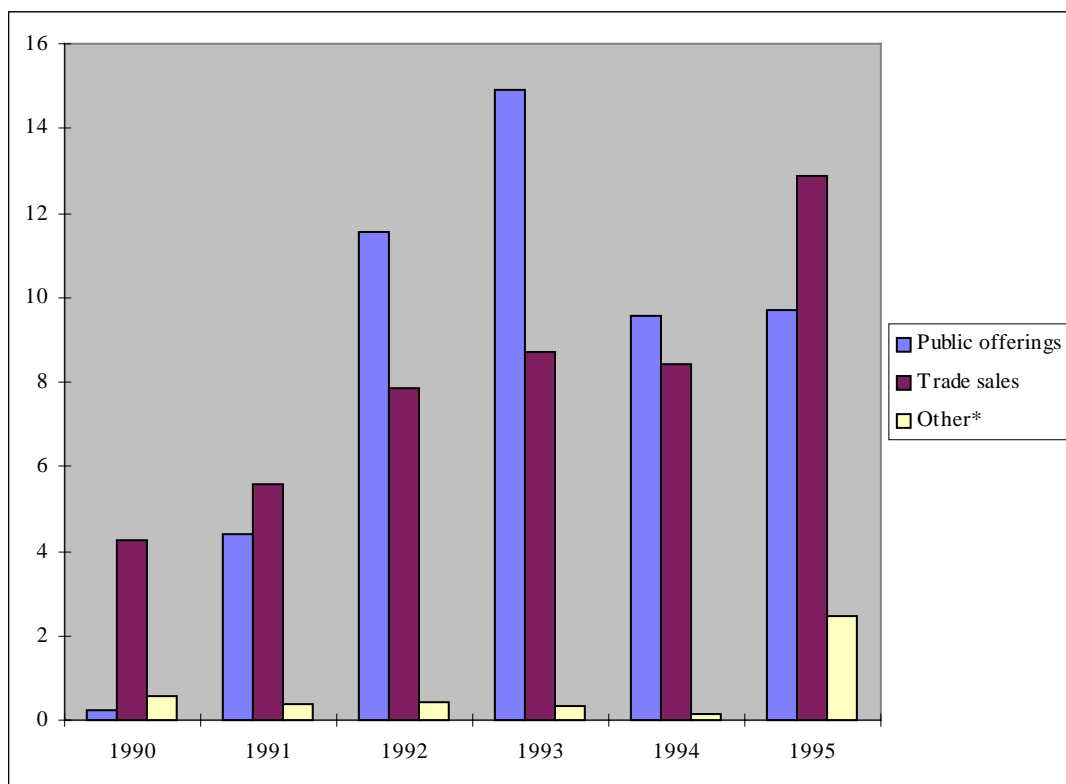
* Including management or employee buy-out, asset sales and lease or management contracts.

Sources: National statistics, OECD, World Bank and SBC Warburg.

Finally, residual stakes have been sold by the company offering to buy back its own shares. If the company has the necessary funds, this may be an alternative privatisation method. In 1996, share buy-backs as a means of privatisation took place in Australia (Commonwealth Bank of Australia), Finland (Valmet), France (Elf Aquitaine), the Netherlands (DSM) and Sweden (Nordbanken). The share buy-backs were in many cases a part of a larger transaction involving either a public offering or a block trade. Also, the United Kingdom government has sold significant amounts of privatised industry debt to the market or (more commonly) back to the companies

concerned. This debt was injected into the companies' balance sheets as part of their restructuring. In 1996, some £1.2 billion was raised from the sale of such debt.

Chart 5. Privatisations in non-OECD countries by type of transaction
(US\$ billion)



* Including management or employee buy-out, asset sales and lease or management contracts.

Sources: OECD and World Bank.

For several reasons, it could be expected that privatisations via trade sales are relatively more important in countries outside the OECD area than for OECD countries. First, capital markets are generally less developed in non-OECD countries; presumably, this should limit the possibility for privatising through public offerings. Second, in non-OECD countries, finding a foreign strategic investor, who will bring

know-how and increased efficiency to the company sold and to the economy in general, may be relatively more attractive. Indeed, the evidence suggests that trade sales are a more favoured method in non-OECD countries than in the OECD area.¹⁰ This being said, the fact remains that privatisation through a public offering is generally the single most important privatisation method, also in non-OECD countries, (see Chart 5). To some extent, privatisation-related public offerings from non-OECD countries are likely to have benefited from the strong general interest on the part of international investors in many emerging markets.

