

The Mixed Ownership Model

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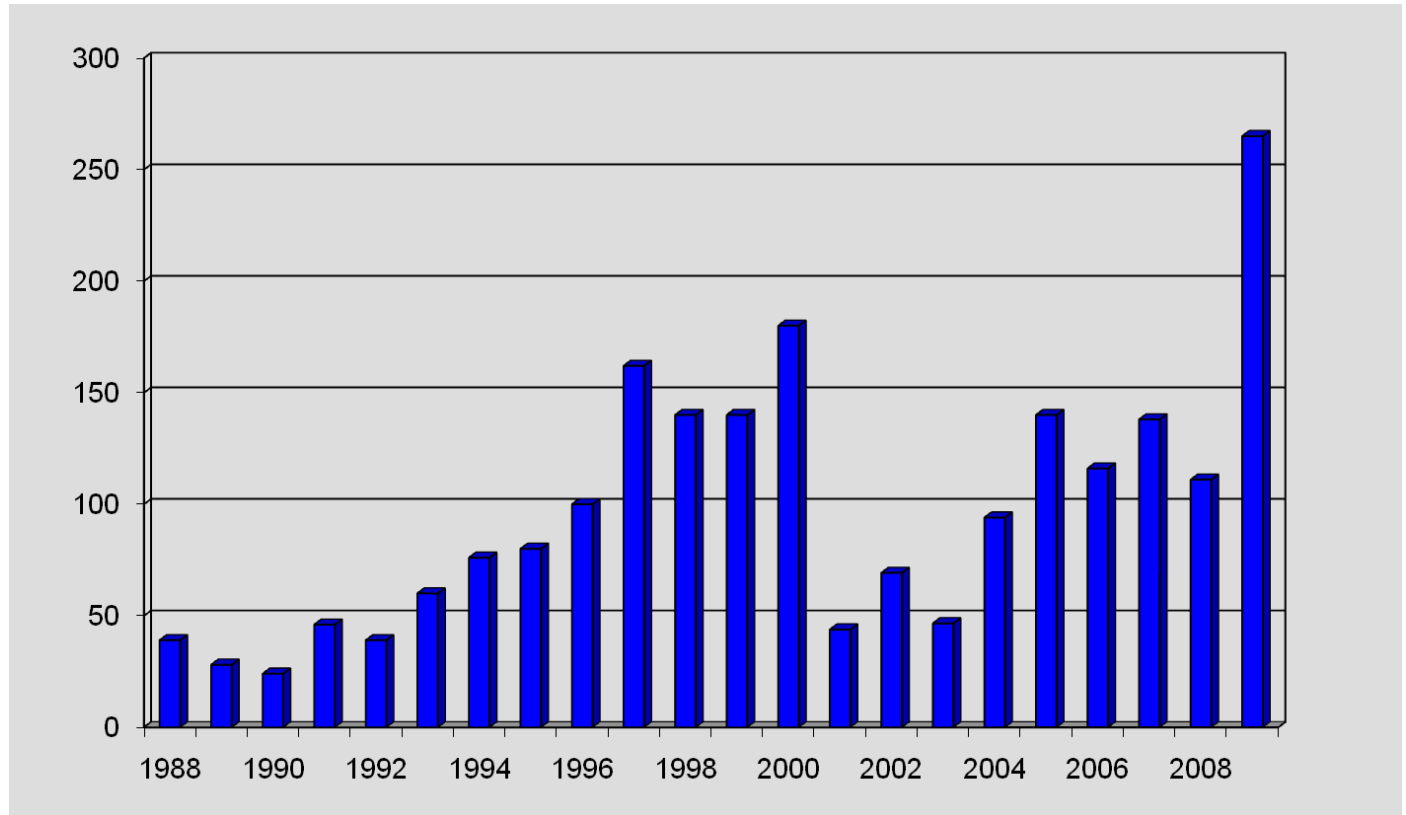
Background

- Government plans to sell minority stakes in 4 SOEs & Air NZ

	Enterprise value \$m	Total equity value \$m	Potential Crown proceeds (1) \$m
Air NZ	4,390	1,208	285
Genesis	2,170	1,686	826
Mighty River	4,685	3,755	1,840
Meridian	7,759	6,373	3,123
Solid Energy	1,868	1,663	815
TOTAL	20,871	14,684	6,888

Privatisation: global trends

Global proceeds from privatisation: \$US bn



Trends internationally

- Total US\$2 trillion privatisations over the last 30 years
- Matched by US\$2 trillion growth in nationalisations and Sovereign Wealth Funds
- Growing significance of mixed ownership business models

