



SOFIA BUSINESS SCHOOL

KNOWLEDGE LABORATORY FOR LEADERS

The trade offs of different privatisation models for government assets

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Why Privatise ?

- Before you privatise anything, you need to determine why are you are privatising and what do you hope to achieve ?
 - Government agenda
 - Management agenda
 - Other agendas
- Efficiencies in the economy via transfer of state owned or controlled assets to the private sector ?
- Will the private sector give you what you want by way of missing skill sets or other ?
- Do you have the skills or do they only come from overseas ?
- Proceeds to Government, to fill budget gaps or other ?



Why Privatisise ? Cont...

- Political objectives, e.g. to remove Government subsidy and support ?
- Are the assets/businesses to be privatised actually suitable for privatisation ?
- Break monopolises and increase competition ?
- Free up resources to be reallocated to more productive parts of the economy ?



Is the business REALLY suitable ?

- It is ALL about the business
- There is no one size fits all; each one is unique
- What policies would have what effect on the business (good, bad, neutral) ?
- What capital does it need ?
- What human and soft-skilled capital does it need ?
- Who is it competing against and how will they react ?



Is the business REALLY suitable ? Cont...

- Is it capable of reform to implement new business model(s) ?
- What regulation is required to protect against monopolies ?
- What growth, new business opportunities ?
- Corporate governance and reporting structures ?
- What other measures does it require to make it a “normal” private-enterprise business ?
- Competitive positioning ?



Government Policy

- Aims in privatising enterprises:
 - Increase efficiency in state owned enterprises ?
 - Need proceeds to reduce national debt/other uses ?
 - A means to attract outside capital ?
 - A means to attract new management ?
 - Political messaging, e.g. less rather than more government ?
- National interest (defence, strategic, other) ?



Government Policy Cont...

- Regulation
 - Competition policy ?
 - Avoidance of monopolies ?
 - Lower consumer pricing ?
 - Opening market to foreign competition ?
- Protection measures
 - Anti-embarrassment
 - Wrong purchaser not performing
 - Wrong price with less proceeds to Government
 - Ability to remove a non-performing regulated supplier, e.g. rail operator
- Other; got to get it right first time !



- Domestic competitors
- International competitors
- Scope of business
- Changes in business model:
 - Sales/marketing/branding
 - Procurement
 - Outsourcing
 - Quality control
 - Financial control and reporting
 - Management structures, packages and incentivisation



Business considerations Cont....

- Modernisation and upgrade
- Capital required:
 - Debt
 - Equity
 - Mezzanine/other



Competition and Monopoly

- General provisions in Competition Law
 - Existing participants
 - No barriers to new entrants
- Domestic and international competition
 - Fully open
 - Timing and phasing to allow for adjustment
- Specific measures to prevent monopolies in key industries
 - Price mechanisms
 - Limits on number of competitors and specific geographies
 - How to define a monopoly ?



Investors

- What investors looking for ?
 - As a trade buyer ?
 - As a company listed on the Stock Exchange ?
 - Private Equity/other ?
- Income/income and growth/growth only
- Dividend policy
- Sector exposure compared to existing exposures ?



Investors Cont....

- Asset class/exposure they previously have not had access to before
- Understanding of the market
 - Analyst community – covered ?
 - Technical/specialist understanding needed, e.g. life sciences (Celltech), Aerospace (BAe)
 - Expert's reports in a prospectus
 - Number of competitors in sector may determine e.g. trade sale versus float
- Valuation
 - Key – proceeds to Government
 - Orderly after-market/ good liquidity/reduced embarrassment to government etc.



