

**Case Studies in  
Australian Public Enterprise Divestment**

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## CASE STUDIES IN AUSTRALIAN PUBLIC ENTERPRISE DIVESTMENT

### Chapter 1

#### INTRODUCTION

This collection presents nine case studies of public enterprise divestments in late 20th century Australia, one occurring in the mid-1980s and the other eight in the first half of the 1990s. In this introduction, we explain how we came to undertake these particular studies, and describe the research methods we have used. Other commentaries and assessments based on the research program of which these studies were a part are being published elsewhere, and are noted briefly at the end of this introduction.

There is now a huge international literature on privatisation, both supportive and critical; as one of the major privatising techniques, public enterprise divestment commands an important place in this literature. But most available studies deal with the general movement, presenting argument for and against; some of the most interesting items are those seeking to show how and why privatisation became so popular in the last two decades of the 20th century, and the paths of diffusion as it spread out around the world after the early attacks on the public sector and what it stood for by a few national leaders like Thatcher in Britain, Reagan in the United States and Pinochet in Chile.

But this literature contains few case studies providing information about specific cases of public enterprise divestment. As the program whose origin and development we describe below built up, we have found ourselves presenting papers about it at various national and international conferences and university seminars; we have usually found much interest in the “stories” about the transitions individual enterprises have experienced as they have been affected by this privatising agenda, and received requests that we should make our data more widely available. We have also found a few other scholars beginning to pursue similar paths, and getting similar responses. We have repeatedly been told that such case studies provide very good teaching material for use in relevant courses, and it is in this spirit that we now offer our set of nine such case studies.

This said, we acknowledge another rare but significant and systematic exercise in approaching the study of privatisation in this way, one in whose design World Bank officer Ahmed Galal played an important part. Galal developed a research proposal which led the World Bank to commission a series of privatisation case studies, and he managed the proposal on the Bank’s behalf. He had built on some exploratory work on a proposed methodology for evaluating the effects of privatisation in which Leroy Jones of the Boston Area Public Enterprise Group (or BAPEG) had played an important part,<sup>1</sup> and the outcome was a study of four

countries which had, by the mid-1990s, done much privatising. The countries were Britain, Malaysia, Chile and Mexico, and across these countries 12 privatised enterprises were investigated by World Bank and Boston University researchers. The results were presented at a conference in Washington in June 1992, and both the conference proceedings and a summary volume were published two years later.<sup>2</sup>

Galal believed that, from a fiscal point of view, there might often be good arguments for divesting an enterprise. But he warned that there was enough anecdotal material available to suggest that the expectations would often not materialise. Nowhere in the world, he declared, 'are we able to find even a single serious and balanced study of what actually happened in the wake of divestiture' (Galal 1990: 8-9). This was the huge empirical gap he wanted to rectify, and he designed the World Bank project with this objective in mind. In the event, this project produced useful information about pitfalls in privatisation schemes, about policy successes and policy failures, about difficulties in attributing causes to changes in performance, and particularly about how privatisation outcomes affected different stakeholder groups in each case studied. As we discuss our own methodology below, we note some points of connection between this World Bank study and our own.

## **The case study program**

### *Conception and objectives*

The research project in which these case studies have formed a central focus attracted a beginning large grant from the Australian Research Council, and the study has been in progress for about five years. It has been undertaken primarily in the Centre for Research in Public Sector Management (CRPSM) in the University of Canberra. Over the period of the project, the principal investigators have been Jim McMaster, Dean of the University's Faculty of Management and Associate Professor of Economics when the project began in the latter part of 1995, and Roger Wettenhall, at that time recently retired as Professor of Public Administration in the University of Canberra and newly accredited as Visiting Professor in CRPSM. They were soon joined by Dr Fran Collyer, a sociologist who had hitherto worked mostly in the field of health sociology, in the capacity of Research Officer. The three have continued to be associated in the project throughout its development, though towards the end of 1999 Professor McMaster moved to the University of the South Pacific in Fiji and Dr Collyer to the University of Sydney---resulting in the need for the association to be pursued at fairly long distance over the past year.

The primary aim of the project was to show how privatisation has been impacting on Australia through a detailed examination of divestment action in a small group of enterprises disposed of by government in the period 1986-1995. A secondary aim was, as far as was possible in the time and space available to us, to set these particular experiences against a wider picture of the worldwide movement.

For most of its settled history, Australia has steadily established, and occasionally disposed of, public enterprises. Except in the recent period, ideology has rarely been significant in this process; mostly the relevant decisions have been taken on severely pragmatic assessments of socioeconomic need in areas such as transport and communications, electric power, irrigation and water supply, commodity marketing, banking and insurance, and the unlocking of the resources of the Snowy Mountains. As an extension of this process, from the 1970s Australia embarked on a serious program of public enterprise management reform. This major thrust continued through the 1980s, even as some other Western polities which also had many public enterprises (led by the United Kingdom and New Zealand) were dramatically shifting gear and selling off such enterprises to the private sector. These so-called asset sales were an important part of the developing worldwide privatisation movement, and were matched by massive shifts in the countries of Eastern Europe from public sector to private sector orientations; many developing countries were moving similarly, often in deference to pressures from international financial institutions.

Australia was in no sense a leader in this privatising movement. In 1990, Wiltshire described what had happened up to that time as mere 'flirtation', and four years later he found it necessary to explain why the 'ideological drive behind privatisation has not really caught on' in this country (Wiltshire 1990, p. 224; 1994, p. 204). But a rapid change was occurring through the middle '90s, so much so that, by March 1998, a Sydney newspaper could proclaim Australia to be a 'world leader in selling public assets'. It asserted that 'Australia, led by Victoria's Premier, Mr Kennett, is [now] officially one of the world's keenest privatisers', and quoted an investment banker who suggested that another \$80 billion could be raised from sales of public assets over the next five years (Hughes 1998). The Reserve Bank had just reported that, among the OECD countries, Australia was second only to Britain in the value of privatisations from 1990 to 1997; and, relative to the size of the economy, second only to New Zealand (RBA 1997, p.8).

This dramatic conversion was begging to be documented. We concluded that this task could well be approached through case studies, which have accordingly constituted a central focus of our research. Such case studies would provide the best data on how the disposal of public enterprises has been handled in Australia, and the best opportunity for exploring the vital question of the costs and benefits

of privatisation---or, put in another way, who wins and who loses from such disposals. This concern with winners and losers is apparent in much of the international literature, and is flagged specifically in the World Bank study noted above (Jones 1994).

What Australian literature has emerged on the subject of privatisation is---apart from one important book published earlier this year (Walker & Walker 2000)---mostly either anticipatory or reporting on overseas experience. Since Australia's own experience is more recent, it has not yet attracted much serious analysis. We believe that our set of case studies will advance knowledge of what has actually been happening in this country.

We have already indicated that there is a huge international literature on privatisation, even though it mostly lacks empirical case studies. In the course of our project, we have exchanged bibliographies with some privatisation scholars in other countries. And we are aware of a stern challenge issued by one of them, Peter Curwen, when he reviewed yet another book on the subject (a collection of nine European country studies). So much has already been written, he observed, that one must ask why a further book is needed: it should either 'cast new light upon privatization; cover new ground (in this case countries); contain a new set of data; and/or be very up-to-date' (Curwen 1996, p. 418). We believe that this collection does contribute on several of these criteria.

### *Selection of cases*

We began our study by selecting a single case, the Belconnen Mall in the Australian Capital Territory (ACT), using this as a pilot to test our evaluation methodology. Belconnen Mall was particularly suited for this purpose: it was both the first of the Commonwealth privatisations of the recent period, and also easily accessible to us in our University of Canberra location. Rather than assuming *a priori* the criteria for our case studies, we spent some time with key informants learning about the privatisation process and the range of divestment methods.

From this we produced a list of nine case studies, selected on the basis of several criteria. First, we wanted our cases to have gone through the full privatising cycle, so that we could gain sufficient history to allow some comparison of post-sale performance with pre-sale performance. We still believe this was a good strategy---and we note that it was a significant factor in the selection of cases for the World Bank study (Galal 1990: 25)---even though it prevented us from covering some major enterprises divested more recently as the privatising mood has gained strength in Australia.

Second, we wanted our cases to display a variety of divestment methods and range over several Australian jurisdictions, geographical settings and industry sectors. Thus we settled on cases covering four jurisdictions (New South Wales, Victoria, South Australia and the Commonwealth, with the Commonwealth enterprises chosen based in Canberra, Melbourne and Cooma), nine industry sectors (hospitals, retail, fish, grain, insurance, betting, banking, pharmaceuticals and engineering), and five disposal methods (trade sale, industry take-over, public float, management/staff buy-out, and a build/own/operate---or BOO---concession).

Third, we wanted our cases to offer examples of both ‘poor’ and ‘good’ enterprise performance prior to divestment. This was more difficult for, contrary to what is so often suggested in political debate and in the arguments of the economic rationalists, many Australian public enterprises in the past have been reasonably successful, giving considerable satisfaction to their clients, often making profits and returning dividends to their owning governments, and contributing significantly to the cause of national development. It was immediately clear that several we had selected for other reasons had been both profitable and reasonably efficient in their public ownership phases; two others, temporarily unprofitable, were suffering because they had recently taken out large loans for redevelopment purposes at a time of very high interest rates. We wanted a more obvious case of ‘failure’, and because we also wanted to extend our coverage of jurisdictions we decided to include one of the two notoriously failed state banks---but even there it was soon clear to us that the fall from grace was a late feature of what had, over more than a century, been a generally well-regarded record in public sector ownership and management.

A final consideration was our need to get some cooperation from the managements of the subject enterprises and from others closely involved in their privatisations. In the event, the degree of cooperation we received from the enterprises themselves has been variable. In some the cooperation has been full and unstinted, and for this we are very grateful. All have supplied documents to facilitate our study, most have granted us interviews with senior management personnel, and some have commented readily on early drafts of the case study chapters. But we have to report that, in a couple of cases, there was some withdrawal of cooperation as it became clear to the enterprise managements that we were giving serious attention to some critiques of aspects of their performance or of the particular sale. In these cases we have pointed out that, as serious students, we could not ignore these critiques, but we have also asked the enterprises for their responses to them and undertaken to give careful regard to those responses in our case reports. The degree of response to this request also has been varied. We have of course interviewed or otherwise consulted other people who have been involved in these disposals in one way or another---we are



grateful to them all, though the conventions about public service anonymity mean that not all such assistance can be specifically acknowledged. It is somewhat ironic that, in response to circulated drafts, we have been criticised both for being too sympathetic to enterprise managements seeking and achieving privatisation, and for adopting an unscholarly anti-privatisation stance. Clearly privatisation is a controversial business!

### *Research method*

Similar information was sought about all the selected enterprises, even though accessibility to information varied. Some cases---especially where there had already been critical study---had been fairly well documented, so that we could concentrate on gathering very specific information through interviews and further documentary searches. In other cases there had been little previous study or documentation, and time had to be spent in gathering the very rudiments of the case. But we found that the cases showed such a diversity in the privatisation experience that each case had a 'different story to tell'; and we allowed, and even encouraged, the diversity of the cases to show through, thus emphasising the historically contingent nature of the policy process.

In general we sought the following information in each case:

- \* the history of the organisation and the reasons for government involvement;
- \* public interest issues relating to, and community service obligations of, the enterprise;
- \* the management and operating systems operating prior to privatisation;
- \* the past financial performance of the organisation;
- \* the political and economic arguments put forward to support or reject the privatisation option, including alternative ownership options that were considered;
- \* the state of the enterprise at privatisation, including the physical condition, value of assets, capital structure, human resource management system, comparative advantage and position in the market;
- \* preparations made for privatisation, including legal, financial and workforce restructuring;
- \* significant events surrounding the actual hand-over process; and
- \* indicators of performance after privatisation and the distribution of costs and benefits of privatisation to stakeholders and the wider community.

Documentary sources were extremely important, particularly parliamentary records, government and enterprise reports, press coverage of relevant events and, where it already examined the subject enterprises, the academic literature. Telephone and face-to-face interviews with key informants were also vital: we

have been in touch variously with enterprise executives, government officials, political advisers, staff and representatives of employee associations/unions. Some of our best informants were those who have since retired or been redeployed, allowing them to speak freely about past experiences. We found that this qualitative approach yielded 'rich' data, and we explicitly avoided the use of quantitative surveys to gather organisational and financial data because other studies of privatisation relying on these methods (such as those reported in Martin & Parker 1997) have produced rather ambiguous findings. This ambiguity is not surprising, given that the privatisation process is a dynamic one in which the enterprise undergoes rapid and radical change. As a consequence, the privatised enterprise is often not much like the one that existed prior to privatisation. As the case studies demonstrate, many of the privatised enterprises have changed their function, organisation, objectives and size, making the 'before' and 'after' comparison not easily amenable to statistical measurement (Collyer 1996, p. 24). The fundamentally *dynamic* quality of the privatisation process was therefore captured through a focus on qualitative methods which enabled us to gain an insight into the changing context within which each enterprise was operating. We soon realised that Robert Walker was correct in his assessment that '[q]ualitative research reaches parts that other techniques don't' (1985, p. 18).

There is now a considerable literature on the case study method generally. While we do not want to extend this introduction by using it to justify our own research method, we point to one particular observation emerging from this literature which deals with efforts to make comparisons across case studies in multi-case research projects. Thus Bradshaw and Wallace suggest that, when the subjects of such studies are being compared, 'they should be compared as wholes and not as oversimplified parts' (1991, p. 162)---in other words, the contextual integrity of the case studies should be respected throughout the analysis. Without this, meaningless analysis could occur where one or two isolated features of a case are removed from their context and compared superficially with features from other cases. We have avoided the temptation to do this.

Exercises in the evaluation of organisations or enterprises which seek to attribute changes in performance to a particular cause face a particular problem. We wanted our case studies to show the extent to which the ownership change involved in the sale of a previously publicly owned enterprise affected performance, but we found this extremely difficult to establish. So often, other changes in the enterprise's environment may be taking place independently of the ownership change. For example, there may be changes in market demand for the goods or services provided or in the regulatory environment. Or other government-imposed changes may be occurring which have no essential connection with the ownership change, such debt-stripping, staff downsizing or

the removal of some functions or addition of others. Galal noted in his preparation for the World Bank project that a 'critical question is: to what extent are observed changes in performance due to the divestiture itself, as opposed to exogenous concurrent factors?' (Galal 1990: 22). We have not found it possible to solve this problem; our battle with it has suggested rather that all such exercises in evaluating the outcome of ownership change in complex situations must produce an ambiguous answer to Galal's question.

We have already alluded to the withdrawal of some management support from our project when the managements realised we were taking seriously some critiques of their performance. What we have been seeking to do is to assess the impact of an explicit type of policy 'experiment', undertaken by State and Commonwealth governments much influenced by international trends and economic theorising but with not much in the way of historical precedent to guide their actions. Our research is thus an exercise in evaluation, and all evaluation is an exercise in value judgment. As our work progressed, however, we were confirmed in our belief in the need for a multi-faceted approach to the study of privatisation that takes into account a wide range of political, social and economic factors. As a consequence, our evaluation of the 'performance' and 'impact' of each privatisation takes into consideration, but does not stop with, managements' own evaluation of its enterprise. As Considine points out, management measures its performance and output according to its own goals and objectives, and these are vulnerable to the dominant values and political concerns of the day (1994, p. 243). Instead our evaluation is a measure of 'performance' across a number of social as well as economic indicators, and it identifies a range of 'impacts' of the privatisation process on groups and organisations from the wider community, thus taking into account differing perspectives and experiences. It would thus not be surprising if our evaluation takes a broader perspective than that of management, and if at times it differs significantly from that of management.

Explanatory notes accompany each case study to indicate which of us has had the main responsibility for that particular study. But we have all read and commented on drafts as they have been produced, and we have discussed extensively both the general direction of the project and the circumstances of each case. Since we come variously from the disciplines of sociology, economics and political science/public administration, it has been an interesting challenge to us to try to fit together the perspectives of these distinct disciplines. In the outcome, we believe that our collective approach has brought an interdisciplinary freshness to the subject matter.

### **Lessons from the case studies**

A thorough analysis of the material presented in these case studies would fill another volume. Nonetheless it is appropriate to point here to some of the more salient features of the privatising action taken in these cases and to the conclusions that may be drawn from them. Primary among these must be the generally poor financial return to the owning government from the divestment.

There are of course several methods of ascertaining whether the sale price was an appropriate one, and differences between them often give rise to heated debate. Conventional evaluation procedures such as the Discounted Cash Flow method, the Price Earnings Multiple method, and the Net Tangible Asset method, offer significant problems when applied to the sale of a publicly owned enterprise. This is because privatisation is generally accompanied by other organisational and market changes, such as industry deregulation, financial restructuring, asset stripping or downsizing. None of these methods are able to take into account such radical changes facing the enterprise, where future earnings are highly unlikely to reflect previous trends. Similar difficulties arise with methods based on a comparison between the final sale price and the stated asset value of the enterprise. Not only does such a method fail to take into account the usually significant costs of disposal, but the value of the enterprise prior to sale is particularly difficult to ascertain when it has not previously existed as a saleable commodity within a competitive market. Taking these difficulties into account, and acknowledging that offering detailed financial assessments would be highly misleading, our research instead is offered as an indication that buyers of enterprises have generally done very well (with the exclusion of the GIO), purchasing themselves a 'bargain'. In contrast to the main beneficiaries of privatisation - the new owners and investors - the selling governments have lost some good income generating businesses with the potential for growth. In some cases, such as the PMBH and the CSL, where government continues to fund the service through the private operator on a contractual basis, the privatisations represent an on-going drain on the 'public purse'. Indeed in all cases it appears that the citizens of Australia have not been adequately compensated for the permanent loss of a previously collectively-owned asset.

The first lesson that can be drawn from our case studies then, is that long term financial returns to government appear to have played very little part in the decision to privatise. Given the generally poor returns to the public sector for the sale of a valuable asset, it is not difficult to conclude that governments have opted for short term boosts to the budget, and that decisions have been based on ideology rather than on the rational calculation of costs and benefits.

A second important lesson that can be drawn from the case studies relates to the economic performance of the enterprises after privatisation, which is an issue of concern widely addressed in the literature. We noted above that evaluations based on comparing pre-privatisation and post-privatisation performance are fraught with methodological difficulties because of the often radical changes experienced by the enterprises during the disposal process and the virtual impossibility of proving that ownership change was the decisive factor. We quickly became aware of the extent to which our nine case-enterprises were transformed---often in the lead-up to privatisation---and it did not therefore surprise us to see them flourishing to varying degrees after privatisation, given the enormous level of assistance and subsidisation the new owners often received from government. This assistance included variously downsizing, hiving-off of unprofitable units, financial and organisational restructuring, new technology, ongoing subsidisation of costs, and very significant debt-relief. Clearly these forms of assistance---not unique to Australian governments---had as much to do with performance change as the change in ownership. Our study thus supported findings reported elsewhere (eg Sundquist 1984; Walshe & Daffern 1990; Goodman & Loveman 1991) that, despite the rhetoric, ownership change is itself no panacea for a failing enterprise nor a necessary means of enhancing an already successful one. Business acumen is a prerogative of neither the private nor the public sector, and governments are mistaken if they see privatisation as an essential tool for increasing efficiency.

A third lesson to be drawn concerns the winners and losers from privatisation. The evidence here is clear and consistent from case to case: Privatisation maintains and exacerbates existing class inequalities. The winners from privatisation are the large shareholders, financial institutions, enterprise executives, private consultants and advisers, and to an extent political parties and politicians. The losers are those who have lost their jobs or been reduced to the status of casual contractors, the public who have lost access to public spaces and services, future generations left without the income from public enterprises that used to pay for essential services, taxpayers who see their tax dollar devalued as governments have to pay more for the provision of those essential services, and sometimes the small shareholders who have little protection against stockmarket fluctuations.

There is of course much more that can be drawn from a careful reading of the case studies, which are presented in considerable detail to enable readers to make their own interpretations and draw conclusions. We will welcome comment, critique and discussion. But we are confident that the case studies do point clearly to the ideological underpinnings of the modern privatisation movement, and to the conclusion that privatisation in Australia has generally not been in the national interest or in the interests of the citizenry-at-large.

## **Related studies and assessments**

As indicated above, our research has already had some exposure. As is usual with such projects, we have presented various progress reports to conferences and university seminars, and we have published some associated articles drawing on the material being collected. Of course we had prior interest in relevant topics that had led to earlier publications, and to an extent our pursuit of this project drew on that work. We conclude this introduction with a pointer to the other papers which have emerged as spin-offs from our case study research program or which are connected with it in other ways.

Thus McMaster and Collyer (both 1996) presented early commentaries on some methodological problems involved. Together we drew on insights from our own case studies to comment on the valuation arithmetic used in the sale of a second tranche of shares in Telstra, previously the Australian Commonwealth government's Telecommunications Commission (Collyer, McMaster & Wettenhall 1998); and a jointly written chapter reviewing both the development of the Australian public sector and the late swing to privatisation is included in an international compendium on public enterprise reform and privatisation just published in the United States (Collyer, McMaster & Wettenhall 2001).

Collyer's earlier relevant work related mostly to the sociology of health, and she has written particularly on the extension of private ownership in the hospital field (White & Collyer 1997, Collyer 1998, Collyer & White 1998). McMaster had previously explored the prospects of privatisation in Pacific Island countries, largely through an association with the East-West Center in Hawaii (McMaster 1990, McMaster & Samad 1996). And Wettenhall had earlier written on the development of the Australian public enterprise system (1987, 1990, 1996) and on the impact of the privatisation movement on public enterprise systems generally (1983, 1993). More recently we have, either jointly or separately, presented reports on the progress of our research and on Australian privatisations generally to conferences of the Economics Society of Australia, the Australian Sociological Association, the Institute of Public Administration Australia, the Manila-based Eastern Regional Organization for Public Administration, the Korean Association for Public Administration, the American Society for Public Administration, the International Association of Schools and Institutes of Administration and the International Public and Private Sector Partnerships Network, meeting in places as varied as Canberra, Sydney, Wollongong, Macau, Seoul, San Diego, Beijing, Birmingham (England) and Cork (Ireland); and to university seminars in several Australian cities, Hong Kong, Brunei and Zimbabwe.

Finally we need to record that five of the case studies included in this volume have previously been presented in preliminary form (Collyer 1997; Collyer,

McMaster & Wettenhall 2000; Wettenhall, Collyer & McMaster 1999; Wettenhall 2000c, 2000d).

NOTES:

1. On the earlier work of Jones and other members of BAPEG in developing a performance evaluation system for public enterprises, see Wettenhall & O Nuallain 1990: 16-19.
2. The initial proposal is to be found in Galal 1990, the conference proceedings in Galal *et al* 1994, and the summary in Galal & Shirley 1994.

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## Chapter 2

### **BELCONNEN MALL\***

One of the first 'modern era' privatisations in Australia<sup>1</sup> was that of a publicly owned mall in the northern Canberra satellite town centre of Belconnen. The sale---by the trade sale method---was concluded before the creation of the regular divestment machinery which came as privatisation firmed into an on-going program more-or-less supported by all the major Australian political parties. Indeed, the Belconnen Mall case revealed the Australian Labor Party (ALP) in considerable disarray as arguments for and against privatisation were presented with considerable emotional force. In this case the decision to sell was conditioned by the unusually controversial history of the enterprise in public ownership.<sup>2</sup>

This divestment occurred at a time when the Australian Capital Territory (ACT), where the subject enterprise was located, was beginning to flex its muscle as a potential new and distinct governmental entity: it became a self-governing territory within the Australian federation in 1989.<sup>3</sup> At the time it was effected, the divestment represented the largest single property purchase in Canberra's history. Initially the sale went to a public-private partnership rather than constituting a full conversion to the private sector. And finally it revealed, for all who wished to see, the great difficulty often experienced when those wanting to evaluate the impact of ownership change try to proceed by comparing pre-sale and post-sale economic performance.

### **The subject enterprise**

#### *Why a public investment?*

The shopping mall in Canberra's northern suburb of Belconnen is a large enclosed shopping complex, on three levels and with adjacent multi-storey parking. It was built between 1976 and 1978 by the Canberra Commercial Development Authority, a statutory corporation set up by the Commonwealth government, and then operated by that corporation. The mall was a public sector development, seeded with public money but with the construction capital raised through a mix of private and public sector loans.<sup>4</sup> It was conceived, designed and built before the Canberra region had self-government, when the Territory was administered by the Commonwealth's Department of the Interior and later the Department of Capital Territory and its successors.<sup>5</sup>

The idea of building the mall as a community enterprise was discussed in the late 1960s by leading Canberra residents and by Peter Nixon, the Country Party

Minister for the Interior in the then Coalition government. The Coalition lost office in late 1972, by which time another Country Party Minister, Ralph Hunt, who had replaced Nixon in that portfolio, had a submission ready for cabinet recommending construction of the mall. The proposal was simply taken over by the incoming Labor government, and in April 1973 Minister for the Capital Territory Kep Enderby announced that a statutory corporation would be established to develop and manage Belconnen Mall; he indicated that the proposal for the mall authority had been developed by the Department of the Capital Territory and the National Capital Development Commission (NCDC), with input from the ACT Advisory Council and community organisations (Enderby 1973).

The commitment of *public* funds for a retail mall was justified as a way of correcting the existing monopolisation of retailing and development in Canberra. One developer, Lend Lease Corporation, held the leases for the other two Canberra malls, the Monaro Mall in Civic and Woden Plaza, and was also involved in the development of the Coolamon Court shopping centre in Weston Creek. Canberra also had little variety in retailing: one major retailer, David Jones, was a major sub-lessee in both existing malls.

Advocates for the 'public' development of the mall argued that a public authority would introduce a competitor to Lend Lease, and attract other large retailers to Canberra. They argued that it alone offered the opportunity to adopt new development techniques; select developers according to criteria other than those of financial suitability; offer expertise which has the public interest in mind; return part of the profits of consumer spending to the local community; offer community facilities often unavailable in privately run malls; and allow public participation in development of the area, thus constituting a valuable 'social experiment' (NCDC 1973). Opponents, such as some members of the Canberra Chamber of Commerce, believed that other strategies could produce some of the same results (see eg Newby 1972; *Courier* 1973), but they did not carry the day.

### *Implementing the decision*

Ensuing developments indicated that there was still some multi-party support for the proposal. New Labor Minister Gordon Bryant, who replaced Enderby in the portfolio in October 1973, pursued the project vigorously, and the Canberra Commercial Development Authority (CCDA) was created by ordinance late in 1974 to design, construct and operate the mall 'in accordance with the principles of sound commercial practice in so far as those principles are not inconsistent with the public interest' (Canberra Commercial Development Authority Ordinance 40/1974, s.16). It then fell to the Liberal Eric Robinson,

first Minister for the Capital Territory after the formation of the Fraser Coalition government in December 1975, to ensure the funding of the project (Sparke 1988, pp 219-20; Grundy *et al* 1996, pp 65, 84, 88). Robinson also took the opportunity to put legislation through the Commonwealth Parliament requiring CCDA to pay income and sales taxes (Territory Authorities (Financial Provisions) Act 6/1978).<sup>6</sup>

CCDA was chaired by Jim Pead, a Canberra businessman with experience in retail, hotels and residential development, who was chairman also of the ACT Advisory Council and a doughty fighter for ACT self-government. The Joint Committee of Public Accounts would subsequently note that Pead had been a 'prime mover' for the establishment of the mall, and that he firmly believed that revenues derived from it should 'provide a means for broadening the financial base' of the ACT (JCPA 1980, pp 12, 18). It is likely that Pead's strong inclination to push the ACT interest against that of the Commonwealth was one source of future tension.

By 1976 CCDA had completed the feasibility study and loans had been secured for the building of the mall. Construction began in that year. Through 1977 CCDA was arranging tenancies, and the mall opened in three stages in February, July and October 1978. The first stage featured 49 retail outlets including Woolworths, Coles and KMart, the second 70 more shops and two major banks, and the third notably included the Myer department store.

The total cost of the project was \$41m. The Commonwealth provided \$1 million of equity capital, the balance being raised by loans from the private sector (\$15.75m in government-guaranteed bank loans and \$24.5m by public subscriptions in the form of government-guaranteed inscribed stock ranging from small \$100 personal investments to \$4m institutional investments). CCDA was expected to repay the equity capital to the Commonwealth as a form of dividend, and the terms of the repayment were negotiated annually with the minister after profits had been determined. From its revenues, it also had to pay interest on loans and taxes.

CCDA was given both a 'financial' and a 'social' charter. As to the first, the already-quoted section of the creating ordinance was strengthened by another (s.26) which required it to 'pursue a policy directed towards securing revenue sufficient to cover all its expenditure properly chargeable to that revenue, and to permit the payment to Australia of a reasonable return on the capital of the Authority'. As to the second, ministerial and other authoritative statements left no doubt that it was to assist in the urban development of Canberra and to provide competition to private developers and large retailers, greater retail choice, and better community facilities (see JCPA 1980, pp 15-17).

CCDA made the significant claim that, untypically for a public developmental project, the mall had been constructed both within budget and within the set time limit. Once it was opened and operating, it had fulfilled one of the major objectives of the early advocates of the mall: it had broken the monopoly previously enjoyed in the ACT by the principal developer and principal retailer. For a few years thereafter, it was mostly valued as a public asset: it was producing a sound financial return on the initial investment, and considered to be a unique and valuable means to provide much needed community services.

At the time, it was recognised as a leader in two senses. It was at the same time a core element of the business centre being established for Belconnen as one of Canberra's satellite towns, and an Australian trail-blazer in the development of the shopping mall concept. During the construction, its senior staff proclaimed that the project was 'so exciting we get goose bumps about it', and visitors from abroad rated it as 'of world class' in the evolving shopping mall movement (reported in Boling 1977). It claimed to be a pioneer in bringing Friday night shopping to Australia and, through its non-exploitative public ownership, to have shown how the 'Jumping Jack' cost inflation common in private sector mall projects<sup>7</sup> could be avoided. CCDA's own view that it was conducting 'a valuable social experiment' was shared by many in the expansionist Canberra community of the 1970s (CCDA 1979; Hird 2000).

### **A decade of controversy**

As a public-sector enterprise, the mall had a life span of less than 10 years. At no stage during the decade was its management entirely free of the threat of sale to the private sector. There were members of each successive government who were keen to sell it, and members of the public who continually lobbied the government to hand it, and the construction of other ACT developments, to the private sector. But it also had some strong defenders and, as already noted, it was promoted on the argument that it would introduce competition into mall development in the ACT.

It is likely that, for many members of the community, a shopping mall within the public sector had far less legitimacy than a public utility such as a transport, communication or electricity service. The stage for ongoing instability was well set by Dr EDL Killen (1973), at the time president of the Canberra Chamber of Commerce, who reflected conservative ideology in asserting that the idea of a public trust running a shopping mall was based 'on doctrine alone' (see also Newby 1972).

CCDA's problems were not confined to the need to placate people like Killen. It found itself having many confrontations with others in the public sector who looked askance at its efforts to behave in a way that would satisfy the commercial side of its charter.

*Battles with the bureaucracy*

There were many such battles; there is space for only a few indications here. While CCDA had a number of powers to acquire, hold and dispose of property, enter into contracts, erect buildings, grant leases and engage staff for those purposes, it needed Public Service Board approval for the terms and conditions of its staff, and ministerial approval for the conduct of some relevant undertakings. As a public authority, it was also expected to maintain a high standard in maintaining accounts and records of its transactions and affairs, to furnish the minister with an annual report, and generally to keep the minister informed about the conduct of its operations.

As manager of the mall, CCDA often grew impatient over delays caused by the bureaucratic processes involved in getting the necessary approvals. Thus it had difficulty in obtaining Public Service Board agreement to staff pay levels matching those of privately run retail complexes. And, in the developmental stage there was tension between it and the NCDC: there was a collision between the two authorities over the site plan and over the cost of site preparation for car parks, as well as over the amount of information CCDA was expected to send the NCDC. The press picked up allegations that CCDA decision-making was concentrated in the hands of an 'inner caucus' of three board members, and publicised two protest resignations by other members. There was further criticism eg that the public had not been provided with information about major mall tenancies (the defence of 'commercial-in-confidence' was not yet well developed!), that there had been excessive travel by board members and unauthorised investment in bank bills, and that CCDA had not followed appropriate protocols in contracting builders.

For those following these developments at the time, it was noticeable that CCDA always had strong defenders within the Department of the Capital Territory (DCT) itself. Unusual among government departments, it was driven by the 'place principle' of public administration rather than the 'functional principle' (Fesler 1949; Stewart 1974, ch.13), and it spawned some untypical bureaucratic attitudes. While it would be too much to suggest that DCT was a united force on such matters, it certainly housed senior officers who were prepared to promote the cause of ACT self-government and to shelter Pead and his CCDA colleagues against all the criticisms (Lawrence 1996; Wettenhall 2000).<sup>8</sup>

Eventually the operations of CCDA came under scrutiny in the Commonwealth parliament, with investigations by both the Public Accounts Committee and the Senate Standing Committee on Finance and Government Operations. A long inquiry by the first committee followed adverse comments by the Auditor-General. In a damaging 1980 report, it concluded that CCDA had not been adequately aware of the nature of the relationship between a publicly owned commercial operation and its political supervisors, the minister and parliament. There were a number of specific recommendations, mostly involving tightening government and parliamentary control over this statutory authority and over statutory authorities generally (JCPA 1980).

The committee also recommended a full inquiry by the Attorney-General into tendering arrangements during the mall's construction (p. 13). The Attorney-General duly investigated the security of tenders, but found no evidence of impropriety. In its own defence, CCDA repeatedly pointed to a classic problem for government business enterprises: it could not act according to commercial principles if it had continually to seek approval from others in regard to investment and personnel practices. Despite the criticisms, CCDA continued with the management of the mall and a number of the recommendations of the committee were ignored. Financially, the mall was operating profitably, and members of the Public Accounts Committee were accused of conducting a political and ideological vendetta against the CCDA board.

CCDA was not restructured as the committee had proposed, and then Minister for Territories and Local Government Tom Uren reappointed the existing chairman and deputy chairman (Pead and David Elsworth), stating publicly that he had full faith in their management. Uren now explored the possibility of using CCDA to construct and operate a second mall in the developing Tuggeranong Town Centre, and as late as March 1985 this involvement was being actively planned (Longhurst 1985). But CCDA and the minister both knew by now that they were fighting an uphill battle. There had already been one attempt to sell the mall and, given the rise of the forces of 'economic rationalism', it was unlikely that there would not be more.

#### *A first attempt to sell*

In 1981 the Fraser Coalition government set up a Cabinet Review of Commonwealth Functions---conducted by the so-called ministerial Razor Gang---to review public expenditure generally, and the resulting report recommended the sale of Belconnen Mall along with many other proposals designed to curtail government activity (Fraser 1981, p. 8 & appendix). Armed with this recommendation, cabinet agreed in April 1981 that it would sell the

mall and wind up CCDA, and both actions were authorised in the ensuing Commonwealth Functions (Statutes Review) Act 74/1981. The minister was empowered to give CCDA directions 'for the purpose of facilitating the sale', and there was provision for dismissal of one or more board members in the event that it should fail to comply (ss 7-8).

A private sector consulting firm (Richard Ellis, NSW) was appointed to advise on the sale. The firm completed its report in April 1982 and, despite considerable criticism of the decision including a promise that a future Labor government would renationalise it if it were sold, the mall was advertised nationally.

But the mall failed to sell. The government had hoped for about \$68 million, but none of the biggest institutional investors in Australia or overseas lodged an offer. In fact the only offer was made by the Belconnen Mall Traders Association representing the smaller traders but not the bigger department stores; this was not accepted by the Fraser government. Failure to attract other tenders was blamed on the general decline in the retail sector and the prevailing level of interest rates.

The Hawke Labor government was elected in 1983, with Tom Uren as Minister for Territories. He recommended that the mall be withdrawn from sale due to the general lack of interest and the sole low tender, and the government accepted his recommendation in June 1983. We have seen that Uren became sympathetic to CCDA, so for the time being it was able to carry on.

By 1985 CCDA had built up an asset valued at about \$80m; it owed \$34m but had repaid \$6m of loan capital, and paid \$25.8m in interest, \$2m in land rent, and \$3m in dividends to the Department of Territories. Its net income for 1984-85 was \$7.2m, out of which it expected to pay \$1m in taxes, leaving it with around \$10m in reserves (reported in Longhurst 1985a, 1985b). Also--as a measure of its effort to satisfy its secondary social mission---it gave Belconnen a child-care centre in the mall, provided space for various volunteer and community groups, housed Legal Aid and Meet Your Neighbour groups, and sponsored many local competitions and charities. These were valuable initiatives given the dearth of such facilities in the ACT at the time. Moreover it charged comparatively low rentals to tenants and so contributed to the growth of small business in the ACT; it broke the monopoly of developers and large retailing; and it amassed a great deal of experience in the community development function---which is why it was proposed for the Tuggeranong development (eg Wedgwood 1985).

## **The sale**



*Labor changes its mind*

Within two years, however, the mall was again on the market. In a clear policy reversal announced in the May 1985 economic statement (described as a 'mini-budget'), the Labor government declared its intention of selling the mall and having Tuggeranong Town Centre developed and operated by the private sector (Keating 1985, p. 2320). The decisions provoked howls of outrage from Labor interests in the ACT. Thus Ken Fry, former Labor MHR for Fraser (one of the ACT electorates in the federal parliament), said he was 'disgusted and angry' about the reversal: 'I never thought I would have to fight this campaign again, and never against a Labor Government' (Fry 1985; see also Wettenhall 1988, pp 250-1).

Labor's change of tack was so easy to demonstrate. During the 1982 election for the ACT House of Assembly, the Labor Party had taken out advertisements in the newspapers to show its strong opposition to the sale of the 'community-owned' mall. Early in 1986, the *Canberra Times* printed a copy of a 1982 election dodger to show the inconsistency (see Box 1). More generally Bob Hawke, now Prime Minister, had castigated the Liberals for espousing privatisation---as he put it, a 'big, ugly, distasteful word ... which is just a flash way of saying they would flog off the assets of the people to their rich friends in private enterprise': that too was remembered in 1986 (see Box 2).

But the government went ahead despite these protests, in part because federal Labor had little sympathy for what it regarded as its left-leaning ACT branch, but mostly because of the rising dominance of the new political philosophy of economic rationalism---which had already virtually captured the Coalition parties and was beginning to make inroads in the Labor Party.

Asked to explain the decision to sell, the then Minister for Territories, Gordon Scholes, stated publicly that the divestment would free capital invested in the mall to be available for more urgent priorities and provide 'further scope for productive investment, job creation and growth by the public sector' (Scholes 1985). Another 'government source' added that 'it was difficult to see any advantage, either to tenants or shoppers, in the continued "government ownership" of the mall' (reported in Longhurst 1985b). And of course, although this was not stated, advantage was seen in distancing the government from an enterprise which was always controversial and had, from time to time, challenged the authority of other government agencies.

Outside Canberra, the government got support from Canberra-hating journalists working for Sydney and Melbourne newspapers and feeding the prejudices of Canberra-hating politicians. Supremely indifferent to the early sponsoring role of Country Party ministers, these reporters dubbed it 'Whitlam's white elephant' (Bowers 1985; Humphries 1995) and 'a monstrosity [which was] Gough Whitlam's contribution to the theory of retail socialism' (Costigan 1985). One of them (Humphries) did, however, have the grace to concede that, while 'it had lived those years in the strange surrounds of public ownership', it had returned, 'despite the doubting Thomases, a fair cop to Government coffers'.

CCDA made its own disappointment very public in its 1984-85 annual report. First, it criticised the decision to allow the Tuggeranong Retail Mall to be developed by private enterprise on changed 'parameters', so wasting \$600,000 of direct CCDA costs already incurred in developing that project. And second, it argued that the decision to sell Belconnen Mall deprived the people of the ACT of a major source of revenue and an appreciating asset (CCDA 1985, pp 3-4). This public criticism resulted in a flurry of activity within the ministry and the bureaucracy, both of which considered it inappropriate for a public authority to make such a statement.

The Labor Party in the ACT now suggested that the CCDA should be turned into a company and floated, with the people of Canberra invited to invest in it. Then, 'a future ACT government could buy shares and gain revenue from the venture', just as the States did from their commercial enterprises. 'The ACT has none of these, and the Commonwealth is withdrawing its one successful venture' (quoted in Longhurst 1985b). In the (still advisory only) ACT House of Assembly, members reminded themselves that CCDA had been created 'to give Lend Lease a run for its money', and that it had 'become a valuable capital asset only because the people of Canberra had supported it'. On an Australian Democrat's motion, the Assembly voted to 'strongly condemn' the Commonwealth decision (CT 1985b). The ACT Trades and Labour Council also mounted a campaign against the sale (CT 1985a). Others explored ways of satisfying 'philosophical requirements' that ownership of the mall 'be vested in the people of Canberra' (Longhurst 1985c). But all to no avail.

