

## **PRIVATISATION: THE NEW ZEALAND EXPERIMENT OF THE 1980'S.HOW DID RETAIL INVESTORS FARE**

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### **Abstract**

Many would judge the privatisation program, a significant feature of the “*New Zealand Experiment*” of the 1980’s and 1990’s in which both Labour and National governments adopted extreme right wing policies, a failure. In looking at the privatisation of state assets we find they were, at least from an investors’ perspective reasonably successful. Returns to investors who held a portfolio of privatised assets outperformed the NZ share market as a whole. An investment strategy of buying each privatisation, on the market on day one, yielded a return of 7.99% representing an XHPY was 1.19% over a similar investment in the entire NZ market. There can be little doubt; the nine privatisations in this sample had a considerable impact on the NZ stock market, following the listing of Telecom in 1991 total privatised assets comprised 49% of the NZ total market, for twenty years the capitalisation of the privatisation sample averaged 37% of the NZ total market. Analysis of government papers of the day reveals the government’s overall objective was increased efficiency, flowing from a fundamental belief that government couldn’t and shouldn’t run commercial businesses. In this they were successful, but at what cost?

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### **Introduction**

The New Zealand economy, in the late 1980s and early 1990s, was subject to what has become known as the '*New Zealand experiment*' (Kelsey, 1995). Despite New Zealand being recognised leaders in the provision of social welfare the 1984 (re-elected 1987) Labour government made an extreme shift to the right, largely abandoning New Zealand's traditional welfare state, instead adopting neoliberal policies which ultimately resulted in a state based on competition (Larner, 1997). The neoliberal agenda introduced by Labour was then continued, if not finished, by the centre right National government elected in 1990.

It would be an error to assume the neoliberal programme introduced by the Labour government was accepted Labour party policy. For the most part the government was relying upon and following the advice of the New Zealand Treasury. In 1987 the incoming labour government was presented with a briefing paper entitled 'Government Management'. This briefing paper was in effect a book of some 400 pages that outlined a *blueprint* that Treasury suggested the government adopt. The *blueprint* contained chapters such as 'The Role and Limits of Government', 'Social Policy', and more importantly for what was to come – 'The Public Sector'.

Upon even a superficial reading 'Government Management' could not simply be considered advice. It is in essence an argument for the adoption of orthodox neoliberal ideology. The core of the argument was one of deregulation and an appeal to market forces market forces. For example Treasury advise "*it is only sensible to organise economic and social activities...if the particular form of organisation chosen enables these activities to be provided more cheaply, more effectively or more equitably...than would provision through the market*" Treasury (NZ Treasury, 1987, p. 3).

As well as a move to deregulate the New Zealand economy, there was also a desire to make the business of government more efficient. In other words

government departments were to be operated as corporate business units. It was a requirement under the State Owned Enterprise Act (1986) for SOEs to operate as successful business operations. To enable this, government departments were *corporatised* by being converted into State Owned Enterprises (SOEs), and under the State Sector Act (1988) CEOs and board directors appointed. As with private businesses, the performance of SOEs was to be measured in terms of profitability and as long as they returned profits to the shareholding minister and operated within the boundaries of the Companies Act, SOE's were given *carte blanche* to largely compete as they saw fit.

Government Management was published in response to the increasing levels of government debt. Debt was a major concern for the 1984 labour government and the spectre of privatisation was first raised in its 1987 budget speech as a solution (Wilson, 2010). This was most likely as a result of advice received within the pages of Government Management in a section entitled "The Case for Privatisation" Treasury (NZ Treasury, 1987, pp. 112-113). The other two solutions identified were raising taxes and or cutting government spending. Both alternatives were at first considered unacceptable to this Labour government, who were philosophically opposed to any increase in taxes, believing tax increases would discourage job creation and investment. Reduced government spending was also not an option at this time, the only areas of government spending large enough to provide meaningful savings were health, education and welfare, areas viewed as core government business by most labour politicians and their voters.

The government, acting upon advice from both Treasury and powerful business lobbies such as the Business Roundtable, eventually followed neoliberal orthodoxy. It was also becoming apparent that the first corporatisations had not yielded the expected efficiencies, as returns from SOE's to the government were expected to remain below the New Zealand Stock Exchange (NZX)<sup>1</sup> market average (Wilson, 2010). Privatisation was viewed by the government as a sensible solution. The 1988 budget speech outlined the government's privatisation policy, which would reduce government debt and signalled the move to private sector ownership of SOEs. Such a move it was argued would improve their efficiency and raise economic growth. Rodger Douglas then admitted, "*the mix of politics and commerce has proved to be a recipe for failure*" (cited in Wilson, 2010). It was a path that deeply divided the party members and was a contributing factor to Labour's electoral loss in 1990.