Trends in privatisation methods

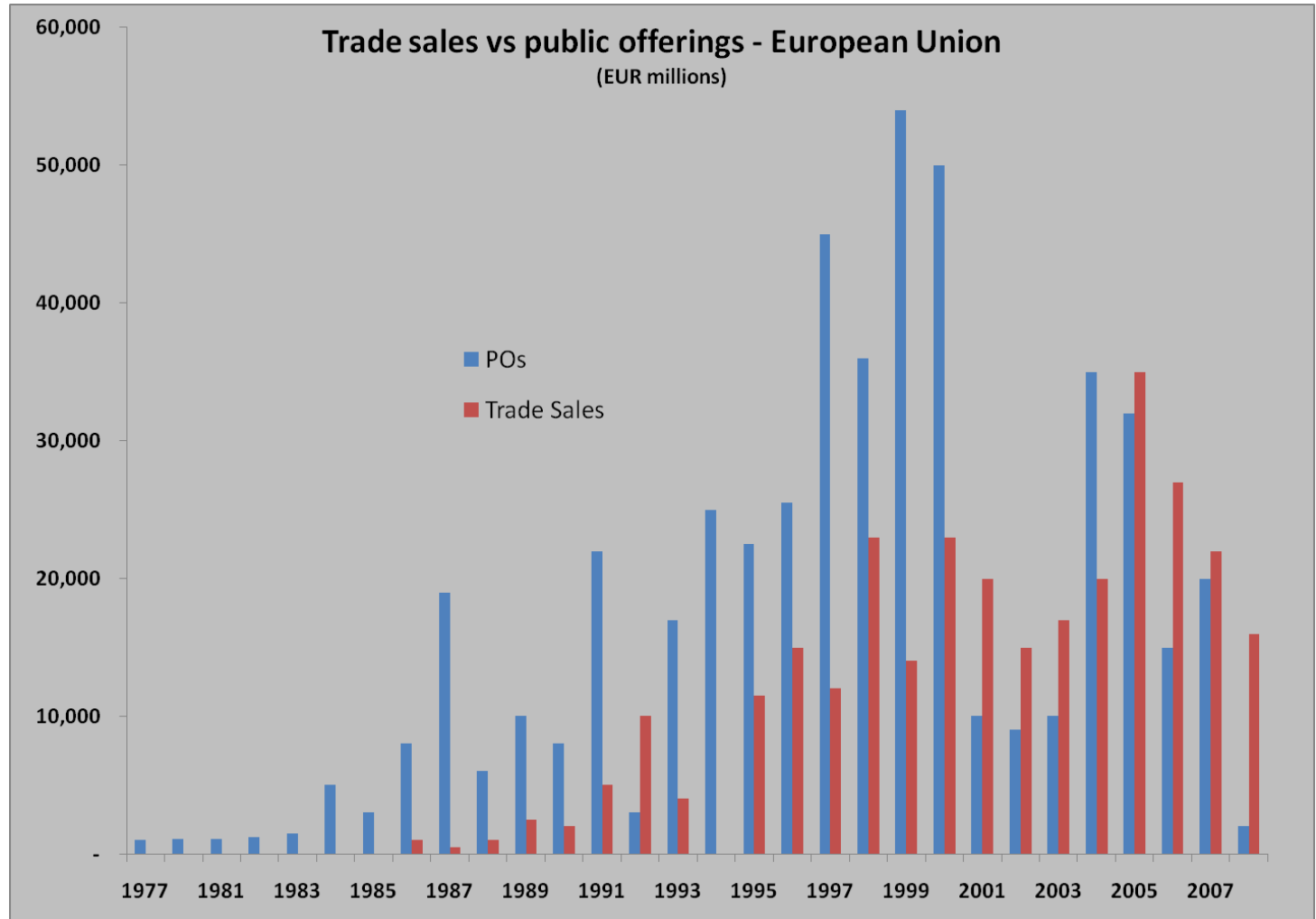
- Public share issues were dominant form globally
 - 62% pvt proceeds from floats 1977-2000 (vs NZ 17%);
- Now increasing use of trade sales (quicker and cheaper to run)
- The rise of accelerated bookbuildings
 - now the dominant method for second and subsequent tranche share issue privatisations
- Increasing importance of indirect sales
 - stake sales by government-controlled financial institutions, rather than directly by governments

Privatisation methods ctd.