### *The sale process*

At this time there was no central government machinery, such as developed later, to handle asset sales. Almost immediately after Treasurer Keating had announced the decision to sell, an inter-departmental committee was set up to handle the sale, under the chairmanship of Tony Hedley, who then headed the Department of Territories' legal division. Some traditional Labor values were still present: the committee's first decision was to exclude private enterprise from the process in order to minimise costs (it was estimated that the previous attempt to sell had cost \$348,500, most of which was paid to private agents, lawyers and accountants). This time the government decided to use its own resources. The valuation was conducted by the Commonwealth Valuer's section of the Australian Taxation Office, the legal work by the Attorney-General's Department, and the marketing by the Department of Territories and the Department of Local Government and Administrative Services (from departmental files).

The national advertising campaign began on 29 June 1985, inviting expressions of interest from prospective purchasers who could demonstrate the financial capacity to purchase the mall. Applicants had until the end of July to register their interest. To ensure that only serious tenderers would register their interest, the Commonwealth asked for a security of \$400,000 to be lodged with the registration. The deposit would be returned to unsuccessful bidders.

At the same time, the government began a public campaign to encourage a positive community response to the sale. Fierce public criticism of the sale continued, now raising issues such as the likely loss of the community services provided by CCDA and the further community facilities for the Belconnen area

it had been planning; the director of Belconnen Community Service suggested that the threatened services were worth \$200,000 a year (*CT* 1985a). There were several government announcements aimed at reassuring the public that these facilities would be provided despite privatisation.

This time there were 17 registrations of interest. Applications were then evaluated and eligible parties invited to lodge formal tenders within 90 days. Firms were provided with relevant financial details of the mall's operation, current income, projected income, further development opportunities, lease details and a copy of the sale contract. This was rather like the prospectus or information document which became a standard feature of later privatisations, although it is likely that CCDA played little or no part in the preparation.

At some time in this period an event occurred which was to effect profoundly the further processing of the sale and lead to a protracted litigation process. As established in subsequent court proceedings, a 'millionaire Adelaide businessman', Guisepppe Emanuele, approached Hedley through an associate, offering a bribe in exchange for inside information about tenders submitted by other parties; it was reported that Emanuele's plan 'was to submit a series of tenders at \$2 million intervals and for Hedley to take the lowest tender necessary to beat any other tender and discard the rest'. Hedley reported the matter to his superiors, who called in the Australian Federal Police and the Director of Public Prosecutions. Hedley and a hotel room used by Emanuele were wired for sound, so that when Emanuele paid Hedley the first instalment of the bribe the proceedings were recorded. In November 1985 Emanuele and his associate were arrested and charged with attempted bribery; eventually---much later---Emanuele was found guilty, but then his counter-claim of 'entrapment' earned him a quashing of the conviction (Campbell 1993, 1995).

After the 90-day period had elapsed, the Department of Territories presented a short-list for consideration by cabinet so that it could make a decision about the buyer. The decision was announced on 2 December 1985. Not surprisingly, the lodged Emanuele bid from South Australia had been disqualified. The highest offer, from a Perth-based property trust, was for \$102 million, but it involved staggered payments. The government preferred a lower tender of \$87 million, submitted jointly by the Commonwealth Superannuation Fund Investment Trust (SFIT: responsible for holding and investing the retirement funds of Commonwealth government employees throughout Australia<sup>9</sup>) and Westfield Property Trust, because full payment could be received in the 1985-86 financial year (Longhurst 1985d, 1985e; Hawke 1986, p. 322).<sup>10</sup>

Each of the tendering partners would become a half-owner. They had seven days to sign the contract and 90 days to settle the account. Once the contracts

had been exchanged, comprehensive statements of revenue and expenditure had to be prepared in order to wind up the sale of the mall. These were to ensure adjustments of revenue and expenditure between buyer and seller and enable a smooth transition to the new owners. An accounting consultant was then engaged to prepare these statements, to be ready by 14 March 1986. Settlement occurred speedily on 26 March, thus beating another legal challenge (see more below). The Minister for Territories was a signatory to the contract for the sale of the mall on behalf of the Commonwealth. The sale price of \$87m represented a very good return on the Commonwealth's initial capital investment of \$1m; the Commonwealth also acquired the \$10m held in reserve by CCDA.

The mall passed into the ownership of this public-private partnership on 1 April 1986. However the management would henceforward be fully private, this function going to Westfield Shopping Centre Management Co. (ACT) Pty Ltd as agent of the joint owners (WSC 1986).

This first sale of a public enterprise by the Hawke Labor government had significant precedent value. That government was still unable to persuade the ALP at its 1988 National Conference to water down its general prohibition on privatisation. But Belconnen Mall, as a lesser known public enterprise, had already been sold, and with that precedent behind it the government was able to move fairly easily to dispose of other small enterprises such as the Williamstown Naval Dockyard and the Defence Service Homes Corporation (Wettenhall & Beckett 1992, pp 276-7).

### *The fall of CCDA*

CCDA had opposed the sale, but had carried on in caretaker mode for several months. In light of the government's decision, however, it decided that its 23 staff should be offered redundancy packages equal to double the amount prescribed for public servants under the Public Service Regulations. The two departmental officers on the seven-member board had opposed the decision, and reported it forthwith to the minister. The Prime Minister and Minister for Finance were consulted, and the immediate abolition of CCDA was decided on. This happened on 27 February 1986, a month before the sale settlement. Former CCDA Chairman Pead protested as did the staff unions, but to no avail. The decision meant that the financial assets and management of the mall reverted to the Department of Territories for the interim period, and the about-to-be retrenched staff became employees of that Department (Wettenhall 1988, pp 238-9).

This decision to abolish CCDA was heatedly criticised in the Canberra press, and was challenged in the Federal Court: the challenge was mounted by the Administrative and Clerical Officers' Association (ACOA) on behalf of members formerly employed by CCDA and CCDA's former promotions manager, Harold Hird.<sup>11</sup> ACOA's original intention was to obtain an injunction restraining or preventing the sale settlement. The government's very quick action in settling with the new owners scuttled this plan, so the union instead sought a declaration that the abolition of CCDA was null and void and that the redundancy payments it had decided on should go ahead (Campbell 1986). The challenge was, however, unsuccessful.

### *Sale wrap-up*

The cost of running the mall during this transition period was about \$2.5m, which was offset by a payment into consolidated revenue of \$2.4m which was in the accounts of CCDA at the time of its abolition. The Department of Territories continued to finalise dealings with creditors and debtors after the sale, this process extending through to June 1986. The related decision not to use the expertise of CCDA in the development of facilities in Tuggeranong Town Centre resulted in a delay of 18 months in establishing those facilities.

Many members of the ACT community who were battling at this time to achieve self-government for the Territory were angered by these actions of the Commonwealth government. They complained that its 'solution' to the problem of the mall had insured that the large windfall gain from what was essentially a financially successful operation conducted by local residents went into Commonwealth coffers and so did not bring direct benefit to the Canberra community.<sup>12</sup>

The litigation concerning the Emanuele bribery charge extended into a court saga which took so long to resolve that it came to be seen as constituting the 'most protracted legal proceedings in ACT history' (Campbell 1998). After the initial arrest and long proceedings in the ACT Magistrates Court, Emanuele was found guilty and given a suspended sentence. But he had claimed that he had been affected in his judgment by the entrapment activities that followed the initial contact with Hedley, and initiated civil proceedings against Hedley and various police officers (Campbell 1991, 1993). Eventually the conviction was overturned on appeal in the ACT Supreme Court in 1995, and a year later Emanuele received a small contribution towards his legal costs. But his corporate empire had collapsed with debts of around \$240m, and he and two of his companies re-activated the civil proceeding against a number of defendants,

notably Hedley and the Commonwealth, who were blamed for that collapse and sued for \$240m damages. But the claim was dismissed in December 1996, with the liquidator of Emanuele's companies ordered to pay costs on the ground that he knew the companies had no way of covering costs and should therefore not have allowed the case to proceed. Emanuele now appealed against the Supreme Court verdict to the Federal Court, but in June 1998 it dismissed his appeal, declaring it to be 'malicious', 'fallacious' and 'hopeless'. Then the liquidator appealed to the Federal Court, and in September 1999---more than 14 years after the sale process began---it upheld his appeal on the argument that he was not guilty of 'serious delinquency'. All now fell on the already-bankrupt Emanuele (Campbell 1998, 1999a, 1999b).

### **Post-sale experience**

The private Westfield Property Trust was the operator of a number of other large shopping complexes throughout Australia, and the other partner, the public SFIT, was content for it to absorb the Belconnen operation into its national structure and to establish a subsidiary company to act as managing agent. Just three of the CCDA staff took up employment offers from Westfield; the rest took redundancies or were redeployed in the public service. Some administrative functions, particularly accounting, were reassigned to Westfield head office and so lost to Canberra.

Tenancies were continued until their agreements came up for renewal. When this time came, some were discontinued as the new management sought to introduce a greater variety of shops, and there were complaints (hard to verify because tenancy rentals are a commercially sensitive issue) that rental rates were increased. It was also soon being alleged that, whereas CCDA had supported many small family-owned or individually owned businesses, Westfield had a policy for all its malls of letting shop-space only to tenants who are themselves parts of networks and so are backed by the security of those networks. It is likely that there was merit in this complaint, but also that the change was consistent with industry-wide practice in privately managed malls.

The centralising of the accounting function meant that precise sets of accounts for Belconnen Mall were no longer maintained. Though we had the goodwill of the new mall management, we did not find it possible to collect data that would allow a close comparison of pre-sale and post-sale financial results over an extended period. Indications are that there has been a gradual growth in both turnover and profitability, but this growth was already evident in the period of full public ownership so that the effect of the ownership change has been continuity rather than reversal. There has also been gradual expansion, evident most notably in the addition of a cinema complex; but CCDA also had plans

for expansion, so that this also points to continuity rather than reversal. Now, however, the government had to find money for new community facilities of the kind that used to be provided out of shopping revenues; in place of the site rental previously paid by CCDA, the new owners were committed only to pay a peppercorn rental of 10c per annum if and when demanded (file reference 85/5449); and profits mostly left Canberra to swell the coffers of the new owners.

The 50/50 ownership contract between the joint purchasers has continued to the present day (WH 1999, p. 26), though there have been some changes in the status of the two partners. First, the publicly owned SFIT: consistently with the treatment of several other Commonwealth enterprises, that statutory authority was converted to the company form in 1991 as Commonwealth Funds Management (CFM) Ltd; and then in 1996 it too was privatised, by a trade sale to the (previously privatised) Commonwealth Bank of Australia. So the public ownership element in Belconnen Mall was finally eliminated by another divestment.

Second, the Westfield Trust, which is described in Westfield documents as one of 'three property entities managed by Westfield Holdings Limited' (WH 1999, p. 15). The Westfield commercial empire gains much notice in the commercial press both for its international expansion and for the very high stipends it pays its executives. There has been much recent expansion overseas, particularly in the United States through Westfield America Trust. Thus the parent firm, Westfield Holdings Ltd, whose affairs are dominated by a single family, claims to have grown from 'simple beginnings as a small Sydney company' into 'one of the world's largest shopping centre companies. We are a fully integrated shopping centre group with expertise in every aspect of the shopping centre business' (WH 1999, pp 1-2). In 1998-99 it was reported that Westfield Holdings had experienced '38 years of unbroken profit growth' and was 'a quality long term investment' (Were 1999). As its chairman, Frank Lowy<sup>13</sup> retained his position as one of 'Australia's highest paid executives' in that year, with total remuneration of \$A7.68m; in the same year son Peter got \$US1.4 as Westfield America Trust president, son David got \$A1.4 as Westfield Holdings managing director, and son Stephen got another \$A1.4 as Westfield Trust executive director (reported *CT* 1999). So a large part of the profits from Belconnen Mall since the divestment have gone to support the Lowy family and its shareholding associates.

### **Final word**

At the broadest level this case illustrates how political and policy fashions change. The Belconnen Mall project began when it was still generally



acceptable to propose that public initiatives could be applied usefully not only in designing and constructing but also in operating commercial enterprises in the proud Australian 'development stimulator' tradition.<sup>14</sup> But that was soon to change, and with the change it was inevitable, particularly in this industry, that a movement would develop to shift this enterprise into private management and eventually full private ownership.

There were important lessons in this public-to-private transition that deserve to be heeded by all those who accept uncritically the mantras disseminated by economic theorising and international capitalism about the inevitability of public enterprise failure. First, *this* public enterprise was established not to create a state monopoly but to break a private monopoly. Second, the process of creation showed how private capital could be raised to contribute to such a public project, keeping the government's own investment to a very modest level. Third, the period in full public ownership showed an innovative enterprise management making important contributions to the social development of its community as well as proving profitable by commercial standards. Fourth, however, the experience also showed that a highly committed management seeking to behave commercially and competitively was likely to face major frustrations in dealing with a central administration more interested in maintaining total-system conformity. Fifth, the experience also contained the fairly distinctive feature that, in the run-up to a significant constitutional change (the establishment of the self-governing ACT) this management directed its primary loyalty to the Canberra community rather than to the owning government. And sixth and notwithstanding, the federal treasury was the major winner from this trade sale, along with the buying group whose assets and profits benefitted materially from it.

The privatisation was probably inevitable, but these ingredients of the Belconnen Mall story mostly demonstrate that there can be no single, universal pattern of public enterprise performance and no single, universal justification for divestment of such enterprises. Each case should be considered on its merits, and we should beware of establishing policies which assume that such universalities exist. It has sometimes seemed that these lessons have not been learned, as privatisation has risen to be a major policy objective in its own right and as special government machinery---not in existence at the time of the Belconnen Mall sale---has been created (in the form of an Office of Asset Sales within the Department of Finance and Administration<sup>15</sup>) to implement that policy.

*Summarising*, the main stages in the evolution of this enterprise have been:

1974-1986: a free-standing public enterprise planned, constructed and operated by a statutory corporation, the Canberra Commercial Development Authority.

1986: sold to a partnership joining the private Westfield Property Trust and the Commonwealth's Superannuation Fund Investment Trust (SFIT: another statutory corporation), and thereafter operated on their behalf by the private Westfield Shopping Centre Management Co. (ACT) Pty Ltd. Subsequently SFIT became a government-owned company and was then itself privatised.

NOTES:

1. There were, of course, occasional Australian privatisations before the onset of the modern reform period: see Wettenhall 1983, pp 16-18.

2. Our study of this case is based on a careful review of reports and commentaries in the Canberra press over the period of public ownership of the mall and the subsequent sale, and of relevant files of the old Department of Capital Territory/Territories, on which see note 6; we are grateful to officers of the ACT public service for this access. We thank also the post-sale Belconnen Mall management for access to many of their documents, and Harold Hird, formerly Promotions Manager for the Canberra Commercial Development Authority, for giving us access to his scrap-book of cuttings and papers relating to the mall and its sale. Only very specific items are separately referenced in our report.

3. The story of the long march to self-government in the ACT is told in Grundy *et al* 1996.

4. This money-raising process was not unique: previous Australian public sector projects such as those organised by the Telecommunications Commission and state power authorities had raised funds by the same method.

5. The omnibus Department of the Interior had been broken up on the formation of the Whitlam government. On the state of ACT government at this time, see Grundy *et al* 1996, ch. 6.

6. Such ordinances, made under the Seat of Government (Administration) Act 1910, were a type of delegated legislation, and were the standard form of law-making in the pre-self-government ACT. However doubts arose in the early 1970s about the legal 'power' of an ordinance to deal with financial issues, leading to the passing of Territory Authorities (Financial Provisions) Acts in 1973 and 1978: see Robinson 1978, p.120.

7. 'Jumping Jack' is a term coined to describe a system in which interlocked private companies sell and resell properties such as shopping malls to each other, with spiralling valuations and therefore purchase prices, and consequent inflationary effects. The establishment of Belconnen Mall under a distinctly different ownership enabled its management to put a brake on that system.

8. Though the Department of Capital Territory lost its separate identity when the Hawke government was formed in 1983 (being merged into Territories and Local Government, then just Territories, and after 1987 Arts, Sport, the Environment, Tourism and Territories), this remained a characteristic of the staff group attending to ACT affairs under subsequent ministerial/departamental arrangements up to the granting of self-government in 1988-89: see Grundy *et al* 1996 for more detail.

9. SFIT had itself been a very controversial Commonwealth authority in an earlier period: see Wettenhall 1986, pp 98-104.

10. This particular decision received surprisingly little attention in the Canberra press, being trumped by another decision announced on the same day by the same minister, Minister for Territories Gordon Scholes, to establish an ACT Council as a way of conferring a very limited measure of self-government on the ACT. This version of a form of self-government was, however, bitterly contested and failed to pass the Parliament: see Grundy *et al* 1996, ch. 11. It was left to former Labor Minister for the Capital Territory Gordon Bryant to note

the incongruity: the mall 'was established as an endowment for the people of Canberra', but it was 'being taken away' from them by a government claiming to give them self-government: Bryant 1985.

11. Hird was unemployed for a time after the abolition (Castle 1986), but was eventually elected to the ACT Legislative Assembly, where he sits at the time of this writing.

12. Pead, CCDA's former chairman, was another casualty. He had won much respect in the Canberra community because of his long championing of its interests against those of the Commonwealth (see Grundy *et al*: 12-13ff). On the larger issue---the fight for ACT self-government---he was on the eventual winning side, but his experience with Belconnen Mall had left a bitter taste in his mouth ('Gang Gang' 1986). He was soon to leave Canberra altogether, and has since returned to it very occasionally and with considerable reluctance.

13. Frank Lowy presents a classic 'rags to riches' story. He arrived in Australia in 1952, a young Slovakian-born holocaust survivor who had served in the Israeli army, and rose to become one of Australia's richest men. He was celebrated for that achievement with a Year 2000 Australia Day award as Companion in the Order of Australia, and his biography published soon afterwards (Margo 2000a) was seen by some in Australian business circles to be 'part of the public canonisation of Frank Lowy' (Signy 2000; also Margo 2000b, Harley 2000).

14. Defined in this way by Liberal statesman RG (later Lord) Casey (1949, pp 7-9), the tradition had been well accepted by all Australian political parties before the onset of economic-rationalist thinking in the 1980s (generally see Wettenhall 1987, 1996).

15. Now Office of Asset Sales and IT Outsourcing.

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## Chapter 3

### STATE BANK OF SOUTH AUSTRALIA\*

The State Bank of South Australia was a composite of two former banks owned by the state government which had, up to 1983, operated successfully for a combined total of over 220 years. The decision to sell occurred after the public had been made aware of spectacular losses incurred in a few short years following the merger. The state government was eager to be free of this apparent source of mounting public sector debt, and privatisation was offered in 1995 as part of a state debt management strategy. The privatised, and much smaller, bank continues to operate in the state as a savings bank under the trading name of BankSA and under the control and authority of a private bank which acquired it in a trade sale.

The case is unusual among Australian privatisations because it relates to a public enterprise in deep financial trouble before the rearrangements of which the sale was a part. Notwithstanding that this was a rare experience following on the heels of the Tricontinental and State Bank of Victoria losses<sup>1</sup>, the case had an enormous impact on how politicians, officials and the public came to think about public enterprise and privatisation over the next decade.

At the outset, it needs to be explained that there were really two State Banks of South Australia. The first operated in parallel with a state savings bank for several decades; the second was constituted by a merger of the original bank and the savings bank, and was the one which came to point of collapse at the end of the 1980s. As this account will show, the bank which was a product of the reconstruction implemented to cope with that collapse, and was the one which was actually sold in the early 1990s, was called BankSA.

#### **A long history**

SBSA had a long history, being the second publicly owned bank to open in South Australia (SA). The first was the Savings Bank of SA, which opened in 1847 and focused its operations on the needs of its depositors. The original SBSA opened in 1896, and was established as a result of a failed attempt by the Kingston government to use the Savings Bank 'as a channel for government loans for farmers and local government'. The parliament instead gave approval for the creation of a second state bank---the State Bank of South Australia or SBSA---with a charter to facilitate rural

development and encourage home ownership through low-interest loans (Radbone 1995, p. 39; 1996; 1997).

The two banks operated successfully in parallel for nearly 90 years, and SBSA became a key instrument in state development (Radbone 1996, pp. 56-61; Sykes 1996, p. 472). In the 1980s a new trend emerged in Australian banking to merge the savings with the general banks. In part these mergers resulted from a policy decision 'by the Reserve Bank to apply regulations to full banking groups rather than maintaining a separate set of rules for each component banking activity' (Valentine 1996, p. 383). Somewhat ironically, the formal writ of the Reserve Bank did not extend to banks established by Australian state governments, leaving them less regulated than the private banks.

The SA government followed this trend. In 1981 Liberal Premier and Treasurer David Tonkin asked the two banks to investigate possible merger, and this request was pursued by Labor Premier and Treasurer John Bannon after the 1982 state election. In May 1983 Bannon announced that the two banks were moving towards merger, and a merger bill was introduced into the state parliament in November 1983. It had been decided that a combined and larger bank would be better able to succeed in the emerging deregulated national financial market, and in speaking to the bill the State Treasurer referred to the expectation that the new, larger State Bank of South Australia would become an 'active, innovative and effective participant in the South Australian economy and financial markets' (quoted Radbone 1995, p. 39). The legislation required the new combined bank to operate both to promote 'the balanced development of the State's economy' and 'the maximum advantage of the people of the State', and to operate 'in accordance with accepted principles of financial management and with a view to achieving a profit' (State Bank of South Australia Act 105/1983, s.15).

Throughout the 1980s all Australian banks grew rapidly. The assets of the big banks grew at an average of 17.7% annually over the period 1985-90, but SBSA 'grew even faster' (Radbone 1995, pp. 40-1). Its group assets (total loans) grew by an average of over 40% per year over this period, and by 1990 it was no longer just a South Australian bank because two-thirds of its assets were held in other Australian states or overseas. This phase also saw the bank transformed predominantly from a retail bank into a wholesale one, sourcing funds for other financial institutions. SBSA also acquired subsidiaries such as a large Australian finance company (Beneficial Finance Corporation Ltd or BFC), a trustee firm and a real estate firm, half a stockbroking firm, and a small New Zealand bank; and it opened branches in Hong Kong, New York and London. In Radbone's words, the single

biggest factor in explaining the increased scale of operations was ‘simply a far more aggressive lending policy’. Over the period, its trading activities diversified into finance, investment, insurance, property and business services---far beyond the beginning objective of facilitating rural development and home ownership. Yet it did so with initial apparent success until the late 1980s, receiving the plaudits alike of the Australian financial press, the local media and the international credit-rating agencies (1995, pp 40-1).

Like the forerunners which merged to create it, SBSA was structured as a conventional Australian statutory corporation, with a part-time board reporting to a minister and through him to the state parliament. In the later 1980s the minister was John Bannon, holding the Treasury portfolio as well as the premiership; SBSA was formally an outrider of the Treasury and so reported to Bannon in that capacity. One of the board’s responsibilities was to appoint the managing director, who had executive control of the organisation (subject to the board). Timothy Marcus Clark, with private banking experience and a Harvard MBA, became managing director; he demanded a seat on the board as a condition of his appointment but was not its chairman. His personality was dominating and aggressive and, whether because of this or independently of it, the chairman chose to take him along when he went to see the minister; Clark’s dominance over the board was thus enhanced (Radbone 1997, pp. 125-7, 133; Sykes 1996, p. 474; Bills 2000). Clark was the only board member with professional banking experience; he acquired that experience mostly with the old Commercial Bank of Australia, where he was a key figure behind that bank’s disastrous expansion into acquisitions and lending which forced it into a merger in which it was the junior partner (Bills 2000).

Obviously Clark was a problematic choice as managing director. However, as indicated, his early expansionist activities were greeted with applause. He was reappointed in 1986 and 1988.

## **The collapse of SBSA**

### *How the problems were revealed*

Doubts about the bank’s financial health were first expressed early in 1989, after the collapse of two private institutions, Equiticorp and the quaintly named National Safety Council (NSC, on which see Thomas 1991). In each case, SBSA was one of the main creditors, and in each it had no security. Equiticorp had no current audited accounts, but Clark was a personal friend of its chief and one of its directors, creating a classic conflict-of-interest



situation. The accounts of NSC had been subject to audit qualification. When the news broke, analysts asked what this suggested about the quality of SBSA's loan book, but the bank continued to expand for another year.

There were many corporate collapses throughout Australia in 1989, and the losses of the State Bank of Victoria and its merchant banking subsidiary (Tricontinental) were announced in February 1990. Treasurer Bannon knew that SBSA shared many of the same customers as the Victorian bank, and he had already been advised of the South Australian Auditor-General's concerns about the lack of adequate audit scrutiny of some state enterprises like SBSA which had been allowed to use private auditors. Through 1989 Liberal and Democrat MPs began asking questions in parliament about the bank's activities, and by early 1990 Bannon's own economic adviser and the Adelaide press were also expressing concern. However evidence before the subsequent royal commission indicated that Bannon refused to initiate any inquiry about possible parallels with the Victorian bank (Bills 2000).

A significant article in the *Adelaide Advertiser* at this time sought to draw lessons from the Victorian collapse which, by implication, had great relevance for the situation developing in SA. The article recorded questions asked in Victoria about why the state government was 'picking up the tab' on the State Bank/Tricontinental debacle, and observed correctly that 'as owner and guarantor' the government had no choice.<sup>2</sup> It went on to suggest that 'a government owning a financial institution' made some sense when that institution was, like the 'old' State Bank of Victoria or its 'bigger cousin' the Commonwealth Bank, ... primarily a people's bank, particularly in the almost exclusive provision of home finance ... there was [then] a very direct link between the people as borrowers and the people as guarantors of the bank's balance sheet'. But all that changed when the banks went entrepreneurial and developed a 'more exclusive clientele [of] spivs and main-chancers'. In these circumstances, accepting the loss and selling the bank was the only sensible solution (McCrann 1990).

Also early in 1990, the Leader and Deputy Leader of the Liberal Opposition, Dale Baker and Stephen Baker, and their Senior Adviser, Kym Bills, met with Clark and other SBSA executives for a luncheon briefing. Bills was convinced that Clark lied in answering questions about the bank's relatively low level of provisions. Bills was thus provoked to give intensive attention to SBSA's loan portfolio, and he prepared over 100 questions probing the bank's financial health which were asked in parliament during 1990, mostly as questions without notice. He also wrote the Leader of the Opposition's 1990 budget reply speech which suggested that a key reason for the bank causing concern was the 'principal/agent problem': the government

principal (Bannon/Treasury) was unable effectively to monitor and control its SBSA agent (principally Clark).<sup>3</sup> As Bills summarised the position, SBSA's assets grew from \$15 billion at 30 June 1989 to \$23 billion at 30 October 1990, even though Clark had conceded in August 1989 that the bank had reached 'critical mass'---Clark's bank:

bought bad business from other people to keep the cash flow going, and of course when the crunch came it was perhaps three times as large as it would have been otherwise ... (it) was behaving like a gambler borrowing on his credit card and doubling his bets to try to win back past ruinous losses (Bills 1997, 2000).

Poor management information systems helped to conceal knowledge about the true state of the bank's affairs until it was forced to announce a severe drop in profits anticipated for the year 1990-91. Members of the board began to have doubts about their managing director, but were not yet ready to tell the minister and, amazingly, they gave Clark a pay rise and extended his contract. In late 1990 the board commissioned a firm of investment bankers to conduct an inquiry, and its initial report early in 1991 revealed the need for an injection of \$1 billion to keep the bank afloat. By September 1993, after further reports, it was known that the total amount needed to cover SBSA's losses was \$3.15 billion, representing 'the biggest single financial disaster to hit any government in Australia this century' (Radbone 1995, pp 37, 41-2, 1997, pp 131-2; Sykes 1996).

The Premier/Treasurer sought the managing director's resignation immediately the initial report was available, and all board members soon followed. The government appointed a new board and, after prodding from the parliamentary opposition, appointed a royal commission of inquiry in March 1991 and also set up an inquiry by the Auditor-General. The Auditor-General was also appointed as the bank's auditor, replacing the private auditors who had previously served in that role. Until now probably the most popular and best respected of the Australian state premiers of the period, Bannon was attacked mercilessly for his failure to understand and control what was going on in this leading state enterprise, and his August 1992 resignation from the premiership is generally seen as the consequence of this failure.

### *Explaining the collapse*

Most published accounts of the financial demise of the bank focus on the mistakes, inadequacies, and misdeeds of individuals and institutions. Particular culpability was attributed to Premier and Treasurer John Bannon, general manager Timothy Marcus Clark, the SBSA board, other bank executives, the private auditors and the Treasury.

The Premier was the public focus of much of the criticism. While many defended his personal integrity, he was accused of being too accepting of the generally popular dictum 'let the managers manage'. Thus he had been unwelcoming when the Treasury Department had sought to alert him to developing difficulties. Also he had approved various SBSA acquisitions even after concerns about the bank's loans portfolio had become very clear, and he had not been above letting it be known that the government would like the bank to behave in uncommercial ways when it suited the government's political agenda. Bannon was similarly criticised for allowing another SA Treasury outrider, the State Government Insurance Commission (SGIC), to enter into a major risk in relation to a Melbourne construction project, one which eventually cost SA taxpayers hundreds of million of dollars and was seen by the SA Liberal Opposition as a measure taken to support a Victorian Labor government facing an election (Jacobs 1992, p. 390-1; AG 1993a; Radbone 1995; Bills 2000).

A major political science review of 'the Bannon decade' emphasised the Premier's 'restrained' style and, in the matter of the SBSA debacle, saw him mostly as the victim, though with an inadequate plan for controlling the bank (Parkin 1992, pp 339-42). But a press and TV political reporter was not so kind, writing critically of the Bannon style which he saw as similar to the 'facadism' of recent architectural development in the city of Adelaide--- buildings with attractive facades but a highly speculative over-supply of space, leading to 'collapsing towers'. This reporter also attached much blame to the South Australian media which, in lauding the entrepreneurs of the 1980s, was also focusing on the facade rather than the substance (Kenny 1993, pp 5, 50, 74). Bills (2000) extends this criticism to the Adelaide business community generally: in his view, at this time it 'had a huge chip on its shoulder', 'unrealistically wanted to view Adelaide as a world business and financial centre', and so 'closed ranks about any problems, encouraging a lack of openness and accountability'.

General Manager Clark was shown by the royal commission to have been an ineffective manager, allowing the various organisational sections to remain isolated from one another and failing to coordinate the bank into an operational whole. The Auditor-General described him as professionally aggressive and entrepreneurial, but without sufficient appreciation of the need for prudent banking controls and good management (Sykes 1996, p. 472). A writ was taken out against Clark, with the state quickly winning a damages suit for \$81.2 million---but it was a Pyrrhic victory as Clark was bankrupt. Other SBSA executives were criticised, the Auditor-General finding them generally to be incompetent and 'happy to follow where their

chief led' without exercising independent professional judgment (Sykes 1996, p. 472; *BRW* 1997, p. 100).

What of the SBSA board? The royal commission found that it had failed in four ways: it failed to exercise due care in making important decisions; it failed in its dealings with the general manager; it failed to inform the minister about the circumstances of the bank; and it failed to protect the bank from the minister's attempts to influence its investment decisions (Radbone 1997, p. 128). The Auditor-General argued that the board of directors was 'out of its depth' and, on many occasions, unable or unwilling to exercise effective control (Sykes 1996, p. 472).

The state government recovered \$2.75 million from the professional indemnity insurer of the former SBSA directors, and another \$120 million in a settlement of its claim that the private auditors of the bank and its BFC subsidiary, KPMG and Price Waterhouse, had failed to exercise due diligence; it had, however, demanded much more (*BRW* 1997, p. 100).

The Treasury Department was another to receive strong criticism from the Auditor-General and the royal commission. One problem was that, although it should have put a representative on the bank board, it played a low-key role because it understood that was what its minister wanted. In its stead the Department of State Development put forward a government representative, and this official was more interested in economic growth than in prudential management. In addition, the Treasury was more interested in the cash flow to the government than in the quality of the bank's performance; and (through the South Australian Financing Authority with which it was closely associated) it actually:

encouraged the unrestrained growth of the Bank by the uncritical supply of capital upon demand, but on terms that were favourable to [it rather than the bank] (Jacobs 1992, pp 390-1; AG 1993a).

### **The decision to sell**

Not long after the collapse of the bank had been made known to the general public, the SA Labor government under new Premier Lynn Arnold (who had succeeded Bannon in September 1992) announced that it would privatise SBSA as part of a state debt management strategy. The state debt had become a problem that could no longer be hidden. Prior to the collapse the state was in debt to the tune of \$4 billion (at June 1990), but with the inclusion of the losses of the bank and SGIC state indebtedness rose to \$7.9 billion by June 1993. While the size of the debt was about the same as that facing Victoria after its bank collapse, on a per capita basis SA taxpayers

were massively worse off, and SA had a less robust economy and so would find recovery more difficult than would the neighbouring state. The financial credibility of the state depended on drastic remedial measures being taken, and the decision to privatise the bank has to be seen in this light.

But the role of the Commonwealth Labor government under Prime Minister Keating must also be factored in to explain the decision to sell. This government agreed to a financial ‘bail out’ package of \$600 million over three years providing the bank was sold.<sup>4</sup> This package helped to persuade the state government toward the option of sale. The agreement was signed in April 1993 by the Arnold government, accepting all terms and conditions, including the fact that the sale would occur in a ‘timely manner’, with NSW-style corporatisation<sup>5</sup> preceding privatisation so that the bank would be subject to Commonwealth tax by July 1994. The assistance package was understood to be both an inducement for the state government to ‘reduce the size of government’ and a commitment to substantially reduce state debt (summarised by Baker 1994c, p. 9; 1995, p.1461-2).

In the event, there were three major stages to this divestment.

### **Stage 1: splitting the bank**

Before the close of 1992, the Labor government divided SBSA into a ‘good’ bank and a ‘bad’ bank, terms that quickly gained wide currency in SA. The ‘good’ bank continued operations under the chairmanship of Nobby Clark (who had recently retired as managing director of the private National Australia Bank: no relation to the former SBSA managing director), and was relaunched as BankSA. The ‘bad’ bank, comprising all the bad and doubtful assets and loans, became the Group Asset Management Division (GAMD: Sykes 1996, pp 513-4). GAMD began operating from 1 July 1992, with its own board and its losses to be met by the government. ‘Doubtful’ assets included the State Bank tower, Beneficial Finance (and Southstate Insurance, of which it was the sole shareholder), the Myer-Remm project in downtown Adelaide, and a property at 333 Collins Street in Melbourne in which the bank and SGIC had both invested heavily.<sup>6</sup>

This division of the bank into two entities meant that GAMD became the focus of the state’s debt management strategy. In 1993, its first year of operation, GAMD reported a loss of \$287m, while the ‘good’ bank, BankSA, reported a profit before tax of \$108m (AG 1993, vol.1 p.3).

Both the 'good' and the 'bad' banks were thoroughly reorganised. GAMD dealt with its under-performing loans and bad debts by selling them off or rehabilitating them. It also reduced its staff from 132 to 63, and it wound up its operating subsidiaries. The 'good' bank began a program of downsizing, replacing the board and senior executives, establishing new reporting methods, and targeting markets that had been successful in the past. The 'good' bank thus returned to its previous focus of providing banking services to South Australians rather than involving itself in the big national or international corporate arena.

At first this division into two banks was merely an administrative one, causing critics to declare that this 'accounting change' was unlawful and inappropriate. However the division was soon ratified by parliament, representing the first of three phases of legislative activity required to process the enterprise through corporatisation and eventual sale.

In April 1993, the government had established a steering committee to progress the corporatisation and sale process. The first part of this work was completed by August, and the first legislation was immediately introduced. Becoming the State Bank of South Australia (Investigator's Records and Preparation for Restructuring) Act 70/1993, it included a number of technical arrangements which would enable the corporatisation and sale process to proceed, including a direction requiring bank directors and officers to supply relevant information without fear of breaching the confidentiality provisions of the State Bank Act, but also prescribing tough new penalties of up to \$50,000 for leaking confidential information. These amendments were aimed at protecting customer information during the process of preparing the bank for sale (Ferguson 1993a).<sup>7</sup>

The division of the bank into a 'good' and 'bad' bank was a clever political strategy that allowed the government to present the State Bank as a viable enterprise in the face of its shocking debts. But perhaps not clever enough: a state election was held in December 1993, and the Labor Party lost government with a swing of almost 9.5% against it. This outcome was not surprising given the heated political debates over the losses of the State Bank, the fact that Premiers Bannon and Arnold and the State Labor Party became common targets for derision in the parliament and the media, and the mounting of an effective 'scare campaign' by the Liberals warning of the grave economic dangers to come if Labor were returned to office. Overshadowing all the positive achievements of the decade (such as the staging of the Australian Formula One Grand Prix in Adelaide, the development of a Science Park, and winning a major contract for the construction in Adelaide of new submarines for the Australian navy) was the

very public, multi-billion dollar ‘bail-out’ of the state. In the eyes of the voters, the government had lost all credibility---it was seen as incapable of successfully managing the state economy. At every conceivable opportunity the electorate was reminded that, under the Labor government, the bank had lost \$6000 for every South Australian, that taxpayers would be paying for the bank’s debt for at least a decade---from its collapse in 1991 until the year 2000 (eg Ferguson 1993b, 1993c, 1993e; also eg Bauer & Read 1993).

Election promises by both major parties were consequently focused on the strategies they would use to eliminate state debt. Thus the Liberal Party promised to increase the asset sales program, selling the State Government Insurance Commission, the Adelaide Entertainment Centre, the Central Linen Service, the Pipelines Authority and several other assets (Ferguson 1993f).

## **Stage 2: turning the ‘good’ bank into a company**

The second legislative phase followed swiftly. On 22nd February 1994 new Liberal Premier Dean Brown held a press conference to announce the formal transformation of the ‘good’ bank into the ‘new’ Bank of South Australia Limited (to be known as BankSA) and launched the new bank’s logo.<sup>8</sup> On the same day new Treasurer Stephen Baker introduced a bill to enable the new bank to come into existence on 1 July 1994 (Baker 1994b, pp 210-15). All parties in the parliament, including the Australian Democrats, supported the bill, which became law as the State Bank (Corporatisation) Act 17/1994.

It created a corporatised entity for the ‘good’ bank, and approved the transfer of necessary assets and liabilities (so that customers would not have to transfer their business to the new bank), and of the majority of staff. BankSA would be a company capable of being listed on the stock exchange, formally supervised by the Reserve Bank, come under the Commonwealth Banking Act, and pay Commonwealth tax. The new BankSA was to be smaller than the previously undivided bank, with a capital base of between \$400 million and \$500 million compared to \$600 million at February 1994. The bank would continue to be government-guaranteed, and have a funding facility of about \$3 billion, for a transitional period. It would no longer be a government agency, as is ‘appropriate for an entity which will be privatised’. In addition, the board and its management were to be ‘strengthened’, with new appointments made.

The statute provided further that, while the ‘good’ bank was thus to become a new corporate entity, the old statutory authority would continue to function. It would be renamed, but would take over the operations of

GAMD. So the 'bad' bank, previously GAMD, became the South Australian Asset Management Corporation (SAAMC). SAAMC retained those staff associated with activities that had been 'wound down', and those associated with the GAMD. It would continue the operations of the GAMD, involving the wind-down of performing assets and of SBSA's government-guaranteed liabilities to the capital markets. All SBSA entities outside South Australia, particularly those overseas, would remain within SAAMC. Outstanding interstate loans would be divided between the new bank and SAAMC, depending upon their performance. The newly named authority would be subject to the direction and control of the Treasurer, while the capital of the bank would be held by the Treasury-related South Australian Financing Authority and transferred to the Treasurer. SAAMC would provide wholesale financing to BankSA and was expected to have a life of approximately three years (after which the Treasurer would auspice residual loans).

In the debates on the 'corporatisation' bill, one issue was of paramount interest to many members---the impact on SBSA employees. Prior to corporatisation, the former Treasurer had given an undertaking that staff would retain existing terms and conditions of work, including access to the State Superannuation Fund. After the new Liberal government had been elected, but prior to corporatisation, bank staff were informed that this latter condition would no longer be supported. Staff would have their entitlements transferred into a new scheme. There was also considerable concern that corporatisation would lead to the loss of 800 jobs. The new government acknowledged the possibility of staff losses at the bank, but argued rationalisation was occurring throughout the banking industry. New Treasurer Baker stated that the preference was for a public float as this would offer greater job security than would an early trade sale to another bank. It was estimated that selling to an existing bank would be likely to result in more branch closures through rationalisation. The government was 'absolutely committed to retaining SBSA under its new name as a viable entity in this State, and will ensure that that happens' (Baker 1994a, p. 148).

In April, negotiations between the employees, the union and the bank resulted in an agreement relating to superannuation. Its essence was that employees could remain with the State Superannuation Scheme until 1999, at which point their benefits would be preserved at their existing rate. Certain redundancy issues were also clarified at the same meeting, resulting in an amendment to the 1994 statute.

### **Stage 3: selling**



Notwithstanding all the electoral hype before the introduction of this legislation, there was a good deal of common ground between the debt-reduction plans developed in the twilight period of the former Labor government and the corporatising and privatising objectives of the new government. However, not all members of the state parliament or the general community were in sympathy with the proposition that sale was the necessary end-point of this reconstruction. Thus a number of petitions were signed and sent to the parliament to ask the government not to sell the bank, and a telephone poll of 500 residents showed that only 18% supported the sale (Altmann 1995).