Privatisation by residency of buyer

One extensively debated question is how important are international investors for privatisation issues in the capital market. On the one hand, some countries have historically had a relatively small domestic institutional investor community, which implies, all other things being equal, that a large share of the privatisation offering will have to be placed with international investors. Second, a wide international placement of equities has often been an explicit objective in some privatisations as a means to increase international investor awareness of the country.

On the other hand, it has been pointed out that – partly as a consequence of large-scale privatisations – domestic equity markets are developing rapidly in many OECD countries, becoming deeper and more liquid. At the same time, institutional investors in many OECD countries, where bond markets have traditionally played the main role, are slowly becoming more interested in equities. The blossoming equity culture, possibly coupled with the political objective of a widening of domestic individual share ownership, should reduce the need to place a large share of privatisation offerings abroad. Furthermore, some privatisation offerings have included an upper limit on the share that could be taken up by foreigners.

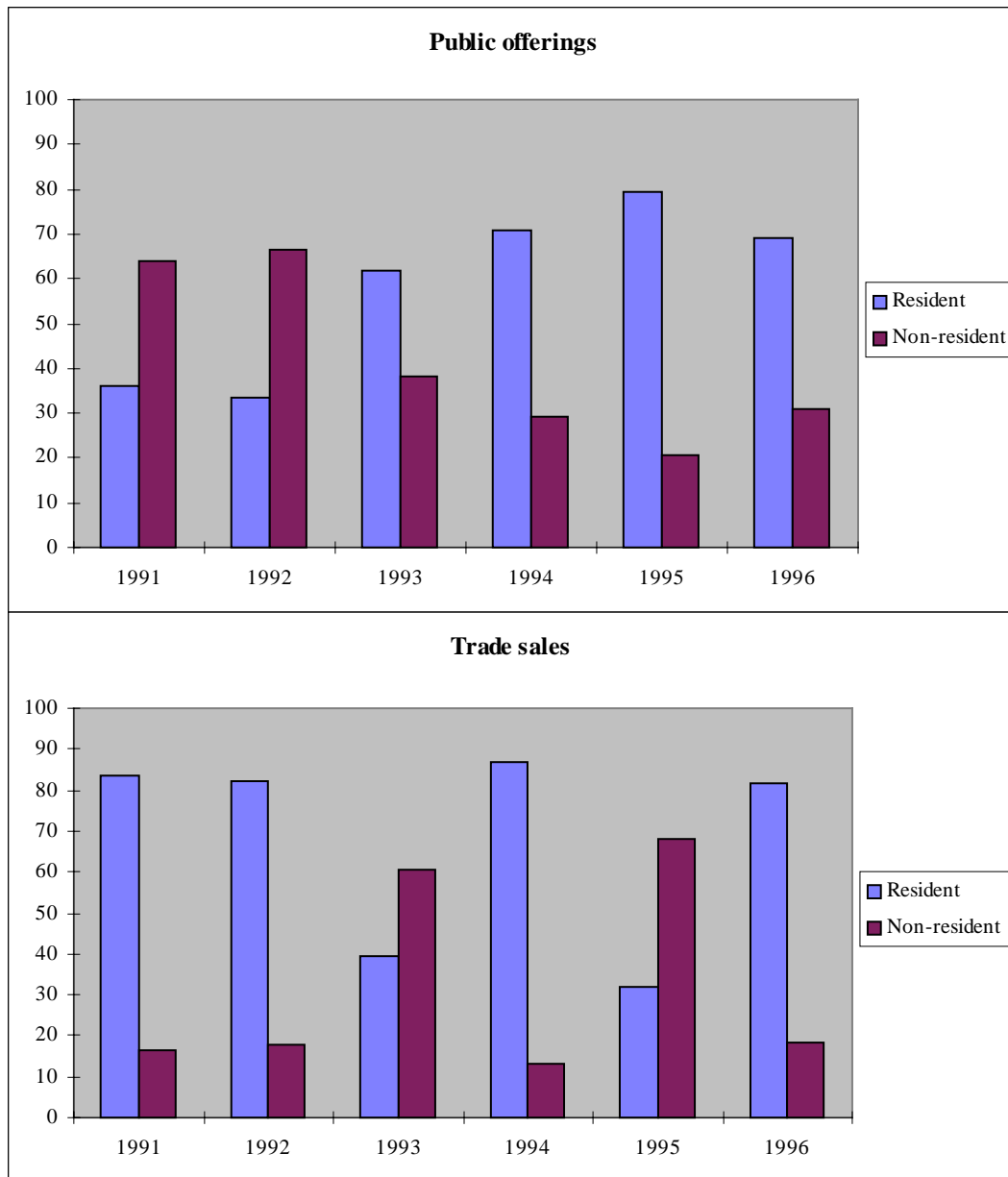
Bringing these different arguments together, it would seem that the relative importance of international and domestic investors at any given moment is the complex outcome of several factors, including the depth of the domestic equity market and political objectives of placing more or less domestically. Since 1991, the share of privatisation-related public offerings bought by non-residents has declined steadily, while that of residents has increased (see Chart 6). Even though international investors continue to play an important role, this would seem to suggest that privatisations are having some success in promoting domestic equity investments even in those countries where such investments traditionally have been relatively limited.¹¹