- Govts usually don't sell entire SOE or even controlling stake
 - on average 44% of issued shares sold in initial offer
 - 23% in subsequent offer
- Most govt floats use fixed-price method; tender (book-build) for institutions; 90% oversubscribed
- Most govt floats significantly underpriced (mean listing day premium 34%; NZ 10%)
- Often use Golden Share

Jones, Megginson, Nash, Netter, 1999

Public offerings vs trade sales



Trends in NZ

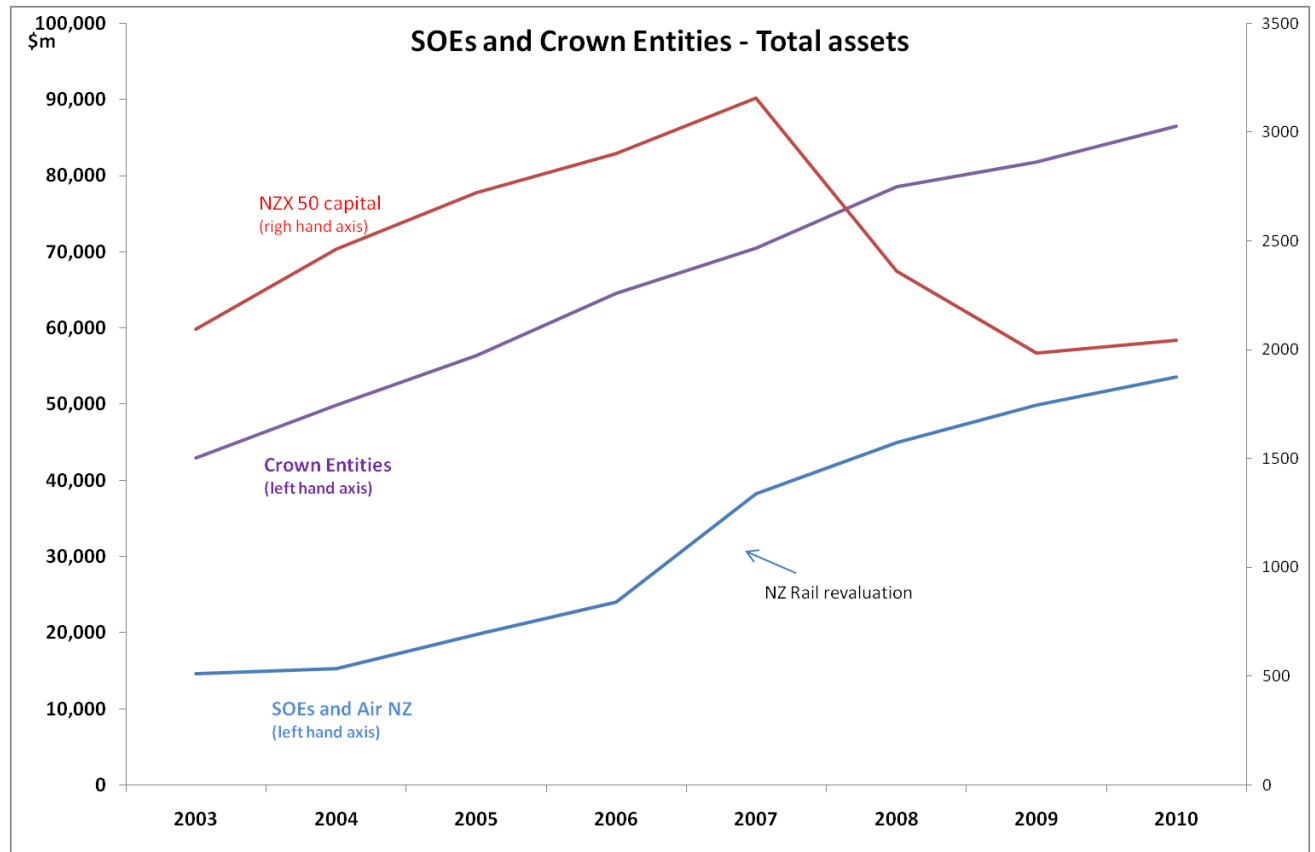
New Zealand: 1988-1999

	Number	Value
Privatisations	30	\$15b
- trade sales	28	\$12b
- floats	3	\$3b

New Zealand: 2002-2010

Nationalisations	Air NZ (82%) Rail (lines, ops & ferries) Kiwibank (start-up) Ports of Auckland
Assets of SOEs and Crown Entities increased	2.5 X

Trends in NZ ctd



Does privatisation work? - the evidence

Formal studies of relative performance

	Private superior	No difference	Public superior
Private vs public efficiency	8	2	0
Effects of privatisation	20	1	1

How large are the gains?