A good deal of public debate focused on the role of public banks and the fact that SBSA had managed to operate successfully and commercially from its commencement in 1896 until the financial disaster of the late 1980s. Some described the disaster as merely an ‘aberration’ which need not be repeated, and a lone National Party MHA opposed the intended sale because of the fallacy of assuming that,

if (the bank) is no longer owned by the State, there cannot be another disaster. If the new owners of the bank get into trouble, it will be those new owners who will bear the pain and not the taxpayers. There is no doubt that the State Bank got into trouble because it did not have the appropriate competent board and senior management, and it is my view that we should fix that problem now rather than throwing the baby out with the bath water (Blacker 1993, p. 438).

He argued further that the State Bank problem had been caused by imprudent financial deregulation during the 1980s and reductions in Commonwealth resources to the states, forcing the state banks to seek large profits rather than provide services. The sale of the public bank, forced on the states by the Commonwealth, would compound the problem rather than fix it, because the banking sector was inadequately regulated, and private directors ‘are free to repeat the disasters any time they get such a whim’. On the other hand, public banks can be a ‘useful agent of Government’, particularly during drought or depression, delivering public subsidies and rescue packages to those in need without conflicting with the interests of shareholders.<sup>9</sup>

Other opposition to the governmental plans focused on concerns that the bank would be sold to foreign investors, that this would result in the loss of jobs for many of the 3,000 bank employees, and that the state would lose the revenue stream. Some believed that the bank should be retained as a public bank and, with prudent management and Reserve Bank regulation, be allowed to trade out of its current situation over a period of 15-or-so years; others argued that, in proposing to sell the ‘good’ bank, the government had over-reacted to the problem, had under-estimated the performance of many

of the doubtful debts, and as a consequence was under-estimating the value of the bank.

But the die was cast before the Labor Party lost office in the state. As the Liberal Treasurer pointed out in February 1995, there 'was no going back' on the sale because reneging on the agreement with the Commonwealth would require SA to pay back the \$650 million tax compensation package as well as foregoing the sale proceeds of the bank (estimated at that time to be worth between \$550m and \$750m). This he argued, would mean an extra \$145m per year in interest payments on the debt and, after allowing for the yearly profit of \$35m from the bank, would result in a net cost of not selling the bank amounting to \$110m per year (Baker 1995, p.1462).

It is worth remembering that in this case---unlike some others we have reviewed---converting into a company and privatising were coupled in a single reforming drive. So preparation for the sale of this public enterprise (and, indeed, other SA public enterprises) proceeded simultaneously with that conversion, and in 1994 the Brown government established an Asset Management Task Force answering directly to the Treasurer, to set up a protocol for asset sales.

The Liberal Party, both while in opposition and later in government, consistently stated a preference for sale via a public float. This, they suggested, would offer greater job security to employees than would an early trade sale to another bank, because it would maintain the bank's independence, ensure that the bank's future headquarters would be kept in South Australia, and allow the bank to be rated by international agencies. In the early stages of sale preparations, the opposite case was put by Labor MHA Kevin Foley, who argued that, if the bank had to be sold, a trade sale would be preferable to a float because it would attract a higher price.

In the event it seemed easier to work within the banking industry, so that Foley's preference prevailed. In April 1995 the government and its principal advisers (CS First Boston) released information to a number of interested parties (including some overseas banks). The Treasurer expected a sale price of between \$550m and \$750m, given that the bank had assets of \$7.2 billion, held 30% of the SA market and had shareholder's funds of \$441 million. There was an initial show of interest from 15 banks, but this soon narrowed to three: Advance Bank, Westpac and St George.

On 6 June 1995 the government announced that it had entered into an agreement to sell BankSA to Advance Bank Australia Ltd for \$730m. Advance Bank had a strong presence in its home state, New South Wales,

was newly established in south-east Queensland, and was the market leader in the Australian Capital Territory. It had operations in all states but did not have an extensive branch network in SA. Advance paid for the acquisition through a new share offer (72.7 million shares at a cost of \$7.75 each: Advance Bank 1995a). The merger enabled it to expand its customer base, access new markets and expand geographically. Advance had kept its interest in the purchase very quiet, and most market analysts had believed Westpac to be the only serious contender. Advance had not been expected to win the bid against Westpac, given that its asset base was about \$12 billion compared with Westpac's \$94 billion. However industry sources suggest that Westpac's bid was about \$80 million under the successful bid (Gibson 1995).

With the sale of the bank by the government, a facility of \$1.2 billion was made available to Advance Bank, with an agreement to repay by the end of 1995. This was repaid (a few months early) to SAAMC. The sale of the bank also enabled the state government to receive its final \$80 million instalment from the Commonwealth, the completion of a rescue package totalling \$675 million that was contingent on the bank's sale (Kelton 1995).

The third-phase legislation---Bank Merger (BankSA and Advance Bank) Act 41/1996---was required to facilitate this sale. It was necessary particularly because of the Reserve Bank's policy requirement that all banking groups have only one banking authority. The Bank Merger bill was introduced to enable the transfer of most assets and liabilities to the Advance Bank, and to enable one of the banking authorisations to be surrendered through a merger process. In introducing the bill, Treasurer Baker explained that the Bank Sale Committee had won a change in federal banking policy that would allow Advance Bank, under this legislation, to operate the banking business under the name of BankSA or Bank of South Australia, using the Advance Bank authorisation (Baker 1996, pp 1488-9). The merger legislation also finalised the transfer of staff to the Group Employer. This legislation was supported by the Opposition and the Democrats.

### **Wider impact**

For many the SBSA case, taken together with the collapse of the Victorian state bank, came to define the 'problem' with the public enterprise system. The faults and failings of the two banks came to feed a growing anti-public sector rhetoric that arrived with the neo-classical economic revival of the 1980s. Proponents of this position argue that public enterprises are unable to function effectively in the market place, that they are unable to match the productivity and efficiency of the private sector, and that they carry great

financial risk but do so without the appropriate controls and restraints found in the private sector. With great glee, the proponents grabbed at the financial failure of the two banks as 'evidence' that their theories had at last been 'proven'.<sup>10</sup>

This effect was well in evidence as we interviewed for other case studies as part of our research project. The matter of the risk governments entertain when they operate commercialised public enterprises was raised alike by senior officers of the Commonwealth, New South Wales and Canadian public services and, almost inevitably, the cases of the Victorian and South Australian state bank collapses were brought out to show that the actualising of such risk is no mere theoretical possibility.

Yet the failure of the bank is in significant part due to the failures of the general manager, Timothy Marcus Clark. He had come direct to SBSA from a position in one of Australia's older private commercial banks but, as already noted, it was one which had its own shortcomings. He had no previous public sector experience and no sense of a special kind of public sector ethics. On the contrary, he fitted easily into the bold entrepreneurial environment of the 1980s which produced a considerable number of dramatic commercial successes followed by equally dramatic collapses; several of the entrepreneurial leaders of the period ended up in Australian prisons or dodging extradition orders overseas. Clark's fortunes were more-or-less matched by those of Ian Johns, managing director of the State Bank of Victoria's subsidiary merchant bank Tricontinental (see Armstrong & Gross 1995). For public administration, the ultimate tragedy is that the managerial behaviour of these imports from the private sector did so much to create general and widespread disillusionment about the ability of the public sector to operate businesses successfully. In today's polity and economy it does no good to point out that there have been many successful public enterprises, and that the publicly owned banks in Victoria and South Australia had given broad satisfaction over a period of a century or more. Conservatives are reinforced in their view that this can't be done, and even Labor Party leaders and senior public servants are brought to the same view. The now-rampant ideology of privatisation thus gets immense comfort and support from two aberrant cases.

The case should instead be used for some serious reflection on the role of public enterprise and the damage that can be done when the unique qualities of the public sector are ignored and the public enterprise is expected to act as a private sector company. To some extent this view was expressed by Bills (1997):

The worst of all worlds is where you have a corporatised entity which regards itself as an empire separate from the government, but yet which has an implied or actual government guarantee, which has no share market discipline, cannot effectively go bankrupt, and hence the financial sector doesn't give it the same scrutiny as in the private sector. You have political appointees on boards which means that you normally have weak boards, and that people use it as a personal plaything, which is what happened with the State Bank of South Australia.

Others have long recognised the value of the public enterprise system, but fear the consequences of forcing public enterprises to function like private ones, which is a leading objective of the modern corporatisers. Thus, as already noted, journalist McCrann (1990) saw a case for government ownership in banks that were primarily 'people's banks', but not in banks that had gone 'entrepreneurial'. In somewhat similar vein, radical historian Humphry McQueen has asked (1994):

What point is there in the State running its own bank if that institution mimics the corporate ones? A State-owned bank becomes part of a socialist project only when its policies contribute towards social equality.

For Radbone, who has chronicled the SABA story in some detail, both the early SA state banking institutions

had a clear purpose and ... this purpose was not primarily commercial. [To recall McQueen] they were not here to mimic the private banks. They had clear social objectives. The commercial objective was clearly subordinate. Neither bank returned lots of money for the government and neither grew dramatically. But this was not their purpose ... So if there is a lesson from this, it is that a successful public enterprise should have two features: a non-commercial reason for existence and clear understanding of the limits of entrepreneurial behaviour (Radbone 1996, p.61).

Bills responds (2000) that the two state banks in their later years not only mimicked McQueen's 'corporate ones' but 'made worse decisions due to political influence and had riskier loans due to naive expansionism'.

It is a great pity that those who eagerly select new managers for our public enterprises based on their reported private sector skills have so often failed to consider the damage that can be done when the non-commercial functions of the enterprises are ignored or under-rated.<sup>11</sup> The fall of SBSA led not only to the loss of South Australia's only state bank, but the stigma of failure helped to silence the voice of support for public enterprise. With mounting public debt, proponents of privatisation gained a free hand to assess the monetary value of the state's assets and, with little consideration of the needs of future generations of South Australians, entered into a blind rush to sell as many other public assets as possible. The 'privatise or perish' mentality was the true legacy of the State Bank saga.

**The bank since the sale**

In accordance with the sale agreement, Advance Bank was committed to maintaining the trading name and market presence of BankSA for its South Australian operations, and the acquired property and staff functioned as a distinct organisational division within the expanded Advance Bank Group. Much effort was, however, invested in establishing 'a consistent focus and common policies, procedures and products' (Advance Bank 1995b, pp 6-7; 1996, p. 8). As a result it was not possible to identify separately the ongoing financial performance of the South Australian operation in a way that would enable convincing long-term pre-sale and post-sale comparisons to be made.

Advance Bank was itself soon to be the subject of another take-over, as a result of which it merged with the Sydney-based St George Bank in January 1997. So the question of retaining a separate identity for the now-privatised SA state bank re-emerged very quickly after the initial public-to-private conversion.

It would appear that it was again settled in a manner fairly satisfactory to the interests of the state. St George retained BankSA as a separate division trading under its own brand name for its operations in SA and the Northern Territory and, indeed, it readily took on board the celebration of the 150th anniversary of the birth of the original BankSA predecessor, the Savings Bank of South Australia, in the year of the merger (St George 1998, pp 7, 30). In 1999 it could report that, 'through our BankSA franchise', it had more customers in SA than any other bank (St George 1999, p. 13). The separation does not, however, run to the publication of distinct financial information for BankSA, which is treated as an integral part of the 'consolidated entity' for reporting purposes.

With partial deregulation, banking in Australia has become a volatile industry outside the four protected major banks (the privatised Commonwealth, Westpac, National Australia and ANZ). So there is much speculation at the time of this writing (mid-2000) about the possibility of another take-over likely to affect this South Australian banking trail: National Australia and ANZ have both been increasing their shareholding in St George, and the financial press gives considerable credence to the possibility that both banks see a potential take-over of St George as a way of furthering their own expansion in the industry (Were 1999). Whether the BankSA identity will survive for much longer is therefore a moot point.

*Summarising*, the main stages in the organisational history of the enterprise have been:

1847: Savings Bank of South Australia established as a public enterprise under statutory authority management.

1896: State Bank of South Australia established as a second banking statutory authority to facilitate rural development and home ownership through low-interest loans.

1983: The two publicly owned banks merged as the new State Bank of South Australia, and thereafter expanded rapidly but disastrously as a supposedly strengthened statutory corporation.

1992: Divided into two parts---a 'good' bank renamed BankSA and a 'bad' bank restyled as the Group Asset Management Division (GAMD) to take over all the bad and doubtful assets and loans.

1994: BankSA becomes a government-owned company, formally the Bank of South Australia Ltd; GAMD reconstituted as a statutory corporation, the South Australian Asset Management Corporation.

1996: BankSA sold to the private Advance Bank and incorporated into its business, though with BankSA recognised as a separate division; a year later Advance Bank itself taken over by the private St George Bank.

**Notes:**

1. On the Victorian experience, see particularly Armstrong & Gross 1995 and Holmes 1995.
2. In the Victorian case, the government guarantee was explicit for the State Bank itself, having been written into the legislation establishing that bank as a statutory corporation. This was not so, however, with the Tricontinental subsidiary, an existing company which the bank had bought. Nonetheless, the government took the view that it had no option but to assume the guarantee applied also to the subsidiary. In an exploration of such 'implied guarantees', the South Australian Crown Solicitor indicated that the same situation applied in his state: Selway 1995.
3. Having uncovered many of SABA's problems, Bills subsequently spent 18 months at the Jacobs royal commission briefing the QC representing the Leader of the Opposition and helping write the Leader's submission to Commissioner Jacobs.
4. The package was described as a tax compensation package, because once privatised, a bank pays tax to the Commonwealth rather than tax equivalent returns to the state. The Commonwealth offered one such package to each state for the privatisation of a financial (banking or insurance) enterprise.
5. On the NSW notion of corporatisation and its New Zealand antecedent, see Wettenhall 1998, esp pp 246-7.
6. In part this was similar to a technique used in the restructuring of the debt-laden Japanese National Railways in 1987. The old nation-wide public corporation was then split into six regional passenger-carrying companies, one nation-wide cargo-carrying company and the JNR Settlement Corporation 'to bear the financial burden and help settle the debts of the former JNR'; the Settlement Corporation also had to carry 23,600 surplus staff who failed either to find jobs in one of the new streamlined companies or

elsewhere or to retire (see Nakamura 1995, pp 45-8). There has since been argument about whether this Japanese reform constituted privatisation; since large elements of public ownership remained, it would seem that it was rather a case of reform by disaggregation and to an extent regionalisation.

7. The Arnold government had also set up a Task Force on the Reform of Government Trading Enterprises and, in the light of its recommendations, legislated (Public Corporations Act 36/1993) to establish a monitoring regime for all statutory corporations deemed to be 'public corporations' under the provisions of that act. The aim was to ensure that the problems which had led to the collapse of SBSA would not recur. However Radbone expressed doubt that it would have prevented the SBSA disaster even if it had been in existence before matters began to go wrong in the bank (Radbone 1997, pp 136-7).

8. Removal of the word 'State' from the bank's name was necessary given the intention to sell the bank to the private sector.

9. Fairly similar arguments were mounted in the upper house of the SA parliament by Australian Democrat members Ian Gilfillan (1993, p. 372) and MJ Elliott (1994, p. 597).

10. Kym Bills, who supported this privatisation, nevertheless reminded us that the corporate greed which followed financial deregulation in the 1980s and contributed so heavily to the losses of the South Australian and Victorian state banks did considerable damage also to some of Australia's private banks. In particular, 'Westpac's \$3b losses ... show that state banks did not have a monopoly on such greed and stupidity' (Bills 2000).

11. For a general discussion of this problem, see O Nuallain & Wettenhall 1987, esp. pp 10-11.

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## Chapter 4

### NSW GRAIN CORPORATION\*

The privatisation of this enterprise holds particular interest for several reasons. First, it presents a major example of industry buy-out: that is, while the methodology was essentially that of a trade sale, in this case the government announced its preference to sell the organisation to the concerned industry, represented by a single buyer. How to inject any real competition into such a sale is a central issue: here the government proceeded by way of a 20-year loan to the buyers, and valuation of the business was complicated by the risks and uncertainty associated with the cycle of New South Wales wheat harvests which vary widely according to weather condition.

Second, this privatisation occurred at a time when the wheat industry was undergoing deregulation as state and federal governments embraced microeconomic reform promoted by National Competition Policy. New South Wales was moving in line with other grain producing states (notably South Australia, Western Australia and Queensland) where ownership was being transferred from government to industry, but it was also pioneering in that this was the first public enterprise to be brought within the terms of the NSW State Owned Enterprises Act passed by the Greiner government in 1988. Its conversion---before sale---from a statutory authority-corporation to the company form completed the process of corporatising it according to the then-current NSW philosophy and provided the government with what it regarded as an ideal legal entity for producing major organisational change such as writing off bad debts, negotiating changes in workplace practices with unions, and implementing management-initiated measures to prepare the way for privatisation.

Finally the case deals with an enterprise which has evolved through the full cycle of organisational types. From its origins as a branch within a department, it was progressively transformed into a statutory authority, a government-owned company and a privatised company with its shares traded on the exempt stock market, through to its present form as a public company listed on the Australian Stock Exchange

#### **Pre-sale organisational evolution**

*Branch of a department*

Government involvement in bulk wheat handling in New South Wales began in 1916 with the passing of the Grain Elevator Act that authorised the construction of a grain elevator system. The then state government decided to construct permanent grain silos, in response to the demands of wheat farmers who had suffered heavy losses of wheat during the period of the First World War. The losses were caused by lack of secure storage facilities, wet weather, plagues of mice and weevils and the disadvantages of handling and storing grain in bags. A Commonwealth Royal Commission of Inquiry in 1917 recommended the construction of permanent grain storage facilities, and, in the Wheat Storage Act of the same year the federal parliament provided for advances to be made to states for the construction of wheat elevators. Construction of a network of 28 silos alongside railway lines in the NSW wheat belt commenced in 1917, and construction of the Sydney export terminal elevator commenced a year later. During the 1920s this network of grain elevators expanded rapidly, the number standing at 84 in 1929. For 30 years, the Grain Elevators Branch of the NSW Department of Agriculture had responsibility for the handling and storage of this wheat; it traded under the name 'Government Grain Elevators' (*OYB* 1929, p. 584; 1955, pp 859-60).

*Statutory authority on representational basis*

With their growing experience of representation on the many marketing authorities established by various Australian governments to promote and sell primary produce, wheatgrower organisations were increasingly urging the NSW government to set up a board for the management of the elevator system on which they could be similarly represented. This action was taken by the Cahill Labor government in 1955, Minister for Agriculture Graham having advised parliament that, with 'continued expansion over recent years, the bulk handling system had reached the stage of becoming a public utility of the most vital concern not only to wheatgrowers, but also to the community as a whole' (Graham 1954, p. 1722). The second stage in this enterprise's evolution thus arrived when the Grain Elevators Board (GEB) was established as a conventional statutory authority under the Grains Handling Act 1954 to take over the functions of the old Branch. The existing branch manager became full-time chairman and chief executive of the board, with part-time members representing the State Treasury, the State Railways (which carried the grain away from the silos) and wheatgrowers (two representatives).

GEB undertook a range of functions related to the transport and storage of grain, including operation of grain export shipping terminals. Its largest customer was the Australian Wheat Board (AWB) which operated in both domestic and export wheat markets: under National Security Regulations during the war and then the complementary Commonwealth and State

Wheat Industry Stabilisation Acts of 1948, an organised marketing scheme and wheat stabilisation plan were established to provide security to the industry on a continuing basis. AWB was established as the central exporting arm of the industry with export monopoly powers, and within NSW the GEB acted as its agent, receiving, testing, storing and loading grain for shipment while the AWB arranged sales and shipping programs.

Through the 1970s, however, problems emerged in the running of the elevator system. Increased wheat production, developments in wheat growing and harvesting technology, a deterioration in industrial relations, a new state accounting system and a new financial agreement with AWB all focused attention on GEB efficiency, and in 1980 the Wran Labor government established a major inquiry to investigate the grain handling system and make recommendations for its improvement. In a first report, the inquiry pointed to the inability of the existing board to face up to these challenges because of the lack of general business experience of the majority of its members, and their preoccupation 'with country operations to the detriment of terminal operations, financial controls and industrial relations' (Cunningham 1980, p. 4). In a striking pre-run of the arguments used by federal Primary Industry Minister John Kerin in restructuring Commonwealth marketing authorities a few years later (see Kerin 1986 and, for comment, Wettenhall 1988: 197-9), the Wran government determined that GEB needed to be reformed to provide 'a high level of management skill and experience', with board members having the 'range and depth of skills to make policies in all areas and evaluate the management performance' (Day 1980, pp 3152-5).

The outcome was the replacement of GEB by a new Grain Handling Authority of New South Wales (GHA) under the Grain Handling Amendment Act 1980. There would still be grower representatives, and also union representatives in line with the then-current policy of the state government, but there would also be members with expertise in business management and industrial relations, and the offices of chairman and chief executive would be split to give a better balance between policy and control on the one hand and executive management on the other. GHA was described quite specifically as 'a corporation' by its creating minister (Day 1980, p. 3154), and it was generally put on a much firmer business basis: the processes of its creation indicated that at least some of the components of the policy to be described as corporatisation' by later NSW governments had already arrived.

*Strengthened statutory corporation: 1981-1989*

At the time of GHA's establishment, the grain handling system consisted of some 480 bulk storages located in over 270 centres throughout the NSW wheat belt, linked to shipping terminals at the ports of Sydney and Newcastle.

The Cunningham inquiry also recommended that urgent consideration be given to the building of a third seaboard terminal. From the outset the new GHA board gave high priority to the determination of the need for and location of this third terminal: a variety of options included upgrading the existing terminals or planning for a new terminal taking into consideration factors such as rail congestion, changes required in the rail network and the likely impact of the drift of nearby pollutants. In 1982, Coopers and Lybrand were engaged to undertake an independent financial evaluation of eight specified options: they provided a cost analysis comparison for handling NSW grain exports up to the year 2001, and recommended building a new terminal at Port Botany and closing the existing Sydney terminal when the new terminal became operational (GHA 1981; Coopers & Lybrand findings reported in GHA 1982).

Following the release of the Coopers and Lybrand study, the GHA board invited submissions from interested parties. An early reaction came from interest groups in Port Kembla, particularly the Port Kembla Task Force and the South Coast Labour Council, proposing a new terminal at Port Kembla as a ninth option. GHA noted that the State Rail Authority's decision to proceed with the construction of the Maldon-Dombarton rail link greatly enhanced Port Kembla's claim, and the Ministry of Transport undertook a costing of the various options including the new option of Port Kembla (GHA 1983).

A record harvest of 8 million tonnes in 1983-84 placed great strain on the two export terminals and hastened a decision on the new terminal, and in February 1984 the state premier announced that the new terminal would be built at Port Kembla (GHA 1984). The state government agreed to provide a grant of \$28.5m for the provision of rail and shipping facilities and the Commonwealth provided a grant of \$18.7m. The decision in favour of Port Kembla was strongly influenced by the problem of high unemployment in the Illawarra Region and the availability of the grant for this site from the federal government.

#### *Financial impact of the Port Kembla Grain Terminal*

The Port Kembla grain terminal commenced operation in August 1989, but its financing went close to crippling the GHA. The cost of construction---\$230m---

was substantially above the original estimate. It was argued that the terminal was over-designed with expensive high-quality technology and that a cheaper design would have been a more cost-effective solution. Not only did the new terminal provide an export capacity well in excess of contemporary average annual export levels; its cost placed a greatly increased interest burden on GHA, which found itself with a crippling debt at the end of the construction period--- and this in a period of record high interest rates. In most years the GHA had made sound profits, but these turned into losses in 1986-87 and 1987-88; in the latter year, the debt reached \$222m.

Two were two significant related factors. First, deregulation had been proposed by the 1986 Royal Commission into Grain Handling, Storage and Transport, ushering in a period of major change and uncertainty in that industry. And second, the Greiner Liberal-National Coalition government elected to office in NSW in March 1988 adopted the so-called corporatisation policy considered in Chapter 5. We have already noted that the reorganisation which produced GHA in 1981 involved a substantial tightening of management and business expertise in this state enterprise; now the state would proceed to reorganise it once more in the light of that policy.

In May 1988 the GHA board accepted the major recommendations of the royal commission; it requested the state government to restructure the organisation financially to enable it to be more competitive, and to amend the governing legislation to enable it to operate commercially. Then, in September 1988, the Deputy Premier and National Party leader, Wal Murray, announced the decision to 'corporatise' GHA under the new policy, to convert \$95m of its existing debt into equity (reducing its debt-servicing costs by \$12.5m annually), and to 'consider offers from established private companies in the grains industry and the Australian Wheat Board' to buy the enterprise. Commenting on the decision, Premier Greiner made much of the former Labor government's 'outrageous' decision to build the Port Kembla Terminal, and estimated (on the basis of figures produced by his Commission on Audit) that the likely return from a sale---\$190m---would result in the state's taxpayers losing between \$85m and \$87m. The GHA Managing Director, Vince Graham, responded by welcoming 'the decision to establish the GHA as a commercial and competitive organisation through corporatisation' (all reported in Lagan 1988).

GHA was the first state-owned enterprise to be processed under the terms of the State Owned Corporations (SOC) Act 134/1989; in fact, its own conversion legislation followed that act very closely (Grain Handling Authority (Conversion) Act 135/1989). The immediate effect was to turn

GHA into NSW Grain Corporation Ltd (almost immediately shortened to GrainCorp), a company incorporated under the NSW Companies Code.<sup>1</sup> The two ministers holding the shares of GrainCorp under the SOC system were authorised to appoint the corporate board: it was to comprise a chairman, three directors selected for their commercial expertise, one for industrial relations expertise, three as grower nominees, and the chief executive.

### **Preparation for sale**

No one was in any doubt that, under the Greiner government, privatisation was to follow. GrainCorp introduced a comprehensive range of management strategies to modernise the organisation in preparation for this sale, and the government wrote off some \$250m of its debt to establish a realistic asset base.

It made an operating surplus before tax of \$5.2m in its first year even though the 1989-90 season recorded the third lowest wheat harvest for two decades. 1990-91 returned another profit of \$22m, and in this two-year period \$11m was paid to the NSW government in lieu of taxes and another \$11m as dividends. Some \$28m was expended on capital items, together with an \$18m payment for the Port Kembla Terminal completion. The new terminal was officially opened in February 1990 after a six-year construction period; the Sydney terminal had already been decommissioned and was transferred to the books of the state government. In 1991-92, however, GrainCorp recorded a deficit of \$6.5m.

There was a strong drive for productivity improvement. In 1989-90 GrainCorp reduced staff by 15% to 460 personnel, and its annual reports claimed a doubling of productivity at the Newcastle terminal and the development of innovative manning arrangements at silos. New industrial awards were negotiated, based on structural efficiency principles and significantly streamlined employment conditions: they provided for much improved operational flexibility, staff skills development and progression opportunities. Ship turn-around times at the Port Kembla Terminal were more than halved, following new arrangements for extending ship-loading hours introduced by the Australian Wheat Board. Despite deregulation GrainCorp retained a strong position in NSW, with approximately 95% of the export wheat market and more than 70% of the domestic wheat market (GrainCorp Ltd 1990-1992).



These were impressive achievements, but they were made while the enterprise was still in public ownership and give rise to the inevitable privatisation question: given a similarly resolute government and similarly resolute management, could they not also have been made in an enterprise intended to remain in the public sector?

The sale process

The divestment got under way in February 1991, when Minister of Transport Bruce Baird announced a two-stage trade sale. The GrainCorp board had produced an Information Memorandum for potential purchasers containing information on the process to be followed and the business, financial position and history of the enterprise. In the first stage potential buyers were invited through national and international advertisements to submit expressions of interest by 28 June 1991, being asked to indicate how much they were willing to pay and what was their proposed means of financing the acquisition. The parties were also required to indicate:

- how they would propose to manage the business including their intentions regarding the future employment of current employees and the terms and conditions of their employment;
- what arrangements, if any, they would be prepared to make to permit NSW grain growers and the employees of GrainCorp to participate in its ownership or profits or those of the purchaser.

The second stage involved selecting a short list of parties who demonstrated a serious interest in purchasing the company. Detailed discussions were then held with each of the short-listed parties and arrangements made for them to be given access to corporate information, the senior managers, and material contracts. A draft contract of sale was provided at that time. These short-listed parties were now requested to make final offers and to disclose any amendments they would seek to have made to the draft contract (GrainCorp Ltd 1992). The negotiations extended over a considerable period after receipt of the bids, indicating that the process of arranging a satisfactory sale was a complex one.

Despite the international advertising, it was soon clear that the government intended to sell GrainCorp to the grain growers with some possibility for staff-share participation. The terms of the invitation to express interest aimed to discourage bids from private corporations without strong industry associations, and that was also likely to discourage foreign buyers, even though they may have had the capacity to pay more. Rothschild Australia

was appointed to advise the government on the sale, and it estimated that GrainCorp was worth between \$90m and \$120m.

Eventually GrainCorp was sold, on 30 September 1992, to Prime Wheat Association Ltd (PWA). PWA was widely representative of the NSW grains industry, having over 8,000 members representing approximately 90% of the industry. Sale to this group attracted widespread industry support (O'Meara 1998a), and the Labor opposition agreed that, if it had to be sold, there could not be a more desirable purchaser. What debate there was centred mostly on the rights and welfare of GrainCorp personnel, and strong feeling within the Illawarra region against sale of the so-recently constructed Port Kembla Terminal.

Initially PWA paid a minimum purchase price of \$90m though, dramatically, that sum was actually lent to PWA by the government. Depending on the level of grain receipts, the sale price under the contract was capable of being increased to \$110m. The final price was \$100m. Also the state government retained GrainCorp residual cash of around \$12m plus its head office, which was estimated to have a value of \$5m. The terms of the sale provided for the debt repayment costs to the NSW Treasury to be spread over two decades, with provisions for reduced payments in poorer seasons (mostly from PWA 1992; for background, see also PWGA 1970).

The sale of the issued share capital to PWA was conditional on the passing of enabling legislation. The effect of this legislation (NSW Grain Corporation Holdings Limited Act 31/1992) was that GrainCorp ceased to be a state-owned corporation but remained a corporation under the Corporations Law.<sup>2</sup> The act also protected the position of GrainCorp's remaining employees and ensured that they were not prejudiced by the sale: their entitlements were preserved and PWA was required to undertake to honour all existing contracts and awards. Also in relation to superannuation, all accrued benefits of the employees were preserved by regulation. It was a condition of sale that PWA should establish a superannuation scheme for GrainCorp staff on no less favourable terms than the state scheme.

At the time of privatisation GrainCorp owned and operated 664 bulk storages at some 270 rural sites in NSW's grain growing regions, with total storage capacity of 11.2 million tonnes. The majority of storage sites were located on rail lines operated by the State Rail Authority and linked by rail to the seaboard terminals at Newcastle and Port Kembla, which GrainCorp also owned and operated.

### **Since privatisation**

The privatised management focused quickly on the need to accelerate repayment of the debt to government; to raise equity through a shareholding system which would provide incentives in the form of rebates to shareholders linked to the tonnages of grain they deliver to GrainCorp; and to achieve further productivity improvement and increased flexibility in staffing to allow greater adjustment in drought years. It wanted also to develop the exempt stock market and trading in shares, and to introduce other incentives for growers who use its storage system (O'Meara 1998a).

Three classes of shares were set out in GrainCorp's articles of association: one non-transferable 'foundation' share held by PWA, conferring two-thirds of the total number of votes and the right to appoint six directors, and serving much as a golden or kiwi share in other privatisations; Class A Ordinary shares issued to the public (mostly wheat growers, but some also held by GrainCorp) under a prospectus dated 29 September 1993; and Class B Ordinary shares held by PWA but not conferring voting or dividend rights. In expanding the Class A share issue, GrainCorp listed on the Australian Stock Exchange (ASX) in mid-1997 as an 'exempt stock market', with the consulting firm KPMG providing share-registry services. It became the first agribusiness in Australia to operate such a market: the arrangement provided greater convenience and security for buyers and sellers of these Class A shares, which were trading at \$6.90 in December 1997 (GrainCorp 1998c).

The expansion of the share base provided much greater financial stability, reducing the cost of funding, and facilitating early repayment of debt to the NSW government. PWA had no debt before it purchased GrainCorp and its asset base before privatisation amounted to only \$2 million; after the purchase, it had a \$90 million debt to the government. Debt reduction commenced in the first year after privatisation, and in 1993 GrainCorp negotiated a credit facility with the National Australia Bank at competitive market rates which enabled it to repay this debt fully in 1998, with the aid of a year of record profit (O'Meara 1998b).

The financial performance of GrainCorp is influenced very largely by the size of the annual NSW wheat harvest, which fluctuates greatly. So climate-driven rises and falls in profitability are to be expected, and GrainCorp explored further cost reduction measures: thus one review of the optimal quantity of storage required identified 62 sites surplus to requirements, and a process of disposing of these sites began.

In June 1995 GrainCorp purchased a 25% stake in Vic Grain Ltd, which had purchased the former Grains Elevators Board from the Victorian government a month earlier. This investment enabled GrainCorp to spread financial risk and enabled the cross-utilisation of resources between Victoria and New South Wales.<sup>3</sup> Other diversification measures have included GrainCorp's movement into the area of fertiliser distribution, enabling the back-loading of grain-to-port trains. Successful joint ventures have been established for the operation of fertilizer facilities in Parkes and Junee (O'Meara 1998a).

A dividend re-investment program was launched in 1995, enabling shareholders to re-invest dividends back into the company and so improving GrainCorp's capacity to reduce debt. There have been more improvements in labour productivity, and many functions have been devolved to the district level; also computerisation has greatly reduced the volume of paper records and eliminated the very labour-intensive tasks under the old system that involved manual record-keeping and physical checking of loads at weighbridges---though the sceptic would observe that this would surely have happened whether the enterprise was within the public or the private sector. An employee share acquisition plan came in 1997 (O'Meara 1998b).

In 1998, GrainCorp listed fully with ASX, requiring an amendment to the articles of association and the cessation of the exempt stock market. The change was intended to facilitate trading in the Class A shares and enable their 'true' market value to be established. But PWA retained its 'foundation' share and continued to hold about 74% of the Class A and Class B shares (GrainCorp 1998, p. 26; Martin 1998).

The grain handling enterprise thus became a fairly normal private trading corporation, having travelled through a virtually full range of organisational forms since its establishment in 1916 as a branch of a public service department.

*Summarising*, the main stages in GrainCorp's organisational evolution have been as follows:

1916: New South Wales' grain elevator system commenced as a branch of the state's Department of Agriculture.

1954: a statutory authority known as the Grain Elevators Board (GEB) established to take over the running of the system.

1980: a strengthened statutory corporation, the Grain Handling Authority of New South Wales, replaces GEB, and is later transformed into NSW Grain Corporation Ltd, the first NSW government-owned company established under the State Owned Corporations Act 1989.

1992: the company sold to Prime Wheat Association Ltd, a private company representing NSW grain growers and now the principal shareholder in the main operating (holding) company, which was renamed GrainCorp Ld in 1993.

**Notes:**

1. However the legislation provided for the eventual establishment of a second state company, NSW Grain Corporation Holding Ltd, with GrainCorp to become its operating subsidiary. This restructuring was completed in September 1990 (NSWGCH 1990, p. 1). The legislation also established a Grain Handling Ministerial Corporation to hold and dispose of assets, rights and liabilities excluded from the property of GHA before the conversion.
2. At time of sale NSW Grain Corporation Holding Ltd was renamed GrainCorp Services Ltd, and the operating subsidiary, NSW Grain Corporation Ltd, became GrainCorp Operations Ltd. Post-sale restructuring was completed on 1 October 1993. The group structure now comprised GrainCorp Ltd as the principal company and two “controlled entities”, GrainCorp Services Ltd (wholly owned by GrainCorp), and GrainCorp Operations Ltd (wholly owned by GrainCorp Services). Most of the assets and liabilities of PWA were effectively transferred to GrainCorp Operations in exchange for over 450,000 Class A shares, while certain testing activities previously performed by PWA resurfaced as a division of GrainCorp Operations (GCL 1994, pp 5, 23).
3. Eventually this Victorian business was formed into another controlled entity.

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## Chapter 5

### THE SYDNEY FISH MARKET\*

This is the second of our industry buy-out case studies. As in the case of GrainCorp, the privatisation occurred in the context of plans to deregulate what had been a protected industry. Formerly owned and operated by an authority of the New South Wales government, the market was sold to a joint-venture partnership established by the two main sectors of the state's fishing industry, the catching sector comprising the commercial fishermen and the wholesale/retail tenants at the Sydney Fish Market (SFM) site.

It is the largest fish market in Australia and the second largest seafood market in the world for variety of fish; an average of 65 tonnes of seafood is sold every day at a rate of 1000 crates of fish every hour. The new company has repaid the debt incurred at privatisation and has implemented measures to reduce operating costs and charges to suppliers and buyers. It has established a good reputation with customers and the suppliers.

#### **Before the sale**

Prior to 1949, the marketing of fish in New South Wales was conducted at SFM by licensed fish agents, or by unlicensed operators elsewhere in the state. However, in 1945, fishermen had complained that the agents were not passing on to them reasonable returns from the sale of fish, and eventually the state government responded by amending the Fisheries and Oyster Farms Act 1935 to require that all fish would be sold through a recognised market, either SFM or fishermen's cooperative trading societies in other coastal locations. The Chief Secretary's Department managed SFM from 1949 to 1963.<sup>1</sup>

In the latter year management passed to the NSW Fish Authority (later Fish Marketing Authority or FMA),<sup>2</sup> a statutory corporation whose board was composed mainly of licensed fishermen from the catching sector and which was responsible to the Minister for Agriculture and Fisheries. It administered an orderly marketing system comprising SFM, the cooperative trading societies and, in locations not serviced by them, a scheme of approvals under which individual fishermen and retail/wholesale outlets were given permission to buy or sell outside those markets. FMA derived all its revenue from commissions charged on sales of fish product, property rentals and other miscellaneous services. Except for those holding exemption approvals, all professional fishermen were required to sell their catches to SFM or to one of the cooperative trading societies.

FMA inherited an old market conducted in premises rented from the Sydney City Council in Haymarket, close to the centre of the city. But in 1966 it moved the market to its present site at Blackwattle Bay on Sydney's inner harbour. Then in 1982 it purchased a paper store building adjoining that market with a view to developing the site as a new, modern market. This development plan would eventually bring FMA to a severe financial crisis; however, from 1966 to 1988 it operated successfully as a financially independent and self-funding organisation, regularly making small profits on its operations ( FMA 1963-94; Skepper 1996, 1998a).

Work on relocation and development commenced early in 1988, the cost of the work estimated at the time to be \$14 million. A contract worth \$11.9 million was awarded for the refurbishing of a warehouse building to provide facilities including a large auction room, cold storage, and retail, wholesale and office facilities. The handling systems and facilities were designed to meet export quality assurance standards, and to allow the introduction of a computer-controlled Dutch auction system similar to those operating in produce markets in Holland, Denmark, the USA and Canada---it would be the first such system in Australia.

The new market was completed in 1989. Its efficiencies enabled FMA to rationalise its staffing arrangements: thus 35 different job classifications in the old market were replaced by the single classification "market floor operator" at five different levels. The new auction system speeded up the sale process and the transmission of data, stabilised selling prices on the day of the sale, and generally provided a better service to buyers and sellers.

FMA continued to pursue the cause of excellence in its work. In 1989, its general manager and a board member undertook an overseas tour to learn about the most recent developments in handling practice and in training buyers in the operation of computerised marketing systems. And in the same year the scope of the construction project was extended as the result of a decision to upgrade the refrigeration, processing and storage facilities. The refrigeration system that resulted was the only one of its kind in Australia, and it was constructed to the highest standard (FMA 1989).

But all this placed FMA under substantial financial pressure. The full cost of redevelopment was \$27 million, well in excess of the original budget of \$14 million. It was financed by a loan from the NSW Treasury Corporation with a fixed interest rate of 19%. FMA now incurred large losses. The cause of the deterioration in financial performance was of course the sudden acceleration in these debt-servicing costs, the capital investment coinciding with a period of



abnormally high interest rates. A severe cash flow crisis resulted, the industry lost confidence in the market, and it appears likely that a black market developed with catchers selling high-value low-volume seafood such as prawns and lobsters directly to retailers (Skepper 1996, 1998).

This downturn was one of two factors now drawing the NSW government's attention to SFM. The other was the prevailing climate of microeconomic reform, which encouraged effort to reduce the high degree of industry regulation in primary product industries. The marketing monopoly FMA held in Sydney was antithetical to the new spirit of National Competition Policy; and it was observed that fish marketing in other states was in the private sector.

### **Towards privatisation**

In 1991 a loss of \$4,172,463 was incurred mainly as a result of the debt servicing costs. In that year new general manager Graham Crouch submitted reports to the government recommending strategies to enable FMA to trade on a commercially viable basis, and it engaged the consulting firm Coopers and Lybrand to conduct a managerial review, with wide terms of reference covering the management structure, core and non-core activities and financial matters. Among other things its report pointed to possible staff reductions, and FMA reduced its staff from 78 in 1991 to 47 in 1992 (FMA 1991, 1992).