Turning to privatisations by trade sale, it is not surprising that residents account for the largest share. Notwithstanding the high level of cross-border deals, mergers and acquisitions within the country remain the rule, and there is little reason to believe privatisations to be any different. Thus, it is particularly noteworthy that in 1993 and in 1995, privatisation-related trade sales to non-residents exceeded those to residents.

Privatisation by type of buyer

The importance of institutional investors *vis-à-vis* retail investors in privatisation-related public offerings has also been extensively discussed.

Chart 6. Privatisations in OECD countries by residence of buyer (in per cent)



Sources: National statistics, OECD, World Bank and SBC Warburg.

On the one side, some observers have argued that, in line with the general trend in capital markets, institutional investors are becoming increasingly important, while the role of retail investors in privatisations is declining. Privatisation offerings are often huge, compared to the size of the existing domestic market, meaning that they will constitute an important part of the market index. Consequently, institutional investors seeking to track the index will be obliged to purchase the equity. Also, privatisation has in some cases opened up avenues of investment in sectors that hereto had been closed.

On the other side, other analysts have presented the argument that retail support remains of paramount importance for successful privatisation offerings. In particular, it is argued that strong retail investor demand is necessary to create sufficient price tension between the retail and the institutional (both domestic and international) tranches, and that institutional investors will in some cases only come into an offering when they are confident that there is substantial demand from the retail side, thus helping to promote a liquid aftermarket. For retail investors, privatisation offerings of equity have often come with several special attractions not available to institutional investors. These incentives often seek to secure a wide distribution of shares among the general public and aim to motivate the retail investor not to sell the stock right away. Thus, the offer price for retail investors is usually set below the price for the institutional tranche. Also, retail offerings have included bonus shares, if the equity is retained for a specific period. Furthermore, there have been offerings where the investor was entitled to a price reduction on the services provided by the privatised company. Finally, within certain limits, retail investors have been insured against future price falls.