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<sup>1</sup> The name New Zealand Stock Exchange was changed to the NZX in 2003 – for simplicity the NZ stock market is referred to as the NZX regardless of the time period.

The privatisation push for efficiency continued under the subsequent National governments with privatisation program extended to local body business units<sup>2</sup>, such electricity lines companies, ports and airports. This was enabled by amendments to the Local Government Act (1974), which established Local Authority Trading Enterprises<sup>3</sup> (LATE), now known as a Council Controlled Organisations. A LATE, like an SOE, was required to make a profit and follow recognised business practice. In addition the amendments established the CEO as the employing agent for all local government employees rather than the council. This followed the separation of operations and policy which was in vogue in central government at the time.

As the capital market New Zealand was comparatively small and undeveloped and in order to achieve the highest price possible, the early privatisations of SOE's were via trade sales to international businesses or syndicates who then on sold a portion in local and international markets. This policy of trade sales was halted in 1996 when a coalition elected under New Zealand's newly introduced mixed member proportional election system resulted in a National and NZ First coalition government. The balance of power held by NZ First enabled it to extract a high price from National with the NZ First leader, Winston Peters, able to secure roles as Deputy Prime Minister and Treasurer. NZ First was fundamentally opposed the sale of state assets, particularly their sale to foreigners, which bought about a softening of the asset sales program, with the identification of *strategic assets* which would not be sold and those assets which were sold should be sold to New Zealanders.

In the period from March 1988, when NZ Steel was sold to Equitycorp until September 1999 when Vehicle Testing NZ was sold to the Motor Trade Association \$19.122 billion was raised from government asset sales (NZ Treasury, 1999). It is worth considering that the assets sales were initiated by a Labour government, continued by both a National and National NZ First coalition before finally ending under a Labour led coalition in 1999. Clark and Cullen (Prime Minister and Finance Minister respectively) turned their backs on the privatisation policies they had supported when last in power in the 1984 and 1987 Labour governments. The culmination of this reversal was the buying back of rail

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<sup>2</sup> The privatisation of local body assets was often not about raising funds as often shares in these privatised bodies were given to residents or vested in community trusts.

<sup>3</sup> The particular legislation was Local Government Amendment Act No 1 (1989) and Local Government Amendment Act No 2 (1989).

fixed infrastructure for a dollar from Toll holdings in 2004, followed by the rolling stock and inter-island ferries<sup>4</sup> in 2008 for \$665 million (Espiner, 2008).

New Zealanders looking back on this neoliberal experiment largely view it as a failure while accepting reform was necessary and New Zealand is a more efficient economy as a result (Schick, 1998). A common criticism raised is that the social costs of the reforms were too great with Quiggin (1998) saying, “*the New Zealand Labour government dug the grave of social policy, even if the burial was left to its National successors*”(p. 86). A second major criticism is the privatisation program resulted in New Zealand’s assets being sold too cheaply and largely to foreigners. Despite criticisms raised over previous New Zealand privatisations the prospect of privatisations is again on the political agenda, with the Key led second term government claiming a mandate to privatise.

SOEs slated for partial<sup>5</sup> sale are Air New Zealand<sup>6</sup> and energy utilities Genesis Energy, Meridian Energy, Mighty River Power and Solid Energy. Two decades on from New Zealand’s first privatisations there are similarities in the privatisation rhetoric, with its primary purposes listed as; 1) Providing a future investment fund, which will reduce the need to borrow, while still providing investment capital needed to grow the economy and improve public services, 2) Giving New Zealanders the opportunity to invest in significant New Zealand assets, and 3) Deepening New Zealand capital markets (NZ Government, 2012). Even while there are the claims that the political landscape has changed over the last twenty–five years, there is still the 20th century rhetoric regarding the inadvisability government ownership of revenue generating assets. However unlike the last neo-liberal Labour government, the current neo-liberal National government has recognised the public is unwilling to see strategic state assets sold out of New Zealand hands. The government’s stated intention is to retain a 51% government interest and encourage retail investors, putting them at the head of the queue in the IPO and giving a loyalty bonus shares if they maintain their holding (Key, 2012).