For its part, the Greiner Liberal-National Party Coalition government now in office in New South Wales commissioned a number of studies into the operation of fish marketing. One report by the Centre for International Economics recommended that the government should consider the complete deregulation of the industry, including withdrawal of the state from fish marketing activities, sale of the market site, and dissolution of FMA (reported by Skepper 1998).

The government's decision was announced by Premier Greiner when he visited the market on 17 March 1992. First, it would transfer SFM from public to private ownership and management, but not sell the market site; and second, it would remove restrictions on the marketing of fresh seafood in the County of Cumberland, the planning area that covered the Sydney metropolitan region (Greiner 1992).

### **The sale**

The privatisation process commenced when the government issued a consultation document entitled "Reform of the Marketing of Fresh Seafood in New South Wales" that set out information including:

- information on the bidding process and the timetable for transfer;
- who was invited to express interest;
- preferred criteria;
- details of non-binding expression of interest;
- information on the consultation process and audited financial statements of FMA.

Parties submitting non-binding expressions of interest were required to specify:

- their interests in and association with the fishing industry;
- their financial and management credentials including an indication of likely sources of finance to fund the purchase of SFM;
- the intended ownership structure;
- the basis on which they intend to operate the wholesale market and whether they intended to continue the established operational processes;
- the terms and conditions upon which they proposed to acquire the enterprise.

The intention was to privatise SFM by a trade-sale process using a two-round bidding process.

The next step was a call, issued on 22 September 1993, for non-binding expressions of interest from parties wishing to place bids. Six such expressions of interest were received by 17 January 1994 at the close of the bidding period. They were then evaluated within the NSW Treasury, and three were chosen to proceed to the next stage of the privatisation process: SFM Tenants and Merchants Pty Ltd; NSW Fishermen's Co-operative Association Ltd; and a group of licensed fishermen from the NSW South Coast.

Following a series of meetings, the two main industry stakeholders agreed to join together and lodge a combined bid. They formed a company called Sydney Fish Market Pty Ltd, and at the close of tenders on 13 April 1994 this was the only remaining bid, the other bidder (the South Coast fishermen's group) having withdrawn from the contest. It is a joint-venture company with 50% owned by the SFM Tenants and Merchants Pty Ltd and 50% owned by the commercial fishermen of NSW through a holding company and unit trust. The catching sector was unable to pursue its own separate proposal because it lacked the financial resources necessary to fund a successful bid. The tenants' and merchants' company, owned by groups already operating at SFM, was in a stronger financial position.

Legislation was required to facilitate the sale and dissolve FMA. Minister Causley explained to parliament that his government believed it was not a proper function of government to run fish markets, and also that the industry itself was

capable of managing its own affairs and should be given the opportunity to do so (Causley 1994, pp 1908-9). For the Labor opposition, J Martin complained that the consultants hired by the government in 1991-92 had been spreading the word “that the Sydney Fish Market was up for a fire sale”; he also commended the industry itself and his own party “for waging a campaign to ensure that this market did not fall into private or foreign hands” (obviously, in this view, *the industry* was not private!). The opposition now generally supported the proposed changes, but moved amendments relating to the deregulation process and to provide a transition period for the employees to ensure “that they are given a fair go” during the transition (Martin 1994, pp 2585-6). The legislation passed both houses of the state parliament on 13 May 1994 (Fish Marketing Act 37/1994).<sup>3</sup>

The sale took place on 31 October 1994 and was announced in the *Government Gazette* on 28 October 1994. Sydney Fish Market Pty Ltd purchased the business operations of FMA from the NSW government for the sum of \$3 million. Placing a market value on SFM had been complicated by the planned deregulation of the industry, which created concerns about the long-term future. Delaying deregulation by three years was seen as a way of giving the new owners an opportunity to establish a good reputation before this further change arrived (Skepper 1998).

The sale contract provided for:

- . purchase by the company of the assets of FMA including plant and equipment, computer software and inventories;
- . the granting of a concurrent lease of the SFM site to the company for a term of 40 years with an option to renew for a further 10 years at an annual rental of \$1.5 million; and
- . the offer to all 47 FMA staff of employment on similar terms and conditions with a guarantee of employment for at least 12 months.

The government provided the joint-venture company with a reduction to its commercial risk by agreeing in the contract of sale to reduce the annual rent if there was any substantial reduction of supply of fish to the market for a limited period after deregulation. The agreed rent was, in any case, much less than a full market rent for the property and represented an on-going subsidy to the owners. The government also wrote off FMA’s accumulated losses and debt.

To finance the purchase of the market and provide working capital, the company borrowed \$5 million from the State Bank of New South Wales, partly as overdraft, partly as a bank bill facility, and partly as a fixed-interest term loan. The bill facility and term loan were repayable over 2 1/2 years, with the final instalment to be repaid in April 1997.

## **After privatisation**

The new company board comprised two members nominated by each of the joint-venture partners and three independent members. The SFM finance and administration manager, who had 20 years' experience under the old Authority and retained his position after privatisation, has reported that the leadership of this board has been much more commercially focused since the transition:

There is now a strong customer and client focus to all operational issues. The real competition that deregulation has introduced has provided a stronger incentive for the Market to sharpen up its act in terms of providing the best possible management and service to all stakeholders ...The independent board members have provided very valuable commercial experience and, along with the retailers, have given the strong commercial leadership. The members from the catching sector have provided the board with extensive practical knowledge of the supply side of the business. The unique combination of skills and knowledge of board members from the different perspectives has given the company an excellent balance between industry issues and commercial priorities (Skepper 1998).

As a consequence of the deregulation, since 1997 the fishing cooperatives have no longer been required to sell their catches through SFM---they can choose to bypass it and sell directly to the large retail chain stores. But of course their part-ownership of SFM is a disincentive for them to do that, so long as they believe it is operating with reasonable efficiency. The new management reduced handling charges to fishermen to make selling through it more attractive to them, and it handles the greater part of the NSW catch. Increasingly, it also imports fish supplies from outside NSW, partly to obtain tropical varieties of fish and partly as a means of conserving the long-term sustainable yield from NSW waters.

The government's waiving of the old debt placed the new owners in a much better financial position than their predecessors, and the company was soon well ahead of schedule in its repayment of the debt undertaken to finance the purchase. The final payment was made in April 1997 (SFM 1997): to facilitate this quick discharge, it paid no dividend in 1995, but dividends flowed to the two shareholders in following years. In the years since the sale, SFM has pursued the aim of establishing the company 'as the focal point of the industry' and of developing the site 'into Australia's Seafood Centre of Excellence'. As the deregulation process has continued, SFM has consistently returned profits after tax of just over \$1 million per year (SFM 1995-99).

## **Brief assessment**

A quick assessment of this privatisation shows that it has been broadly successful in meeting the Greiner government's objectives, and also that it has furthered National Competition Policy objectives. It is likely also that the two joint-venture purchasers have regarded it as a good investment.

However an issue in many Australian privatisations is whether the price at which the enterprise is sold represents the real market value. When one considers the actual post-privatisation profit performance of SMA, the purchase price of \$3 million was a real bargain for the industry. The annual rent of \$2 million from the retail shops at SFM exceeds the annual rent of \$1.5 million that the government charges for the whole site. In hindsight, the terms of the sale can be seen as generous, particularly because they took into account the risk factors associated with deregulation.

*Summarising*, the main stages in the Fish Market's organisational evolution have been as follows:

1949-63: the Sydney Fish Market managed by the NSW Chief Secretary's Department.

1963: management passed to the NSW Fish Authority, a statutory corporation mostly representing fishing interests, which was renamed Fish Marketing Authority (FMA) in the late 1960s.

1994: sold to Sydney Fish Market Pty Ltd, a private consortium joining the commercial fishermen of NSW and the tenants and merchants at the market.

#### NOTES:

1. More information on these early arrangements can be found in FMA 1971a. This account makes it clear that there has long been, within the fishing industry, a strong desire to have marketing conducted by a fishermen's co-operative.

2. NSW Fish Authority established by Fisheries and Oyster Farms (Amendment) Act 20/1963; name changed in the late 1960s.

3. In common with other NSW privatising acts of this period, this legislation also established a "ministerial corporation" (in this case, the Fisheries Administration Ministerial Corporation) to hold assets, rights and liabilities excluded from the sale. Other such ministerial corporations are noted in our case studies of the GrainCorp and GIO divestments.

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## Chapter 6

### GOVERNMENT INSURANCE OFFICE OF NEW SOUTH WALES GIO AUSTRALIA \*

This case is of particular interest for four reasons. First, it was the first in Australia to use the public float method to secure the divestment of a whole public enterprise, and so became an exemplar for subsequent divestments of this kind. Second, the enterprise that was sold was both a competitor in a heavily contested commercial field and widely regarded as successful in its public ownership phase. Third, notwithstanding its subsequent exemplar value, it was a case in which few decisions were clear cut, and some of the steps that were taken were contested by the main actors: the range of activities of the enterprise itself, what ‘corporatisation’ meant, whether to sell by trade sale or float, and what potential shareholder market to target. And fourth, because these contests occurred, it is likely that personalities were more important in this case than in most other privatisations. The sale itself was a messy affair, but it showed Australian public administration grappling with a new kind of challenge and having to learn as it worked through the sale process.

The subject enterprise came ‘unstuck’ several years after the sale, and this will no doubt be seen to support those who argue that the public sector should not engage in risk-taking commercial activities. For those who care to look, it will also highlight the risks being entered into, mostly unconsciously, by all the small investors (in the Australian idiom, ‘mums and dads’) who buy shares in these public floats. But these are post-sale features: they do not affect the perceptions held at the time of the sale and in the early years afterwards that GIO was successful as a public enterprise and that, through the sale conditions, the state conferred a considerable benefit on those who bought into it.<sup>1</sup>

#### **A successful public enterprise**

Government insurance activity in New South Wales (NSW) began in 1891, when the state began insuring its properties and activities---and soon those of government contractors<sup>2</sup>---against risk through a special fund created in the Treasury. From 1926 the state required all employers to insure their workers against workplace injury, but private insurers either refused to cater for this business or charged high premiums; the state decided to expand its own operation to take on this business and exert competitive pressure on the rates charged by the private insurers. In 1927 legislation formalised the Treasury insurance branch as the Government Insurance Office (GIO) under a statutory general manager.

The operations soon became politically controversial. Reflecting the embarrassment often felt by conservative governments when public enterprises are successful, efforts were made to restrain GIO's competitive activities in the 1930s. But, under a Labor government in 1941, it was authorised to write life insurance, incorporated as an independent authority, and required to make payments to the owning government in lieu of the taxes it was exempted from as a state authority. Also in the 1940s, the state made third-party motor vehicle insurance compulsory and GIO entered that business. Rising court-awarded damages in motor vehicle accidents soon made this business unprofitable for the private insurance companies and by 1977 GIO, aided by its government guarantee, was conducting 97% of this class of business. This was regarded as 'social insurance', and for this business alone GIO was exempted from the requirement to make the tax-equivalent payment and later (in 1984) given a monopoly: here government wanted to use GIO to influence the level of court verdicts in road accident damages cases.

Otherwise it was progressively commercialised, with separate life, third-party and general insurance divisions. A board of directors was provided in 1978, with the general manager becoming full-time chairman and part-time directors appointed for their industrial, commercial and investment experience. GIO had become 'one of the largest and most influential insurance offices in Australia' (Renshaw 1978, p. 1742). In 1982, the board was reconstituted so that it was more aligned with the constitutions of leading insurance companies, and in 1985 it was given a subscribed capital and required to pay dividends to the owning government; consistently with the treatment of most Australian statutory corporations, its staff was now separated from the NSW public service, requiring the management to deal with employment and industrial matters independently of the Public Service Board and as an insurance provider rather than a public service agency.

Crucial for this case was the election of the Liberal-National Coalition (conservative) government under Premier Nick Greiner in 1988. This government quickly formulated its 'corporatisation' policy and tried to impose that policy on GIO.<sup>3</sup> *On the one hand*, it acknowledged that GIO has been performing well as a public enterprise. It was, it soon reported,

a significant earner of funds for the NSW Government, with Group after tax profit for 1988-89 of \$118.4 million (expressed in 1989-90 prices). In total through tax payments, dividends and increases in net worth of the enterprise, the State of NSW benefited by some \$234 million (in 1989-90 prices) from GIO's 1989-90 activities (NSWG 1990, p.27).<sup>4</sup>

According to Labor leader Bob Carr (1991, pp 3188-89), Greiner had said, when Leader of the Opposition and before becoming Premier, that GIO was



‘precisely the kind of efficient and legitimate government enterprise which should not be sold off’. *On the other hand*, the Greiner government commenced a series of actions whose end-result would be the privatisation of GIO.

### **The divestment**

#### *How to explain the decision to sell?*

As part of its increasing commercialisation, GIO had been building up a new management team. Three actuaries who had worked for the large Australian Mutual Provident Society (AMP) but had become dissatisfied with that employer moved to GIO in the late 1970s; they were highly motivated to demonstrate that a public enterprise could compete successfully with a private enterprise in its own field, and they worked well and constructively with the GIO board. One of them, Bill Jocelyn, became General Manager in 1983; his managerial style was often provocative and aggressive in support of the general aim to build up the enterprise to be one of Australia’s leading insurers. For much of this time the board chairman was Stan Howard, brother of the then Liberal (ie conservative) leader and now Prime Minister John Howard. It would have been difficult now to write GIO off as a pampered Labor creation, but that did not prevent the private insurers, hurt by GIO’s competitive endeavours, from exerting political pressure to have those endeavours curtailed. Jocelyn and his colleagues were convinced the private insurers were bringing such pressure to bear on the Greiner government.<sup>5</sup>

By 1990 GIO had symbolically ‘gone national’ by adopting the trade name GIO Australia. It had opened offices in some other Australian states, and it had seized the opportunity offered to many insurers by the collapse of Lloyd’s of London to enter the reinsurance business.<sup>6</sup> So it became a competitor in an international business, and its senior staff often needed to travel abroad. It made every effort to learn from the mistakes of others, and its general performance was spectacular. An assessment of its achievements in 1990-91 showed that, in that year, it wrote single premium policies worth \$461 million; it ranked fourth in the whole country as a general insurer, seventh as a life insurer and eighth in the annuity market; it had assets of over \$8 billion, compared to \$4.9 billion four years earlier; and it declared a net profit of \$95 million, tax expenses of \$92.6 million and a dividend of \$30 million (Casey & Dollery 1996, pp 19-20). It is remarkable that it could do all this as a public enterprise. But its rapid growth was placing great strain on its relationship with its owning government.

Jocelyn argued, in annual reports and elsewhere, that frequent political intervention was inimical to the business interests of such an enterprise. He was dealing with the long term, but the Greiner government took exception to his statements which it regarded as illustrating the propensity of an enterprise management to speak out or gather support in its own interest against proper government strategy-setting. Greiner, who was both head of government and Treasurer with ministerial responsibility for GIO, was soon objecting publicly both to its spread of business into other states and to its move into off-shore reinsurance; indicating a desire to extract extra dividends from GIO to help alleviate budget problems in other areas;<sup>7</sup> and demanding that his government's corporatisation policy be applied to GIO. With much logic on his side, Jocelyn expressed puzzlement about this; he believed GIO had been corporatising over several years---but of course it was a statutory corporation, not a company, and so did not satisfy the New Zealand test of corporatisation which NSW legislation had now adopted. Generally Jocelyn did not respond warmly to Greiner's attacks, and so he attracted rebukes from Greiner and the hostility of some of the latter's advisers.

It seems likely that the Treasury, which carried direct responsibility for the eventual privatisation of GIO, was mostly concerned about the risk factor. Trained as an economist, Mike Lambert, who was Deputy Secretary and then Secretary to the Treasury in the early 1990s and played a leading part in preparing for the GIO privatisation, argued simply that governments should not be required to accept the degree of risk involved in the entrepreneurial initiatives being taken by the GIO management at that time; Treasury was particularly conscious of this factor for the reason that all the insurance business being captured by GIO was still underwritten by government guarantee. The collapses of the Victorian and South Australian State Banks were still of recent memory, and in this view they provided strong evidence of the need for caution. Lambert also expressed the very general view that governments are not good at ownership, for which the harsh disciplines of the marketplace are necessary (Lambert 1997). It is ironical, as our companion case study of the State Bank of South Australia is revealing, that these Australian enterprises had mostly given many decades of safe and satisfactory service under public ownership and in the public interest, and that the failings to which Lambert and others now attached so much attention arrived only with their importation of private sector entrepreneurs and private sector operating styles in the heady days of the 1980s.

Gary Sturgess, who is widely regarded as the architect of the NSW corporatisation policy and was now Cabinet Secretary, opposed Jocelyn for another reason. He became very cross at what he saw as a 'subversion of the policy process' by GIO's senior managers. He believed strongly that they were 'thumbing their noses' at the government and that they had no right to adopt and

publicise a view different from the government's; indeed, he thought they had got so far out of line that they were worthy of sacking (Sturgess 1997). Elsewhere he referred to the 'the strains which globalisation is placing on our traditional concepts of the state' as a further explanation of the tensions which had developed:

The government faced the difficulty of explaining to the taxpayers of NSW why they were reinsuring satellites and the merchant navies of several Asian countries. In recent years the GIO has lost [money] as a result of Hurricane Hugo in South Carolina in 1989, ... Storm 90A in Europe later the same year, ... Florida's Hurricane Andrew ... and the fires in California in 1993. How does a Premier stand up in Parliament and explain to the people of NSW that there will be no dividends from the GIO this year because of a hurricane in South Carolina? ... As government businesses outgrow the geographic boundaries of the nation (or sub-national) state, territorially-based governments are being forced to relinquish their interests (Sturgess 1994, pp 9-10, see also Wettenhall 1998a, pp 97-9).<sup>8</sup>

The impulse to move down the path towards privatisation now came quickly, and quite as much from within the enterprise itself as from the government to which it reported. In March 1991 Lambert prepared and Greiner signed an instruction to GIO to get out of the reinsurance business (see Appendix). Lambert has explained that he fully expected Jocelyn to fight for what he saw as the best interests of the enterprise under his management, and that he drafted this letter somewhat tongue-in-cheek, using the direction deliberately as a means of forcing GIO to decide once and for all either to subordinate itself to the government's wishes or to get out of the public sector. He rather expected it to take the latter course (Lambert 1997). Within GIO the direction was seen as a declaration of war, and Chairman Howard told the press his board 'was keen for GIO to be privatised', and that 'it had already commissioned private consultants to help it mount its arguments for privatisation' (quoted in Larriera, Ellis & Moore 1991).

Around this time Jocelyn gave several public addresses. He made no secret of the fact that he had battled various agencies of the state such as the ombudsman in what he regarded as the best interests of his own organisation. One important message was that, while GIO showed it was possible to be successful under government ownership, that outcome could only be achieved if a public enterprise management was prepared 'do its own thing' and fight against various kinds of control exerted by central agencies. As for 'corporatisation' as proposed by Sturgess, he said both that turning statutory authority-corporations into companies 'may be a neater way for central control to be exercised over monopolies; ... (but that) of itself ... it will not secure any behavioural change'; and that, while it may be done with good intentions, it is not possible 'to prevent governments re-intervening ... while you are in public ownership, you can't keep focused only on the profit motive' (Jocelyn 1989a; 1989b; 1990, p.11; 1996).

*How to sell?*

Since both parties wanted the divorce, events could now move rapidly. But the question how to sell produced more controversy.

Once the agreement to privatise was known publicly, there was pressure on Greiner to approve a trade sale rather than a public float. The GIO management was convinced that private insurers were exerting such pressure through Liberal Party channels, seeking to break up the enterprise and have it sold in bits; through buying the bits, they could add to their own empires and eliminate a powerful competitor (Jocelyn 1996). Sturgess (1997) also favoured a 'direct sale', though for another reason. He was, as we have seen, strongly opposed to the tactics employed by the GIO management to force their view on the government; now he believed a float would pass effective ownership into the hands of that management since, in his view, a mass of small shareholders would not provide significant counterweight within the post-privatisation enterprise. Lambert (1997) indicated that the Treasury investigated both approaches: it concluded that a trade sale would net a bigger return to the government, and initially favoured it for that reason. Fairly obviously, 'the trade' would have paid well to eliminate a rival.

The evidence that GIO was doing well in its own right as a viable and innovative insurance enterprise was, however, compelling. Working against the pressure for a trade sale was the growing commitment, by all the major Australian political groupings, to the competition ethic. Also NSW Treasury research into the British privatisation experience was suggesting that it was possible to minimise value loss from a float by adopting a 'book building' approach which relies on market bidding for shares instead of the underwriting approach based on a pre-determined value for each share sold, with the underwriters taking up the shortfall at what is effectively a discounted price if all shares on offer are not sold on the open market (Lambert 1997). So there were also arguments in favour of floating GIO and so ensuring its continued existence as an independent enterprise. Greiner still had to decide what his exit strategy should be.

A GIO Sale Task Force was established, charged with preparing the enterprise for sale. This work included several valuations of GIO: Greiner was still saying he considered it important to ensure that the retention value to government was not greater than the sale value. A major task was to obtain parliamentary approval for a quick, clean sale. It seems likely that the government had armed itself with several versions of a draft bill, and likely also that the GIO representatives on the task force were not fully aware of all the planning that had gone on. When the bill eventually came to parliament, Opposition Leader Carr asserted not only that Labor had earlier forced Greiner

to 'back off' from his plan to raid GIO reserves but also that, just two weekends before the bill was introduced, it had blocked the government's plan 'to flog off the GIO by tender' by drawing public attention to that plan. So, according to Carr, the provision for a float was hastily incorporated into the final version of the bill to be presented to parliament (Carr 1991, pp 3187-8). Introducing the bill for Greiner, Minister George Souris indicated that, 'in the event that a public float proves to be not possible or financially attractive', the government would return to the parliament to seek approval for an alternative approach (Souris 1991, pp 2480-3).

As the Government Insurance Office (Privatisation) Act 38/1991, this legislation converted GIO from a statutory corporation into a public company limited by shares, with a nominal share capital of one billion \$1 shares and the new name GIO Australia Holdings Ltd. To this end all the older legislation was repealed and the new company made subject to the national Corporations Law. The state's existing equity in GIO was replaced by the issue to the state of fully paid-up shares, with machinery provisions to enable the state to receive the proceeds of sale of the enterprise by a public float (ss 5-19). The float would dispose of the shares initially issued to the state, with the maximum initial shareholding of any one purchaser limited to 10 per cent (ss 29-33). Another provision continued the state guarantee in respect of existing or pre-sale policies, but removed it for post-sale policies (s.16).<sup>9</sup>

While the minister claimed that the sale 'will represent the first complete float of any public trading enterprise in Australia' (Souris 1991, p. 2483),<sup>10</sup> the act contained a precautionary provision authorising him to exclude from the projected sale any part of the business undertakings of GIO or its subsidiaries ('residual assets' which might detract from the good balance and saleability of the whole), and establishing a NSW Insurance Ministerial Corporation to accept and manage any such excluded undertakings (ss 24-8). This provision was used to establish a vehicle for the 'run-off' of old third-party insurance scheme liabilities, which GIO would henceforth manage for the government on a fee-for-service basis (Green 1997).

The company came into existence on 1 January 1992, and a new board was appointed retaining six of the nine former members and adding five new ones. A new corporate structure was established, aligning the parts with the relevant federal regulators (notably life versus general) so as to minimise possible administrative complications. Within GIO, it was understood that several of the new board members had been briefed to get the float going and then dump Jocelyn, so the management remained very watchful.

GIO proposed that the government should underwrite the float, offering shares to policy-holders first, then the public and finally the institutions. This method, Jocelyn believed, would both demonstrate loyalty to GIO's own customers and prevent the exercise becoming an expensive 'free-for-all'. As he subsequently told *Business Review Weekly's* Robert Gottliebsen, who reported critically on the float (1992, pp 46-8), GIO:

was still under threat of being sold to [its] rivals. By the time [Jocelyn] was certain the NSW Government would float the company, a multitude of highly paid people swarming around the NSW Government were able to howl him down.

Gottliebsen's account continued:

without [Jocelyn's] restraint, it became a free-for-all: institutions, brokers' clients, the public and policy-holders would be encouraged to compete against each other for a share of the action, and there would be fees galore ... Jocelyn, who did not believe the float should be advertised, expressed his opposition as a member of the privatisation committee. 'I don't like advertising campaigns much', he says. 'I said my piece and then shut up. The advertising was overdone'.

The task force negotiated with the Commonwealth about tax compensation for the loss of substantial revenue to the state: NSW would lose dividends and tax-equivalent payments from its profitable enterprise, whereas the Commonwealth would gain a new income tax stream from the privatised company.<sup>11</sup> And Jocelyn, who survived much longer than some of the new board members, turned his energies towards negotiating a take-over---in the event, highly beneficial for GIO---of the Victorian State Insurance Office.

### *Conducting the float*

The task force and the government opted for a saturation advertising campaign designed to 'soften up' the general public and attract the small investor, selling it as 'the mums' and dads' float'. The drafting of the sale prospectus was a major task, and 'members of the financial services industry' earned big fees for their contribution (Walker & Howard 1992, p. 17). There were extensive discussions with Australian Securities Commission (ASC) officers relating to an application for relief from Corporations Law restrictions on pre-prospectus advertising of projected floats, and from the requirement to allow adequate time for investors to examine prospectus information. While the ASC authorised some relaxation for the GIO float, it felt compelled after the float to express misgivings about the way it had been conducted, particularly with respect to the advertising campaign (Walker 1992, p. 17).

There were detailed technical briefings of members of parliament, GIO customers and GIO staff, and the government launched a \$2.5m advertising and public relations campaign (Larriera 1992). Through January and February 1992,

the government pushed the message that ‘privatisation is for everyone’, featuring the slogan ‘Share in the future of NSW’. This provoked serious questioning about how far such polemical publicity was an acceptable charge against the public purse: though it had accepted the GIO sale in principle, the ‘loyal opposition’ (Labor) in the state was vehemently opposed to this generalising of the alleged benefits of privatisation. The advertising also produced a spate of complaints from members of the public who asserted that they already owned the assets they were now being pressured to buy (eg McGregor *et al* 1992). The campaign entered a new stage in May, when advertising attention became focused specially on the GIO float. Now the central message was that ‘everyone can own a piece of GIO Australia’. Press and television advertisements, as well as brochures widely distributed through a mail-out campaign, advised that the sale prospectus would soon be available and gave advice on how to obtain copies.

Launching the prospectus on 22 June, Premier Greiner hailed this disposal as ‘the model for future privatisations’ (CT 1992). As the first total divestment of a public enterprise by public float in Australia, it was certainly breaking new ground. But there was too much haste, with the end of the financial year so close: the government had been hoping to bring the proceeds into account in that year’s financial accounts.

The share offer was to open on 29 June 1992, but just days before ‘reserved’ copies of the Prospectus had still to be mailed out. This part of the operation was heavily criticised on three grounds. First, prospective investors who got it had little time to study it. Second, many requests for it were never answered.<sup>12</sup> And third, it was said to be badly organised and difficult to follow, and it contained conflicting profitability estimates from the GIO directors and from the investigating accountants hired by government, Coopers & Lybrand and Ernst & Young, about whose role Jocelyn was very critical. “‘There have been 15 ceremonial burnings of ... [their] \$8-million report”, he says with some passion’ (Gottliebsen 1992, p. 48).<sup>13</sup>

The float lasted less than two days, using---for the first time in Australia---the ‘constrained open price’ tendering system in lieu of underwriting (Mychasuk 1992). In that 32-hour period, as Gottliebsen reported it:

128,000 Australians wrote cheques worth a total of \$2.2 billion in a mad scramble to get shares in GIO Australia---\$1 billion more than was needed to fill the issue. If the issue had remained open for its full term, another \$1 billion would almost certainly have been subscribed. It was the biggest public float in Australia, and it showed the enormous latent demand for stakes in big Australian undertakings ... The ill-judged handling of [this] recent mammoth float has damaged the climate for further big issues and privatisations. Woolworths and Qantas will need to avoid GIO’s big mistakes ... Those who missed out on the shares were so angry that they threatened to sue the GIO, their brokers, Australia Post or anyone else they thought could be blamed for depriving them of the chance to make a certain killing.

Observing journalists variously accused the government of generating ‘retail euphoria/hysteria’ or complained that ‘television viewers were treated to the spectacle of hordes of people stampeding to get their share’, and that ‘newspapers carried a blunt message of greed’ ((McCraan 1992; Frith 1992).

Eventually 127,200 shareholders held 500 million shares after paying \$2.40 per share, the top feasible price within the authorised range of \$2.10 to \$2.40. This represented a ‘taking’ of \$1.2 billion. Most shares went to the small investors, customers (30% of shareholders) and employees (6 million shares through the concessional staff share plan, with another 10.1 million taken up by staff on a non-concessional basis). Another 35% was allocated to the ‘institutions’ (banks, superannuation and investment funds and the like), which individually took far more shares than any of the ‘mums and dads’: when a shareholders’ census was taken in September 1992, after just a few months of secondary trading, 1.85% of the shareholders held nearly 43% of the shares (GIO 1992, p.21). As GIO itself reported, ‘there was inevitably a large number of subscribers whose applications could not be granted in full’. Moreover, ‘a large number of potential investors ... were taken by surprise by the overwhelming public support ... [and] failed to submit applications before the offer was closed’ (GIO 1992, pp 6, 8).

GIO refund cheques---sent to those whose applications could not be completely filled---had notes attached suggesting that investors might consider buying GIO stock on the open market, and stockbrokers quickly prepared lists of alternative investment options for their disappointed clients. However brokerage and stamp duty would now have to be paid---mostly those who bought in the initial float escaped those charges (Laurence 1992).

The NSW government netted altogether around \$1.8 billion: the \$1.2 billion from shares sold, plus about \$600 million from the tax compensation agreement negotiated with the Commonwealth and certain other assets transferred to the state in lieu of various state taxes. It was all applied to the reduction of state debt. Notwithstanding the furore at time of sale, the operation was soon judged ‘a success’ by the NSW government, and as such it ‘paved the way for the privatisation of the State Bank’ and other enterprises (from new Premier John Fahey, who replaced Greiner in June 1992: quoted in Thomas 1992). Lambert had little doubt that a trade sale would have produced a bigger ‘take’, but he concedes that the float produced a ‘halo effect’ with a high degree of public participation and eventually much goodwill, and ensured retention of the Sydney base for the enterprise (Lambert 1997).



Though they were not shouting out their satisfaction, the various participating members of the private financial services industry---the legal, consulting and sharebroking firms and their allies in advertising and marketing---had done very well. Academic analysis, eventually accepted by the minister in charge of the float, showed that the costs of this sale amounted to \$71.3m (or 5.94% of the sale proceeds), much of it going to these sale ‘facilitators’ (Walker & Howard 1992; Walker 1992).<sup>14</sup> The size of this ‘bill’ was attributed in part to the dissension between the enterprise and the owning government, as a result of which each party had engaged its own consultants. It is incontrovertible that this Australian industry was discovering just how lucrative the privatisation process was proving for it, and so was developing a vested interest in persuading governments to undertake more privatisations. To further this interest, it began recruiting from the ranks of officials who understood the process from inside government: as a fairly direct spin-off of the GIO case, Lambert from the NSW Treasury joined the private firm BZW Australia Ltd,<sup>15</sup> and became heavily involved in many other divestment projects.

### **After the sale**

#### *Stage one: continuing good performance*

After the sale GIO continued to expand for several years and, earning many accolades, Jocelyn stayed on as chief executive until his retirement in June 1998. In the year of his retirement, GIO was able to report that the value of an investment of \$2,400 at time of sale (for 1,000 shares) would have grown to \$6,298 at 30 June 1998, representing a compound return of 18% per annum (GIO 1998a, inside front cover). Leading stockbrokers (eg Were 1997) and academic commentators (Casey & Dollery 1996) alike were supporting this sort of analysis. GIO was now described as ‘the second largest general insurer/reinsurer in Australia’, and it won an upgraded assessment from international ratings agency Standard & Poors based on its ‘strong business profile and sound financial structure’ (Morrissey 1998).

This represented continuity of good performance through the move from public to private ownership. GIO had performed well in its public phase; now, under an essentially unchanged management, it was continuing to do well in its private phase.

#### *Managerial restraint*

Jocelyn’s leadership was distinctive also for the restraint that was shown in the matter of directors’ and senior executives’ remuneration. First, *this* case of privatisation produced a compact in which neither the managing director, the

deputy managing director nor any of the non-executive directors were given options to purchase GIO shares. Second, Jocelyn was content to see his own salary limited to around \$600,000 pa at 1996-97 levels, so holding down the salary packages of other top executives. Directors' share options and extravagant executive salaries have become highly controversial features of top management in many Australian private companies (including recently privatised ones), but that sort of controversy was totally absent in the GIO case. A GIO communication commented modestly that 'GIO has certainly not been a leader in this respect' (Green 1997), and Jocelyn's own annual salary restraint was publicly acknowledged in a survey of executive salaries in major Australian companies:

Salaries range from Frank Lowy's \$5.6m for running Westfield Holdings<sup>16</sup> to \$600,000 for GIO's Bill Jocelyn. Jocelyn, ranked one of the most successful company chiefs in Australia, has received no increase in salary since July 1, 1995 (Young 1997).

In the year of his retirement, Jocelyn observed the demutualisation of AMP, the insurer he had left to join GIO 20 years before and whose current managing director, the American George Trumbull, was reported (*CT* 1998) to be collecting nearly \$2.5m per annum as base salary and a share packet worth \$18.9m by the year 2000. In a parting shot, Jocelyn expressed the view that, 'generally speaking, the chief executives in the financial services industry are overpaid relative to what it is the community ought to pay them'; criticised the AMP demutualisation for not delivering benefits to the community; and suggested that there was now 'an unholy alliance between shareholders and senior management' which removed the focus from customers (ie policy-holders in the insurance industry). All this, he said, had caused him to have second thoughts about the privatisation of GIO, over which he had, of course, presided: he now thought that 'a government organisation that actually works as a mutual, that looks after the people who are doing business with it, ... that ploughs the benefits back to the people who use it ... is probably the best approach of the lot' (Jocelyn 1998).

### *Stage two: the collapse*

Notwithstanding all this, 1998 was to become a crisis year for the privatised enterprise. There were two causes, separate in their origins but becoming entangled as events unfolded. First, the reinsurance business soured as a spate of major natural disasters around the world took heavy toll of all reinsurers. And second, stung by serious problems relating to its own floating on the stock exchange (an inevitable part of the demutualisation process) and no doubt also by Jocelyn's unkind comments about it and its chief executive, AMP made a take-over bid for GIO, unleashing one of the most bitter and expensive struggles in Australian corporate history.<sup>17</sup> Millions of words have been written

about these issues in the Australian press; only a very summary outline is presented here.

Serious studies have suggested that the world has suffered an unusually heavy incidence of natural disasters and technological mishaps in the last few years of the 20th century (eg Radford 1999, Hanna 1999). Thus GIO declared a first-time loss of \$743 in 1998-99, and suspended payment of dividends for that year. Subsequent disasters worsened its financial situation, and the value of its shares took a severe battering.

The impact of this spate of disasters has been disastrous for many reinsurers, though it is also clear that after several reorganisations of this enterprise the GIO board had lost effective control of that part of its business. Sadly, Jocelyn now speculates that his holding on to the chief executive position for 'too long' may also have contributed: it may have 'created scope for the next level of management to focus on the succession, rather than on the business' (Jocelyn 2000).

The AMP take-over bid was quickly recognised as hostile. It led to several court confrontations, and huge expenditure by both sides in publicising their respective positions (notably AMP 1998; GIO 1998b, 1998c; and massive press advertising by both). The small shareholders---the 'mums and dads'---remained loyal to GIO, but by early 1999 sufficient of the institutional shareholders accepted the bid to give AMP a controlling 57% interest in GIO. As the devastating impact on GIO finances of the crisis in the reinsurance business became apparent, a class action was commenced against the GIO directors who had encouraged their shareholders to resist the take-over. In late September 1999 AMP announced plans for a 'mop-up' of the remaining independently held shares in GIO, intended to give it 100% ownership; and this came to pass in December 1999. GIO was de-listed on the stock exchange, its remaining shareholders receiving one AMP 'income security' for every 36.4 shares still held. The value of those shares, at the end, was very nearly the same as that paid by investors in the original float; all subsequent gains had been lost, and anyone who had bought GIO shares after the float suffered badly. As the business and staff of the two organisations were integrated and the reinsurance operation phased out, there were many retrenchments. Several board members departed, and Trumbull made an early return to the United States, albeit with a princely 'pay-out' reported by the company itself to total \$13.2m (Smith & Wardell 2000). AMP was now also a loss-maker and its share values tumbled. Its intervention has been widely regarded with distaste: eg variously as 'disastrous', as a 'debacle', as a 'mistake by a combination of foul means and foolishness', as 'a nightmare for AMP' (Knight 1999, Hanna

2000, Mitchell 2000). The weakened AMP was itself subsequently seen as a possible target for take-over by a major bank.<sup>18</sup>

Such is life in the corporate jungle, into which the once-proud and well-respected GIO was catapulted by the act of privatisation. Of course it has to be recognised that part of its seeming success at point-of-sale---its fairly dramatic rise as a reinsurer---was built on the riskiest part of the insurance business. Clearly the risks were not handled well under private ownership, and we can only speculate about whether they might have been better handled if public ownership had continued---so that the crisis that surfaced in that part of its work at the end of the 1990s might have been averted or at least have been less acute. The fact is that privatisation had taken place, and because of it the NSW state was relieved of much of the financial responsibility for meeting the crisis, having shifted the burden to the new private owners, many of whom were the ‘mums and dads’ who had so few resources with which to cope.

*Summarising*, the main stages in GIO’s organisational evolution have been as follows:

1891: Government insurance activity begins within NSW Treasury.

1927: Government Insurance Office of NSW established under a statutory general manager.

1978-85: Progressively commercialised and arguably corporatised as conventional statutory corporation.

January 1992: Converted to state-owned company.

June 1992: Sold by public float.

1998-99: Subjected to hostile take-over bid, became AMP subsidiary, and eventually went out of existence---although its general insurance operations continued under the AMP banner.

#### NOTES:

1. Only specific citations are referenced in the text. Material on the early history is drawn mostly from *OYB* 1931, Kelly 1971, Hansen 1988, ERC 1989 and speeches on various statutes relating to GIO in *NSW Parliamentary Debates*. Unless otherwise indicated, comment on the sale itself is drawn mostly from Gottliebse 1992, Walker & Howard 1992, Casey & Dollery 1996, the sale *Prospectus* and GIO reports; and from interviews with or correspondence from the GIO’s Jocelyn, Roach and Green, and former Greiner advisers Lambert and Sturgess.

2. By the turn of the *last* century contracting out was so prevalent in Australia that government was persuaded of the need to extend its own insurance facility to its contractors, thus demonstrating that it is by no means a new process! See McIntosh *et al* 1997.

3. Here the Greiner government followed the New Zealand reform example and so set NSW on a rather different course than most of the rest of Australia. New Zealand had made very little use of the device of the statutory corporation and so for it ‘corporatisation’ meant turning public enterprises that had mostly been

departments or parts of departments into government-owned companies. In following this model, the Greiner government was rejecting the long Australian statutory corporation tradition, even though the statutory corporations had usually embraced some elements of corporatisation. For further discussion, see eg Wettenhall 1995; 2000, pp 30-1.

4. At the time of this revision---October 2000---the value of the Australian dollar (A\$) has sunk to about US 53 cents, but for most of the 1990s it has been around US 66-70 cents.

5. This belief was abundantly confirmed when the magnitude of the crisis in the reinsurance business became apparent in 1999 (on this business, see next paragraph, next note and final section of this paper). Some of this lobbying history is recorded in Maiden & Ferguson 1999. No doubt those who were lobbying Greiner are now indulging feelings of the 'I told you so' variety!

6. A reinsurer is an insurance business which is prepared to insure other insurers against the possible adverse consequences to them of the first-instance risks they have insured. The essential international character of this business comes from the need to spread risks widely, beyond national boundaries.

7. In their critical review of Australian privatisations published in June 2000, Bob and Betty Con Walker (2000, p. 247) inferred that the government's demand for extra dividends directly influenced the build-up of high-risk reinsurance activity. In also suggesting (pp 247-8) that no one had questioned publicly what a state enterprise was doing 'punting taxpayers' funds on the outcome of [eg] Indian satellite launches', the Walkers were obviously unaware of Sturges's 1994 comment to be noted shortly.

8. Hurricane Andrew figures heavily in disaster insurance folklore. It resulted in an insurance industry loss of US\$15.5 billion and, together with the Northridge earthquake of 1994 (US\$12.5 billion loss), led to the failure of nine insurance companies. The next largest insurance industry loss associated with a natural disaster was then US\$2 billion, for Hurricane Hugo in 1989: Lewis & Murdock 1996, p. 570. However it is likely that the combined costs of hurricanes in the Caribbean, tornadoes in the United States and other disasters in the later 1990s have exacted an even greater toll on reinsurers.