	% change
Profitability	46.5%
Efficiency	19.6%
Investment	35.7%
Output	83%
Employment	1.2%

Source: *ibid.* - average results from 211 privatised firms

Partial privatisation: - the evidence

- Most studies find significant performance gains from partial privatisation
- Will performance gains be sustained if state retains partial state ownership? Are risks:
 - how does Govt control work in practice?
 - will Govt bail out company?
- Some (earlier) studies suggest no lasting difference between performance of 100% state-owned and partially state-owned enterprises

1. Megginson and Netter: op.cit.
2. Gonenc, Maher and Nicoletti (2000).
3. Shirley and Walsh (2000).
4. Boardman and Vining (1989) *Journal of Law and Economics*, 32:1, pp 1-33.

Has the experience changed?

- More recent evidence confirms the above conclusions on effects of privatisation
 - ownership matters - but it's not all that matters
 - privatisation leads to improved performance on average and over time
 - allowing foreign ownership increases the gains

Estrin et al, survey article (JEL 2009)

Pros and cons of partial privatisation

Partial privatisation cf 100% public ownership	
Pros	Cons
Greater transparency of performance	Company may be capital constrained
Better monitoring of performance	Crown may be hostage – capital raisings
Greater ability to incentivise management	
Company less open to political interference	

Conclusion: mixed ownership probably a step forward. But ownership isn't all that matters.

Partial privatisation cf 100% private ownership

Pros	Cons
Political control maintained	Foregone control premium (20% - 30%?)
NZ control maintained	Reduced pressures to perform - control not contestable - limited incentives to monitor performance
	Reliance on deep pockets of government
	Company still open to political interference

Conclusion: mixed ownership likely to be inferior to 100% private ownership on average and over time.

Myths

1. Privatisation in NZ failed
2. Why sell SOEs – they are making good returns
3. Mixed ownership works best
4. Foreign participation not in Kiwis' interests

Myth 1: Privatisation in NZ failed

- 30 privatisations in NZ
- 2 formal studies: net benefits of up to \$15b NPV
- Improvements in productivity and public debt
- Failures of some individual companies (eg Air NZ and TranzRail) does not mean privatisation failed: you expect some business failures in the private sector

Myth 2: Why sell SOEs as they are making good returns

- Total shareholder returns from all the state-owned enterprises exceeded 15 per cent on average over the past five years while the average 10-year bond rate was 6 per cent.

Source: NZ Govt Investment Statement, December 2010

Myth 2: Why sell SOEs as they are making good returns

- If SOEs are expected to make good returns the government will get a good sales price
- Question of risk
- Why privatise? increase competition and improve efficiency
- Question reported returns – much due to revaluations, some at least questionable