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<sup>4</sup> Toll Holdings retained its profitable road transport assets. Furthermore the claim was made in 2009 that they continued to receive preferential treatment from Kiwirail with discounted freight forwarding and zero property costs for some Toll freight depots on rail land.

<sup>5</sup> Key has stated on numerous occasions that no more than 50% of any state asset will be sold.

<sup>6</sup> Air New Zealand was originally privatised and then listed on the NZX in the NZ’s first round of privatisation, but after a disastrous investment in Ansett Airlines which was liquidated in 2002 the NZ government recapitalised the Airline resulting in a 74% government holding (Wilson 2010).

Despite the reluctance of the New Zealand public to see public New Zealand revenue generating assets sold overseas, they have appeared reluctant to venture into equity investment, preferring banks, finance companies and direct property investment. Whether this is because of lessons learnt from the 1987 share market crash and the excesses of big business which were continually highlighted through the 1990s is unknown. What is known is that attitudes to saving and investment have changed. New Zealanders appear to have accepted the likelihood of a state funded pension, sufficiently large to enable a reasonable quality of life in retirement, is unlikely. Consequently many have started making provision for their own retirement, either by saving directly or joining various Kiwi Saver schemes<sup>7</sup>. The current Prime Minister expects the new public share offers will renew New Zealander's interest in investing in shares (Key, 2012).

## **Privatisations a Quantitative View**

Given the government's desire for New Zealand investors to be at the front of the queue in this new round of privatisation this is an opportune time to re-evaluate the privatisations of the 1980s and 1990s as a retail investment vehicle. The basic research question is how retail New Zealand investors would have fared if they had bought into the public offerings of these privatisations. We update a study by Kerr, Qiu and Rose (2008) and track the performance of their privatisation sample until either the eve of the 2011 New Zealand general election<sup>8</sup> or until they were delisted. Rather than measuring the medium return result this paper focuses on the long term, with holding periods for listed privatised assets ranging from 7.3 years to 22.1 years. The aim being to calculate the returns a retail investor would enjoy if they followed a *buy & hold* strategy of being fully invested in a portfolio of privatised assets rather than the market portfolio<sup>9</sup> as a whole.

From an investment viewpoint some privatisations were more successful than others. This analysis looks for factors which may distinguish a successful privatisation investment from those which were less so. Further, we consider the contribution the first privatisation program had on the NZ share market as a whole. This research should prove valuable to government policy makers and investors alike when future privatisations are undertaken.

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<sup>7</sup>Kiwi Saver is a government sponsored but not guaranteed superannuation scheme, which was a policy initiative of the 5<sup>th</sup> Labour government.

<sup>8</sup> Prime Minister John Key claims the election on November 26, 2011 gave him a mandate to privatise state assets.

<sup>9</sup> The market portfolio is taken to be the DataStream NZ Total Market Index.

## Long Run Performance

Kerr, et al., (2008) detail the impact of privatisation programs in both Australia and New Zealand in the late 1980s and 1990s and serves as a base point for this analysis of New Zealand privatisations. The aim of the Kerr paper was to examine, in both countries, the relationship between privatisation and share market capitalisation, liquidity and share ownership. The research also evaluated the long-run risk-return performance of the privatised companies' portfolios, though performance was only measured for five years at most. Their findings show a significant increase in share market capitalisation and increased liquidity, while also demonstrating an investment in a portfolio of privatised companies generated significantly higher returns than the market portfolio as a whole, for 4 out of 5 years (Kerr, et al., 2008).

As the Kerr, et al., (2008) results<sup>10</sup> were completed using data only up to the 2001 year returns to the privatised portfolio were only evaluated in the short or medium term. To evaluate the long term performance of interest in this study holding period yields (HPYs) and excess holding period yields (XHPYs) are recalculated with DataStream Return Index data up to the date a privatised firm was delisted or the eve of the 2011 NZ General Election on November 25 2011.

Results are presented in Table 1 (shown graphically in Appendix Figure 1) for each firm in privatised sample with HPYs and excess XHPYs reported. The overall or average HPY for the listing period was 7.99% representing an XHPY was 1.19%, though this result was not statistically significant. However these results contain extreme negative values for BNZ -9.47, AIR -6.20% and TRH -4.40% which are balanced by the like of TPW 23.10%, POA 18.48% and CNZ 18.25%.