9. In order to retain the public goodwill associated with the old statutory corporation and to assist in securing continuity in contracts and the like, the initials GIO were built into the name of the new company; but as it was destined soon to leave the public sector it was no longer permitted to use the fuller version of the old name (*Government Insurance Office*).

10. The first sale of shares in an Australian public enterprise by the public float method occurred a year earlier, when one-third of the shares in the Commonwealth Bank of Australia (which had just been converted from a statutory corporation to a company, thus creating a divisible shareholding) were sold. But this was done to provide the Bank itself with additional capital so that it could acquire the State Bank of Victoria, and so was not an outright privatisation. Its significance for privatisation was rather that it showed governments that there was a lot of money in the community to be attracted by such sales, so encouraging them to think of more sales which might attract funds in this way. A semantic oddity is created by the juxtaposition of two senses of 'public' in the context of these public-float privatisations: the public-sector sense of the collective ownership of enterprises by the state (ie the general body of citizen-taxpayers); and the private-sector sense of ownership by a fairly large group of investing members of the public. For one comment, see Wettenhall 1998b, pp 111-2, 119-22.

11. Since World War II, all income taxes in Australia have gone to the Commonwealth government. Public enterprises owned by state governments were exempted from this tax, but mostly---as with GIO---they made tax-equivalent substitution payments to their owning governments. A significant issue for state governments contemplating privatisation of their enterprises has therefore been that they will lose these tax substitution revenues while the Commonwealth will gain the company taxes to be paid by the new private owners.

12. This was Wettenhall's experience back in 1992. As a student of Australian public enterprise, he had wanted to share this new development fully. At first he simply assumed that he had been low on the priority list for sending out prospectuses because he was not a resident of NSW. But it soon became clear that the system established to process requests for the prospectuses was unable to cope with the huge demand.

13. Jocelyn has since explained (2000) that his 'vitrol' was directed primarily at the Ernst & Young report.
14. Walker was subsequently to assert that these 'high transaction costs'---rather than a low selling price---made this one of Australia's worst privatisations: Walker & Walker 2000, p. 247.
15. Initially Barclays de Zoete Wedd, BZW was the Australian branch of the investment banking division of Britain's Barclays Bank PLC (see BZW 1997). In late 1997 it was taken over by the Dutch bank ABN AMBO NV. Privatisation studies elsewhere show officials like Lambert and even government ministers who have presided over public enterprise divestments not infrequently moving to join such privatisation advocating and facilitating firms.
16. The companion case study of the privatisation of Canberra's Belconnen Mall deals with an enterprise which, after the sale, joined the Lowy empire.
17. Another view of the causes of 'this most spiteful of takeover battles' suggests that the GIO board had 'sealed their fate' when they effectively removed control of the reinsurance business from Jocelyn in 1995 and then appointed another American, Nick Steffey, who had worked with Trumbull in the early 1990s, as their new chief executive in 1998 (AFR 1999).
18. For some general reviews of these recent developments, see Bartholomeusz 1999; Hughes 1999; Maiden & Ferguson 1999; Mellish & Knight 1999a, 1999b, 2000; O'Riordan 1999.

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**APPENDIX: GREINER'S DIRECTION TO GIO CHAIRMAN**

## Chapter 7

### COMMONWEALTH SERUM LABORATORIES/CSL LTD

There are several particular points of interest in this case. The actual sale, coming soon after that of GIO, borrowed a good deal from that example. The enterprise being sold was not only widely regarded as being successful in public ownership but was also unusual in its combination of research and competitive commercial functions and its heavy involvement in public health policy issues. The sale was therefore particularly controversial, and it raised prominently the question of a government's preparedness to indemnify the new owners against major risks.<sup>1</sup>

#### Evolution in public ownership

##### *From branch of a department to statutory corporation*

CSL was established within the Quarantine Branch of the Australian Commonwealth's Department of Trade and Customs in 1916; it became a branch of the new Department of Health formed in 1921. The creation reflected First World War concerns about Australia's ability to obtain overseas supplies of antitoxins to meet domestic requirements. Based in the city of Melbourne, CSL quickly established an excellent reputation on the basis of successes such as the production of three million doses of influenza virus vaccine for the pandemic which swept Australia in 1918-19; soon it was internationally recognised, being selected in 1923 as one of four world establishments entrusted with large-scale preparation of insulin; and it played a prominent part in the development and production of penicillin in the 1940s and Salk poliomyelitis vaccine in the 1950s. Also in the 1940s and 1950s, it became associated with the Red Cross blood transfusion service, established serum fractionation facilities, and began producing blood products. Other achievements were in the development of vaccines for veterinary use, the supply of immunising material for use in mass campaigns against diphtheria, whooping cough and tetanus, and eventually, after protracted developmental work, in the production of antivenoms for use in the treatment of snake-bite and spider-bite.

To do all this, CSL had a 'two-fold purpose' (Cameron 1961, pp 1779-80). On the one hand, it had to produce and sell (involving, of course, commercial transactions) sera, vaccines and other bacteriological products. On the other, it had to conduct research related to such products. This conjunction had two major consequences. First, in 1961 the owning government, under Liberal Prime Minister RG Menzies, determined that this public enterprise should be

turned into a statutory corporation to operate more clearly on commercial lines. And second, its director at that time, Dr PL Bazeley, contested that decision in a very public way, creating what became a *cause celebre* in Australian public administration history: his actions attracted much attention to the issue of the right of a public servant to speak out in opposition to the government he was serving (eg Armstrong 1961; Gilbert 1961; Parker 1961a, 1961b, 1964; Brogan 1990: ch.13; Beauchamp 1994: 63).

A year before, a large American drug company had sought to buy CSL from the Commonwealth government.<sup>2</sup> But the government was swayed by evidence that CSL was ‘dear to the hearts of the Australian people’ and that ‘the public would have viewed [its sale] with the most vehement disapproval’ (CT 1961). So the Menzies government decided to commercialise rather than privatise, and prepared legislation to transfer CSL from the Department of Health to a new ‘statutory commission’ to be headed by a board comprising ‘two medical men of very wide experience’ and ‘three men of wide and appropriate experience in business and financial fields’ (Cameron 1961, p. 1781, and eventually Commonwealth Serum Laboratories Act 38/1961).

Bazeley was famous for his work in the development of penicillin and anti-poliomyelitis vaccine, and wanted to protect the research side of CSL’s work. He feared that the government’s proposal would have the effect of subjugating all research to commercial considerations. Having failed to persuade the government through internal public service channels, he ‘went public’, writing for the newspapers and talking to radio reporters and opposition members of parliament. Under Westminster traditions that was, of course, unacceptable behaviour for a public servant, and Bazeley was charged with breaching provisions of the Public Service Act and Regulations. He was demoted to the rank of a senior medical officer in CSL, with a corresponding pay cut. He took leave of absence, went to the United States to resume work with Salk (inventor of the polio vaccine), and later became attached to the University Hospital in San Diego.

His opposition did not thwart the government’s plan, and so CSL became a statutory corporation. But the issue raised by Bazeley’s protest was not stilled. Near the end of the 1960s, the Commonwealth parliament’s Joint Committee of Public Accounts described it as a ‘dilemma’, and reported that it would remain so:

until it is made clear that the Commission is to be regarded either primarily as a part of the public health service of the community with a section devoted to commercial activities or is primarily a commercial activity with limited government responsibility (JCPA 1969, p. 63).

The dilemma continued to produce casualties. Thus, in 1980, one of the organisation's prize-winning scientists who had recently developed the first anti-venom against the deadly funnel-web spider, but who was also pushing hard the research line, was suspended (Smith & Hanford 1980).

Nearly a decade after the Public Accounts Committee report, an Independent Inquiry established to review the corporation's purposes, functions, organisational structure, financial viability, research program, commercial operations and capital works program, devoted a chapter of its report to what it too described as 'the C.S.L. dilemma---national interest or commercial profit?'. The national interest component of CSL's functions was now stressed: the report concluded that 'there has been national uncertainty about whether C.S.L. should be primarily a profit-making commercial enterprise or part of the nation's public health service'. It wanted CSL to cover its costs on a user-pays basis wherever possible, but its general thrust was towards identification with the national interest. Thus the Commonwealth should fund *all* costs of directed national interest services, since requiring CSL to partly offset those costs from its trading profits was seen to disadvantage it in what had become a highly competitive market, and all restructuring that did not recognise the value of CSL's contribution to national security should be resisted. This contribution included 'the reserve value of the trained and dedicated staff' and the 'proud record' of the organisation; a 'great expansion in regulatory agencies' would be required if it were in any way diminished (Nossal & Reid 1978, chs 3, 10).<sup>3</sup>

Amending legislation followed in 1980, seeming to accept most of the Nossal-Reid recommendations: CSL's commercial activities were distinguished more clearly from its national interest activities, and it was enabled to produce non-biological as well as biological pharmaceutical products---biological products represent the least profitable segment of the pharmaceutical industry (Commonwealth Serum Laboratories Amendment Act 7/1980).

Through the 1980s the national interest activity remained significant. Notably Commonwealth funding was made available to CSL for research into the new problem of identifying and treating AIDS/HIV. By now, however, over 80% of its sales were coming from products which faced strong competition. It won awards for exports to some 80 countries, and signed licensing and distribution agreements with pharmaceutical manufacturers in Britain, the US, Italy, France and Denmark. But CSL was facing difficulties in competing and in achieving good financial performance, and increasingly it protested to the owning government about these difficulties. On the one hand, government decisions sometimes favoured overseas vaccine suppliers (CSL asserted that only it could ensure the supply of vaccines composed of strains matching the disease strains circulating in Australia); on the other, it was constrained by the tying of its

superannuation arrangements to the public service system, by a profitability limit on products sold, and by restrictions on its ability to enter joint equity ventures or to acquire property for business growth purposes (see eg Forbes 1981, pp 5-7; Robbins 1986a, 1986b).

In 1985 the Hawke Labor government made some changes to the enabling act, *inter alia* clarifying and expanding the powers of the commission to form subsidiaries and enter commercial relationships, allowing greater flexibility in the use of plant and equipment in responding to changes in technology and market opportunity, and removing the requirement for Public Service Board approval for terms and conditions of staff employment. A year later, when the long-term problems of blood testing were being more clearly appreciated and Australia was beginning to think of itself as part of the Asia region, the decision was taken to establish under CSL management 'the best blood plasma processing plant in the world and [to] make it big enough for the demands of not only Australia, but the whole region' (Gottliebsen 1993, p.26; also Robbins 1986b). These changes removed some of the ambiguities and constraints which had hindered CSL's commercial and technological development. But they were a mere preliminary to a bigger change in 1990.

#### *Conversion to the company form*

From the late 1980s, the Commonwealth was coming to favour the organisational form of the government-owned company over that of the statutory corporation for managing public enterprises, especially where there were few if any community service obligations (CSOs).<sup>4</sup> The change reflected the hardening view that public enterprises must operate unambiguously according to, and be judged by, commercial standards; in accordance with this view, CSL was scheduled for conversion along with other public enterprises such as a domestic airline, the national shipping line, the engineering-consulting corporation which grew out of the Snowy Mountains hydro-electricity and irrigation scheme, the Commonwealth Bank and the public service superannuation investment trust. The Commonwealth Serum Laboratories (Conversion into Public Company) Act 77/1990 authorised this change, though there was a rub: CSL did have substantial CSOs, represented by its complement of 'national interest' responsibilities.

The act provided for the reconstruction of the organisation as a fully government-owned company, Commonwealth Serum Laboratories Ltd (formally shortened a year later to CSL Ltd), with its memorandum and articles of association registered under standard company registration procedures. The Minister for Community Services and Health would be the sole shareholder with power to appoint and dismiss the board of directors and to issue guidelines

to the board, which would be required to provide a three-year corporate plan defining the company's goals, financial targets, and strategies to achieve those goals. CSL's assets would be consolidated by transfer to it of remaining land and buildings vested in the Commonwealth. However a division of shares into classes allowed the Commonwealth to have special rights in relation to the existing serum fractionation operation (a 'national interest' function) and the sale of CSL land, and the community service (or national interest) functions would be further regularised under a formal contractual arrangement with the Commonwealth.

A new chief executive, Dr Brian McNamee, was recruited from a private Adelaide-based pharmaceuticals firm, and the board was renewed over the next two years with the chairman and other members coming from established private companies including accounting and consulting firm Price Waterhouse. The financial press reported exchanges between new chief executive McNamee and Minister for Health Brian Howe about the future of the organisation. Apparently Howe sought the management's view about its own future, and the management took that as an implied threat to privatise, explaining that people in government businesses were now asking 'My God, how can we survive?', observing that the 'survival mentality is a very destructive force in any company' and adding:

we have been able to demonstrate to Howe and the rest of the Government that [CSL] has a very good asset base, a good company with good growth prospects. It was not so long ago that the Government was not confident that it had an asset here. It has come almost as a shock to them (reported Stevens 1992, p. 28).

By now others were declaring that CSL was the 'best government enterprise', a distinction gained in the 1991 'Top 500' businesses survey conducted by Deloitte Ross Tohmatsu.<sup>5</sup> Reporting this, *Australian Business Monthly* commented that the conversion to company status had meant the end of 'soft' government money and that in consequence a new business program had been established. McNamee told reporter John Arbouw that the Labor government had 'pointed out to us quite correctly that we were an endangered species and that we didn't have a God-given right to exist'. That, he said, had 'really shocked the organisation' (Arbouw 1991).

A few months later merchant bank Hambros Australia's executive director David Williams described CSL as the 'jewel in the crown' of privatisation candidates because it was profitable, had significant potential to expand, and had done most of the 'cost trimming needed to bring the company to market' (reported in Smithers 1992). The strange implication was that, because it had these characteristics, it did not belong in the public sector! But it had already been listed in the federal Opposition's list of privatisation targets. Now McNamee matched Williams's observations by suggesting that location in the

public sector had significant disadvantages *for CSL*, particularly the constraints on raising new capital (also Smithers 1992). Much later, in their general criticism of Australian privatisations, the Walkers would point out both that the Commonwealth did outlay much new capital at this time on CSL-related facilities and the privatisation advocates were not expressing much concern *for the interests of the community* (Walker & Walker 2000, pp 235-6).

As we have seen, CSL was not only a profitable operation in both its later statutory corporation years and its first three government company years, but also enjoyed a high scientific reputation based on much excellent work over more than 70 years in developing, producing and distributing new vaccines and serums to secure the good health of Australia's human and domestic and farm animal populations.

#### *'Sleepers' in CSL's history*

But there were some dramatic 'sleepers' in its history which were to cause considerable embarrassment just as firm proposals emerged for its privatisation. One related to its developing blood fractionation technology; another flowed from its production of hormones and other forms of treatment in a number of very sensitive and, to a degree, experimental areas of health management.

Both were the subject of studies published in 1994. The first, by the Australian Blood Regulators Study Group, reported that the Red Cross discovered in 1985 that CSL had been bringing foreign blood products into Australia since the 1960s and mixing them with the local plasma supplied by it. This practice, it believed, not only posed grave health risks but also placed Red Cross itself in breach of its legal duty of care to the users of its blood; and the report urged much closer regulation by the Commonwealth government (Beauchamp 1994).

The second concerned the relationship between the use of hormones derived from the pituitary glands of dead people extracted during autopsies (and sometimes imported into Australia) and Creutzfeldt-Jacob disease or CJD. CSL had begun producing these hormones in the 1960s and distributing them to medical practitioners for use in the treatment of infertility in women and of stunted growth in children. It was not until much later that a direct connection was established between the onset of this always-fatal disease and the administration of the pituitary gland hormones; the CSL program was discontinued in 1985, when the risks were clearly identified. A considerable number of Australians had already received this treatment, but the virus was slow-acting and the first CJD death of a recipient of the CSL-produced hormones did not occur until 1988. Others followed, and damages claims had begun to be lodged against the Commonwealth by relatives of the afflicted people (Allars 1994; see also Coulter 1995 and Cooke 1998a, 1998b).



Both inquiries were under way and gathering notice as plans were being developed for the sale of CSL. They drew special attention to the related matter of indemnities already provided by the Commonwealth to CSL. In September 1987, for example, indemnities had been provided for claims arising from certain CSL products including AIDS-related claims from its blood plasma products. Between 1989-90 and 1994-95 the Commonwealth in fact outlaid \$28.6m in settlement of HIV-AIDS claims ‘for reasons of public policy’, covering all CSL’s and 40% of the Red Cross’s proportion of settlement amounts (ANAO 1995, pp 28-33). By this time the working out of the sale arrangements was well under way, and not surprisingly this question of indemnities assumed critical importance as they were being developed.

### **The sale process**

#### *The decision to sell*

The Finance Ministry announced the decision to sell CSL, along with the Snowy Mountains Engineering Corporation (SMEC), in the 1992-93 budget papers (Dawkins & Willis 1992, p. 3.279). It has been shown elsewhere that, from early in the period of the Hawke government, the small-government ‘rhetoric and ideas of the Department of Finance’ had been influencing Labor ministers towards the privatisation of many Commonwealth enterprises (Simms 1986, p. 32).

Sources tapped by the Australian Blood Regulators Study Group inquiry indicated that the sale of CSL was first proposed to the Estimates Review Committee of cabinet and then to cabinet itself by the Health Department and that the proposal was ‘strongly backed’ by the CSL management, but that thereafter the issue was largely taken over by the Department of Finance. Consultation with stakeholders was very restricted because CSL ‘had agreements with forty-six companies including internationals’, and ‘its commercial interests had to come ahead of accounting to the Australian people’. The author of the Blood Regulators report asked why it had to be sold, and got an answer in several parts (Beauchamp 1994, pp 316-21):

\* The general political climate favoured privatisation, and government was learning that it could recoup some budget losses and fill some budget holes that way.

\* Though ‘no one in Government ... thought that CSL was inefficient’, there was concern about the ‘incongruity in Government being CSL’s owner, customer and regulator’.

\* CSL itself ‘wanted to be sold’: one of its officials told the investigator that it had ‘had a gut full [*sic*] of Government interference, of restraints on raising money, and being told what to do in the R&D area, and thinks it can compete’ in the private sector.

As we have seen, CSL had a new chief executive and several new board members imported from that sector. ‘On the face of it’, this investigator reported, ‘CSL stood to gain far more from the sell-off than did Government and some of its gains were at Government’s considerable expense’. Nonetheless she was uncertain whether the government was selling to investors ‘a pup, a pig, a bargain or the crown jewels’.

One serious economic analysis (Hamilton & Quiggin 1995a, pp 3, 8-10) offered a heavy qualification to the argument that CSL was able to operate commercially and competitively under market conditions. It asserted that ‘it would be difficult to imagine a market in which there was less scope for the play of market forces’. On CSL’s production of blood products:

there is no commercial market ... in Australia; the sale of blood is prohibited by law ... the supply of freely donated blood, in which even the costs of collection are met by taxpayers, represents a massive cost saving for CSL [and has been] the primary factor in allowing [it] to supply blood products at around 30% of world prices ... CSL’s sole customer for blood products is the Australian hospital system supplied by the Commonwealth through its contract with CSL.

The connection between CSL and the government was intricate and many-sided, and it ‘remains for most practical purposes a regulated monopoly, with the rate of return being determined by the Commonwealth Government’. The clear implication was that continuing public ownership was much more appropriate for *this* enterprise.

Given that the government was determined to sell, it was inevitable that some special conditions should be included in the sale arrangements. The drafting of these conditions turned out to be one of the major challenges of this particular sale process. Indeed, some major steps were taken before the sale to ensure that the conditions would be satisfied and at the same time to ‘sweeten’ the deal for prospective purchasers.

#### *Legislating and ‘sweetening’*

The Department of Finance had already established a Task Force on Asset Sales to handle sales of government assets. Now Task Force on Asset Sales B was set up to manage the new tranche of sales. Financial consultants were quickly engaged to undertake a two-stage ‘scoping study’ of CSL. The first-stage report, acknowledging a government-imposed restriction on foreign ownership and the likelihood that there were few possible Australian trade bidders, recommended that sale should be by public float. This was quickly decided and announced by the relevant ministers on 9 November 1992: it would be the first 100% offering of shares by the Commonwealth by this method (ANAO 1995, pp 8-9).

Going the float route meant that this sale would be part of the movement towards achieving ‘a peoples’ capitalism’ which emerged as an important part of Thatcher’s privatising ideology in Britain. Australia joined this movement with the mass appeal to potential buyers among all the ‘mums and dads’ featured in the Commonwealth Bank tranche sales and in that of the New South Wales Government Insurance Office (GIO) in the early 1990s.

A quite detailed account of the procedures followed in the preparation and conduct of this sale is available in the Performance Audit report prepared by Commonwealth Audit officers Victoria Walker and Colin Cronin (ANAO 1995), and there is space for only a brief summary here.

The second stage of the scoping study involved a detailed analysis of CSL’s ‘financial, managerial and operational performance, ... including an indicative flotation valuation, recommendations for sale timing options, and an implementation plan’. The initial advice was that the government could expect to receive between \$347m and \$422m, but that estimate subsequently had to be downgraded. The advice was also that cessation of existing indemnities would have an adverse effect on the flotation value (ANAO 1995, pp 8, 21, 29).

The Task Force then established three working committees (steering, due diligence/prospectus, and marketing/logistics), for each of which CSL and the Task Force provided joint chairs. And a small army of consultant business advisers and legal advisers was engaged. While CSL had its own legal advice, it did not employ separate business advisers; the Performance Audit team reported that this ‘absence of duplication appears to have contributed to an effective working relationship between CSL and the Commonwealth agencies involved in the sale process’ (ANAO 1995, pp 2, 4, 8-9).<sup>6</sup>

Major issues for the preparatory committees were the drafting of legislation prescribing the conditions of the sale and the entering into of agreements relating to the continuation of CSL’s national interest functions and to the issue of those Commonwealth indemnities. Reporting the identification in parliament of matters the indemnities were intended to cover, one journalist drew attention to a ‘stream of writs’ which had been lodged during 1993 ‘for damages arising from CSL products’, commenting: ‘if they are successful, it is the taxpayer who will pay most’ (Cooke 1993). The Performance Audit report would eventually criticise the various indemnity provisions on two grounds: they were not brought specifically to the attention of cabinet, and there was no actuarial study to quantify the Commonwealth’s potential liability (ANAO 1995, pp 30-2).

The Sale Bill was presented to parliament on 29 September 1993 (Johns 1993, pp 1344-6). It contained a series of detailed provisions designed to ensure the

continuation of CSL as an independent company under Australian control, the continuation of blood product supply to the Australian community in the national interest, and the protection of staff entitlements. Accordingly there were injunctions about what should be included in the company's articles of association after the sale: these included requirements that the head office and the blood fractionation facilities must 'always be located in Australia', that CSL must remain incorporated in Australia and that two-thirds of its directors including the presiding director must be Australian citizens. There were other requirements eg that CSL must maintain a register of foreign-held voting shares (there was to be an aggregate beginning limit of 20% on foreign shareholdings), that it may not dispose of its blood fractionation facility without the consent of the minister, and that there would be a formal contract between CSL and the Commonwealth relating to the production and supply of blood products derived from plasma collected from Australians (CSL Sale Act 88/1993). An immediate conclusion must be that there can be few public enterprises being prepared for divestment anywhere in the world subjected to so many ongoing constraints by the selling government.<sup>7</sup>

Passage of the legislation was seriously contested only by the Australian Democrats, although the impression is strong that many members felt they were simply being swept along by the climate of the day. Thus one Labor MHR who had initially opposed the sale could see no point in extending that opposition to a vote against the sale bill: 'when I look round I do not seem to see too many fellow travellers, so I have to accept that the inevitable will happen' (Jenkins 1993, p. 2638).

In December 1993 the Commonwealth took several actions which had the effect of 'sweetening' the deal for private investors by ensuring a substantially improved revenue flow to CSL. Thus it entered into two contracts with the enterprise for the supply of blood plasma products for the Australian health system. Indemnities for product liability claims were included in both agreements, which were extendable by further contract. Then there was an Indemnity Agreement formalising and to a degree extending the earlier indemnities granted for some other CSL products, notably covering any potential claims arising from the pertussis vaccine used in whooping cough treatment, from the pituitary gland growth hormone which could transmit the fatal CJD, from AIDS and hepatitis contracted from blood products, and from asbestos-related disease. And the Commonwealth transferred to CSL the blood fractionation plant which it had built in exchange for more than 50 million ordinary CSL shares (intended to recoup it for construction costs), in order, in the words of the Department of Finance, 'to enhance the saleability of CSL because it would reduce CSL's gearing substantially and make it more attractive to investors'. The Performance Audit report indicates that another \$51m 'in

transition funding' related to the new fractionation facility was provided by the Commonwealth. Yet another late-1993 agreement assured CSL of continued Commonwealth funding of \$300,000 per annum (indexed) for ongoing national interest work in ensuring the availability of appropriate and effective influenza vaccines (ANAO 1995, pp 17-8, 30-2, 36, 39-40, 42, with Dept of Finance advice quoted at p.40; also Beauchamp 1994, pp 322-3).

In the event delays in completing and commissioning the fractionation plant delayed the sale itself; when it eventually took place, the share market was falling, although the government had one month to spare in realising its aim of completing the sale in the 1993-94 financial year (ANAO 1995, p. 17).

### *Selling*

The decision to sell had been announced in the 1992-93 budget papers; in March 1994 the Minister for Finance was ready to approve details of the flotation strategy. There would be 130 million shares, the total divided into three parts: the largest reserved for retail (general public) and broker clients, with a minimum of 1,000 shares per client; a minimum allocation of 35% of the issue reserved for institutions and brokers; and 2% of the issue reserved for CSL employees, in respect of whom the CSL board had already designed a General Employee Share Ownership Scheme. No single buyer could get more than 5% of the total stock, and there was a maximum foreign allocation of 20%.

A cap price (\$2.40 per share) was set for the first part; for the second part there would be a 'bookbuild' process under which bids would be made before prices were determined, within a 'constrained offer' price system within a predetermined range (\$2---\$2.40), 'the market' thus affecting the eventual price, with a minimum of 50,000 shares per bid. The Asset Sales Task Force had given close consideration to the merits of underwriting the float, a process which provides insurance against the risk that not all shares will be sold. However it eventually advised against this because the additional cost to government would have been between \$2.25m and \$3m and because the 20% price range provided some flexibility to absorb market movements while the offer was open; in announcing the sale strategy, the minister indicated that he had accepted this advice (ANAO 1995, pp 7, 17, 19-21).

The drafting of the prospectus had proceeded while this strategy was being worked out, and the draft prospectus went to the Australian Securities Commission (ASC) for 'pre-vetting' early in April 1994. The final version was signed by the CSL board and the Minister for Finance on 15 April (ANAO 1995, pp 11, 25; *Prospectus* 1994). There were public/retail, broker/institutional and overseas marketing campaigns.

The sale plan was criticised on several grounds. The *Australian Financial Review* reported that ‘every major broking house’ had recommended that the issue be underwritten and that, given the plunge in share prices, the Task Force could not have chosen a worse time not to appoint an underwriter (Ries 1994). And Blood Regulators Study reporter Beauchamp (1994, pp 333-6) expressed serious criticism on two grounds: first, that the matter of the risk involved in the production of biologicals was not mentioned until page 91 of the *Prospectus*, and that it ‘slides around’ the issue of the availability and use of foreign plasma; and second, that in the run up to the sale CSL employed an external public relations firm ‘which held media at arm’s length from CSL [itself]’, and that mostly the media followed ‘the Government line at the time’ in presenting CSL as ‘a good sale prospect’ or [following Williams, as noted earlier] as ‘the “jewel in the crown” of privatisation candidates’.

*Business Review Weekly’s* Gottliebsen (who had earlier expressed serious reservations about the GIO float) was surprisingly positive. Because of its purely voluntary blood collection system, the quality and controls of Australia’s system are much superior to those of the US and Europe, and CSL has been very careful, he wrote; if it can now make a success of the new blood product facility, ‘shareholders will do well’ (Gottliebsen 1993, pp 26-7). Beauchamp (1994, pp 335-6) assumed he was unaware of the indemnities relating to the CJD hormone, blood products and plasma-mixing.

Beauchamp’s report makes it very clear that officials of the government and of CSL regarded her as a serious nuisance as she persisted in asking her questions as they were preparing the float; Senator Coulter subsequently referred to ‘the whispering campaign of lies about the author of that report that had been seeded in Parliament House and in the financial sector’ (1995, p. 221---see more below). But her questions were serious ones, well worth asking. Her analysis convinced her that the float was a bad deal for the Commonwealth and its taxpayers (Beauchamp 1994, pp 316-9).

The float ran according to plan from 2 May to 27 May. The public offer was marginally oversubscribed; the institutional offer did better, being ‘significantly oversubscribed with strong demand from broker-sponsored bids, medium-sized domestic institutions and foreign institutions’ (ANAO 1995, p. 16). A few days after the close, the government announced that it had decided to issue all shares at \$2.30, compared with the set cap of \$2.40, thus forgoing \$13m of possible revenue. An early press report said that this was done in order to ensure a positive privatisation experience and to give the forthcoming \$2 billion Qantas issue the best chance of gaining retail support---‘a \$13 billion investment in the climate for the Qantas float’ (Bartholomeusz 1994). Reasons

advanced officially to the Performance Audit team were that the discounting would ‘provide a premium to investors; establish an orderly secondary market; create an ownership base of long-term shareholders; and send positive signals to the community for forthcoming asset sales’ (ANAO 1995, p. 22).

Some 37,000 retail investors took 62% of the shares, 124 Australian and overseas institutions took 37%, and 1,050 CSL employees took 1%; foreign institutions had taken the maximum 20% they were allowed. Applicants who subscribed for up to 3,000 shares got their allocation in full, with ‘scale-back’ of higher bids. Gross proceeds from the sale to the Commonwealth were \$299m, against which the Performance Audit team identified costs of \$9.2m (or 3% of total proceeds), which included Task Force salaries and administrative costs of \$1.1m, Commonwealth legal fees of \$1.8m, business adviser fees of \$1.4m and selling and float management costs of \$2.7m (Bartholomeusz 1994; ANAO 1995, pp 5-6, 21, 23). The Task Force on Asset Sales B reported that the ‘[g]ross sale proceeds of \$299 million were subsequently credited to Consolidated Revenue’ and that ‘[t]ransaction costs involved approximately two percent of total proceeds’ (DOF 1994, p. 119).

### **After the sale**

#### *Expansion and increase in value*

The privatised company has seized several opportunities to expand into new areas. Within months of the float, it had acquired the assets and business of a US cell culture manufacturer and marketer, a majority interest in a Swedish company with global rights relating to a vaccine response enhancer, and a new veterinary viral vaccine plant in Wellington, New Zealand. Also it became the exclusive Australian distributor for the products of a US ortho diagnostic systems manufacturer; entered a 10-year agreement with Australian Red Cross for the supply of plasma to CSL and for the distribution of fractionated products; and launched several new pharmaceutical products of its own (CSL Ltd 1994, p. 2). Two years on from the sale, an Australian Industry Commission report on the pharmaceutical industry described CSL as ‘one of the largest and most highly integrated pharmaceutical companies in Australia, employing around 1350 people’ (IC 1996, p. 26).

But the expansion continued. Over the next two years it entered into other collaboration, licensing and distribution agreements with companies in France, Italy, Poland, Canada, the US and elsewhere (CSL 1995, 1996, 1997). Then in 1999 came a highly publicised deal with American Red Cross to develop a rapid blood-clotting bandage (Gosch 1999)---followed in 2000 by the acquisition of the plasma products division of the Swiss Red Cross, a deal

claimed to have ‘burst open the door to the plasma products market in the US’ (Wood 2000).

There has been a fairly steady rise in profitability since the float, exceeding the profit forecasts in the sale *Prospectus* and in part reflecting the expansionary activity since that time. However, since the enterprise also returned profits and was generally regarded as efficient in the earlier period, this demonstrates a healthy continuity over the public and private ownership phases and not in any sense a dramatic break with the past, or a reversal of fortune. It is likely, of course, that the opportunities for expansion have been enhanced by its freeing up from government ownership and from the restrictions associated with that ownership.

Since the sale, however, media attention has focused more on the dramatic increase in CSL’s share value than on its expansionist activity. A 1977 report by leading brokers JB Were and Son indicated that the average share price gain over 16 ‘major floats’ since 1993 was 77%, but that CSL did far better with a gain of 263% over those three years (Were 1997, pp 1-2). The impact on share values of the American and Swiss Red Cross deals was too recent to have been built into that analysis. A day after the first of these arrangements was announced, however, the share values ‘surged’ by a further 26%, adding \$440m to CSL’s market value and representing a seven-fold increase for the original investors who participated in the privatisation five years before. A leading asset management firm official then declared: ‘it’s been the best of the (Australian) privatisations by a stretch’ (reported in Hughes 1999).

Best for whom is, of course, an important question. In their general critique of Australian privatisations completed after the US but before the Swiss Red Cross CSL deals (when the shares were trading at around \$23), the Walkers calculated that the value of this enterprise at 31 December 1999 was \$2.9bn, representing a \$2.6bn profit to the private sector on the near-\$0.3bn paid in mid-1994. In the sense of loss of value to the public sector, it was probably ‘the winner’ among all the Australian privatisations; on those late 1999 prices, the Walkers also calculated that share options given to CSL Managing Director McNamee, that ‘most vocal advocate’ of privatisation, would have delivered an entitlement worth \$13.8m---a ‘handy bonus’. For the Walkers, all this made the CSL divestment one of the worst privatisations---compounded by the fact that the Commonwealth retained exposure to claims for product liability under the indemnities granted (Walker & Walker 2000, pp 24, 224-5, 234-40).

At the end of year 2000, the value of a single CSL share stood at \$39.06 (Were 2001, p.4)---compared with \$2.30 at point of sale!



Movement since the sale within the total initial package of 130 million shares is as indicated in Box 1. Consistently with patterns observed in other public floats of this

### **BOX 1: SHAREHOLDER MOVEMENT**

[Source: CSL Ltd 1994, 1995, 1996, 1997, 1998, 1999.]

Date of compilation	Total no of shareholders	No of shareholders with 5,000 shares or less	No of shareholders with over 10,000 shares	Per cent of shareholders with over 10,000 shares	Per cent of shares held by shareholders with over 10,000 shares	Top 20 shareholders: per cent of shares	Top 20 shareholders: total no of shares held by them
30.8.94	35,873	33,910	592	1.650	45.72	33.08	42.96m
25.9.95	31,189	29,396	553	1.773	53.00	37.87	51.52m
30.8.96	29,035	27,297	548	1.887	56.46	36.15	51.24m
29.8.97	27,528	25,909	532	1.933	60.61	40.56	53.24m
31.7.98	27,237	25,695	520	1.908	62.53	42.37	57.64m
30.6.99	27,921	26,418	504	1.805	63.18	40.56	51.40m

Note: The total no. of shares at time of float was 130,000,000; this had grown to 131,652,084 at 30.6.99.

kind, share ownership has consolidated in the hands of the larger investing institutions. The number of individual shareholders decreased by over 20% in five years' trading: while that number remained reasonably large at almost 28,000, just 1.8% of those shareholders held over 63% of the shares; the largest investors were almost all bank, insurance, and superannuation funds.

A feature of the float was that the foreign ownership restriction did not apply to secondary trading after close of the primary share offer, though the company was required to monitor foreign trading. Annual reports of the privatised CSL certify that there are no significant foreign shareholdings (eg CSL 1996: 56).

### **Controversies**

#### *Research involvement*

CSL functions in an industry where ongoing research is of vital importance, as recognised long ago in the forceful contribution of the somewhat quixotic former Director Val Bazeley. However the commercialising and corporatising of the organisation during its public ownership period seemed to some to involve rejecting this proposition. Thus, immediately after privatisation, Professor Straun Sutherland, suspended from CSL 14 years before and now described as 'Australia's foremost anti-venom scientist', protested that privatisation was 'threatening vital anti-venom research' (quoted in Norman 1994). A year and a half later, the Alfred Hospital's Dr John Weiner

complained about the lack of funding for the development of a venom extract to protect:

Fifty thousand people living in rural southern Australia ... at risk of death from extreme allergic reaction to ant stings ... A few years ago, the task of making a desensitising agent would have been given to the Commonwealth Serum Laboratories, but that had now been privatised ... The pharmaceutical companies aren't interested in producing [such an] agent (quoted Cribb 1996).

Senator Coulter complained (see below) that CSL's anti-venom production was 'cast off shortly following the sale' (Coulter 1995, p. 221).

The conclusion many drew was that a profit-seeking company would invest in research only where very large at-risk populations were involved. Thus a university biochemical scientist reports:

I don't know a lot about CSL privatisation except that it's now impossible to get collaboration with them. They used to have their finger in many biotechnology projects within the university sector but their new corporate culture demands that they focus on only three or four projects [which] are substantially conducted in house (Collyer 1998).

The privatised CSL nevertheless presents itself as a big researcher. It has maintained one division focusing on 'research and development' (R&D), with this effort now supported from the government's R&D assistance budget. A year after the sale, CSL reported that it had been named the leading company in terms of total R&D expenditure in the Australian pharmaceuticals industry and 14th highest of all Australian companies in respect of total R&D expenditure (CSL 1995). An industry bulletin confirmed that it was the pharmaceutical company 'spending the most on research' in 1994-95 (*PBN* 1995b, p. 17). In 1995-96, CSL reported that it spent more than \$30m on R&D, retaining its position as the largest R&D investor in the Australian pharmaceutical industry and rising to 10th position among all Australian companies (CSL 1997).

### *A management under siege*

Clearly, CSL's management got most of what it wanted from the sale. But it was also very much a management under siege. While the sale was in progress, and during the settling-in period that followed, five serious inquiries or critiques focused on the organisation itself and/or the sale conditions. Only one---the audit performance evaluation---could be regarded as 'par for the course' for a Commonwealth privatisation. Two focused mainly on health issues and two on economic or accounting issues, while the fifth was a wide-ranging digest of all the problems.

The Blood Regulators Study was well under way before the float was decided, so that its commentary on the divestment itself was a late addition to the study's main purpose and came very soon after the sale was completed. The strong

official opposition to this inquiry and the principal investigator's conclusion that the sale was a bad deal for taxpayers have already been noted. To give a net result, she deducted from the proceeds (\$299m):

six million for the cost of selling the authority, ... one hundred and seventy to one hundred and eighty million put into the new blood processing plant, ... twenty million a year in forsaken lease payments and ... annual dividends from CSL's business. [Then mildly:] Government also had to declare some indemnities... (Beauchamp 1994, pp 318-9).

Though it was not an official document, Senator John Coulter, a member of the small Australian Democrats party, tabled this report in parliament in October 1994, and during estimates hearings in November two other senators asked upwards of 40 questions mostly derived from it. These questions exercised both CSL and the Department of Human Services and Health over the summer months, and their answers were provided on 9 February (SCALC 1995). There were also direct statements from CSL and the department (CSL 1995; DSHS 1995). Though mixing of blood plasma from many sources (as claimed by the author of the report) was admitted, the answers asserted that only mixing for the production of clotting factors carried risk, and that this practice was stopped in 1984 as soon as the risk was understood; other mixing was subsequently discontinued. Most would no doubt have been satisfied by these reassurances. But Coulter, himself a medical professional, was soon to make it clear that he was far from satisfied.

The second health-related inquiry, commissioned by the government and conducted by Margaret Allars, described as 'an administrative law expert from the University of Sydney', focused on the issue of pituitary-derived hormones and CJD. As journalist Cooke digested it, the resulting report demonstrated that 'laws had been bent, ethics ignored, corners cut, red tape avoided and dead bodies ... unlawfully raided for pituitary glands' (Allars 1994; Cooke 1998b, pp 229, 248), and CSL got its fair share of these criticisms. By the time of the sale there had been several deaths, and hundreds of others who had received this hormone treatment had organised to seek redress; several writs had already been taken out, joining the Commonwealth and CSL as defendants (Coulter 1995, p. 247).

The third inquiry, and main economic critique, was that of Clive Hamilton and John Quiggin from The Australia Institute think-tank. Their conclusion was that this privatisation was 'a fiscal scandal'. In their view, 'one of the best-performing Commonwealth business enterprises' was sold in a way that 'raises some larger questions about public accountability and the extent to which the Commonwealth Public Service can be relied upon to protect the interests of the public'. Their summary extracts many of the main features of the account here presented, but pushes on to a longer-term evaluation that leads them to their highly critical conclusion:

To support the sale the Commonwealth entered into a new 10-year contract to buy blood products for an annual fee more than twice as high as in previous years. In addition, the new owners have been indemnified against AIDS-related and other claims arising from the use of blood products manufactured by CSL in the past.

Apart from a brand new tax-funded fractionation plant valued at two-thirds of the sale price, the main fiscal impacts of the sale are twofold. The public sector will forego a minimum of \$20 million per year in profits, and taxpayers will have to find an extra \$50 million per year in additional payments for blood products.

Allowing for depreciation, the Institute's analysis shows that the sale of CSL will result in an additional annual expenditure by the Commonwealth of \$45 million. After a little over six years, the \$299 million proceeds of the sale will thus have disappeared and each year thereafter taxpayers will be \$45 million worse off as a result of the sale (Hamilton & Quiggin 1995b, drawing on fuller analysis in 1995a).