National interest

- Definition of key national interest sectors
 - Ports
 - Defence
 - Core infrastructure e.g. electricity grid
 - Agriculture
- Golden shares
- Regulation, e.g. stimulating competition yet being able to be regulated
 - Priority order in electricity
 - Avoidance of monopolies
- Combinations of Golden shares, Regulation and other measures



Measures to protect the taxpayer/voter

- Not just about regulating the market and the company (ies) being privatised
- Mechanisms also have to be in place to protect the shareholder/voter
- A number of measures, which need to be included in regulation suite, inter alia:
 - In the UK, Public Accounts Committee
 - Proper Parliamentary scrutiny ultimately reporting to voters via open Parliamentary process
 - All State Assets being sold had to pass proper scrutiny, i.e. Value for Money to the Taxpayer
 - Method of sale:
 - Public flotation with mass marketing to the public
 - Public are shareholders and votes lost if process abused
 - Versus private trade sales, where public cannot get involved via flotation, so more open to abuse
 - Assets need to be big companies, typically large Utility companies like Water, Gas, Electricity



Ongoing regulation

- Assumes initial regulation works
- But markets change, so regulation will need to change too
- Interplay between general competition law and specific measures related to privatisation
- Regulatory review mechanisms
 - Longer term
 - Shorter term, typically in response to market changes at shorter notice
- Political interference, ideally avoided by independent bodies (e.g. Ofwat, Ofgen, etc)
 - Management better able to plan and manage
 - Investors have better consistency and therefor confidence
 - Reduced market volatility



Flexibility

- Nothing ever stays the same:
 - Economy
 - Markets
 - Sector
 - Government
 - Competition (international and domestic)
- Regulatory “suite” (Competition law/industry specific regulation) needs to work seamlessly, efficiently and flexibly as circumstances change
- Principles based generally better than rules based approach
 - Broad principles
 - Supported by more detailed rules, but not over-regulated
- Why ?
 - Rules based can be over rigid and prescriptive and not works well when something goes wrong
- Ability to fire poorly performing monopoly suppliers
 - E.g. Rail Operators



Optimising the process

- Understanding the business from the start:
 - E.g. basic split of rail track from train operators in UK not been ideal
 - Demarcation issues between operators and common rail track operator
 - Different motivations leading to inefficiencies overall for the customer
- Civil servants need to understand the business and take appropriate advice on business/sector to find appropriate regulatory measures
- Cleaning up the business before it is privatised
 - Residual contracts/obligations removed
 - Getting the right management and staff in place
 - Getting the right corporate structure/board of directors early in the process
 - Ideally, those people who will be responsible for managing it post privatisation, as they then “own” the results thereafter



Optimising the process Cont.....

- Finding means to deal with difficult legacy issues, e.g. nuclear facilities, where decommissioning difficult, long term, expensive and not easy to predict
- Ring-fencing matters that are unattractive to investors
- Being clear on objectives, e.g. degree of regulatory control plays proceeds to Government



Everything is possible even the exotic !

- Worked example of the Plant Breeding Institute and National Seed Development privatisation
- Responsible for 90% of all winter wheat varieties grown in UK, so strategically important aka defence/ports
- Had to split the organisation in two (!) with theoretical research back to a new Government institute and the applied commercial side sold to third parties on commercial terms



Everything is possible even the exotic ! Cont....

- Due to history, ownership of assets not clear:
 - Devolved out of Cambridge University into a Registered Charity limited by Guarantee
 - Assets like the National Seed Bank “gifted”/evolved but not clear
 - Third party contracts with commercial parties had to be unwound, again ownership issues over Intellectual Property to be unscrambled
- Sharing a site; how do you ensure that secrets don’t leak either way (Government to Commercial Enterprise and vica versa).
- Overall, took 2.5 years with
 - (i) appraisal work,
 - (ii) primary legislation via Parliament
 - (iii) preparation
 - (iv) implementation



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Edward founded Intrinsic Partners in 2012 having had a thirty-year career in the City with Lazard Brothers & Co., Limited, Cazenove & Co. and Panmure Gordon.

Edward has broad experience in project finance, equity capital markets, M&A and general corporate finance advice in the UK and internationally focussing on problem solving and innovative solutions.

He was active in 1980s at Lazard and Cazenove on a range of privatisations ranging from the Plant Breeding Institute/National Seed Development Organisation to the Water, Electricity and Gas privatisations.