Myth 3: Mixed ownership works best

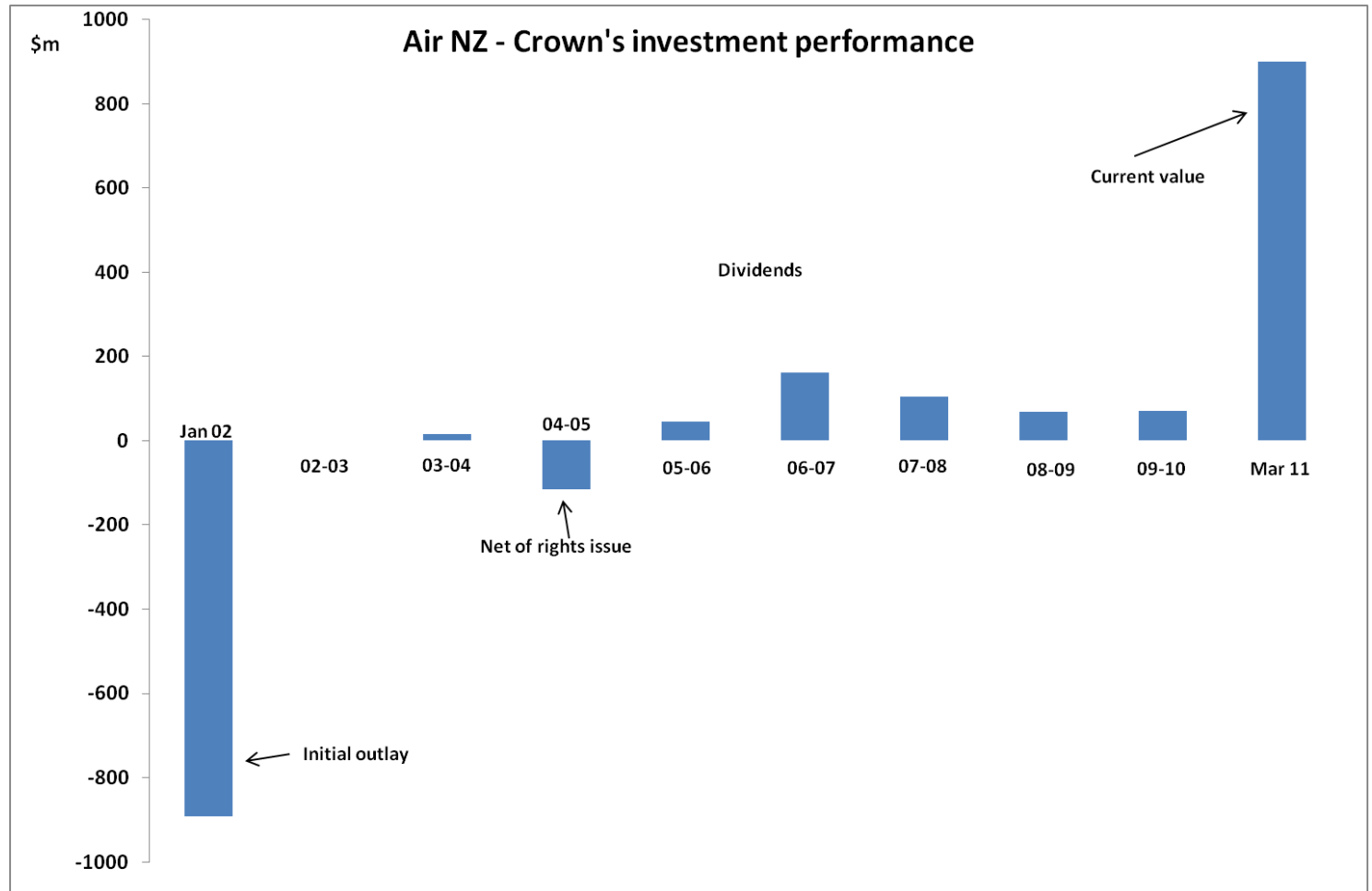
“The sort of mixed-ownership model under which Air New Zealand operates – where the government owns most of the company but there is a minority of outside equity – gives the best of both worlds.”

John Key, 26 Jan 2011

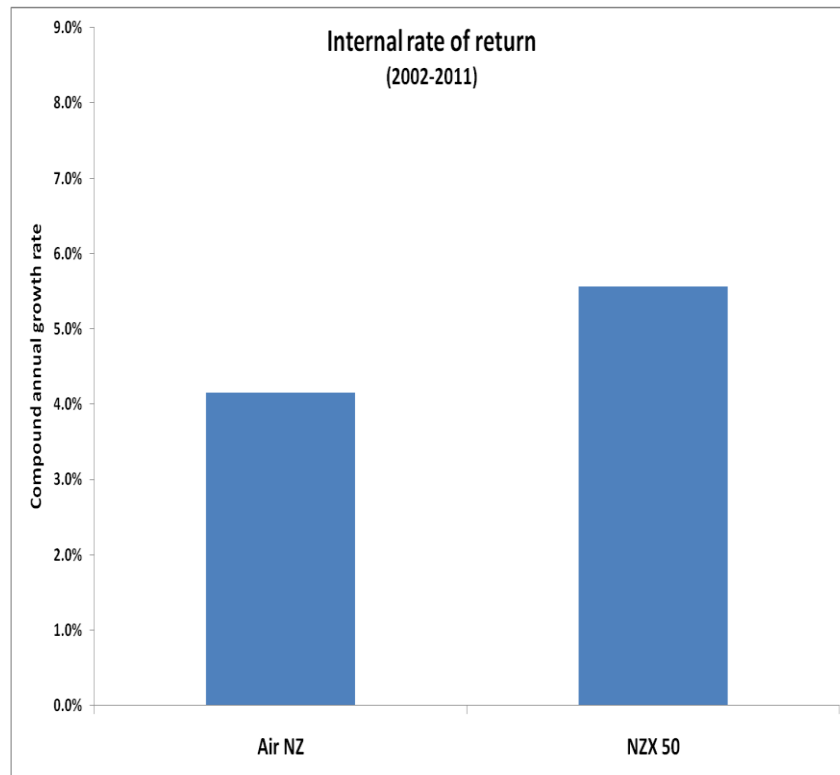
Air NZ

- The best of all worlds?
- Operating performance good
- But investment performance for Crown?

