Who Put the Fat in "Fat Cat"?

Or the Health Risks of Privatisation.

John Crowley

Who put the fat in "fat cat" – or the health risks of privatisation.

Privatisation is bad for your waistline. Sure it improves industrial efficiency, increases tax revenues and can redeploy capital to better uses, but be prepared to let your belt out a notch, or two. Finance ministers may love it but researchers ought to look into the unintended health consequences of transferring state assets into the private sector. I've been involved in some major privatisations, especially in Eastern Europe, and now those aeroplane seats just don't seem as roomy.

Here's the source of the obesity problem. Company management teams are usually very wary of the kind of oversight associated with private ownership. As state-owned enterprises they have an easy life, few clear objectives, often a protectionist environment and they can use the company for all sorts of patronage or worse. Governments make really bad shareholders. If an enterprise reports to a particular ministry, the unstated mandate is usually to just keep out of the press. In other words they are judged on an absence of problems rather than the achievement of any goals. In my work I have been amazed at how little governments know about their corporate investments; the very term they often find foreign. One company had built up hundreds of millions of dollars in cash (in the local currency) and when I asked the government why they hadn't asked for a dividend, they said they had never thought about it. Ownership by a state property fund is somewhat better as there is usually a broad plan to maximise value and some experience in exercising shareholder rights.

Still managers do not want to see changes to a sleepy system where rewards are based more on relationships than performance. So when a government decision is made to liberalise, transfer, restructure or transform (privatise is a dirty word so these euphe-misms have become popular), nerves set in. When the investment bankers arrive, management gets instructions to provide all possible cooperation. What happens next; let's do lunch. Company bosses want to tie up your time so due diligence can't really proceed but they want you in a good mood in case the Minister of Finance asks after you. Most of the bankers' time is spent in the executive dining room or sitting in traffic on the way to a special restaurant that will open your eyes to their culture (almost always ten miles outside of the capital). Then the same process is repeated with each department head, maybe a few friendly cabinet ministers, some senior parliamentarians and top union officials. Breakfast meetings, coffee updates, lunches and dinners and soon your clothes seem to be shrinking.

All this eating does highlight the central reality of privatisations, that they are highly political. In private sector corporate finance we focus on strategy, regulation and taxes and serve one master, the shareholders. There are of course cases where shareholders' interests are not all aligned and means can diverge but broadly value maximisation is the principal goal.

With privatisation everyone has an opinion, many of them have a mouthpiece and every parliamentary party has suggestions about the process. I've done transactions where we were the lead story on the national news for weeks at a time, and I'm still smarting from the unflattering photo on the front page of Politika. Usually the biggest, most vocal and influential observers are the unions. They see themselves as having the most to lose by the restructuring and create all manner of impediment and contact anyone with any connection to the process. They do however seem to have expense accounts at the better resta-urants, whereas MPs are usually only good for a pleasant coffee.

Figuring out who really does have an influence over the process is very difficult. Often even at completion you still don't know, as decisions come down from the official sources but the underlying deals are made quietly. So you have to operate as if everyone is a player, especially at the early stages. This leads to meetings, meetings and more meetings and the inevitable, "would you like a sweet with your coffee?" Early on you can fall back on the 'no decisions are made' stance. Near the end you'll have a better read on who really decides, which is often a surprise. One clue is that the loudest voice rarely has any authority. As a banker, you keep the focus and provide the best possible advice as well as the most complete supporting facts and arguments. It is useful to publicise your work so that politicians can point to an objective basis for their decisions and redirect some of the criticism. On one level this means providing background for the press but it also entails a lot of meetings with interest groups. Translation: more calories.

This has however led me to some interesting people and experiences. For example, there was the discussion of corporate finance with the head of the Communist party. We had put together an extensive restructuring plan for a state enterprise in a Middle Eastern country and the governing party asked me to then sell it to the leaders of their coalition members. The chairman of the Communist party understood business far better than anyone else I met. He was very interested in and well informed about all the elements of our valuation. His position was essentially that he wanted to see the very highest price obtained for the asset, but he was against the very idea of privatisation. This seeming contradiction made more sense when I found out the party owned the most profitable newspaper in the country; yes owned, and yes profitable. In much of the world communism is pretty much a brand name now, not a philosophy. They also serve great coffee.

At the other end of the spectrum are some overpaid executives. In a developed country I was actually running a troubled company on behalf of an investment fund. One of the first things I did was to go out on sales calls to key customers and prospective customers (some over lunch of course). This helped identify some of the problems and also highlighted the stars within the company. Within a few weeks I scheduled a meeting with the sales manager to review the weekly sales printout. His answers were generally pretty soft but he couldn't even explain two significant and quite regular adjustments to the totals. Not only did he not know the background that week but he couldn't define what the category meant. I believe he was the first employee to go when the inevitable happened.

One incident reflects some common issues in privatisation. We were in contract negotiations with a global strategic investor for the sale of a minority stake in a national telecom company. The Chief Operating Officer sat in on the negotiations but said almost nothing, and seemed so uninterested that I often thought he was asleep. This is typical in government sales; the investment banker often leads the negotiations, in part because we do it so much and have the expertise. The real reason however is for deniability; if the deal falls through or is criticised, the management can point to us and say they were out of the room at the time (maybe eating). But the COO surprised everyone and became quite animated at one point when he thought he might lose his company car; that was never in the plan and would be too inconsequential to even discuss. Still we got him a written commitment that he would keep his car; he apparently liked driving and was one of the few executives without a driver. The smallest things sometimes take on outsize significance to the detriment of the deal and everyone is out for himself.

Sometimes there are ways to overcome the obstacles. This happened a few years ago under an autocratic govern-ment. We were experiencing the usual disingenuous non-co-operation from our client. It was getting desperate to obtain certain due diligence information in order to structure contract warranties on a very big transaction. I was just about begging the Chief Financial Officer for answers in his office, when I was offered the latest excuse, "but John it's Sunday and the entire accounting staff are celebrating harvest day with their families". So I said, "Well I sympathise with you, here you are working hard on a Sunday and the staff are relaxing, why don't I help you out, give me their names and addresses". He looked confused but suspicious and asked why. "Well I'll call the Prime Minister and have them arrested." Investment bankers are paid to think on their feet and I wasn't at all sure I could do it, but the CFO apparently thought I could. They were there in forty-five minutes, we closed the deal three weeks later, and he and I are still on friendly terms. In fact afterwards I think we went to dinner.

John Crowley is an international corporate restructuring consultant, based in New York.

johncrowley@optonline.net