The fourth inquiry, the performance audit conducted by the Australian National Audit Office (ANAO), has already been noted for its useful description of aspects of the sale process. It identified the costs of sale to government as higher than Beauchamp's estimate (\$9.2m, in its view not excessive for a float of this kind); it also identified other costs associated with the new blood processing plant, lifting the total Commonwealth outlay to \$201m; and it too was critical of the way in which the issue of indemnities had been handled. In particular, it questioned two Commonwealth decisions: to transfer ownership of the fractionation plant to CSL rather than to lease it to the enterprise with a resulting regular income stream; and not to include a 'clawback' option to give the Commonwealth some later return should CSL make significant gains from future dealings in property redevelopment, as had occurred with a number of British privatisations. Here the Department of Finance disagreed, arguing that transfer of the fractionation plant had enhanced the saleability of CSL and that, in respect of clawback, it was better to 'capture' all such potential gains at point of sale and so avoid future complicating transactions (ANAO 1995, pp 40-1).

Another ANAO report under preparation used the CSL sale as a lead example in its concern about the government's risk management practices.<sup>8</sup> And *Sydney Morning Herald* journalist Jennifer Cooke now described the 'scope of the indemnity' to CSL as 'unprecedented in the asset sales of former government-run institutions' (Cooke 1998b, p. 258). A subsequent report by the parliamentary Joint Committee of Public Accounts indicated that CSL had been trying for many years to obtain commercial insurance cover to mitigate the risk to the Commonwealth through all these indemnities. It had obtained limited cover for hepatitis claims but failed to get cover for past employees exposed to asbestos fibres. As this report was being finalised, the insurers agreed to provide cover of \$49m for HIV/AIDS contracted from blood products, subject to the insuree paying the first \$1m of any claim. From the taxpayers' point-of-view, however, there was still a sting: the Commonwealth is contractually obliged to pay the premiums for these CSL insurances (JCPA 1997, pp 20-1).

Senator Coulter now provided the fifth major critique. He conducted his own review of the issues and presented his findings in a speech spread over six Senate adjournment debates between May and August 1995. In essence, he directed his remarks to both the blood plasma mixing and the pituitary gland hormone issues, and suggested that processing errors and lack of quality controls in CSL amounted to negligence---much more than acting with good intent but in ignorance of side-effects. The sale process had therefore been flawed because buyers did not know what they were getting into, past judicial proceedings had been starved of adequate information, and it was grossly unfair that the present CJD litigants should be saddled with the legal costs of sorting out the mess. Claiming he had himself been subject to intense lobbying by CSL and the department---which convinced him they had much to hide---he sought a full parliamentary inquiry. He was further incensed when then-opposition (Liberal-National Party) members refused to support him; they had explained, he said, that such an inquiry would adversely affect CSL share prices, and so in his view totally confirmed the primacy of commercial over public-interest considerations (Coulter 1995).

At the end of this speech in several parts, Coulter asked Senator Peter Cook, Minister for Industry, Science and Technology, whether he accepted the Hamilton-Quiggin analysis. The minister replied by reading out a statement prepared by the Department of Finance, arguing that the analysis was 'seriously flawed' because it failed to take into account either the risks that would exist even if CSL had remained in Commonwealth ownership or the multiple objectives a government is required to meet in any major asset sale (Cook 1995, pp 1905-6).

Over the period of the sale CSL found itself, along with the Commonwealth, instructing lawyers to defend it against the writs issued by the pituitary gland hormone recipients, and much negotiation ensued between the contending parties. It had become clear that the indemnities would not apply if liability were found to arise from deliberate or reckless action endangering the health and safety of human life (SCALC 1997, p. 27), and this would be one of the issues in any litigation. Eventually arguments such as those presented by Coulter and by journalist Cooke, who was completing a book on the CJD affair and had much sympathy for the victims (Cooke 1998a, 1998b), prevailed. Already the Commonwealth had made available a \$10m package to meet some of the recommendations of the Allars report, and a settlement was reached with the families of some hormone recipients who had died of CJD. But between 1993 and 1997 more than 100 new court actions were begun, alleging that knowing the possibility of contracting CJD at some future time had caused nervous shock.

Again the Commonwealth and CSL were being sued for compensation (SCALC 1997, pp 31-2).

In April 1997 the Commonwealth offered another settlement: it would pay compensation if a nervous shock plaintiff actually contracted CJD, and it and CSL would pay the legal costs already incurred by these plaintiffs, ie regardless of whether they contracted the disease. These benefits would supplement those already available under the \$10m package. The offer was accepted by over 90 of these litigants, but not all. At particular issue were the Commonwealth's refusal to grant them legal aid to pursue their cases in the courts and whether this constituted undue pressure to accept the settlement offer; whether documents relevant to the Allars inquiry had been withheld from hormone recipients; and whether all such recipients had been traced. The Senate now sought advice on the fairness and adequacy of both the government's response to the Allars report and the settlement offer from its Community Affairs References Committee, and after careful inquiry the committee made 18 recommendations for more follow-up official action, not closing off the possibility of further litigation (SCALC 1997, pp xi-xiv, 77-85, 105). In mid-1998 the government had acted on several recommendations, but was still considering its response on others: another \$3m would be added to the trust account established under the original \$10m settlement, allowing one-off payments to hormone recipients who could demonstrate that 'a recognised psychiatric injury' had resulted from their being told that they were at risk of contracting CJD (SCALC 1998).

The tensions created by the blood plasma fractionation process also refused to go away. Another ANAO performance audit report published in December 1999 (ANAO 1999, pp 11-18; also Hamilton 2000) revealed that the Commonwealth had paid out over \$400m between January 1994 and April 1999 for therapeutic products derived from domestic plasma without any procedure for checking that the products had been received by the designated recipients or that the invoices submitted by CSL were reasonable. Nor did the Commonwealth have in its records copies of insurance policies obtained by CSL covering risks for which it is indemnified by the Commonwealth and in respect of which the Commonwealth meets much of the premium cost. CSL had also breached certain contract provisions: in a supplementary agreement entered into in 1996, it had contracted with the Commonwealth to supply the Therapeutic Goods Administration (TGA), the relevant section of the Department of Health, with full advance information about any plasma to be imported from overseas sources. Two years later, TGA detected that CSL had breached this agreement in importing and processing plasma from a US source without advising it; this was followed by an 'unannounced audit' (described as a 'raid' by The Australia Institute's Clive Hamilton: 2000, p. 8) by

Commonwealth officers of the CSL plant, which confirmed the breach of the agreement. Amazingly CSL continued to process foreign plasma---from four countries---for several more months without following the agreed procedures. Eventually the Health Minister commissioned an independent inquiry, which confirmed CSL's lapse but declared that it had had no material adverse impact on the plasma products system. The relevant regulations were tightened, but the Audit report considered that there was still significant scope for improvement in the Department's contract management procedures relating to CSL, including a proper vetting of those insurance contracts entered into by CSL relating to risks for which the Commonwealth has accepted liability.

The impression is strong that, despite the privatisation, government health officials have continued to treat CSL as though it were a public agency requiring only a very restrained and gentlemanly sort of supervision. As we have seen, the Commonwealth has already outlaid considerable sums related to the indemnity provisions in the CSL sale compact. Though CSL has obviously borne some costs, it has mostly been protected by these provisions. The remarkable consequence is that, though these vicissitudes related so clearly to CSL's own earlier operations, and though some of the problems have continued past the point of sale, its management has been able to focus on maintaining and improving commercial performance, its share prices have not suffered, and leading stockbrokers continue to recommend it as an excellent investment (eg Were 2000).

*Summarising*, the main stages in CSL's organisational evolution have been as follows:

- 1916: established as branch of a Commonwealth department (Trade and Customs and, from 1921, Health);
- 1961: converted to statutory corporation;
- 1990: converted to government-owned company;
- 1994: sold by public float, and thereafter operated as private company sheltered by several government indemnities

NOTES:

1. We are grateful to the management of the privatised CSL for providing us with Annual Reports, the sale *Prospectus*, and other published company documents. However the company declined to comment on an early draft of this case study when it realised that we were taking seriously a number of critical commentaries on various CSL activities.
2. Around that time the Menzies government disposed of several of its commercial holdings and tried unsuccessfully to dispose of others, in a process then described as 'denationalisation'---the word 'privatisation' was not then in use (Wettenhall 1987, pp 3-4 and ch.9).

3. The Nossal/Reid inquiry drew attention to a burden that public enterprises suffered that was not matched by their private enterprise competitors: subjection to numerous investigations by 'external reviews and inquiries' imposing loads on management 'which must have a negative impact on productivity'. It listed 18 such inquiries (including three by the Public Accounts Committee) that had impacted on CSL between 1974 and 1977: Nossal & Reid 1978, pp 48-50.
4. This general movement is discussed in Wettenhall 1998.
5. Hamilton and Quiggin, who were to be leading critics of the sale, offered another accolade. They saw CSL as 'one of the best-performing Commonwealth business enterprises' (1995a, p. 3).
6. This contrasts with the position noted in our companion case study of the sale of GIO Australia.
7. Given the high degree of 'publicness' in the ongoing work of CSL, it might be asked why the government did not retain a 'golden share' in the company, a privatisation strategy in considerable use elsewhere. It is recorded that this course of action 'had once been envisaged' but that the government 'acted on advice' not to do so, 'instead ensuring that CSL would continue in its vital role of supplying plasma fractionation services for the government by binding it to a 10-year contract' (*PBN* 1995, p. 26).
8. This report estimated that, over all portfolios, the Commonwealth was liable for at least \$222 billion in the form of specified guarantees, some of which had neither financial nor time limits; there were also a 'large number of indemnities and some letters of comfort which [had] no specified financial commitment'. The criticism was directed particularly to portfolio departments which issued guarantee instruments regularly without time and financial limits or termination clauses. The report asserted that there was a need for an increased level of awareness 'of the commercial risk that attached to Commonwealth off-balance sheet exposures and options for treating that risk'. In the case of the CSL sale, ANAO believed the Commonwealth had remained significantly exposed. 'An asset sale', it argued, 'may provide an opportunity to curtail if not transfer contingent liabilities to another party'. In contrast to the CSL sale, the Commonwealth had divested itself of all significant obligations in the sale of the Moomba-to-Sydney gas pipeline, and in the sale of the final tranche of Commonwealth Bank shares it ensured a release from substantial exposure through sunset clauses beginning to have effect three years after sale (ANAO 1996: xiv, xvii-iii, 53-4, 75; Taylor 1996). This Audit report was subsequently considered by two parliamentary committees which made their own recommendations, all leading to the promulgation of Finance Circular 1997/06 announcing revised guidelines on the provision of guarantees, indemnities and letters of comfort (see generally ANAO 1998; also JCPA 1997).

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## Chapter 8

### VICTORIA'S TOTALIZATOR AGENCY BOARD/TABCORP\*

In this case study we observe one of the first divestments conducted by the Kennett government elected to office in Victoria in 1992. The Victorian Totalizator Board (TAB) was also the first of its kind in Australia, demonstrating the use of public enterprise for the purpose of social and economic cleansing. It operated successfully in its appointed field until it was compromised, being forced by public policy change into a new role for which it was unsuited. The new government then used it as an exemplar for the mass privatisation program it wished to pursue, though there was an unusual beginning arrangement to recognise the interest of a third party. The new owners were significantly sheltered as the state assumed many residual costs, although it has proved difficult to get information about the full extent of this shelter.

#### Pre-sale organisational evolution

##### *Establishing a public enterprise with a cleansing mission*

Horse racing and gambling have been closely associated in Australia since virtually the beginning of European settlement. Gradually the several state governments developed schemes for the licensing of racecourses and regulation of their operations, for the registration of bookmakers and bookmakers' clerks, and for the payment of registration fees and a stamp duty on each betting ticket issued. Initially the only legal form of betting was by means of registered bookmakers on licensed racecourses. But associated developments in the late 19th and early 20th centuries introduced both new entrepreneurial opportunity and new regulatory challenge.

The first was the invention of the totalizator,<sup>1</sup> originally hand-driven but later electrically powered, a machine which was capable of indicating odds, counting bets, deducting tax and calculating and displaying the value of different classes of dividend. Its racecourse potential was quickly apparent, and it seriously challenged the bookmakers' role; governments became involved also in its regulation. Second, social pressure developed for a legalised means of off-course betting: Tasmania and South Australia responded with regulated 'betting shops', but they were not replicated in the larger Australian states, the racing clubs protesting that they would lead to a decline in racecourse attendances and therefore a decline in their own revenues (Martin 1959; VYB 1965, p.341; Brawley 1995, p.20; Dickerson 1996, pp 1461-2; TAE 1996, p.2939).

Running against the interests of governments and racing clubs alike, a black market developed to satisfy the insatiable demand for the provision of off-course betting facilities. The hole was filled by a multitude of starting price (SP) bookmakers.<sup>2</sup> But the racing clubs lamented that they earned nothing from this 'multi-million pound economy' (Brawley 1995, p. 20). And state governments wanted desperately to compel the off-course bookmakers to pay taxes. The illegality of these operations had other insidious effects. Since the SP bookmakers and all the people who did business were offending against the law, it had become a major police responsibility to detect, punish and suppress them. But it was 'victimless crime', and such crime constitutes a major invitation to petty corruption: it leads easily to the offering of bribes and in this and other ways brings the force of 'the law' into disrepute.

Many in the community regarded gambling as a social evil and wanted to stiffen penalties against off-course betting and expand police capacity to deal with it. But the sheer pressure of numbers of those who were determined to bet irrespective of the law and the desire of governments to earn revenue from their betting activity led to the establishment of a series of royal commissions by Australian state governments, all charged with the mission of discovering a generally acceptable public policy compromise. By the time Victoria commissioned Mr Justice Martin to conduct such an inquiry in 1958, New Zealand had already taken action to resolve its own public policy problem over gambling, and that action was to provide a useful model for Victoria to adapt to its own circumstances. The New Zealand solution was to establish a form of 'nationalised off-course betting', the means being the creation of a Totalizator Agency Board employing the 'tote' technology, to handle all such betting, extending its coverage to greyhound-racing as well as all forms of horse-racing. This TAB system would return profits to the general community rather than the SP bookmakers, ensure that punters got better returns from their successful investments than they had previously received, and allocate a percentage of the profits to the racing clubs (Brawley 1995, pp 20-1).

Encouraged by Sir Chester Manifold, a highly respected figure in the Victorian racing industry and a close observer of the New Zealand debates, and supported by Premier Sir Henry Bolte, a keen racegoer himself, and by the Martin royal commission, the Victorian parliament legislated in 1960 to establish a new public sector corporation called the Totalizator Agency Board to provide off-course facilities for betting on horse races (Racing (Totalizators Extension) Act 6619/1960). Created by the addition of a new part to the basic Racing Act, it comprised of eight members appointed by Governor-in-Council on the nomination of the main racing clubs. Subject to ministerial approval, the board could regulate its own procedures; and it was empowered to appoint a manager, secretary and

other officers and employees outside the provisions of the Public Service Act (ie in a formal sense they were not public servants).

Until the Victorian TAB (hereafter Victab) was financially self-supporting, all the expenses involved in the setting up of its offices and agencies were to be borne by clubs holding licences for the use of totalizators or sharing in commissions for their use. They were described as ‘participating clubs’, and so had a clear stake in the efficiency of the operation. Once self-sufficiency was reached, they would then share in the distribution of the commission earned by Victab on all bets it handled. These clubs were to submit to the minister administering the Racing Act a financial scheme dealing with the manner of payment and distribution of the moneys due to them from the operations of Victab.

The main intended role of this system was to provide facilities for people away from racecourses to place lawful bets on totalizators operating on racecourses; in doing so Victab would act as agent for the club using the totalizator relating to the event on which the bet was made, and pay all monies received into that totalizator. These moneys would thus form part of the combined (on-course and off-course) pool on a race. However, where no suitable racecourse totalizator was available, Victab could conduct its own pools (Racing (Totalizators Extension) Act No. 6619 of 1960; also *TAE* 1996, p. 2939).

#### *Victab in operation*

Manifold became foundation chairman, and in setting up the organisation he and his colleagues drew heavily on the experience of the New Zealand TAB, a number of whose senior staff ‘have become the nucleus of our organisation’. The original Victab agencies opened for business on Saturday 11 March 1961, in Manifold’s words introducing ‘a period of historic development in the racing and trotting industry and the most satisfactory means of meeting a social demand’ (Manifold 1961, p. 5).

Almost immediately satisfaction was being expressed that a great many Victorians had shown that they welcomed ‘the opportunity of betting legally’, that the provision of legal off-course betting facilities had not seriously affected on-course attendances, and that the setting-up costs were lower than expected (so that the racing clubs had been required to outlay less underwriting capital than anticipated). After one year of operations there were 83 Victab agencies attracting off-course betting ‘investments’ of almost £14 million, a result regarded as demonstrating ‘a remarkable increase in public acceptance of the scheme’ (Victab 1961, pp 8-10; 1962, p. 8; 1963, p. 8).

Though the outcome of a dramatic piece of public policy development and operating as a public-sector body under a clear legislative charter, the board operated at a very long arm's length from government: untypically for a statutory body, it used a private auditor and had its annual report printed privately, and the chairman addressed that report not to 'the minister' but to the board collectively. The impression is strong that, although the state government had found it necessary to intervene in this important part of the gambling 'industry', in both the public interest and that of the racing clubs with which leading government figures had a close association, there was seen to be a sort of 'sleaze factor' about the whole operation which led government not to want to be closely identified with it.

Under Manifold's strong leadership (he retired in 1968), the betting turnover increased dramatically in the early years, and the organisation served as a model for the establishment of public-sector TAB systems in the other Australian states and territories (see obituary in *Victab* 1979, p. 1). Australian public administration students were quick to recognise this development as constituting 'a new province for the public [statutory] corporation' (Brimfield 1967; also eg Bell *et al* 1972). *Victab* gained notice for another reason too: since it employed its own staff outside the framework of the Public Service Act, it had considerable freedom to innovate in personnel matters and, along with the other early Australian TABs, it attracted much interest for its pioneering of permanent part-time work.

In a *Corporate Profile* published towards the close of 1987, *Victab* recorded that, since it had begun, 'the community' (ie hospitals and charities) had benefited by more than \$673m from its distributions. It operated through '420-odd State-wide outlets', and employed 'about 4000 of the racing industry's "population" of 27,000 in Victoria'. Also more than 150,000 Victorians maintained telephone accounts with it and, in the TAB Telephone Betting Group with 'more than 350 telephone lines', a 'team of up to 1000 telephone betting clerks handle the transactions between 10am and 11pm each race day, accounting for about 30 per cent of TAB turnover'. It claimed that it was now rated among the top 500 businesses in Australia (*Victab* 1987a, pp 1, 11).

The portfolio of betting services gradually expanded to embrace also greyhound racing and football competitions, and new forms of betting on horse races such as the quadrella. In the later 1980s, 'new betting products' were introduced such as pools on Grand Prix motor racing, the America's Cup yacht races and one-day cricket, and movement towards the notion of a 'tabaret' in which patrons could eat, drink and bet simultaneously. Fresh legislation authorised the introduction of PubTabs, while the installation of Sky Channel facilities in 320 *Victab* outlets became 'a major factor in retail sales growth'. Other developments included the absorption of the metropolitan on-course totes (take-over of the country on-course totes came a few years later) and computer expansion to enable the state-wide

integration of on-course and off-course wagering services. By 1990 Victab was describing itself as ‘an investment powerhouse’ and as ‘one of the few sources of revenue growth for the State’s health and social policy infrastructure’ (Victab 1987-90).

Under Aspro business head and Victorian Racing Club committeeman Hilton Nicholas, who had replaced Manifold as chairman, the headquarters building was expanded to become the ‘Racing Industry Centre’, with many racing clubs relocating there (Nicholas 1978, p. 1). The assumption of responsibility for the provision of on-course as well as off-course totalizator facilities was made possible and perhaps inevitable by the movement to computer technology and by the continuous refinement and improvement of Victab’s computer facilities thereafter--although, in the longer term, this technology was to prove very troublesome for the organisation.

But it was not able to maintain its managerial distance from the government, the changing relationship demonstrated by a variety of interventions from around 1973 onwards. Further legislation in 1983 reconstituted the board to include representatives of racing interests other than thoroughbred horseracing, stipulated that the minister would nominate as chairman a person not closely associated with any of the racing communities, and as deputy chairman (after consultation with the Treasurer) a person with special expertise in financial management, and required that the chief executive would henceforth be appointed subject to ministerial approval---Victab had previously acted autonomously in this matter. In the reconstruction that followed, only two members of the old board remained, and there were thereafter many signs of a managerialist ‘revolution’, highlighted by a new ‘Corporate Statement’, ‘Corporate Objectives’ and a ‘Declaration of Interest’ by board members (Trezise 1983, pp 1573-4; Racing (Further Amendment) Act 10014/1983; *Victab Annual Reports*, various).

Celebrating its 30th birthday in 1991, Victab recorded that its contribution to the ‘Hospitals and Charities Fund since inception exceeds \$1 billion’. But that year also saw the Victorian parliament pass the Electronic Gaming Act heralding the expansion of electronic gaming, and the government announce its intention to award a licence for the introduction of a casino. The management saw these developments as ‘dramatically changing the gambling policy environment’ and introducing a new need to ‘protect the traditional wagering business’. It had also come to believe that the traditional statutory authority structure which had applied to it since its inception in 1961 was no longer appropriate for the tasks it now faced. So, in the lead-up to the launching of the new gaming machine network, it reported that it ‘must look to new corporate models if it is to meet its challenging mandate’, and that it was ‘seeking to commercialise both its wagering and [its]



gaming systems in partnership with Victorian industry' (Victab 1991, inside front cover and pp 2-4).

A year later, the board reported that, to this end, it had

put a comprehensive proposal to its stakeholders, the Government and the Racing Industry, for legislative reform of the TAB's powers and structures under the Racing Act and reform of associated Government administrative arrangements impacting TAB operations ... these proposals have been the subject of extensive consultation and analysis within Government and the Racing Industry. The Board looks forward to the resolution of these matters at an early date so that the TAB can deliver its business plan in the coming year for the benefit of its stakeholders (Victab 1992, p. 5).

So the board clearly recognised its own limitations in the changing gambling environment, and had suggested a solution to its major stakeholders. But events moved too rapidly for it.

### *Into a new gambling environment*

These changes in the gambling environment were closely related to the dramatic downturn in the condition of Victoria's state finances, associated with the decline of the state's secondary industries, the collapse of the State Bank and several other economic enterprises both public and private, and the need to arrest the growth of public debt and find new sources of both revenue and employment. Hitherto Victoria had been markedly conservative among the Australian states in matters related to gambling. Now, however, the Labor government under Joan Kirner came to promote casinos and electronic gambling as part of a strategy to expand the tourism and entertainment industries and thereby attract new business to the state and new revenue for its government. But in doing so it was determined to put a distinctively Victorian stamp on the new system, marked by avoidance of the term 'gambling industry' and a determination to regulate closely the distribution of operating licences.

The Kirner government therefore enacted legislation in 1991 to create a supervisory Victorian Gaming Commission and to vest control of the gaming machines in large, well-recognised Victorian institutions to which the government could relate closely: the existing publicly owned Victab and the Tattersall lottery organisation, operated by a private trust, were the only possible candidates and duly received operating licenses. For Victab it was accepted that the gaming machines should be located in and regulated in conjunction with its many betting facilities throughout the state, and much innovatory effort ensued to develop both more attractive venues such as 'tabarets' where both sides of Victab's business could be conducted in pleasant surroundings and a Victorian capacity to manufacture gaming machines. Operation of the gaming machines was linked to the existing Victab computer system, creating severe pressure on the technology.

At the same time Victab was absorbing the last of the on-course totalizators hitherto run by the racing clubs, negotiating agreements with counterpart TABs in smaller Australian jurisdictions (Tasmania, South Australia, Northern Territory) whereby their investments were fed into the larger Victorian pool for the determination of dividends, and having to cope with the threat to its business created by some Australian dealings with the privately owned and Vanuatu-based VITAB betting organisation.

Still more pressure on Victab came from the impending introduction of a casino in Melbourne. Concerned about its likely impact on its business, Victab sought to involve itself in the consortium being formed to apply for the casino licence. But it needed fresh capital to do this, and its owner, the impoverished state government, could not oblige. So it proposed a restructuring which would see the rapidly expanding gaming machine operation moved to a separate subsidiary company which could raise capital by offering shares to financial institutions. By now, however, there was much speculation about the likely effects of a change of government widely expected after the general election due in late 1992, and there was beginning talk of possible full privatisation.

### **The disposal process**

#### *Enter the Kennett government*

As expected, the Kennett Liberal-National Coalition won government in the October 1992 general election, and an unkind fate quickly intervened to bring the Victab house of cards tumbling down. Against very long odds, there were three late scratchings, importantly including the favourite 'Let's Elope', from the Melbourne Cup early in November, and Victab staff faced a huge challenge in refunding bets and adjusting dividend rates. Its computer system simply could not cope, producing a 'great financial disaster' for the Victorian Racing Club and a general impression of organisational breakdown. Within a couple of weeks, there was further calamity: a straight-six jackpot was left open for betting for eleven minutes after the first race had been run. The new Minister for Sport, Recreation and Racing, TC Reynolds, immediately announced an independent inquiry, reported to be 'on the entire TAB operation'; and his announcement was welcomed by Victab chairman Redlich who said that the inquiry was opportune because---repeating views already very clearly expressed---Victab's resources had been stretched and because its structure was inadequate for its mission (*The Age* 1992: 4, 17, 18 November).

The question now was: what sort of change would follow? It was no secret that selling off state enterprises was high on the agenda of the Coalition parties. A series of inquiries followed quickly<sup>3</sup> and, on release of the first private consultant's

report, chairman Redlich resigned, giving as his reason the fact that Victab's responsibilities had outgrown its capacity to operate without significant structural change (quoted in Reynolds 1993a).

#### *A holding reconstruction*

As a kind of holding measure, the government introduced legislation in April 1993 to amend the Racing Act, providing among other things that the Victab board would henceforth consist of seven members (including a chairman and vice-chairman) all appointed directly by the government. Gone was the appointment of members to represent various racing interests: the minister explained that it was 'in the interest of the whole community that the TAB should have available to it the best possible people for its board'; the membership 'should be skills based rather than subject to sectional interests'. This legislation also reduced totalisator betting commissions to a rate similar to that applying in New South Wales to maintain Victab's competitiveness (Reynolds 1993b, pp 1360-1; Racing (Amendment) Act 49/1993). The new board took office in 1 June 1993, but an oversight had quickly to be repaired. The board members who had presided over the growth of Victab since its inception in 1961 until now had been entitled only to 'such travelling and other allowances in respect of their attendance at board meetings as are from time to time prescribed'. The government now believed that 'the highly skilled people' needed to serve on the board 'should receive an appropriate remuneration for their services', and so the Racing Act was again amended to provide for remuneration at rates determined by the Governor-in-Council (Reynolds 1993d, p. 505; Racing (Further Amendment) Act 77/1993).

Victab's Chief Executive, Neil Walker, resigned after another private consultant's report was submitted. The role of the former government in driving the move into gaming machines was now mostly forgotten; it was easy to make scapegoats of those more closely identified with Victab itself. *Age* columnist Kenneth Davidson wrote that 'the TAB books have been sandbagged in order to make the previous management look bad and give the new management a flying start' (Davidson 1993).

For the government, a major problem was the involvement of the racing clubs. As talk of privatisation increased, they argued from the back history that they actually owned Victab, and offered to run it themselves, paying a new super-tax and other taxes to government. Resolving this problem took up considerable time, and eventually another private consultant played an important part in negotiating an agreement. Also the government needed to balance its plans for the establishment of a Victorian casino with its determination to restructure Victab. Inevitably the awarding of the casino licence, announced on 6 September 1993, was a dramatic development for the corporation. Against estimates that its racing turnover would

decrease by from 14 to 16 per cent when the casino became operational, it was revealed that the board had withdrawn from the successful bid consortium because it did not have the necessary liquid funds at its disposal; and there was no likelihood that the government would make funds available to a publicly owned Victab for that purpose (Reynolds 1993c, p. 270; Walker 1997).

In the wake of another of the consultant's reports, the Victab board agreed to write off \$96m from its accounts, and recommended a drastic reduction in the surplus available for distribution to the racing clubs. But the government preferred to withdraw the sum from the Victab capital reserve and make a normal distribution, and the Auditor-General disputed some of the board's writing-off action. Then the new chairman, Peter Scanlan, found himself implicated, with John Elliott and other Elders executives, in proceedings before the Melbourne Magistrate's Court relating to allegedly fictitious foreign exchange transactions investigated by the National Crimes Authority, and was forced to stand aside from the chairmanship (Melbourne *Sun Herald*, 26 December).

### *Preparation for sale*

The determination of Premier Kennett and Treasurer Alan Stockdale to sell was very clear. It was well known that they were favourably disposed to selling off public enterprises. Given the difficulties they were experiencing with Victab, and aided by the fact that others were at least half-convinced that privatisation was necessary for it, they decided to make it a show-case for their planned divestment program.

There was early agreement that Victab would not be broken up into separate wagering and gaming organisations, and an early assurance by the Premier that he wanted to retain a viable racing industry in Victoria. Press reports said variously that options were for a 49% float, with the industry getting 'up to a 35%' of ownership plus taxation benefits; or for a 75% float with the other 25% retained by the industry (reported Bourke 1993a). The latter firmed up as the main plan, announced by the Premier on 21 December 1993: he said that the industry 'would be guaranteed a fat annual fee and a 25% shareholding', with the other 25% 'publicly floated, with a limit of five per cent per individual'; the government valued Victab at more than \$1b, and 'the sell-off would provide \$600m to pay off state debt and allow the Government to escape the increasingly competitive and risky industry'. It would be the biggest ever public float of a Victorian company, and become one of Australia's 75 biggest companies. The prospectus would be issued before 30 June 1994: some details remained to be negotiated with the racing industry, but there could be 'no significant compromise' (reported Magazanik 1993).

At this time the Victab organisation employed 443 permanent staff and 1,822 casuals spread over three divisions: *Wagering*: conducting its own off-course totalisator system, as well as on-course totes on 83 race-courses and tracks where it serves as agent of the relevant club; *Gaming*: operating almost 7,000 gaming machines in licensed clubs and hotels; and *Corporate*: providing financial and administrative, human resources and corporate development services to the other two divisions (*Prospectus* 1994, p. 9).

### *Agreements reached*

Further difficulties with the racing industry were resolved by March, when a memorandum-of-understanding was signed joining the government and the industry in what was described as ‘an unincorporated joint-venture company’, to be owned 25 per cent by the industry and 75 per cent by Victab, which would then be floated and be free to pursue other opportunities. Each party would have three representatives on the joint-venture board, whose decisions had to be unanimous. The industry would get a guaranteed \$130m in annual fees from the wagering business plus dividends from the joint venture, racing club members would get preferential treatment in the float, and there would be a relaxing of government regulation of the industry. The government also accepted advice that the float would use the open pricing (or book-building) method in which investors bid for stock in a previously set price range, rather than a set-price underwritten float; and in the absence of an underwriter the government would appoint a ‘lead manager’, probably supported by co-managers to deal with the local and off-shore portions of the issue (Bourke 1994b; Gluyas 1994).

Within days Treasurer Stockdale was ready to announce both that the new organisation would start with ‘an absolutely clean balance sheet’ (ie the government would ensure that none of its old debts or other commitments carried over), and ‘the appointment of stockbroking, legal, accounting and advertising advisers for the start of the due diligence process on the issue’. It was, as the reporting journalist pointed out, ‘a largely home-grown [Melbourne] team’ to steer ‘the first of several privatisation offerings [the government] plans to bring to market’ (McIlwraith 1994b).

Meanwhile a classic spill of management positions took place. Within a month of Kennett’s December 1993 announcement, there was a call for applications to fill all the senior management positions. Several existing managers had resigned and others would have to reapply for positions under review. On very doubtful grounds (it was not the case with other public-float privatisations considered in our project), Acting Victab Chairman Tony Hodgson said this was ‘normal commercial practice when an organisation was moving from public to private sector ownership’, and that it was a necessary step because of the different way in which

the organisation would be able to operate when ‘removed from the considerable constraints of public sector ownership’. Two firms of consultants were engaged ‘to review the senior positions and assist the board in the selection process’ (quotes from Bourke 1994a, McIlraith 1994a).<sup>4</sup>

In June the appointment of Ross Wilson, former chief executive of Southcorp Holdings Ltd (previously South Australian Brewing), to head the about-to-be-privatised Victab was announced. The appointment was controversial : it was widely reported that Wilson was not on the short list of names put forward to the board by the consultants chosen for that purpose, and that he had been offered a very high salary package, described as approaching \$2 million a year. Reports suggested that the government had been told by the float advisers that it should accept Wilson’s appointment or delay the float for at least two years; it would appear that the advice the government received was that it needed a high-profile executive to attract foreign investors, and that Wilson insisted on receiving the same sort of package he had enjoyed at Southcorp if he were to take the job (Magazanik 1994; Greene 1994).

The other major component of the pre-sale reconstruction fell into place with the passage through the state parliament in April and May 1994 of the Gaming and Betting Act 37/1994. It was a very complex piece of legislation, with 235 sections spread over 170 pages and involving the amendment of ten other acts. There was obviously great pressure on the Victorian parliamentary drafting service to ensure its speedy preparation in collaboration with all those engaged in working towards the sale. The main effects of the act were to:

- \* authorise the conversion of Victab into a public company ‘freed from past constraints on its capital funding capacity’, able to make commercial business decisions, and ‘in a very strong position to expand interstate and overseas’, and its subsequent sale expected to attract at least \$600m to be applied to the reduction of state debt;
- \* reduce state taxes on wagering turnover but ensure continuing dedication of revenue from these taxes to the Hospitals and Charities Fund;
- \* establish a single regulatory authority, the Victorian Casino and Gaming Authority to replace the earlier separate gaming and casino regulators, to be funded from consolidated revenue and from an approved supervision charge to be paid by holders of wagering and gaming licenses;
- \* provide for the privatised Victab to be issued the first such licences for 18 years, and to establish subsidiary companies as operators of either or both of those licences;
- \* provide for licensed racing clubs to conduct on-course totalisators and regulate shareholdings in any licence to ensure a diverse ownership structure with no single dominant shareholder; and
- \* establish the mechanisms for the transfer of Victab staff to the new company, and for transfer of its property, rights and obligations to the company or its subsidiaries or the state (Stockdale 1994, pp 1313-7).

In his second-reading speech on 28 April 1994, the Treasurer indicated also that the state was pursuing its case for ‘structural assistance’ from the Commonwealth

to reflect the significant windfall tax gain that would come to it after the sale. Although not spelt out in the speech, Melbourne commentators understood that the intention was to continue both the wagering monopoly Victab had enjoyed for so long and the gaming duopoly it had shared with Tattersalls (eg Davidson 1994).

*The sale in process*

In fact the government had anticipated the approval of parliament (it had a majority in both houses!) and incorporated the new company, TABCORP Holdings Ltd, on 13 April (with the state holding the six issued ordinary shares). Now both the statutory corporation (Victab) and the new company, at this point still government-owned (Tabcorp), were in legal existence. On 25 May Tabcorp entered into long-term contract arrangements with companies established by the racing industry under the Joint Venture Agreement, and on 28 June it was issued the wagering and gaming licences needed to enable it to take over Victab's business, for which it would eventually pay the state around \$600m or \$700m depending on the final share price: it received the sole licence to conduct off-course totalizators in Victoria, this licence authorising it also to conduct on-course totes in its own right instead of as agent for the relevant club as before; and it received one of only two licences issued for the conduct of gaming machines in clubs and hotels. But formal transfer of the business awaited the 'appointed day' under the act (*Prospectus* 1994, pp 2, 8, 10).

The prospectus was now prepared, and was available from about 5 July. There was wide publicity in Australian newspapers through early July, with the public offer for the 300 million shares scheduled to open on 18 July and close on 5 August, and the institutional offer to run from 8 to 12 August. More than one million copies were distributed as inserts in Melbourne newspapers and through Tabcorp's 750 retail outlets---'to give all Victorians the opportunity to participate in Victoria's biggest-ever float' (Henry 1994).

The public offer was open to members of the Australian public, at the 'application price' of \$2.70 per share and with a minimum of 500 shares per application. All Victab employees, agents and associates and members of Victorian racing clubs would receive personalised offers to subscribe for 1,000 shares within this public offer, with loans available to employees. The institutional offer was open to Australian and international institutions, with a minimum shareholding of 50,000 shares and bids to be made within a price range of \$2.25 to \$2.70 per share. Australian residents were limited to a 5% shareholding; no non-resident could have more than 2.5%, and non-residents in aggregate were limited to 40%. The 'final price' would be set after close of the institutional offer; if less than \$2.70, successful applicants in the public offer would receive refunds of the difference, and then Victab employees and agents and racing club members would receive

rebates of 2.5% of the price finally paid, funded by the state government. In place of the usual provision for underwriting, there was a commitment that, in the event that applications were not received for all the shares on offer, the prospectus would be withdrawn and application monies returned. As a form of indemnification of the new company, the prospectus indicated that any outstanding litigation at the time of the float would remain with Victab (*Prospectus* 1994, pp 13, 17, 60). Coopers and Lybrand were appointed as share registrars.

The response to the public offer was sluggish, one analyst describing it as 'underwhelmed' in contrast with other floats of this kind. But overseas interest was said to be 'enormous', and the hope was that any shortfall in the 65% allocated to the public would be taken up by institutional and overseas investors. At the close it was known that all shares on offer had been taken up, but that the number of 'mum and dad' investors (ie the general public) was only a little over half of what had been expected. Announcing the result, Treasurer Stockdale said this shortfall had allowed the institutional investors to set the price at the bottom of the set bookbuilding range---\$2.25 per share, reducing the return to the taxpayer by \$135m. The general public took up 34% of the issue, 26% went to foreign investors, and Australian institutions took the remaining 40%---even though some of Australia's big institutional investors had 'snubbed' the float. They had all got 'a bargain', the Treasurer said: those 'who had expressed their confidence in Tabcorp would find that they had made a very sound investment' (reported Adams, Walker & Kaye 1994; *Canberra Times* 1994: 2, 5, 14 August).

A serious criticism came from *The Age* columnist Kenneth Davidson, who believed the government was 'throwing money away' and asked the classic privatisation questions: 'what purpose or whose benefit is served by asking Victorians to buy a part of something they already own?', and 'why is it in the interests of the existing shareholders that the Kennett Government sells their TAB on their behalf?' He pointed out that Victab was already a profitable business, calculating that the profits would reach \$110 million within a year, so that 'the State Government is foregoing revenue of \$110 million a year to save \$77 million a year [on saved public debt interest], and that 'this gap will continue to widen'. Indeed, he based his calculations on a likely sale price of \$2.50 per share, but as we have seen they sold for less. He reasoned, therefore, that the Victorian taxpayers were not beneficiaries; the government had chosen 'to give a bonanza to the new owners'. Also, given that the enterprise would henceforth pay corporate income tax at 33 per cent but that it now seemed unlikely that the Commonwealth would pay any compensation to the state (indeed, it refused to do so, saying that benefit was a once-only payment which Victoria had already received in respect of the sale of its State Bank), the state government had chosen to make another 'gift of about \$38 million a year of state revenues in perpetuity to the Federal Government for no return whatsoever', based on the 'conservative assumption' that Tabcorp profits



will not increase beyond \$110 million per year (Davidson 1994). *Sydney Morning Herald's* Melbourne reporter Malcolm Maiden did not traverse this territory, though he thought the Victorian government had given Tabcorp 'a dream franchise' (Maiden 1994b).

The Labor opposition in the Victorian parliament was also bitterly opposed. Its new leader John Brumby highlighted the adverse impact Melbourne's just-established Crown Casino appeared to be having on Victab's wagering revenue; the ALP announced a new policy it intended to implement when returned to government which would end the gaming and wagering monopolies and/or duopoly enjoyed by Victab, Tattersalls and the casino (Pinkey 1994; Maiden 1994b).

Inevitably there was a search for scapegoats, and the Treasurer was caustic about Labor's 'economic terrorism'.<sup>5</sup> Brokers and financial analysts agreed Brumby's statements had had some influence, but that 'more likely' explanations for the relatively poor public response were investor concerns about Victorian licensing laws and uncertainty about the impact of the casino on the business, the absence of an underwriter for the float, problems associated with the Victab computer system (indicated at p.39 of the prospectus) and dissatisfaction with the 'estimated \$8 million five-year salary package' of Tabcorp chief executive Ross Wilson. There were 'also problems with the timing of the issue. The market isn't in great shape at the moment' (Thomas & Kearns 1994; *Canberra Times* 14, 15 August). Another explanation offered, however, was that the government was prepared to 'take a haircut on the sale price' to improve the chances of a strong 'after-market' for Tabcorp shares and so 'lubricate' the subsequent unloading of 'chunks of Victoria's power utilities and other assets' (Maiden 1994a).