As these results were obtained over different periods of time and time lengths (5.73 years to 22.10 years) a better measure of performance is obtained by calculating the yield or internal rate of return (IRR<sup>11</sup>) of an equally weighted privatisation portfolio. This is calculated to be 12.71% which can be compared to the alternative strategy of investing in the market portfolio which returned a yield of 7.01% over the same time period. In looking at individual listings those which are the greatest disappointment to investors, with negative XHPYs are, TRH -

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<sup>10</sup> Results obtained indicated some errors in the analysis of Kerr, et al., (2008) the most obvious of which was with BNZ for which they used data from BNZ Finance which was a small subsidiary of the BNZ first listed in 1966.

<sup>11</sup> This was calculated in

15.10%, AIR -12.18, BNZ -7.38% and TEL -1.75%. Three of these privatisations, AIR, TEL and TRH, were in the first instance trade sales by the Crown (AIR and TEL by Labour and TRH by National) who believed that method would yield the greatest value. As part of the trade sale process there was requirement for a portion of the firm's equity to be sold publicly on the NZ market.

TRH, originally NZ Rail and was sold to a consortium, comprising of Wisconsin Central Transportation Corporation, Berkshire Partners III L.P., and Fay, Richwhite & Company Ltd. on 20 July 1993, for \$328.191 million (NZ Treasury, 1999). As part of the sale process the Crown received assurances that a public share float would take place and that the new owners saw the rail passenger network as a key part of the business (NZ Treasury, 1999).

AIR was sold, for \$660 million in October 1988, to a consortium of Brierley Investments Ltd. (65%), Qantas Airlines (19.9%), Japan Airlines (7.5%), and American Airlines (7.5%) (NZ Treasury, 1999). The Crown's requirement for this sale was that the Crown retained one special rights share (Kiwi Share) and 65% remained in NZ hands with Brierley Investments Ltd. to sell down their portion initially (NZ Treasury, 1999).

TEL was initially sold for \$4.250 billion to Ameritech and Bell Atlantic Corp in September 1990 who were required to sell 50% of its equity within 3 years as well as a requirement for one Kiwi share (NZ Treasury, 1999). Fay Richwhite and Freightways then agreed to buy 5% each over three years and Ameritech and Bell Atlantic Corp were required to offer shares publicly until they reduced their holding to 49.9% (NZ Treasury, 1999).

The BNZ was not initially a trade sale in that an issue of 15% was made by the BNZ to the public as a capital raising in March 1987 at a price of \$1.80 (NZ Herald Staff, 1987) and closed on day 1 at a 3% premium. The intention of the was to sell the remainder later (New Zealand Government, 1988), however the BNZ announced a loss of \$648 million for the 1989 year and the government moved to recapitalise the bank by way of a rights issue, with 30% of the bank being taken by Capital Markets Ltd (Singleton, Grimes, Hawke & Holmes, 2006).

The first public sale of AIR was an offering of 30% (5% reserved for airline staff and 25% for the NZ public) of the shares in October 1989 at a price of \$2.40 (Reuters News, 1989). The public issue of shares in TEL took place in July 1991 was at \$2.00 and prompted the size of the float to be increased from 19% to 27% (Reuters News, 1991), heavy demand in NZ and overseas markets resulted in the closing price on day 1 being a 15% premium.