Air NZ ctd.



Air NZ ctd.



IRR for Crown's investment in Air NZ of 4.1% p.a. to March 2011

Compares to return on NZX 50 gross index over the period of 5.6%

But.....

- risks
- dilution (82% to 75%)

Other cases of mixed ownership in NZ

- Some have worked well:
 - Auckland Airport
 - Ports of Tauranga
- Others not so well:
 - BNZ (late 1980s)
 - Ports of Auckland

Myth 4: Foreign participation will harm Kiwis

- Privatisation may lead to foreign control of the privatised company but does not increase foreigners' overall net claims on the NZ economy
- Are substantial advantages to allowing foreign participation
 - higher proceeds for taxpayer
 - higher wages (M Wolf, 2004)
 - better access to markets
- Regardless of who owns the shares in the SOEs, the assets stay in New Zealand, as do the jobs and the government's sovereign powers to tax and regulate

What have we learnt?

Deregulate first

Privatisation is not always the answer

Privatise fairly and transparently

Include foreigners

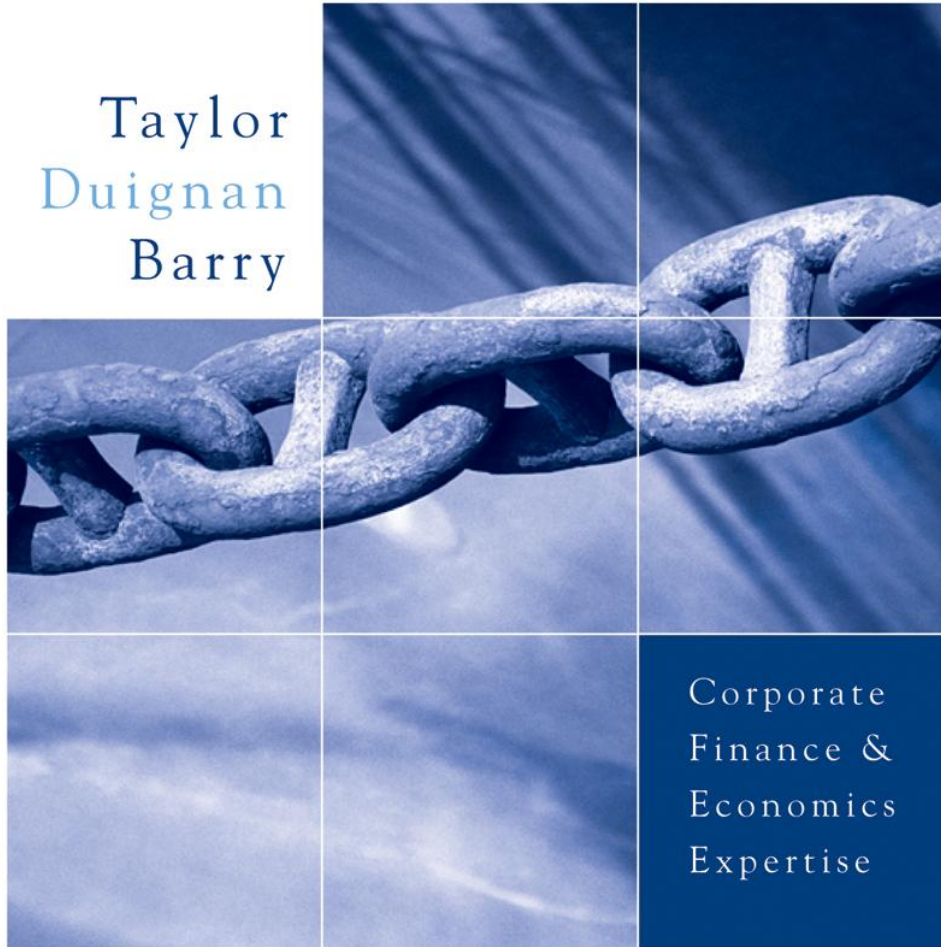
Put proceeds to good uses

Manage the tensions

Conclusions

- Ownership matters - but its not all that matters
- Privatisation leads to improved performance - on average and over time
- Allowing foreign ownership increases the gains - to New Zealanders
- Partial privatisation: a step in the right direction

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