### **Post-sale settlements**

The settlements proceeded according to the prescriptions of the authorising Gaming and Betting Act 37/1994 as elaborated to a degree in the prospectus. Thus Victab's operating staff became employees of Tabcorp with continuity of employment including superannuation rights preserved, although they transferred to a new Tabcorp superannuation fund and alteration of other terms of employment was permitted.

Continued in existence for the time being to process all the necessary transactions, Victab itself was given three months (or such longer period as the Treasurer might approve) to provide the Treasurer with a statement of its property, rights and liabilities (except for those the Treasurer directed it in writing not to include in the statement), indicating whether they were to go to Tabcorp or a wholly owned subsidiary, or to the state; and with the Treasurer's approval the properties that

were to go to Tabcorp were to be vested in the new owner without payment of stamp duty or other transfer tax. And, within 21 days of the vesting day, Victab had (i) to repay to the government all outstanding financial accommodation extended to it and interest thereon; (ii) to pay \$20m to VicRacing, the company established by the racing industry as its principal commercial vehicle; and (iii) to pay the Treasurer the amount received from Tabcorp for all the transferred property etc less the amounts outlaid under (i) and (ii).

The value of the property etc transferred to Tabcorp had been assessed at \$77.9m (the written-down book value). The proceeds of the float (\$675m), collected by Tabcorp, went on this settlement with Victab and on payment of the balance to the state for the wagering and gaming licences; according to Tabcorp itself, the payments were \$77.8m for Victab's business and \$592.2 for the licences (*Prospectus* 1994, pp 8, 30; Tabcorp 1995, p. 2). The state then used this licence revenue to retire debt; but the government had also agreed to meet all the transaction costs involved in preparing for and conducting the float, which had to be covered from other parts of the public account. So the new private company and those who invested in it were sheltered in several ways in the deal that had emerged, and it became a major research problem to discover what items, if any, the Treasurer had directed Victab to exclude from the written statement of its property, rights and liabilities it was required to furnish him as the settlement details were being arranged.

Describing itself as 'one of Australia's leading leisure and entertainment companies', Tabcorp immediately entered upon the management of its wagering and gaming businesses under its 'long-term joint venture agreement with the Victorian Racing Industry'. In essence, it manages the total business of the joint venture, effectively as its agent, and takes 75 per cent of the turnover. It explained that it 'provides the licences and fixed assets, employees and management for the conduct of the businesses, for which it receives a fee'. Effectively this fee constitutes its working capital. Its reporting responsibility, it further explained, extends 'only [to] its 75% share of the joint venture's turnover, revenue and expenses' (Tabcorp 1995, p. 2).

It was soon found necessary to make a number of 'enabling and technical amendments' to the Gaming and Betting Act to facilitate the ongoing operation of the machinery it had established. These amendments tightened provisions for regulation of the probity aspects of the industry by the Victorian Casino and Gaming Authority; supported, guaranteed and indemnified Victab as it worked on to finalise a number of outstanding commercial matters awaiting settlement, with all costs charged against the public account; and authorised Tabcorp to establish a wholly owned subsidiary to own and operate the gaming machines and restricted competitions, giving it 'maximum flexibility to possess or dispose of gaming

machines within its group structure' (Reynolds 1994; Gaming and Betting (Amendment) Act 98/1994).

Several matters relating to the preparation of Victab for sale and to its decision to withdraw from the consortium seeking the casino licence were raised in proceedings before the Victorian Administrative Appeals Tribunal (AAT), but the findings were fairly inconclusive. A legal wrangle in New York courts between Victab and a North American computer company over the supply of software components was settled in December 1944, but details were to remain confidential; it will be recalled that the government had indemnified Tabcorp for any liabilities it might incur through legal actions involving Victab, so these costs became another charge against the Victorian taxpayer (Macdonald 1994). The Victorian Auditor-General, Ches Baragwanath, was also involved in 'wrapping up' operations, and his inquiries drew from him a report that, 'from a taxpayer's perspective, gaming machine assets [of Victab] ... appear to have been disposed of [to Tabcorp] well below their true value', and that Victab's 1993-94 'liabilities were overstated by \$11.25 million and net profit understated by the same amount' (AGV 1995, pp 41-8, and report in Green 1995). It appears, for example, that the value of the gaming machines transferred to Tabcorp was heavily written down because of their age, but that Tabcorp went on using them for several years afterwards. In this and other ways, the 'public's watchdog' implied that Tabcorp had been let off lightly in the privatisation settlement; it is not so surprising that the Auditor-General earned the enmity of Premier Kennett (see Snow 1997 for one comment on this row).

As will be apparent from the above account, the settling of some elements of this transition dragged on for some time, and during this period Victab remained in formal existence to process relevant matters. In 1999 Victoria still lacked a final accounting endorsed by the Auditor-General, who was reporting to parliament annually that he was awaiting a 'signed set of financial statements for TAB, 1.8.94-2.6.95'; it may of course be that, given the age of the transactions, the Audit Office was no longer giving their clearance high priority (AGV 1987, p.269; 1998, p. 314; 1999, p.353).

Within a couple of days of their listing on the stock exchange, the price of the shares had dropped to \$2.20; nearly seven million had been traded on the first day, with two million changing hands in the first ten minutes. But Tabcorp chief executive Wilson then urged patience until 'sentiment' surrounding the stock was removed from the marketplace (*Canberra Times*, 16 August).

Before long those who had invested were doing very well, for after this beginning hiccup share prices have risen spectacularly---in late 1997 it was assessed as having brought the highest accumulated return to shareholders in a group of ten

large floats (eight public enterprises and two propriety private companies) since November 1991 (Eastway 1997). Profitability has been good, and the business has continued to grow, with Chief Executive Wilson exploring a number of possibilities for new investments in the 'leisure and entertainment' industries. In April 1999 he launched a major takeover bid for Sydney's Star City Casino; by October 1999 Tabcorp controlled nearly 94% of Star City's voting shares and had received the NSW Casino Control Authority's approval for the merger; and a year later it posted a higher than expected annual profit 'on the back of (this) acquisition' (Lecky 1999; *CT* 1999; *CT* 2000).

After an 18.2% profit increase was declared in the 1999 Annual Report, Wilson and the other directors sought a \$750,000 rise in the maximum total remuneration payable to the board; many shareholders, supported by the Australian Shareholders Association, balked at this increase, though the chairman explained at the annual general meeting that the acquisition of Star Casino would bring another three directors to the board (Tabcorp 1999, p. 3; Neil 1999). *Australian Financial Review* columnist Steven Mayne now reported that the board itself was 'haggling' with Wilson about a new contract at a time when he already owned 1% of the company. Wilson was said to be 'almost \$30 million in front on his share package', with Premier Kennett, who had engineered his original appointment, reported as having described that package as 'obscene' when it had reached only \$17 million---now it was likely to get even bigger. Mayne remarked that the 'Vics are competing with John Fahey and his great State Bank giveaway on this one' (Mayne 1999). At the end of 1999, the Walkers, who had given Fahey's NSW State Bank sale one of two 'Wooden Spoon Award(s) for Australia's Worst Privatisation(s)', calculated that the Victab divestment had resulted in a 'profit to private sector' of \$3.2 billion (Walker & Walker 2000, pp 24, 274).

*Summarising*, the main stages in the organisational evolution of the enterprise have been:

1961: Victab established as a statutory corporation, operating at a long arm's length from government, initially to provide off-course totalizator betting facilities;

1970-90: gradually brought under much closer government supervision, and in late '80s acquired on-course tote business also;

from 1991: became one of two licensed Victorian operators of gaming machines, and much affected by development of plans for a Victorian casino;

1994: the operating business sold by public float to a new private company functioning within a contractual joint-venture arrangement with the racing industry,

with the old statutory corporation retained *pro tem* while the complicated settlement details were being finalised.

#### NOTES:

1. Notwithstanding that words like organisation and privatisation are usually rendered with an 's' in Australia, the word 'totalizator' is normally (although not always) spelt with a 'z': that practice is maintained here.
2. The starting price (SP) is 'the final quote returned on a runner by on-course bookmakers, and illegal bookmakers pay out on this price' (TABV 1987, p. 2).
3. Commissioned variously by the government, the reconstructed Victab board and the racing industry, Deloitte Ross Tohmatsu, Macquarie Corporate Finance, Arthur Andersens, KPMG Peat Marwick, DMR Group Australia Pty Ltd and Centaur Corporate Finance (formerly Lloyds Corporate Advisory Services) were all involved in this consulting process.
4. At this point former chief executive Neil Walker went public to attack the fairly widely held view that the troubles in Victab were largely due to poor management. 'Every major business decision', he said, had been 'subject to ministerial approval as a statutory requirement', and 'the substitution of business decision-making based on business acumen free of political expediency is the greatest efficiency likely to flow from privatisation'. He congratulated the Victab management and staff on generating the benefits now considered likely to flow from privatisation (Walker 1994).
5. The Labor Party returned to government in Victoria towards the end of 1999, but there was in the event little evidence of any desire to turn this particular clock back. In his election campaign launch in September 1999, the State ALP Leader and now Premier Steve Bracks made a number of anti-privatisation statements (Bracks 1999); however it is generally accepted that his position is that, while a Bracks government will undertake no further privatisations, it will not seek to undo those carried through previously by the Kennett government.

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## Chapter 9

### **SNOWY MOUNTAINS ENGINEERING CORPORATION\***

The sale of the Snowy Mountains Engineering Corporation (SMEC) was the first Australian privatisation by management buy-out. There were particular circumstances which governed the choice of this form of sale: the account will show how the choice was influenced the fact that the headquarters of this public enterprise was located not in an Australian capital city but in the small country town of Cooma, situated in a marginal electorate that usually swings to the new government with each change of government. The managers of the enterprise were able to exploit this circumstance to procure a sale contract beneficial both to themselves and to the community with which they were so closely connected.

The case study examines particularly the influence of key stakeholders in the privatisation decision-making process; the role of political lobbyists, legal representatives, and accounting firms; the influence of officers in the Task Force on Asset Sales in the price negotiation process; and the problem of valuing assets and the goodwill of SMEC in the absence of market competition.

#### **Foundation of SMEC and performance before privatisation**

##### *Establishment and early operations*

SMEC was established as a Commonwealth statutory corporation in 1970 when a decision was made to save the substantial engineering expertise built up within an earlier statutory corporation, the Snowy Mountains Hydro-Electric Authority (SMHEA).

There had long been interest in the possibility of turning the waters of the short and swift-flowing Snowy River back through the mountains of the Great Dividing Range to irrigate the dry lands to the west and generate hydro-electricity in the process. After protracted negotiations between the Commonwealth, New South Wales and Victorian governments, SMHEA was established as a Commonwealth authority (under the Commonwealth's defence power) in 1949 to design and construct the scheme. The organisational form of SMHEA drew both from Australian home-grown experience with statutory corporations and from the widely-copied example of the Tennessee Valley Authority in the USA (Wettenhall 1987, p. 75). SMHEA established its headquarters in Cooma, a town of about 8,000 people



about 120 kilometers south of Canberra and gateway to the Snowy Mountains where the major works would go on. SMHEA's operations over a lengthy period would provide a great boost to the economy of that area.

It embarked on a major project of river diversions, dam constructions, tunnelling under mountains and construction of electricity-generating plants, and it earned much praise for its engineering and managerial initiatives and its general competence. Much of the actual construction work was contracted out to large private firms---giving the lie to a popular modern perception that the contracting out of public business is a product of the recent reform period---but SMHEA also built up its own expert groups of investigation, design, scientific and contract supervision staffs (McIntosh *et al* 1997, pp 22-6). By the end of the 1960s the construction phase was drawing towards its conclusion, and there was considerable debate about what to do with this expert staff group. SMHEA continued on after construction was completed to maintain and operate the power generation facilities, but it was a much slimmed-down organisation.<sup>1</sup> In the later 1960s it was already bidding for and winning tenders to aid major engineering projects elsewhere in Australia and overseas, and the Coalition (Liberal-Country Party) government then in office decided to retain the relevant specialist staffs and pursue this business in a new publicly owned engineering-consulting corporation. This was the genesis of SMEC.

It was established in the form of a corporation sole by legislation passed in 1970. The corporation was constituted by a director, who was to be supported in top management by two assistant directors---this was an unusual form of authority governance, but it was modelled on that of SMHEA itself (a commissioner as corporation sole, with two assistant commissioners) and the matching facilitated a high level of cooperation and staff-sharing between the two corporations, both based in Cooma. The Minister for National Development, introducing the legislation, explained that the new corporation would 'operate as a commercial organisation, pay Commonwealth income tax and be expected to make a reasonable return on capital'. However the minister retained the right to approve the projects it could work on, advised by a statutory consultative committee; this provision was apparently an acknowledgement of the sensitivities of state governments and private organisations who might see SMEC as a potential competitor within Australia. 'As far ahead as we can see', said the minister, 'it will be centred in Cooma to enable full use to be made of existing specialist facilities' (Swartz 1970, pp 81-4; Snowy Mountains Engineering Corporation Act 39/1970) .

For more than a decade SMEC operated profitably, and it quickly established a good reputation in the highly competitive international consulting-

engineering industry. Most of its work was in developing countries, where it undertook assignments through UN agencies, the World Bank and Asian Development Bank, and its consultancies included the design and construction of hydro-electric systems, roads, bridges and water supply/irrigation/flood control facilities, urban development projects, geological and river basin studies, and survey photogrammetry. Some of the projects were very large, such as the \$30m Trengganu power project in Malaysia (Hodgkinson 1978).

By the mid-1980s, a minister in the Hawke Labor government could report to parliament thus:

Until 1983-84 the Corporation had an unbroken record of profitability, returning to government \$3.3m and corporate tax of \$10m. The Corporation developed an international reputation for the Australian engineering industry for the successful completion of some 1,100 projects in 35 countries, involving total consulting fees for the corporation of over \$200m. Its staff members grew from 192 in 1971 to a peak of more than 600 in 1983. In 1984, *Engineering News Record*, a major American publication, ranked the Corporation number 60 in the world's top 200 international design firms. Only two other Australian firms have ever appeared in these listings. The Corporation's outstanding commercial export record over the 1970s and 1980s was marked by its receipt in 1984 of the Governor-General's Award for Export Excellence (West 1985, p. 1013).

#### *SMEC adjusts to decline in workload*

In 1983-84, however, SMEC recorded its first-ever operating loss. The world-wide economic depression reduced aid flows to developing countries and so led to reductions in many development programs; these reductions were compounded by the rise of the 'green' movement, which seriously challenged the hydro-engineering approach to development; and competition from international engineering firms became much more intense as they faced dramatic downturns in their traditional markets. In July 1983 SMEC Director Doug Price reported that the corporation would have to consider retrenching staff to reduce costs. He predicted that the amount of work was unlikely to return in the short term to the high levels experienced in 1981-82. SMEC could sustain a moderate loss by using its reserves, but there had to be staff reductions to preserve long-term viability (reported *CT* 1983).

In this climate SMEC sought a review of its operations by management consultants, and introduced improved accounting, costing and management information systems. For its part the government announced its support for a continued SMEC operation based in Cooma, and approved a 'cash injection of up to \$6m largely to fund a voluntary retrenchment program ... pending decisions on a longer term restructuring'. Staff numbers were expected to decline to 360 by June 1985 (West 1985, p. 1013).

SMEC underwent its first major reorganisation during 1985, when the corporation sole style of management was replaced by a much more

conventional five-member corporate board drawn from the engineering, marketing, finance and trade union sectors and including a full-time managing director. The new legislation also removed restrictions on the range of engineering activities open to SMEC, allowed it to form subsidiary companies and enter into joint ventures, required it to act in accordance with sound commercial principles and otherwise aligned it with developing government policy relating to statutory authorities (West 1985, pp 1012-3; Snowy Mountains Engineering Corporation Act 101/1985).<sup>2</sup>

### *First calls for privatisation*

During the debates on this legislation, the Coalition parties issued their first call for the privatising of SMEC. A joint meeting of the parliamentary Liberal and National Parties in Canberra in April 1985 agreed that, 'in Government [they] would sell it off to private enterprise'. Their spokesman, Shadow Minister for Housing and Construction Michael Hodgman, was reported as saying that 'the continued existence of the corporation and its expanded activities were inconsistent with the philosophy and fundamental principles of Liberalism', that the 'corporation was a burden on the taxpayers', and that it 'competed unfairly against private enterprise professional engineers' (*CT* 1985).<sup>3</sup>

The call was repeated in 1987, when the Opposition Spokesman on Industry, Technology and Commerce, Senator Austin Lewis, said after the tabling of SMEC's annual report in the Senate that the organisation should be privatised (*CT* 1987). This report recorded the capital injection of \$6m to assist SMEC to continue operating. In 1986 it had suffered a reduction in turnover of 25% on the previous year (to \$ 26.9m) and incurred an operating loss of \$ 3.6m (SMEC 1987, p. 4). Ironically this privatisation call came on the same day that Labor's parliamentary caucus carried a strong anti-privatisation motion, specifically including SMEC in its list of enterprises to remain in full public ownership (Malone 1987).

### **Conversion from statutory corporation to company**

To the delight of its supporters, SMEC returned to profitability in 1987-88, recording an operating profit before tax of \$270,000, against a predicted loss of \$1.5m (Jones 1989, p. 976; also *CT* 1988b). However it now faced another major restructuring, the second in its fairly short life as a public enterprise.

As Minister for Industry, Technology and Commerce, Senator John Button announced on 17 August 1988 that SMEC would become a company as a

further step in implementing the Hawke government's program to improve the performance of government business enterprises (CT 1988a). This conversion was effected by legislation passed in 1989, which in Minister Jones's words had 'the twofold effect' of 'making SMEC subject to the Companies Act ... and enabling the removal of many of the statutory controls that have applied in the past and which are inappropriate for a public company'. The Commonwealth would be its sole shareholder, and 'mechanisms [would] be established for strategic oversight of [its] activities by the Government and to ensure that the company operates within wages and industrial relations policies of the Government'. The legislation provided for continuity of corporate identity across the conversion 'from the Corporation to the new public company', so that all existing contracts and agreements could continue to operate. There was also a provision for establishment of a special share premium account, which the minister explained might be used in the future to allow for the introduction of a staff equity participation scheme (Jones 1989, pp 975-8; Snowy Mountains Engineering Corporation (Conversion into Public Company) Act 66/1989).<sup>4</sup>

The changes became effective on 1 July 1989, when the enterprise was formally retitled Snowy Mountains Engineering Corporation Limited. It was now a public-sector company; but it was not destined to remain long in the public sector, and its staff, or more precisely a leadership group among them, were to play a prominent part in shaping the events which would eventually move them to the private sector.

## **The privatisation process begins**

### *Two main impulses*

There were two main impulses for the privatisation of SMEC, one coming from the government as potential seller and the other from this staff group as potential buyer. Once it was decided to sell the enterprise, however, the staff group had to fight hard to prevent a trade sale which would, in their estimation, have seriously damaged their stake in the enterprise.<sup>5</sup>

### *Early buy-out schemes*

Once members of the Coalition parties began calling for privatisation, senior SMEC staff began developing plans for a buy-out---this was reflected in the provision for a possible staff equity scheme in the legislation which converted SMEC from a statutory corporation to a government-owned company. When that legislation came into effect, Minister Jones again hinted that, at some time in the future, employees might be offered some equity in the organisation;

*Canberra Times's* government roundsman Mike Taylor was probably correct in suggesting that this was 'an unprecedented suggestion by a member of the Federal Cabinet', though he erred in stating that SMEC employees were already 'private-sector employees' (Taylor 1989). Now a 'staff buy-out committee' was formed, and the the SMEC board chairman, Jeff Cook, quickly prepared a number of proposals for the distribution of shares to employees, with entitlement to buy shares generally to be based on a formula including salary level and number of years of service.

Two options appear to have been considered: that staff might be offered *some limited* equity, as was happening in some public enterprises elsewhere for largely motivational reasons, Singapore Airlines being a notable contemporary example (Thynne & Ariff 1987, pp 117-9); or that the *whole* enterprise might be disposed of by government through a total staff/management buy-out, as in the case of Britain's National Freight Corporation (Bradley & Nejad 1989; Chambers 1991, pp 289-95). But, either way, the proposal was blocked by opposition from the Australian Council of Trade Unions (ACTU), and in the SMEC view all privatising options were closed off.

The consulting firm Arthur Andersens had been commissioned in late 1990 to provide advice on restructuring options for SMEC, and it 'had identified either outright sale or merger with another engineering consulting firm as the preferred future option'. However the government indicated in mid-1991 that it preferred 'to retain ownership ... through restructuring aimed at improving efficiency and accountability' (Downie 1991).

In the knowledge that a federal election was due early in 1993 and that both the governing Labor and the opposing Coalition parties regarded Eden-Monaro as a critical seat, the group pushing for staff shareholding maintained its pressure. The mayor of Cooma Shire advised it to employ Peter Phillips, a Canberra lobbyist who had previously done good work for the shire council, and he became associated with the group in late 1992.

#### *A budget announcement*

By this time Labor's Finance Minister Ralph Willis had incorporated the sale of SMEC into his planning for the 1992-93 budget. This decision was announced when the budget papers were presented to parliament, along with the proposed sale of the Commonwealth Serum Laboratories (CSL) and some smaller divestments (Dawkins & Willis 1992, p. 3.279). However it was a

commitment to sell the enterprise, not a statement about how that would be done.

For SMEC people, this announcement ‘came like a bolt out of the blue on budget night’ (Boniface 1996). SMEC’s board and management had not been given prior notice; nor had the minister and officials they related to in the supervising Department of Industry, Technology and Commerce (DITAC).<sup>6</sup> But it was not unwelcome news, and the SMEC management quickly reactivated its formal staff buy-out committee and established a ‘fighting fund’ to oppose possible sale to an existing private company. Cooma Shire Council contributed \$5,000 and slightly over \$5,000 was contributed by SMEC staff. At least on this side, it was now abundantly clear that a total buy-out was envisaged.

### *Impact of oncoming election*

In consultation with Phillips, the group determined to work on the sensitivities of the political parties. An early move was to convince the opposition spokesman on privatisation, Liberal MP Julian Beale, that it was in the Coalition’s best interests to have him visit Cooma and ‘make an absolutely unequivocal statement’ to confirm that a Coalition government would sell SMEC, that it ‘would at all times be mindful in the sale of the longer-term interests of Cooma, and the Cooma community, and the Snowy Mountains region’, and that ‘it would support the legitimate aspirations of the management/staff buy-out team to be the purchasers of SMEC’. Beale agreed, visited Cooma, and made a statement to this effect. It then took about ‘three nanoseconds’ to bring this to the attention of Finance Minister Willis and say: ‘Geez these fellows are making a fair sort of commitment; what’s the government going to do to match it?’ (Phillips 1997).

### *Activity in Cooma: establishing a buy-out company*

The buy-out committee decided that a commercial vehicle was needed to ensure a consolidated approach in the pursuit of their objective: ‘a loose group of people’ could not approach the government. A Cooma solicitor therefore advised SMEC’s General Manager International, Jack Boniface, who had assumed the leadership of the buy-out group (and later became SMEC executive chairman), that they should buy a shelf company, and Tinbury Pty Ltd was acquired for this purpose. Six SMEC managers were the initial shareholders, each buying a dollar share in the company; and several different classes of shares were offered to other staff members. To overcome some suspicion in the group that just a few would have voting shares and that the others would put their money in for nothing, Tinbury was converted from

a private to an unlisted public company early in 1993 (Boniface 1996). The intention of this management/staff group was to finance the purchase of SMEC themselves, but of course they wanted to keep the sale price as low as possible and they maintained lobbying pressure to ensure a *non-competitive* sale.

The Tinbury group was now approached by several major engineering-consulting firms interested in buying the business. It believed (Boniface 1996) that these firms were mainly interested in acquiring the SMEC name, international reputation and goodwill, and that a successful buyer would strip the enterprise, sell most of the physical assets in Cooma, move about 20 core staff who had the detailed knowledge and experience of the international consulting market to a capital city to join its own head office, and dispense with the rest. The implications of the alternative trade-sale route to privatisation were thus made very clear, so the SMEC management was reinforced in its view that a staff buy-out was necessary.

Lobbyist Phillips calculated that it was in *the government's* interest to ensure that the reputation SMEC had built up was 'not besmirched or debauched by somebody taking it over and going through a wholesale change---and causing irreparable damage to the reputation of Australia's external engineering services industry'; and so he 'played upon' that consideration too (Phillips 1997). And Cooma Shire Council never needed persuading. It was convinced that, if SMEC was sold on the open market by a competitive tender process, the purchaser would move the headquarters from Cooma resulting in the loss of a major local employer. It was obvious also that the sale of a large number of residential properties on the small market would lead to a plummeting of local property values. So the Council agreed that a trade sale would do much damage to both the staff and the Cooma interest, and a shared desire emerged to retain SMEC as a separate entity and ensure that its headquarters remained in Cooma. In one reported threat, Council President Bill Rushton (who was a former SMEC manager) said that, if a decision were made 'against the interests of the town', then the Cooma 'community would march on Parliament' (McPhedran 1992).

The question of the value of the enterprise now arose, and was complicated by concerns about the accounting treatment of the accumulated sick leave credits of SMEC staff. Successive accountants had adopted different practices in recording this item in enterprise budgets, causing large fluctuations between book profits and book losses. The Tinbury group wanted a valuation of SMEC that overrode this issue, and contracted with Coopers and Lybrand accordingly. From this, the group estimated that SMEC was worth *minus* \$6 million. Though people who were associated with the government's handling

of this matter deny that Tinbury was ever informed, it claimed to know that Andersens had advised the government that SMEC was worth \$7 million, and so understood that there was a \$13 million gap between buyer's and seller's prices (Boniface 1996).

### *Enter the Asset Sales Task Force*

Back in Canberra, the 1992-93 budget decision to sell two public enterprises (SMEC and CSL) and a number of other assets was followed by the establishment of a second Task Force on Asset Sales (to be known as Task Force on Asset Sales B) within the Department of Finance. The original task force (now Task Force A) was heavily engaged in processing the several stages of the Commonwealth Bank and Qantas sales.

Within Task Force on Asset Sales B, an advisory committee to progress the SMEC sale was immediately set up, its membership comprising senior officials from the Finance Department (Ted Mathews, who chaired the task force) and DITAC (Malcolm Farrow), and new SMEC chairman Neil Galwey (TFAS 1994). Tim Garrard, a Canadian Industry Department officer on two-year exchange duty in DITAC in Canberra, became associated with this work around that time, and it occupied him during his last nine months in Australia (details from Garrard 1997; Farrow 1997): Garrard now becomes central to our account. He had a Master of Public Administration (MPA) degree from Queen's University in Kingston, Ontario, and had been in charge of Canadian government relations with the aerospace industry at a time when two aircraft manufacturers (Canadair and Canadian de Havilland) had been privatised. He had not been closely involved in that privatisation process, but had had some knowledge of it.

DITAC staff had been monitoring developments concerning SMEC. They had been aware of Finance Minister Willis's desire not to let Opposition leader John Hewson 'get too far ahead' in the lead-up to the election, and knew of Willis's inclination to push privatisation---he had been asking around the departments 'what are the next cabs on the rank?' As DITAC First Assistant Secretary, Farrow had heard that Finance was interested in putting SMEC on the list. So Farrow had 'sent signals' to Finance warning both that there was a major problem arising in relation to defects in the Dartmouth Dam project SMEC had undertaken in association with Victorian state authorities, and that SMEC would be difficult to sell because 'its assets were the people, not much more'. On budget night in 1992, therefore, the DITAC officers had been surprised to



discover that Finance hadn't heeded their advice. Thereafter Farrow kept reminding Finance of the problems, adding his awareness of the 'political problem', ie the Cooma interest. Eventually Finance responded: 'We hear you. What do you suggest?' (Farrow 1997; Garrard 1997).

Garrard became closely involved with the Finance team considering the matter. The first step, taken through Task Force B in the light of knowledge of British privatisation practice, was to call for tenders to undertake a 'scoping study'. The call went to eight large consulting firms, of which four made bids. The contract went to Arthur Andersens who, in that earlier report, had recommended a trade sale or merger for SMEC. Now, assisted by another consulting firm, they produced a thick report in January 1993 which dealt in turn with the viability of the company under a possible new ownership; realising the full potential of SMEC; the interest of the stakeholders (which Garrard described as 'code for Cooma'); and fair value to the taxpayer. All this, as Garrard put it in interview (1997), 'with Dartmouth Dam hanging over all'.

This dam had been built for the State Electricity Commission of Victoria (SECV) on plans prepared by SMEC. But there had been a serious accident with the sluice gates, and at this time there were six writs in existence: SECV v SMEC, SMEC v SECV, and various insurers against both. Secret discussions were also going on with the insurers as they tried to broker an agreement. SMEC stood to lose \$90 million, ten times the value of its assets, and would be 'vaporised' if the decision went against it. The Commonwealth had firm legal advice that *it* was not liable, but people in the task force were very anxious because they believed the Commonwealth never had and never would pull the plug on one of its own agencies---this because of the likelihood that the Commonwealth would find it much more expensive to borrow if it was understood that bankruptcy of an agency was possible (Garrard 1997; Bills 2000).<sup>7</sup>

Another step now taken by the task force team was to issue a call for expressions of interest in purchasing SMEC. There were 'about 25 or 26 respondents, one of which was the staff/management buy-out group ... task force officers made judgments about which offerers were worth talking to further, and they conducted on-going negotiations ... it remained very much a competitive process all the way through'; and some joint venturing possibilities were considered (Phillips 1997).

Awareness of the Dartmouth Dam issue encouraged Finance officers to look towards a quick sale, which they thought might lessen Commonwealth liability. But it was a very serious issue which necessitated much consultation

with legal advisers. Lobbyist Phillips believes that it worked to the advantage of the Tinbury group, whose engineer members had a close knowledge of the problem and insisted throughout that their design work had not been defective; thus they had confidence that SMEC would not be found liable. No other potential buyers had this sort of inside information, and they 'would have had to put a lot of work in to investigate the issue' (Phillips 1997).

The task force team now put together a ten-page memo for Finance Minister Willis, arguing that SMEC was 'unsellable' unless the issue was settled. The memo noted four possible approaches: granting the buyer full indemnity (which might lead to a monster settlement award); taking SMEC off the market (politically embarrassing in view of the budget announcement); doing nothing 'in a busy-looking way'; or settling for limited liability (money-back payment to the buyer if a heavy damages bill were to eventuate). It seems that the Finance people favoured the first option---unlimited liability---and this was the eventual recommendation. Garrard recalls his amazement that the minister approved it (this and next two paragraphs from Garrard 1997).

But Garrard got support within the Finance Department, and was invited 'to say what you think' in a meeting of concerned officers. He said he believed what had been approved was 'a terrible option', one which, moreover, might set a precedent for future privatisations. The matter was again brought to the minister's attention, and Willis was converted to the view that limited liability was the best option. Garrard prepared a fresh memo, which was now approved.

Andersen's scoping study report now came in, recommending a trade sale because the enterprise was too small for flotation. But they also said that a satisfactory Dartmouth Dam outcome had to be found; until that was done, it would be impossible to put a reasonable value on SMEC. It seemed that the proposed staff buy-out was off the agenda. The Asset Sales Task Force was always prepared to consider a bid from Tinbury in competition with other bids, though its best hope was that key SMEC staff would ally themselves with one of the trade bidders.

### *Tinbury again*

Then came the March 1993 general election, which returned the Keating Labor government. Within DITAC, Farrow had predicted that the staff buy-out group 'would get to the politicians'. The Cooma issue was raised first by Coalition candidates, and then taken up by Willis. Working through Phillips, the buy-out group had secured the strong support of key Labor

parliamentarians including the sitting member for the electorate covering Cooma (Eden-Monaro), Jim Snow, who happened to be chairman of the ALP Caucus; and Willis had been persuaded. Cabinet determined accordingly, and so staff buy-out was now the preferred option (Willis 1993a; Farrow 1997). Garrard had to spend his last few months in Australia dealing with it.

There are deeply contrasting views about developments over these few months. The SMEC buy-out group thought it very strange that the government had ‘a foreign public servant negotiating the sale of an Australian asset’ (Boniface 1996), and saw him as an unfriendly and unhelpful ‘haggler’. For them it was a very emotional issue, over and above the commercial considerations. Tinbury had ‘half a dozen key staff shareholders---Jack Boniface being the primary one---they risked a lot of their money---I mean these guys put their houses up---so they took a huge risk” (Bills 1997). They reported that no progress was made, and negotiations were stalled, until after Garrard had left the country; in fact they walked out of a meeting with him on 20 June 1993 (Boniface 1996). From their point of view, once Garrard had left and an Australian, Kym Bills, had replaced him, there was a greater readiness on the part of the government to negotiate a price acceptable to the buyers, and the main outlines of an agreement were settled within two weeks.

Not surprisingly, Garrard, who is no foe of privatisation,<sup>8</sup> sees it differently (from interview). Of course he wanted to reach a conclusion before his exchange period ended on 30 June. But he was also aware of ‘extreme tensions among the SMEC staff---with Tim Garrard in the middle’; a December 1992 *Canberra Times* feature had highlighted, for all to see, the desperate concerns of non-managerial SMEC staff and their Staff Association, and their deep suspicion of the SMEC board and management at that time (McPhedran 1992).<sup>9</sup> And all Garrard’s socialising into the profession of public administration had armed him with a deep conviction that it was his duty as a public official to protect the taxpayer interest; while on attachment to the *Australian* public service, it was the *Australian* taxpayer who deserved his best service. Lobbyist Phillips thought Garrard ‘was very conscious of the role that he filled in terms of his engagement as an exchangee ... he was absolutely meticulous in doing everything right ... and he drove some of those engineers to distraction with his bureaucratic rectitude’; but ‘I found him a thoroughly reasonable person to deal with’ (Phillips 1997).

Other engineering-consulting firms continued to press their case for a trade sale. ‘They were lobbying the government to change its mind’, and this pressure did not come only from private firms---‘the Tasmanian Hydro-Electric Commission were one of the key ones who were aggrieved; they desperately wanted to buy it’. There were letters to ministers, and ‘phone

calls and threats and everything else' to officials (Bills 1997). To counteract these moves, the Tinbury group, with the Cooma Shire Council behind it, hunted for adverse comments about the competitors, and Phillips's job was to ensure they were publicised (Phillips 1997).

Garrard was still prepared to recommend against a buy-out proposal if Boniface could not demonstrate that he had significant staff support, but some members of the SMEC board were continuing the fight against the trade-sale option. The board was in a difficult position: on the one hand, it blocked moves to prepare the company prospectus necessary for a trade sale, but on the other it had some concern that the Tinbury group was being too transparently self-serving in its activities. There were some Tinbury suggestions that the board should be sacked to remove this obstacle, though they were not pursued.<sup>10</sup> Garrard noted that the board was not consulted before the sale announcement was made nor given any role in the sale, and drew from this the lesson that all 'privatisation planners' need to think carefully 'through what role the board should play' (Garrard 1997, 1998; also Bills 2000).

## **Towards a final deal**

### *Proposals and negotiations*

Acting for Tinbury, Boniface was now asked to make a firm proposal. This was that the management group should buy the enterprise for one dollar; the potential Dartmouth Dam liability was still much in mind, but also Tinbury made much of the ongoing liability for accumulated sick leave. For Garrard, the government simply had to resist making any sick-leave pay-out at the time of the sale, and let any staff members' rights pass to the new owners/managers to sort out. Garrard advised Minister Willis not to accept this offer, and Willis agreed.

So Tinbury was asked to make another bid, and one for \$1 million arrived. Garrard was about to leave Australia, and there was a bargaining meeting. The government side offered to sell for \$3 million, but they had agreed among themselves that they would take \$2 million.

Garrard was replaced as the task force's principal negotiator by Kym Bills, a career Commonwealth public servant who had spent some time on leave as senior adviser to the South Australian opposition leader and in that role had uncovered many of the problems with the South Australian State Bank and the South Australian Insurance Commission before they became public knowledge. Like Garrard, he believed in privatisation (Bills 1997, 2000).

Within a short time, both parties settled at an agreed price of about \$2 million. Boniface and his colleagues saw Bills as more sympathetic to their cause than Garrard, and have said that the settlement would not have come without this change. But, as Bills says (1997), ‘that’s an untestable proposition’; and it is likely (but also untestable) that the hard line Garrard had followed resulted in a better settlement from the Commonwealth’s point of view.

### *The agreement*

The drafting of legislation to cover the sale had commenced in March 1993 and, with the settlement now in train, it was introduced to parliament in September and passed in October. But it would take many months to draw up all the necessary contracts and there could still be hiccups, so the legislation adopted a conditional note. In introducing it, Finance Minister Willis spoke warmly of SMEC’s achievements and wished the likely new owners well in the future. He then explained the terms of the agreement with Tinbury, emphasising that the government had ensured that careful consideration was given to issues of importance to the enterprise’s staff. A large part of the legislation was in fact devoted to these issues (standard in Commonwealth asset sale legislation), and it would come into operation when, in the opinion of the Minister for Finance, a majority of voting shares in SMEC had passed out of the Commonwealth’s hands (Willis 1993b, pp 960-2; Snowy Mountains Engineering Corporation Limited Sale Act 54/1993).

In negotiating the final details, the task force officials had to achieve a balance between getting an adequate return for the Commonwealth and not leaving Tinbury so debt-ridden that it would collapse after the sale---with the Commonwealth then having to pay out staff entitlements. A union representative was heavily involved in these final negotiations (Bills 2000). The draft Sale Agreement was approved by cabinet in October, and the sale details were announced by Willis on 9 November 1993:

- \* SMEC was sold to Tinbury for an up-front payment of \$1 million and two subsequent payments of \$250,000, due on 1 July 1994 and 1 July 1995 respectively.
- \* The Commonwealth also received its normal \$571,000 dividend in respect of 1992-93 profits.
- \* Tinbury agreed to the extinguishment of tax losses which could realise a further benefit to the Commonwealth of over \$1 million.
- \* SMEC’s headquarters had to remain in Cooma for at least five years.

- \* Tinbury could not dispose of shares to non-SMEC employees for at least five years.
- \* Tinbury had to make a further share offer to enable SMEC staff who were not already shareholders, or who only had a small shareholding, to apply for shares on terms at least as favourable as the original offer.
- \* In respect of Dartmouth Dam, it was agreed that, if a decision went against SMEC, Tinbury had a 'money back guarantee' of its \$1 million up-front payment; and the unions had a guarantee that the Commonwealth would pay out any outstanding annual leave and long-service leave if the company were forced into liquidation as a result of an adverse judgment (Willis 1993c; TFAS 1994).

SMEC Ltd became a wholly owned subsidiary of Tinbury, and the staff were formally employed by SMEC Services Ltd, a wholly owned subsidiary of SMEC Ltd (Boniface 1996).

The general manager of SMEC's Australian business, Peter Busbridge, was soon extolling the settlement which, he said, marked 'the first federal government business enterprise to be sold through a management buy-out', and suggesting that 'it should be used as a model for further privatisations'. He noted that some would have preferred a trade sale, but considered 'it was a far better option to enable the staff of SMEC to have the opportunity to decide their own futures': 50% of SMEC's staff were involved in the staff company Tinbury, and a further offer would now be made to those who have no shares or only small shareholdings. Solicitor Chris Chenoweth, who was an adviser to Tinbury on the sale, was also quoted soon after the settlement. He said it 'was a hard-fought deal', but provided a good model for privatisation: 'It restores to the people who put the value into the organisation, the incentive to make it even more valuable' (both reported in Macdonald 1994).

Tinbury had not needed to take out a loan to finance its purchase: six key SMEC staff had put in about 50% of the capital, and each of them had a shareholding of between 10% and 20% . While the objective had been to get as broad a cover as possible from among the employee group, Chenoweth had advised against very small parcels. On 1996 figures there were 140 shareholders in all, as against about 500 people on the Australian payroll, so the coverage had declined in two years. However, while many employees owned between 1,000 shares and 5,000 shares as a demonstration of loyalty to the organisation', the holding of shares provided no guarantee of continuing employment (Boniface 1996).

A summary by Bills for TFAS (1994) makes this claim:

The sale was a significant achievement given that it was negotiated in the shadow of a potential contingent liability totalling \$89 million due to an incident at Dartmouth Dam, involving SMEC as one respondent ... A major factor in the success of the sale was the ability of the sale team to focus on particular high risk issues that may have threatened the sale. The development of a risk management strategy assisted in ensuring that issues which were outside the direct control of the sale team were managed and monitored to minimise perceived threats to a successful sale outcome. In particular, the Dartmouth Dam litigation issue; the negotiation with Tinbury to meet the required conditions of sale; the management of the delicate relationship between the staff buyout members and the Board and management of SMEC; and the negotiations with the unions were risk areas which required close attention.

### **After privatisation**

The structure of the SMEC organisation did not change markedly after privatisation. However a large business development unit previously responsible for marketing activities was abolished, with marketing responsibility decentralised to all staff in the field. Boniface moved to become both chairman and chief executive officer whereas, before privatisation, the two offices were separated. As he explained it, the emphasis at board level was now on strategy and policy rather than compliance issues, board members had to be 'really interested in the future of the company', and the staff had greater incentive to chase new work. For many staff the change overcame the stress caused by years of uncertainty about the future; but there was also a strong post-privatisation trend towards contract appointments, with the non-monetary benefits in public-sector style employment converted into higher cash incomes as in the private engineering-consulting industry (Boniface 1996).