The remaining 5 listings all out performed the NZX market over the period of this study. POA, initially owned by the Auckland Regional Council (ARC) (80%) and the Waikato Regional Council WRC) (20%) was privatised in October 1993 when the WRC sold its 20% stake on the NZX at \$1.60 resulting in a one day premium of 9% (Reuters News, 1993a). In July 2005 the ARC purchased all outstanding shares at \$8.00 per share and delisted the port. Overall investors in POA would have received a XHPY of 9.54% if they had bought on day 1 or 10.39% if they were part of the IPO. TPW was formed out of the corporatisation of the Tauranga Power Board with half of the share in TPW distributed to its customers with the remainder held in a community trust (Reuters News, 1993b). Shares in TPW were first listed in April 1994 and customers who retained their *free*<sup>12</sup> share have received an XHPY of 17.15% over 17.62 years. The Crown which owned a 51.6% stake in (AIA other owners were various Auckland regional local body councils) sold its airport shares in a public offering at \$1.80 per share with 60% going initially to local investors (Reuters News, 1998). The AIA was subject to considerable demand, both internationally and domestically, and share traded on day 1 at \$2.05 for a day1 premium of 14%. Winston Peters, Treasurer of the National NZ First coalition government described the float as an unprecedented success which was more than four times oversubscribed with 20.6% of AIA owned by retail NZ investors, 9.9% NZ institutions, 47.5% Auckland councils and only 20.6% international institutions (Reuters News, 1998). Following the its success with AIA the Crown moved to list its property holding in central Wellington, nine building occupied by government officials and managed by Government Property Services were grouped as Capital Properties NZ Ltd. (CNZ) and listed in November 1998. Investors buying into the IPO were required to pay a first instalment \$0.50 with a second and final instalment of \$0.50 due in June 2000 (NZPA, 1998), share ended the first day trading at \$1.09 to give a 9% day 1 premium on the \$1.00 listing price. The final listing for a New Zealand privatisation was Contact Energy (CEN) which went to the market in May 1999 after the Crown sold a 40% cornerstone holding to U.S. energy giant Edison Mission for \$1.2 billion. While Edison Mission paid \$5.00 per share for its stake participants in the IPO paid \$3.10 (with 70% of the float going to NZ individuals and institutions)(Reuters News, 1999), with strong demand resulting in the price finishing day 1 at \$3.44 giving a premium of 11%.

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<sup>12</sup> With free shares it is meaningless to attempt to calculate a day 1 premium.

## **Contribution to the NZ Share Market**

The New Zealand share market is small in comparison to markets in other developed countries. Total market capitalisation (Capitalisation of the NZ total market and privatisation sample are shown in Figure 1 in the Appendix) at the end of quarter 1 1988 (6 months after the 1987 share market crash) was only NZ\$6 billion which the BNZ, as the first and only listed privatisation, comprised \$1.2 billion of which only \$240 million was free float or investable. The next privatisation to hit the NZ share market was that of Air New Zealand in the latter half of 1989 with a free float of \$117 million. The privatisation with the largest impact on the NZ market was that of Telecom, the total market capitalisation of the NZ market was just over \$8 billion in quarter 2 1991 but the \$6.274 billion listing of Telecom (free float \$2.196 billion) in quarter 3 pushed the total market to \$15.532 billion.

Coincidental to the listing of Telecom the NZ market capitalisation grew rapidly, reaching \$56 billion in quarter 3 1997 of which \$18.139 billion was privatised firms with a free float \$7.710 billion. The NZ economy suffered something of a decline at the end of the 1990's, impacted first by the Asian currency crisis followed by the collapse of the dot com bubble at the beginning of the 2000's. Over this period the capitalisation of the NZ market fell to a low of \$41.755 billion in quarter 3 2001 with total privatisations at \$13.578 billion (free float \$7.350). By this point time Port of Auckland, Trustpower, Toll Hlds (NZ Rail), Auckland Airport, Capital Properties, and Contact Energy had all been privatised and the Government's privatisation program was at an end.

There can be little doubt; the nine privatisations in this sample have had a considerable impact on the NZ stock market. The privatisation of Telecom in 1991 resulted in total privatised assets comprising 49% of the NZ total market (16% free float) and for twenty years the capitalisation of the privatisation sample has averaged 37% of the NZ total market. Over a considerable period of that time Telecom was the largest NZ listing reaching a peak capitalisation in quarter 1 2000 of \$15.968 billion. Despite the decline in Telecom's value from its peak in 2000 and the splitting off of its network assets as Chorus both Telecom and Chorus are still in the NZX10 index (a free float index) along with Auckland Airport and Contact Energy. Privatisation stocks are also actively traded, Figure 2 reports quarterly turnover on the NZX for the 48 quarters since the last quarter of 2000. Trading value in the privatisation stocks make up 50% of the value of all trades on the NZX providing much needed liquidity in a small market.

## Conclusions

The obvious conclusion from the above quantitative analysis is the privatisation program had a considerable impact on the NZ economy with privatisations comprising over a third of the NZ share market. NZ investors have also fared well long run return to shareholders investing in privatised firms generally doing well, with an overall return of 7.99% compared to the market return of 6.80%. This result is even more creditable when one considers that four of the earliest privatisations, BNZ, AIR, TEL and TRH would by most long term investors be considered failures. Further research is required to identify if there are common features in the underperformance of these four privatisations. An obvious factor could be the time period in which they were sold by the government, as they were the first four privatisations<sup>13</sup> and coincided with the bear market. Another factor could be that they were initially sold to consortiums of large investors; with rail going to Wisconsin Central Rail Transportation Corp, Berkshire Partners and Fay & Richwhite Partners; Air NZ went to Brierley Investments, Qantas Airlines, Japan Airlines, and American Airlines; Telecom was sold to US telecommunication firms Ameritech and Bell Atlantic with Fay & Richwhite and Freightways joining the syndicate quickly. In contrast later privatisations were either listed directly or significant holding were given to local government, and appear to have fared well with all outperforming the NZ total market.