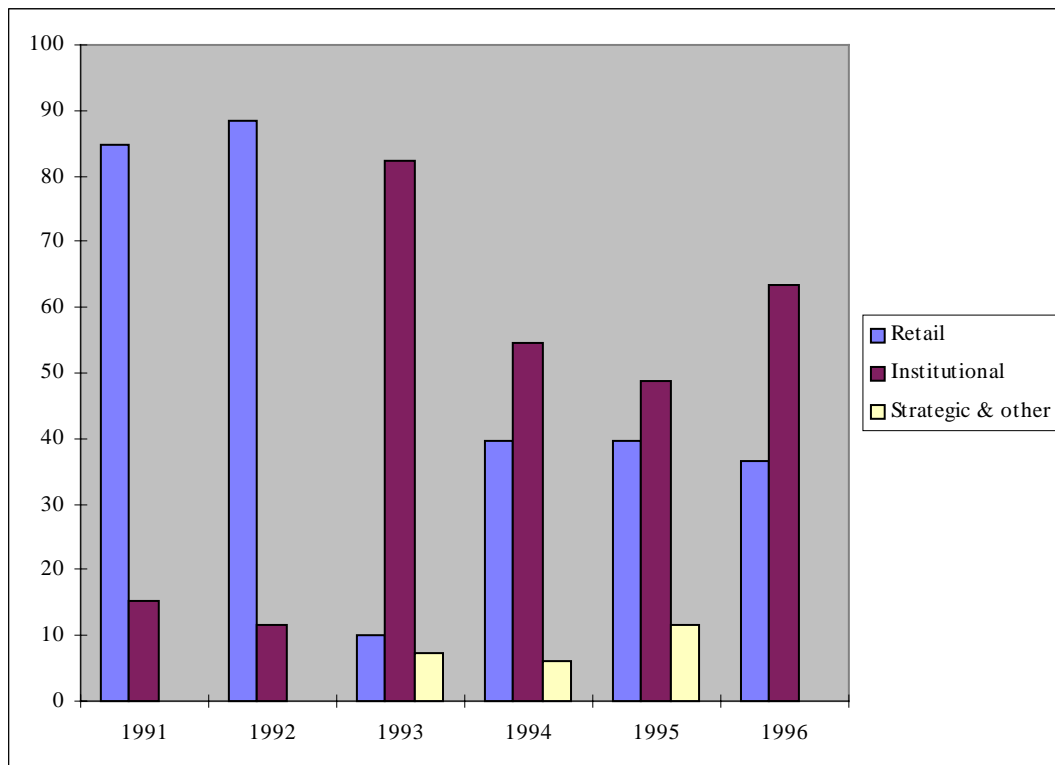
From the evidence at hand, it is difficult to draw any firm conclusions on the development in the relative importance of retail and institutional investors. However, it would appear that in the last three years privatisation issues have been rather evenly balanced between retail and institutional investors, even though the share of institutional investors increased in 1996 (see Chart 7). It should, however, be noted that the information in Chart 7 captures the distribution at the time of sale and that no solid information is available on what happens as a consequence of secondary market trading after the launch.¹²

Impact on capital markets

The global implementation of large-scale privatisation programmes stretching over several years is obviously leading to an increase in equity market capitalisation and to higher market liquidity both in the OECD and elsewhere. Also, with large tranches distributed to retail investors, privatisation-related offerings are a catalyst for more “equity-awareness” in many countries which do not have a tradition of equity ownership by private individuals. This being said, it should be emphasised that although privatisation offerings are often huge in absolute terms, they still constitute a

relatively small fraction of equity market capitalisation in any one year. For example, in the case of Italy, which is running a large privatisation programme and has a relatively small domestic equity market, public offerings of privatisation-related issues have never amounted to more than 3.5 per cent of the domestic market capitalisation in any one year during the period from 1991 to 1996 (see Table 2). Furthermore, the largest share of privatisation offerings in relation to the domestic market capitalisation recorded in the OECD was in the case of Denmark in 1994, when the privatisation of the telecommunications operator, TeleDanmark, brought the share to 5.8 per cent. Even last year's jumbo Deutsche Telekom privatisation only accounted for 2 per cent of domestic market capitalisation.

Chart 7. Public offerings in OECD countries by type of buyer
(in per cent)



Sources: National statistics, OECD, World Bank and SBC Warburg.

The impact of privatisations on equity markets should be seen in a dynamic context. The often high-profile privatisation offerings may work as a catalyst for more equity issues in general. Indeed, the figures for international placements of equities show a record-breaking \$57.7 billion issued last year, as compared with \$41 billion in 1995. In contrast to 1995, when equity placements had been sustained by privatisation offerings, last year's international equity placements were also spurred by new private companies coming to the market and by secondary offerings in already listed companies. It is quite likely that privatisation issues have helped pave the way – along with rallying stock markets – for this rise in private equity issues. And, bringing it one step further, the success of new private issues should help future privatisation offerings, even if they increasingly will have to compete for investor attention.

Table 2. Privatisation by public offering in selected OECD countries as a ratio of domestic market capitalisation

In percentage

	1991	1992	1993	1994	1995	1996
Australia	0.9	0.7	0.6	0.2	0.5	1.3
Austria	0.1	0.2	0.3	2.2	2.1	2.5
Canada ¹	0.2	0.5	0.2	-	0.8	0.1
Denmark	-	-	0.3	5.8	-	0.3
Finland	-	-	0.9	3.0	0.7	1.3
France	-	-	2.1	1.0	0.6	0.3
Germany	0.1	-	0.1	-	-	2.0
Italy	-	-	1.1	3.5	2.6	2.4
Japan ²	-	-	0.3	0.2	-	0.2
Mexico	2.2	1.0	0.5	0.5	-	-
Netherlands	-	-	0.4	1.7	1.4	0.2
Spain ³	-	-	2.1	0.8	1.4	0.8
Sweden	-	0.5	0.2	1.6	0.5	-
United Kingdom	1.4	-	0.7	-	0.4	0.3

- Nil or insignificant

1. Toronto Stock Exchange.

2. Tokyo Stock Exchange.

3. Madrid Stock Exchange.

Sources: National Statistics, OECD, SBC Warburg and FIBV.