After the sale and on a SMEC initiative, a 'mediation' chaired by former NSW Chief Justice Sir Laurence Street, facilitated by a prominent Brisbane law firm, and involving all parties to the previously issued writs relating to Dartmouth Dam, arrived at a settlement of that affair which left SMEC free to carry on under the terms and conditions of the original sale agreement.

The core skill of SMEC is and always has been project management, especially in hydro-electricity projects. However the green lobby has been active in South-East Asia and its effect has been a major cut-back in dam construction and hydro-electricity works. So SMEC has had to diversify its operations: there is an increased consciousness within the company of the market for services related to environment protection, and it has also moved significantly into the education and health sectors of developing countries, building facilities but also with involvement in eg curriculum development and training.

It has also become more active in the Australian domestic market. The original SMEC Act prevented the enterprise from undertaking engineering

works in Australia except under very stringent provisions; the original purpose of SMEC was to sell expertise overseas. But the privatised SMEC is not so constrained and is able to undertake work freely in Australia. Its new objective was to do 50% of its work in Australia, and 50% overseas---without any reduction in the international work. In the first few years after privatisation, it achieved a business growth rate of around 20% per annum.

Another objective has been to become an equity holder in a major project, a move that would provide a regular income that would reduce the present fairly precarious dependence on contract fees. But, as at mid-2000, this objective has not been achieved, and SMEC operates under an acute awareness that its own growth and future prospects are more-than-usually dependent on the health of the global economy. In its private form it remains an unlisted company and demonstrates a strong determination to protect its privacy, so that information on its internal operations, shareholding structure and profitability is hard to come by; it is arguable that this stance actually reduces opportunities for further development.

In mid-2000---seven years after the sale, exceeding the five-year guarantee under the sale agreement---the headquarters remains in Cooma, indicating that that rural community and its residents have done well out of this privatisation. It is probable that this outcome would not have been achieved under any other form of privatisation, to a degree justifying the tortuous process through which the sale took place. Of course, as before, most of its operational work is conducted away from Cooma, and recent advances in communications technology have provided easy links between that headquarters and field operators elsewhere in Australia and overseas. However, in the view of a close observer, this very continuity has made it more difficult for SMEC to break away from the 'public sector culture' that infused its earlier operations: Peter Phillips, who contributed so significantly to the cause of the Tinbury group, explains picturesquely that it has not proved possible to 'take Cooma out of SMEC', and that the enterprise's 'roots are buried deep in the basalt of the Snowy Mountains' (Phillips 2000).

Given the stirring battle between the Tinbury group and the government officials wanting to secure a fair price before selling the enterprise to them, it is important to acknowledge that there was never any suggestion that the members of that group were other than highly meticulous in attending to their duties as officers of the SMEC corporation/company in public ownership. While they wanted to buy cheaply, they were fully aware of the great importance of maintaining a high reputation for professionalism and dedication in winning contracts for ongoing work, whether in the public or the private sector.



This relatively small-scale privatisation had no major impact on the community at large. However, an unrestricted sale of SMEC to the highest bidder in the private sector would probably have realised an extra \$4m to \$5m to government (provided the bidder was not saddled with responsibility for any adverse Dartmouth Dam settlement), and the general taxpayer interest would have benefited to that extent.

More generally, it is relevant that SMEC established a high reputation in its field, and made reasonable profits except for the recessionary years of the early 1980s, as a *public* enterprise; and that it appears to be giving a similar degree of satisfaction as a *private* enterprise. The other favoured party has been the members of the Tinbury group---they were prepared to accept considerable personal risk in battling for this particular solution and so would, in the view of many, be entitled to receive a good reward. They acquired a profitable company with a highly valued international reputation and stood to make future capital gains. As noted, however, the sale did not remove the element of risk: they needed to keep on winning sufficient contract work to ensure the continuing viability of their enterprise. It is likely that their degree of risk exposure is higher than that of most operators in the private corporate world.

*Summarising*, the main stages in SMEC's organisational evolution have been as follows:

1970: Snowy Mountains Engineering Corporation established as a Commonwealth statutory corporation to function as an engineering consultancy service and so save the substantial expertise built up by the Snowy Mountains Hydro-Electric Authority during the construction of the Snowy Mountains scheme; initially operated under a single commissioner, but given a more conventional corporate board in 1985.

1989: converted to a government-owned company, initially Snowy Mountains Engineering Corporation Ltd but subsequently just SMEC Ltd.

1994: sold to Tinbury Pty Ltd, a buy-out company established by a senior SMEC staff group, with SMEC Ltd becoming a wholly owned Tinbury subsidiary.

NOTES:

1. In this work SMHEA has operated as the agent for another public body, the intergovernmental Snowy Mountains Council established under the Snowy Mountains Agreement which accompanied the passing of the SMHEA legislation in 1949. SMHEA has itself, over the last few years, been the subject of intense discussion as the Commonwealth and the eastern states develop their interlocking electricity grids and move unevenly towards privatising the electricity industry. The work of SMHEA attracted both romantic and scholarly writers, and there is a large literature about it: see eg Scott 1975, chs 8-13.
2. For comment on how this policy was developing in the mid-1980s, see Wettenhall 1996, pp 248-50; for later developments, see Wettenhall 1998, pp 244-46.
3. This statement was somewhat ironical given that Hodgman was MHR for Denison in Tasmania. Denison (covering central Hobart) was the electorate in which the Tasmanian Hydro-Electric Commission had its headquarters, and that Commission---still a public enterprise---was soon to make a strong bid to take over SMEC. See more below.
4. The legislation also allowed the new company a choice of auditors, a feature of the contemporary GBE reform process. But this part of the process attracted strong protest from the Auditor-General, the Public Accounts Committee and others, and was soon adjusted: for discussion, see Wettenhall 1992, pp 228-9.
5. Our information about the privatising process in this case has been drawn mainly from a series of interviews with people who were closely involved: Boniface 1996; Bills 1997, 2000; Farrow 1997; Garrard 1997; Phillips 1997, 2000. There was much common ground between the views and recollections of these people, and they are further cited only where they are directly quoted or have provided distinctive information, or where their views differed markedly from those of the others.
6. This department has frequently changed its name in recent years, though Industry and Technology are the important core words. It was the Department of Industry, Technology and Commerce (DITAC) from December 1984 to March 1993.
7. They were obviously not aware of the experience of the First Commonwealth Shipping Line in the later 1920s, on which see eg Wettenhall 1983, p. 16. However a much more recent analysis by a South Australian Crown Solicitor has tended to support them: Selway 1995.
8. He argues, indeed, that no sensible Western government would retain public enterprises. He cites the risk factor, with the fates of the Victorian and South Australian Savings Banks as leading exhibits. He also believes it is impossible to get pure competition when government is an owner; and community service obligations can, in his view, be handled through regulatory mechanisms. In any case, he says, there was no remaining public interest function in SMEC, so it should have been privatised. But he did not believe a staff buy-out was the best option, and thought many of the arguments put by the Tinbury group were 'self-serving rationalisations' (Garrard 1997).
9. The question has sometimes been asked whether this was a management buy-out or a staff buy-out. Garrard expressed the view that he was dealing with 'a management buy-out group hiding behind a staff buy-out image', and recalled that at one stage a counter staff buy-out scheme was launched---'but it was a damp squib' (Garrard 1997).
10. This was in fact done in the case of the board of ANL Ltd, which was considered by the Keating government to have been blocking its attempts to sell the Australian National (Shipping) Line.

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## Chapter 10

### PORT MACQUARIE BASE HOSPITAL\*

This case study reports a privatisation which took a different route from that of our other cases. It did not involve a trade sale, an industry takeover, a public float or a management/staff buy-out, but rather a BOO (build-operate-own) contract for extensive private enterprise involvement in what is essentially still regarded as a public institution. Given this difference, our treatment of the case necessarily involves a course rather different from that adopted in the others.

There remain huge variations in estimates about whether the state (and therefore the general body of taxpayers) has benefited or suffered financially as a result of this transaction. We seek, in our treatment of the case, to consider the various arguments fairly, but we need to record that our conclusion has greatly offended the major private institution involved, Health Care of Australia (HCoA). The criticism we offer is not of the way that institution is managed, either now or in the past, but rather of the financial compact within which that management operates. We express our sadness that the management of the controlling HCoA considered it necessary to disassociate itself formally from our study and accuse us of political bias (Catchlove 1998). From our point of view, its failure to enter into reasoned argument with us is evidence of political bias of the same kind as that of which it accuses us.

A brief outline of the context in which this privatisation developed is presented first. The case will then be explained and analysed in more detail.

#### **The context: increasing private sector involvement in the hospital industry**

In 1978 the New South Wales (NSW) Labor Government announced that a new public hospital would be constructed on the mid-north coast to replace the old Hastings District Hospital, which was increasingly unable to meet the demands of the rapidly developing region around Port Macquarie. The plan was for the new public hospital to be completed by 1983. The promise was repeated (with varying construction starting dates) at subsequent elections, with little tangible result. Funding was provided for consultation and planning, but construction remained stalled. One of the problems related to Loan Council restrictions on public borrowing (SC 1993, p.119-20); Degeling & Thomas 1995, p. 197).

The election of a Liberal-National Coalition government in 1988, and the fall of the local seat to the National Party, brought some members of the community fresh hope, but introduced a new element into the planning process---the new government announced that the *private sector* was to build and operate a new 'for-

profit' public hospital in Port Macquarie. Despite community outrage over the decision, Health Minister Ron Phillips signed a contract with the private hospital management corporation, Health Care of Australia (HCoA), in December 1992, construction took place over the next couple of years, and the 161-bed Port Macquarie Base Hospital (PMBH) opened in November 1994. As a base hospital, PMBH now provides many of the services expected of a public regional hospital, including social work, some outpatient services, and accident and emergency, mental health, oncology, intensive care and neonatal facilities. HCoA owns and operates the hospital, accepting public patients under a 20-year contract arrangement with the state government.

PMBH represented the first privatisation project of this kind in the Australian hospital sector. The hospital 'industry' has always straddled the public and the private sectors, with private hospitals providing many services, and state and federal governments paying most costs. In the past, however, the private hospitals, thought of as constituting a 'cottage industry', were usually small independent organisations owned by medical practitioners and their families, or church hospitals. A complex financing system had developed, with government providing most of the revenue (drawn from the tax base) and transferring it to the private sector in the form of subsidies and the provision of infrastructure (such as the training and education of skilled workers, and an extensive research system). The national financing system is known as Medicare,<sup>1</sup> and it is composed of grants to the states and territories as well as a universal insurance system in which all essential medical costs are paid for by government (or at least substantially subsidised), regardless of whether one has additional private cover, and whether or not one is a public or private patient. This combination of a public and private system has offered opportunities for private investors that are simply not available in nations with fully public or fully private health systems.

In the mid-1980s, a Senate Select Committee considered how the then-existing private hospitals were regulated, and found that there were no effective controls either over their management or their impact on health spending (SSCPHNH 1987). A large section of that report dealt with dangers to the Australian health system expected to come from the growth of corporate chains of hospitals, an issue highlighted when the Liberal-National Coalition under Greiner won government in NSW in 1988, and new Health Minister Peter Collins promised or threatened (depending on the point of view) a 'new era for private hospitals' (reported Bacon 1988; see also Collins 1991).

Over the last decade the 'cottage industry' pattern of ownership has mostly been supplanted by large corporations owning 'chains' of hospitals following a model initially established in the United States. Recognising the investment opportunities, these new privately owned hospital chains are increasingly

associated with public hospitals, and they have become intimately linked with the privatisation programs of Australian governments. There have been several strategies, including (using NSW examples) the development of new private hospitals in the grounds of public teaching hospitals (Prince of Wales/Prince Henry and St George in Sydney), public ownership but private management (under lease: Liverpool and Hawkesbury), and private ownership and management with public funding (St Vincent's at Lismore). Port Macquarie under its BOO contract represented a fourth strategy (Collyer & White 1997; White & Collyer 1998; also Degeling & Thomas 1995, esp. p. 198).

This new hospital industry structure is the result of a widespread change in the policy of Australian governments directed towards the active pursuit of private sector participation for a wide range of infrastructure and service provision projects (Collyer 1998, and see eg Harris 1996, 2000; Neutze 1997). The signing of the contract with HCoA for the construction of PMBH followed public advocacy by the then NSW state government of a policy of allowing a larger role for the private sector in the delivery of hospital services (SC 1993, p. 62-3).

### **The decision to move from public to private ownership**

#### *Beginning official investigations*

Prior to the decision to privatise, the state government was faced with a number of demands for new public hospitals. This was due, at least in part, to the aging of the hospital infrastructure in NSW, where by the late 1980s 60% of the hospitals were over 30 years old, and where expansion in the newer suburbs had resulted in an uneven distribution of hospitals and a concentration of services in the Sydney city centre (Wraight & Bessler 1992, p. 4).

In 1990 discussions were held between the Premier's Department and the ANZ Bank about the possibility of alternative funding structures for public sector infrastructure projects. Public servants in the NSW Health Department (hereafter NSW Health)<sup>2</sup> were asked to come up with a range of alternatives for Port Macquarie, and to include an option of private sector participation. For about 18 months, public servants from NSW Health, the Premier's Department and State Treasury met with the Health Ministers<sup>3</sup> to examine the various options. Departmental officers examined the possibility of private sector involvement in hospital services and prepared an assessment of the cost of building a new public hospital for Port Macquarie compared with the option of allowing the private sector to build and operate a 'public' hospital:

The original proposal for looking at alternative funding models ... came out of a shortage that we had within in our forward capital program. So we had a backlog of need, in terms of substandard infrastructure, and we had an

inadequate supply of capital to address those. So we were looking around for alternative ways to structure funding for projects. We pushed hard at asset sales and then the bottom fell out of the asset market ... but we still had the need for our projects (NSW Health officer).<sup>4</sup>

In 1991 the Health officials presented their findings to Health Ministers Hannaford and Phillips. The position of the departmental officials was that the introduction of private sector participation into the PMBH project would not be the best option. It would introduce competition, but would present too many problems to be viable.

### *The ministerial response*

The response from the ministers was to instruct the officers to pursue the private option, regardless of the potential problems. It was felt that the privatisation option would introduce competition into the NSW Health sector, forcing it to become more efficient: 'there was an inherent feeling at the time within the Liberal government that the private sector could do things more efficiently' (NSW Health officer).

The result of these discussions was that PMBH was nominated by Minister Hannaford in August 1991 as a potential private sector infrastructure project (NSW Health 1992, p. 2). An invitation to tender for the construction and operation of the hospital was issued in September 1991. Three tenders were received, and they were evaluated through November and December 1991 (NSWAG 1996, p. 397). As already noted, a contract with HCoA was entered into in December 1992.

### *Parties involved*

The main parties involved in this privatisation process were the state government (particularly the Departments of Treasury and Health); the financier (Hambros Australia), with development funds from NatWest Australia Bank Ltd; the builders (Fletcher Constructions); the Mayne Nickless corporation (and subsequently its hospital management company, Health Care of Australia); and various community groups and organisations including the local Council of Trade Unions, and the Hospital Action Group.

The publicly visible partner with government in the privatisation is the hospital management company, Health Care of Australia (HCoA). This company now runs the base hospital; it was established as a subsidiary of Mayne Nickless in 1991, when the latter purchased the hitherto US-owned Hospital Corporation of Australia. Mayne Nickless itself began as a transport company, diversifying into the hospital sector in the late 1980s and becoming Australia's largest provider of private health-care services by 1996. HCoA has now extended its operations into Asia (White & Collyer 1998, p. 494).



When the privatisation agreement was eventually concluded, it involved the private sector building a new hospital which would be 'owned' by the special purpose company, PMBH Ltd. This would be under mortgage to the banks, NatWest Australia Bank (51%) and Hambros Nominees Australia Pty Ltd (49%). Hospital services would be provided by HCoA (the operator) under a 20-year service agreement with the Macleay Hastings District Health Service (now part of the Mid-North Coast Health Service). The new hospital would provide both private and public (Medicare) hospital services, and would be built on land owned by Hastings Council.

At the end of the 20-year contract period, HCoA has an option to purchase the hospital from PMBH Ltd. If it fails to take up this option, other purchasers (such as the government itself) may show an interest.

#### *Arguments for and against privatisation*

When the Greiner government publicly announced privatisation to be the best option for Port Macquarie, there were four specified reasons. First, NSW Health and Treasury reasoned that the state faced a shortage in available capital for the provision of public infrastructure, and that the privatisation of PMBH would solve this fiscal problem in this case by injecting private sector capital into the public sector. Second, the privatisation would provide more cost-efficient services than could the public sector. Third, it would provide a more timely upgrading of facilities. And fourth, it would eliminate the need for the state to be both the funder and provider of health services, introduce competition between providers, and thereby stimulate more cost-effective service delivery (NSW Health 1992, pp 2-4; SC 1993, pp 12, 89).

The Treasury particularly was pushing this reasoning. Underpinning it is a theoretical model of the functioning of the economy brought into favour during the 1980s. The primary assumption of the model is that increasing competition leads to greater efficiency---an idea propounded vigorously by the Hilmer committee in its report on a national competition policy (Hilmer 1993)---and that cost efficiency should be the aim of all state activities. The model is used to justify privatisation as a strategy to support the private sector (which is assumed to be inherently more productive than the public sector), to reform the public sector, and to integrate the national economy into the global financial system. Closely associated with this model is a philosophical and political view which opposes a large and viable public sector.

Opposition to the proposal began soon after the NSW government informed the Port Macquarie community that there was no public finance available for a new hospital. It is likely that the strength of this opposition took the government by surprise. It then made a rather crafty tactical move: it would insist that the matter was to be decided by the community itself! So the community was told that it could either continue with the outdated and inadequate Hastings District hospital or have a brand new *private* facility.

Much the same choice was given to the Hastings District Hospital Board and executive staff:

We could start a publicly funded public hospital with no commitment to the finishing date, it would be a slow trickle of funds that may see the hospital built before the end of the decade, emphasise may. Or to explore another option, ie a privatisation option. And every person, every person on the board, every member of the executive staff, said no way. The private sector don't know a damn thing about health, about public health services, there's just no way. But when the reality set in, we thought God, if we don't get a hospital for the community, we are not doing the right thing for the community either, so how do we go about negotiating the best possible deal for the community and the staff? So we agreed to participate in the process, to explore a private option (PMBH employee).

Community opposition was fuelled by this tactic, which had the effect of creating antagonism between community groups and between staff members, as well as disputes within the union movement and within families:

it divided it, it has torn the community apart. I described it in 1992, as ... the Battle of the Hastings ... not the 1066 Battle of Hastings, but the battle of the Hastings of 1992 ... because you try and take away a lot of things from a community ... ordinary Jo and John Citizen. You take away their anything ... and usually with some convincing they accept it, but you take away their right to free health ... and that was what was being pushed, and they fight it ... they fight it (PMBH employee).

Being a small community, every person was affected to some degree. Those who accepted the inevitability of privatisation were viewed by many as 'traitors', while those who fought against the proposal knew they were risking their jobs and future security:

because we didn't have a lot of choices in this town. If you wanted to stay working and you wanted to stay in this town ... the best idea was to accept it and try and make it work (PMBH employee).

But it was pretty clear where the majority of residents stood. As late as 19 September 1992, 615 voted against the government's favoured option in a local referendum and only 39% supported it (Staunton 1992b).

Concern over the private ownership and operation of the hospital focused on a number of issues. One concern related to the monopolistic aspect of the deal, which revealed an inconsistency in the government's own position: the same company was allowed to purchase the only other hospital in the area, giving the

consumers little 'choice' and ensuring HCoA a 20-year monopoly on hospital services (Draper & Owen 1996, p. 199).

A second issue of concern was the potential loss to hospital staff who would have to transfer to the private sector and might lose public sector entitlements and work conditions. Nurses and other staff of the Hastings Hospital held public rallies and 'stop-work' meetings during 1992, expressing their disapproval of the expansion of the private sector in the health sphere (*Lamp* 1992c, p. 10). The situation became so heated that the general secretary of the NSW Nurses Association was, at one stage, banned from entering the hospital by the Hospital Board (*Lamp* 1992b, p. 4).

Union pressure eventually resulted in an agreement between the NSW government and HCoA to ensure that staff who transferred from the old Hastings hospital could keep their public sector conditions and entitlements, including superannuation, maternity leave, long service and the higher rate of pay found in the public service. However, new staff of the hospital (including those who returned after first resigning in protest at the privatisation decision) are covered by a private sector award and have less favourable wages and conditions.<sup>5</sup>

A third concern related to the need for a community rather than a hospital-centred approach to health care in the region. It was argued that hospitals are only one form of health care service, and that there is an inherent conflict of interest if hospitals are given responsibility for preventative health strategies, health promotion activities, and community care. Hospital companies need to maximise hospital admissions to ensure profitability, a requirement which is likely to undermine the hospital's capacity to promote preventative health strategies effectively and so ensure that people stay away from it (Carter 1993, p. 19). In the case of PMBH, this situation was remedied by removing community services from the HCoA contract, and by new contract conditions which stipulate the maximum number of in-patient admissions, and assign additional costs to the operator if the maximum number is breached. However, the contract contains some flexibility in relation to future demand, a flexibility which effectively undermines the capacity of the government to control demand as it does in public sector hospitals (see NSWAG 1996, p. 430).

A fourth concern of the community was about access to good-quality free hospital services under a private sector operator, and there were many who were philosophically and politically opposed to the further commodification and privatisation of health care. Though some argued against privatisation in any form, others recognised that the Port Macquarie case represented something fundamentally different in the provision of health care services, and these groups questioned whether a private-for-profit company *should be* delivering public

sector health services in Australia (eg *Lamp*, 1992-3, p. 4). The Nursing Union expressed concern about the impact of privatisation on universal community access to health services, its cost to the community, the restrictions on consumer choice, its ability to undermine the viability of the public health care system, and its erosion of working conditions (Staunton 1992a, p. 9). Community groups also argued that, while contracts could be made between the private sector and the state government for straightforward services such as the purchase or building of a hospital, contracts are an inadequate means for ensuring the provision of services and protecting the community's interest (Labor Council of NSW *et al* 1992, p.16).

Opposition to the privatisation contract also occurred in parliament where there was action from Independent members to pursue legislation to ban contracts of this nature in NSW---even though there were, by this time, a number of similar contracts already operating with not-for-profit institutions. The Labor opposition warned of the potential for the costs of the privatisation of PMBH to outweigh the conventional public sector option, and Shadow Health Minister Dr Andrew Refshauge argued that, while the private option was likely to save the government \$41m over 20 years, it would require an additional \$30 million from the community in increased private health insurance costs (reported in Ferrari 1992).<sup>6</sup> *Before the contract was signed*, the Coalition government had to factor in an extra \$40 million to subsidise private patients who wanted to use the hospital. The additional expense added substantially to the cost of the private hospital project, and fairly clearly made the private option more expensive than the public one (Carr 1992, p. 13).

One analysis of this privatisation process has been kind to the tactical course followed by the Coalition government. It recognised that the ‘issues to be resolved in bringing this agreement into effect were numerous and politically explosive’. But it concluded that, ‘by following due process and not adopting a confrontational stance, the Liberals attained their goals’ (Degeling & Thomas 1995, p. 197). Essentially they had forced the community to decide between two options: continuing with the existing position, which nearly everyone involved regarded as unsatisfactory, or following the government’s preferred path to a ‘solution’.

Our research suggests a different interpretation. It seems to us that the privatising government was incredibly confrontationalist. Its tactics tore up a community, and alienated the doctors and trade unionists. Also the planning was inadequate, the government then having to expend a considerable amount on meetings, inquiries and public education campaigns in an effort to calm people down. And soon afterwards that government lost office!

*Select Committee inquiry and other evaluations*

The final throw of the due-process dice was such as to ensure that, although the government's tactics produced the action it wanted, the outcome would remain controversial. In this final throw, the Labor opposition and three Independent MPs forced the government to agree to a parliamentary Select Committee inquiry (*Lamp* 1992a). The Select Committee<sup>7</sup> was chaired by a government MP, but it included the Labor shadow minister and the outspoken Independent, John Hatton. In the event, the first (June 1992) report of this broadly based committee failed to support the private hospital option clearly. As a journalist reporting on it pointed out, if the private hospital now failed to proceed for policy reasons, the government was obliged to indemnify Mayne Nickless for expenses incurred up to \$1m (SC 1992; Ferrari 1992).

NSW Health's submission to this inquiry (obviously cleared at ministerial level and so covering up divergent views of officials) had presented the government's cost estimates. In choosing the privatisation option, the government had expected to save \$15m in construction costs and \$46m in recurrent costs, through a contractual arrangement with the 'more efficient' private sector. To justify the policy decision, the Greiner government had produced figures that suggested a publicly funded hospital would cost \$64m in the construction phase and \$417m over 20 years in recurrent expenditure. By way of comparison, it had asserted that the private sector would be able to build the hospital for \$49m and the recurrent costs would be only \$371m (NSW Health 1992, pp 2-4, 8; further analysed in Collyer 1997).

The Select Committee had received and considered submissions from many of the concerned parties. Its proceedings and reports demonstrated both major differences among its members and much complexity and many risks and debatable assumptions in the costing methods the government had used. It concluded that the private option provided some financial advantage to government over the 20-year period and that the negotiations that had led towards the agreement between the government and HCoA had basically been conducted 'in good faith'. But it did not specifically endorse the agreement, and chose rather and more safely to present recommendations that were 'designed to improve the contract if the project is to proceed using the private option' (SC 1992, pp 2-3).

As a result of this inquiry, concessionary clauses were included in the service contract. Thus free public access to the hospital was 'guaranteed' (though subject to annual budget constraints). And the hospital was obliged to work with other community health services; comply with the Community Health Accreditation Standards Program (which benchmarked standards to six public base hospitals in NSW); offer a number of prescribed services to the community such as domiciliary help for aged people (Thomas 1994, p. 76); and share information with public not-for-profit hospitals (Carter 1993, p. 19). As a further outcome (and

as already noted), NSW Health entered into an agreement with HCoA to ensure that existing staff could retain their salary levels and benefits such as superannuation and maternity leave.

The Select Committee's second report had a more general focus. Among other things, it emphasised the capacity of private hospitals to treat more patients than they did, and the costliness to the state of resourcing this unused capacity. For this and other reasons, it stressed the need for a 'more holistic approach to the delivery of (health) services' and for the participation of the wider community in setting health priorities (this against the government's single-minded focus on efficiency enhancement: SC 1993, executive summary).

An Auditor-General's inquiry, completed after the Liberal-National Coalition government had lost office in 1995 and been replaced by the Carr Labor government, was more openly critical of the PMBH project, questioning the capacity of government generally to negotiate acceptably balanced deals with the private sector, and disputing the Health Ministers' earlier view that the PMBH project reflected state interests. Of course, ministerial and official views were now more compatible: as a consequence of the government change, the Health Department was now headed by Dr Refshauge, a leading critic of the plan for the private hospital, so such conclusions would no longer have been politically unwelcome. They were based on the assessment that, contrary to appearances, the project's costs were being met by the state, not by the investors. In fact the cost of capital construction of the hospital was wholly funded by the state through the annual availability charge which it would pay to the private partners over the 20-year period. This arrangement also ensured that the state paid for the cost of the capital construction of the hospital a *second time* through the set fee-for-service payments; although the Health Department had projected its construction costs for the private hospital at nil, it would in fact pay \$143.6m through this servicing charge. In criticising these accounting arrangements, this Audit-General's report exposed significant differences that had existed within the Greiner government, with the Treasury overruling Health on some critical matters. And it observed that, at the end of the 20-year period, the state would have no ownership rights and that its right to have the hospital used by it or its appointed agent would lapse (NSWAG 1996, pp 16, 18 and appendix 4).<sup>8</sup>

The emergence of a Labor government in place of the pliant Coalition government obviously created discomfort for the private operator. Under its new minister the Health Department quickly altered its public position: by June 1995 it was distributing figures purporting to demonstrate that it was costing the state 30% more to run PMBH than its own hospitals in Dubbo, Lismore, Albury and Orange (Patty 1995). Then it was widely reported that there was a 'twelve-month stalemate' in negotiations over the 1996-97 hospital budget between HCoA and the

minister---resolved when, after threats of litigation by HCoA, Refshauge ‘gave in to demands ... for more money to run the hospital when other hospitals in the area were starved of cash’ (Downey 1997; also *Queensland Nurse* 1997, p. 6, digesting other reports). Whereas patient bed numbers are fixed in other Medicare hospitals, the amount paid to the PMBH operators for services for public (Medicare) patients is not fixed but negotiable. So PMBH could make demands on the state budget for an increase. Accompanied by threats of litigation, all demands at this time were met, allowing costs to escalate. The right to take legal action was enshrined in the dispute resolution clause of the basic contract, which also prevented public disclosure of financial information.

The view that the state could have built a fully public hospital for about \$50m and still have owned it at the end of the 20-year period, and the Health Department’s own estimate that it was costing 30% more to run the private hospital than comparable public hospitals, working out at about \$6m extra per year in recurrent funding, was often repeated (eg Evatt 1996, pp 143-4; and see *Queensland Nurse* 1996). At the same time, many other community and patient concerns about the private hospital in operation were raised: publicly operated hospitals are certainly not free of such criticism, but private operation is thus shown not to be significantly different (Evatt 1996, pp 143-4).

The costing figures were strongly disputed by the private hospital management, which asserted that, over the life of the 20-year contract, ‘we would save the government between \$28 million and \$40 million’ (reported Patty 1995). Again, in its 1996-97 annual report, HCoA claimed that PMBH’s costs of operation for 1995 were comparable with those of peer base hospitals. In part, this disagreement can be seen to result from the differing perspectives of the two stakeholders. HCoA is comparing its *own* costs of running the hospital with those of other base hospitals, but its figures exclude the other costs *to government* of financing the private hospital. Thus HCoA’s estimates do not include a wide range of extra costs that the state must incur with PMBH: eg to guard against fraud in its service agreement the government maintains full-time audit staff within the hospital to monitor the number and type of services provided. Similarly, because (due to potential conflict of interest) public and community health services cannot be run by the private hospital (as they can by the other seven NSW public base hospitals) the state has to provide for these as separate administrative units on an alternative campus.

Details of the costs included in the additional 30% required to service the contract with HCoA are difficult to access, even though evaluations have been completed.<sup>9</sup> There is, however, sufficient evidence to permit a judgment to be made on whether this privatisation project met the four stated objectives of the Greiner government.

Though one stated intention was to introduce private sector finance into the supposedly 'ailing' public health care system, the impact has in fact been the reverse; it has enabled the private sector to access public funds and shift funds into the private sector. It has also enabled the private sector to access revenue raised through donations and fundraising, prosthesis fees, facility charges for staff specialist use for private patient treatment, and rental for shops and services space which partially offsets the cost of providing services in public hospitals (cf: SC 1993, pp 91, 107).

Against the second objective---to provide more cost-efficient services than the public sector is able to do---the privatisation of PMBH has not been successful. It is now generally accepted that PMBH costs the government more than equivalent publicly operated hospitals. This finding is not surprising, both because (as noted above) the PMBH management can demand increases in its service charges and because in this case the public sector is not only paying for the cost of hospital services but is also repaying the private sector for investing in the building of the hospital and operating it. Thus the annual charges the state pays to the operators include an amount for interest on borrowings, the cost of invested capital, shareholder returns, and various other costs such as the Commonwealth taxes that the private operator must pay; in other words, the amount paid to the operators must return their costs plus a component for profit, something that need not be included in payments to public hospitals. But in addition to these payments to the operators, the state must meet other costs such as those for auditing and monitoring patient throughput in the hospital and extra administration and staffing for a separate community services program.

Another of the primary reasons given for the privatisation of PMBH was to enable a base hospital to be built in a timely manner, given the 'lack' of public capital available. The community was told they would not have a base hospital unless it could be privately owned and operated. Nevertheless, within a very brief period on from the contracting with HCoA, the NSW government procured public funds for a new public hospital at Albury (SC 1992, p. 2). Indeed, if 'timeliness' had been a real consideration, there were cost-effective alternatives to privatisation. For instance the Hastings Hospital Action Group's submission to the parliamentary inquiry contained a proposal to renovate the existing Hastings District Hospital rather than build a whole new hospital, at the much lower cost of \$12m (HHAG 1992). The group argued that reports about the poor condition of the Hastings hospital were inaccurate, and supplied independent engineering assessments to the inquiry to show that the old hospital was still structurally sound. The submission by independent MP John Hatton (MLA for the South Coast) supported this view, and showed that the churches were interested in providing care in the region (Hatton 1992, p. 35). Neither submission was given serious consideration.



The fourth objective, to stimulate more cost-effective delivery of health services through competition and a split between the provision and funding of services, has been met in a limited way. The need to deal with the PMBH contract has led to the introduction of more systematic measurement systems within NSW Health. NSW Health now has an alternative model of public hospital services, and has begun to collect comparative data to review its own procedures and assumptions about the differences between the private and the public sector. An important innovation, spurred on by the privatisation of PMBH, has been the development of product costing for hospital services. As set out in the service contract, PMBH is measured against the other public base hospitals in NSW. Indicators developed to ensure PMBH delivers services according to the terms of its contract provide the department with a range of financial and clinical benchmarks to assist with hospital management, policy development, fiscal accountability and infection control.

Thus the privatisation of PMBH can be said to have led to better monitoring and measurement systems in the management of the NSW health care sector, but it would be difficult to show that it has led to better services (higher standards of care) for the same cost (ie cost effectiveness). Along a number of indicators (such as infection rates) the standards of care at PMBH are in many ways comparable with those at other base hospitals, but they are achieved at a higher cost to government and, if waiting lists are taken as an indicator of standards, PMBH fares badly, having one of the longest waiting lists in the state, especially for elective surgery. In addition, privatisation has not resulted in a fully cost-effective use of PMBH because, although facilities for a full range of health services were built, not all of these can be fully utilised. PMBH was built to take more patients than the old Hastings District hospital but it has not been taking its full complement of patients, thus effectively costing more for the same services (Richards 1995; Doherty 1998). A lack of cost-effectiveness is also evident in the case of mental health and coronial services, since current NSW legislation does not allow private hospitals to perform post mortem services nor treat scheduled mental health patients (involuntary patients). Consequently these services have to be made available elsewhere, isolating patients from their families and imposing extra transportation costs on the state and families.

The impact of the privatisation on staffing has been to vary rewards according to the occupational group involved. This result is not entirely unexpected. Studies of hospital services overseas show that the quest for cost efficiencies is often directed toward the loss of lower paid jobs and the reduction in the working conditions of many staff (cf: Light 1995, p. 146). The outcome at PMBH is a typical corporate response to the introduction of competition.

The idea of promoting competition between providers in the hospital sector assumed that competition would lead to better and cheaper services. There is no evidence that competition has achieved this in NSW, nor that it could achieve this in the health-care sector (see eg Nevile 1999, 2000). Overseas evidence suggests that competition between hospitals leads to higher operating costs and is a particularly ineffective strategy in markets where the government is the dominant purchaser. Furthermore the hospital sector is one area where long-term stable and collaborative relationships are required, not competitive ones (Light 1995). Competition has been forced on the relationship between PMBH and the public hospitals in the region and there is some evidence to suggest this has had a negative impact on the patient transfer network, and made it difficult for staff to share information (eg about employee back injury rates) and take up professional development opportunities (Lyons 1997, p. 211; and generally White & Collyer 1997).

## **Epilogue**

The funding of the public hospital system remains an intractable issue for Australian governments at the turn of the century. But it does not seem likely that resort to the new breed of corporately owned hospital chains is making matters so much easier. At the end of the 1990s, the Mayne Nickliss/HCoA group which now owns PMBH comprised 47 hospitals, but the corporate owner's managing director, Bob Dalziel, conceded that 20 of them were 'underperforming as a result of "negotiations with the health funds (private health insurance) and the cost pressures we're under"' (reported in Speedy 2000). International ratings agency Standard and Poor's had placed Mayne Nickliss's corporate ratings 'on credibility watch', profitability had dropped, and share prices which had been trading above \$8 in August 1998 had slipped to well below \$4 in early 2000 (CT 1999; Ready 2000).<sup>10</sup>

Since his retirement in September 1999 Tony Harris, the Auditor-General who reported so critically on this private hospital contract in 1996, has several times commented on relevant issues in his personal capacity. He has made it plain that he believes privatisation is often justified, but that he is strongly opposed to privatising action driven by ideology and taken without thorough prior analysis of all available options for service delivery. Clearly he believes this has too often happened in Australia. Of BOO and BOOT schemes generally, he writes that he has 'no doubt that the provision of private sector toll roads in Sydney is a second-best solution that has cost Sydney road users dearly'. Turning to hospitals, he asserts that 'patients in public hospitals are not customers', and that we should be wary of applying 'private sector management principles and practices' to such patients: 'they are not there because of the profits they allow'. His argument is hard to counter: in hospitals we have an obligation to provide service to the last

applicant, to treat all members of the public consistently, and not to distinguish between them on the basis of criteria that are not relevant to the particular public service (Harris 1999, pp 33, 35, 37; also 2000).

NOTES:

1. All Australian citizens, permanent residents and some categories of visitors have a right to be treated as 'public' (ie Medicare) patients, which provides them with free treatment (at the point of service) in public hospitals throughout Australia. This right has been extended to free treatment in hospitals which have a contract to provide for 'public patients'. It is encapsulated in the Medicare Agreement, an agreement between the state/territory governments and the Commonwealth government, under which the latter provides funding for the provision of hospital services. (Medicare is partly funded through a levy on taxable income from all taxpayers. Private hospital insurance can be an additional purchase choice for consumers, but even privately insured patients retain the right to be treated as public patients.)
2. Political and administrative commentaries usually assume an identity between a minister and the department he or she heads. This case is unusual in that the evidence forces us to make a separation in the period of the Greiner/Fahey Liberal-Conservative government. At ministerial level this department was aligned with the government itself and with the Premier's and Treasury Departments, whereas the evidence suggests strongly that many officials within the department took a very different line.
3. Another unusual feature is that, at a critical time in the unfolding of this case, there were two Health Ministers in the NSW cabinet. In a mid-1991 cabinet restructure designed to separate policy from management, Premier Greiner appointed John Hannaford as Minister for Health and Community Services, and Ron Phillips as Minister for Health Services Management. However the system of 'split ministries' did not survive long after John Fahey replaced Greiner as Premier: in July 1992 Phillips became full Minister for Health, with newcomer Jim Longley as Minister for Community Services and Assistant Minister for Health. At the time and reflecting on the personalities, Labor leader Bob Carr responded that the decision to reunite the portfolios under Ron Phillips meant 'a continuation of hospital privatisation'. (From *CT* 1991, 1992.)
4. We are using this method of citing comments or information received in interview from participants in the events being described, several of whom asked particularly not to be identified.
5. This situation does not apply to Visiting Medical Officers (specialist doctors) who receive the same rates as at other public hospitals.
6. The reasoning was that privately insured patients who had basic table insurance and entered private hospitals were required to pay additional expenses, whereas private patients in public hospitals found that their premiums covered all their bills (Forde & Malley 1992, p. 275).
7. This Select Committee was described in the 'Chairman's Foreword' to its first report as a 'Public Accounts Committee special committee', and it was serviced by the regular PAC staff (SC 1992).
8. The purchase of the land for the hospital provided one example of the costliness of this privatisation. The Health Department had purchased the site from the Hastings Council in 1989 for \$550,000, but then sold it to the new PMBH management for \$1.2m. However, rather than receiving this money from the management to offset the project costs, the department allowed it to include the land purchase in its availability charge. After the demise of the initiating Liberal-National Coalition government, the Auditor-General concluded that, in effect, the department had borrowed \$1.2m from PMBH and was repaying it with interest (AG 1996, p. 426). Elsewhere he was making clear his general concern that, through these infrastructure contracts, private profits were coming directly from public losses (eg Harris 1996).
9. The basic proposition that the cost to the state of running the hospital under the contract arrangement was 30% more than the cost of running otherwise comparable public hospitals was repeated in many statements by Refshauge as Minister for Health (also Refshauge 1997). A request to NSW Health in 1997 under FOI legislation for a copy of their evaluation produced a large document with about 1/3 of the pages blacked out. All information on the

comparative costs of PMBH was effectively deleted. NSW Health's explanation for this censorship was that, under the terms of the contract, the information could only be provided with the agreement of HCoA, and that the company had refused permission. HCoA's explanation for the censorship was that NSW Health had declined to give permission. Further assistance from the company on this, or any other aspect of our research project, was refused.

10. There was some recovery in Mayne Nickless share prices in mid-2000, after announcement of the appointment of a new managing director: Peter Smedley, formerly chief executive of the private financial institution Colonial (which had bought the State Bank from the NSW government in a trade sale several years before, and had just merged with the also privatised Commonwealth Bank of Australia), had just accepted this position. But the share prices then hovered around \$3.40, much less than the 1998 level of above \$8 (CT 2000).

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