For today's investors, it appears the current government has learnt from past mistakes. Future privatisations will not be handed directly to foreign investors. The Crown intends to retain a minimum 51% ownership in future privatisations and the Government is expending considerable effort to ensure retail investors have easy access to buy into the new listings. It is only to be expected that some retail investors will sell to foreigners, to earn a quick profit. The magnitude of which will depend on the listing price set by the Government and demand from buyers. If restrictions are put in place, limiting institutional investors, then demand will increase as the new privatisations will form a significant portion of the NZ stock market with many fund managers forced to buy into them to balance their portfolios. Further, after encouraging retail investors to re-enter the share market the Government is likely to be mindful of having disappointed them when the next election is held.

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<sup>13</sup> NZ Rail was first sold in July 1993 but was not listed until July 1996.

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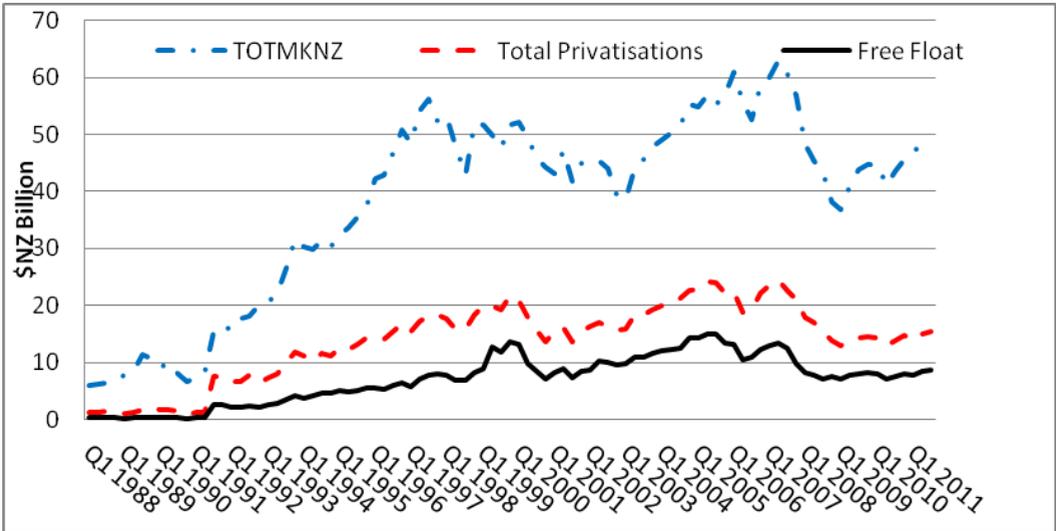
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# Appendix

**Table 1 Sample Firms HPYs and XHPYs**

Sample Firms	BNZ	AIR	TEL	POA	TPW	TRH	AIA	CNZ	CEN	Avg
First Listed	31/03/87	24/10/89	18/07/91	19/10/93	18/04/94	14/06/96	28/07/98	27/11/98	11/05/99	
Day 1 Price Premium	2.86%	14.58%	17.50%	8.75%	N/A	14.70%	13.89%	9.00%	10.97%	
End or Delisted	22/12/92	25/11/11	25/11/11	19/07/05	25/11/11	20/09/07	25/11/11	28/03/06	25/11/11	
Years	5.73	22.10	20.37	11.76	17.62	11.27	13.34	7.34	12.55	
Listing Period HPY	-9.47%	-6.20%	6.58%	18.48%	23.10%	-4.40%	15.68%	18.25%	9.89%	7.99%
Listing Period XHPY	-7.38%	-12.18%	-1.75%	9.54%	17.15%	-15.10%	10.00%	5.79%	4.67%	1.19%

**Figure 1 NZ Privatisations Mkt Value – TOTMKNZ, Privatisations, Free Float**



**Figure 2 - Quarterly Turnover**