At the same time, equity markets in many OECD countries have undergone wide-reaching reforms. These changes have involved both the introduction of (more) automation and a profound transformation of market structure. Also, most OECD countries have taken or strengthened legislative action to define and penalise insider trading.¹³ Apart from these reforms, there has recently been considerable interest in

launching stock markets targeted at listing small and medium sized companies. Furthermore, technological advances along with favourable regulatory decisions have greatly facilitated the establishment of new regulated exchanges.¹⁴

Privatisation will have an important role to play in the more general transformation of capital markets that is slowly taking hold in many OECD countries. At a time when most government budget deficits are declining, the supply of new government bonds will decline. Due to its high profile, privatisation-related issues may facilitate the necessary switch from investment in bonds to placements in equities.¹⁵ Taking the argument one step further, in the face of budgetary constraints and an ageing population, many countries are considering ways to reform their pension systems, most notably by introducing or strengthening funded pension systems, which will need well-functioning capital markets in order to run pension plans in an efficient manner. In this context, privatisations may be an important element in reinforcing equity markets.

Notes

- ¹ This article has been prepared by Karsten Biloft, an economist in the Financial Affairs Division.
- ¹ For a further discussion of governments' motives behind privatisation programmes and the impact of privatisation on capital markets, see OECD (1995a) and OECD (1996a).
- ¹ The term privatisation is not always uniformly defined. In this article, privatisation is generally considered to be the full or partial transfer of ownership of public assets to the private sector
- ¹ The database, which has been established at the request of the OECD Committee on Financial Markets and supported by the OECD Privatisation Network, is run by the Financial Statistics Section of the Financial Affairs Division. The database captures, from national and other sources, the amounts raised from privatisation in OECD countries and incorporates privatisation data from the World Bank Privatisation Database, International Economics Department. The amounts covered would normally include equity sold by the government as well as equity offerings by the company as part of the privatisation operation. Also, the amounts covered are the gross values of the transactions, which may not necessarily correspond to the net amounts available to the government as a result of disposal of its assets.
- ¹ Last year's figure for non-OECD privatisations should, however, be interpreted with caution, as information on privatisations outside the OECD in 1996 is only now becoming available and the picture is still incomplete, in particular concerning trade sales.
- ¹ In a trade sale, the company is sold to a strategic investor seeking to exercise managerial control.
- ¹ The figure for trade sales in 1992 is heavily influenced by several large privatisations of financial institutions in Mexico.
- ¹ The more restructuring that is required in the company prior to sale, the more the government will be induced to look for a strategic investor, who could take responsibility for the necessary changes.
- ¹ In a sale by book-building, investment bankers engage in an extended dialogue with possible investors in order to determine the amount of equity that is likely to be purchased at various prices, that is to say establish the demand curve for the offering. While the book is being built, the replies given by investors on price and quantity are only indicative and do not constitute firm purchase orders. At the same time, management and advisors travel extensively to meet investors at various locations across the globe (the so-called *roadshow*). At the meeting, the company strategy is laid out and investors are given the opportunity to raise questions directly with the management.
- ¹ It should be noted that for most transition economies, the most important method of privatisation has been mass or voucher privatisation, see OECD (1996c).
- ¹ However, as the information used for Chart 6 is partial in the sense that it only takes into account those privatisation offerings where a break-down on resident and non-resident was available, this conclusion should be drawn with some caution.
- ¹ Again, as the information used for Chart 7 is partial in the sense that it only takes into account those privatisation offerings where a break-down on retail and institutional investors was available, this finding should be taken with some caution.
- ¹ For a further discussion, see OECD (1995b).
- ¹ For a further discussion, see OECD (1996b).

¹ With an unchanged government financing need, a privatisation offering will increase the supply of equity while at the same time reduce the supply of government bonds. Assuming a high level of substitution between these two types of assets, capital markets should, in principle, absorb the equity offerings without major effects on either equity prices or interest rates. Fundamentally, the level of substitution depends on the ease and willingness of investors to switch from holding bonds to holding equity.

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