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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON DISPOSAL OF PUBLIC ASSETS

# DISPOSAL OF BP SHARES AND NEB HOLDINGS

Memorandum by the Financial Secretary, Treasury

The Chancellor of the Exchequer said in his Budget Statement that sales of state-owned assets to the private sector served the immediate purpose of helping to reduce the excessive public sector borrowing requirement. They were all the more necessary this year, given the difficulty of cutting back public sector spending programmes in the short term. The Chancellor emphasised that such sales were not justified simply by the help that they give to the short term reduction of the PSBR, but were an essential part of the Government's long term programme for promoting the widest possible participation by the people in the ownership of British industry. This objective had implications, not merely for the scale of the Government's programme for selling state-owned assets, but also for the methods of sale adopted.

2. In accordance with the Committee's remit at their last meeting (E(DL)(79)1st Meeting) I am now putting forward proposals about the relationship of these policy objectives - the immediate need to reduce the PSBR and the extension of wider public ownership - to the sale of part of the Government's holding of BP shares so as to reduce the combined Government and Bank holding to 35 per cent (ie Government 14.87 per cent, Bank 20.13 per cent). This paper also refers briefly to the disposal of NEB holdings. (The application of our policy objectives to the disposal of other assets can be considered later).

3. The 1977 Stock Sale

In 1977 preference for certain types of purchaser was expressed through special arrangements for the distribution of BP stock to favoured groups (no favoured group was given a preferential price). Special application forms were provided for employees of the BP Group (both in the UK and in certain foreign countries) and UK occupational pension funds. The sale prospectus stated that preferential consideration would be given to applications on these forms. Certain preferential consideration was also made available for sub-underwriters. The then Chief Secretary also announced in a Parliamentary Answer that "... we have been concerned to give favourable treatment to small investors and whilst it would be wrong to limit in advance the discretion that must necessarily be exercised when making allocations in the event of over-subscription, this concern will be taken into account.".

4. The Prospectus reserved the right for the Bank to reject any application and to accept any application in part only. In the event applications eligible for preferential consideration for up to 2,000 units were accepted in full; those for larger amounts were allocated 21 per cent of the number applied for with a minimum of 2,200 units and a maximum of 700,000 units. Applications for up to 150 units from non-preferential purchasers were accepted in full; those for larger amounts were allocated 14 per cent of the number applied for with a minimum allocation of 150 units and a maximum of 700,000 units. This maximum limit complied with a confidential decision taken before the sale that no more than one seventeenth of stock for sale should go to any one purchaser, thus preventing major purchases by OPEC Governments.

5. The 1977 sale was fully underwritten in London. However, the Prospectus stated that a part (not exceeding 25 per cent) of the stock for sale could be withdrawn and sold in North America if so determined prior to allocation being made under the UK offer. The price to the public in North America would not be below the UK offer price adjusted for differing terms of issue and converted into US dollars. In order to prevent Americans buying at the cheaper







London rate applicants were required to declare that they were not North American and were not acquiring BP stock for the account of any such person.

6. In the event 13.4m units were sold in America at £8.91 per unit raising £119m whilst 53.4m units were sold in the UK at £8.45 per unit raising £451.5m. Thus 20 per cent of stock for sale was sold in America raising 21 per cent of total revenues from the sale at an extra gain to the Exchequer of some £6m.

7. Groups to Whom Special Preference Might be given in the 1979 Issue

I believe that we should follow the 1977 precedent to the extent of giving preference to small shareholders and BP employees. But given our aim of spreading shareholdings widely among individuals there seems no good reason to give preference to the pension funds any more than other large institutions such as insurance companies. There may be some reduction in the proceeds but this is unlikely to be material. The main disadvantage of a preference system is its complexity, but the administrative problems were dealt with in 1977 and no doubt could be again. (The extent of preference for the chosen groups need not be settled until a much later stage - in 1977 final decisions were not made until allotment in the light of offers received.)

8. BP are keen also to give preference this time to their existing stockholders (see annex for analysis of BP's shareholders). But by definition this would not widen share ownership and would give some preference to large institutions with holdings in BP. I have not yet reached a final view on this question and want to consider it further with the Bank of England and the Company. I will also want to consider with them the case for giving preference to sub-underwriters.

9. Sales Abroad

In 1977 the offer was aimed at both the London and New York markets. Overseas marketing helps maximise sale proceeds and there is therefore a good case for going further this time not only in New York and London but in at least one other centre (possibly Frankfurt).

BP tell us (and the Bank do not dissent) that in their judgement marketing abroad increases the proceeds of the whole sale (not just the stock marketed abroad) by as much as 3-5 per cent (ie roughly £20m-£30m) - if overseas sales were confined to New York the figure would be nearer 3 per cent but if Frankfurt and other centres were added, nearer 5 per cent. The reason for the increased proceeds is that the larger the market available, the greater is the confidence of the managers of the issue in setting a high price, and the greater the willingness of underwriters to accept it. Moreover, there is always the possibility - though never certainty - that the shares sold abroad can command a higher price than those marketed in London. In 1977 this latter effect produced an extra gain to the Exchequer of some £6m. (And, of course, even if the shares are marketed only in London, there is still no practical way of preventing foreigners from buying the shares - and buying in a way which does not help us maximise proceeds.)

10. In 1977 the Company were keen to market some stock in the US. They believed that it was valuable presentationally to have a substantial US shareholding in view of their growing interests there following their Sohio acquisition. (In the event in 1977 many Americans who bought stock soon sold it and it was repatriated to the UK.) BP may favour a sale in Frankfurt this time for similar reasons in view of their recent deal with VEBA, which has resulted in a significant increase in their West German interests. The further advantage of sales abroad is that it reduces the risk of crowding out the UK equity market and to some extent the gilt edged market too. (The monetary implications of sales abroad are dealt with in more detail in paragraph 15 below.)

11. I therefore believe that the stock should be marketed in London, New York and possibly in at least one other centre eg Frankfurt. The greater the Government's proceeds from the sale of BP, the easier it will be to reach the £1bn total proceeds from asset disposals this year which, as the Budget Statement made clear, the Chancellor has counted as an essential element in the Budget arithmetic, and the less that will be required this year from sales from other sources.





12. Form of Issue

A public offering at a fixed price (the procedure in 1977) provides considerable flexibility for giving preferences to favoured classes of applicants. The Bank of England have advised that there is considerable difficulty in combining a system of preferences with an offer by tender. I will be considering the form of the issue further in the light of this discussion and will, if necessary, consult the Committee. The issue would need to be underwritten.

13. Dividend Prospects

The announcement in the Budget Statement of the abolition of dividend restraint will give BP sufficient time to make clear their intentions about dividends, both in respect of the funds already earmarked for distribution and as to their broad distribution policy. This will help to support the share price and so increase the sales proceeds.

14. Timing

The timing of the sale will depend on the assessment of the market conditions which will maximise proceeds. The Bank say that 5 weeks is needed from the time of decision before the sale can take place. The sale would therefore be possible before the holidays if market conditions were thought to be right. I suggest that the Chancellor of the Exchequer should consult the Prime Minister about the timing of the sale in the light of the assessment of market prospects. A decision should, however, be made as soon as possible in order to give maximum flexibility on the timing of the sale.

15. Monetary Aspects

The effect of the sale of BP shares on the money supply (£M3) depends on who purchases them and how they finance it. In the case of sales to domestic residents, for example the long term institutions, the sales may largely displace (ie crowd out) sales of gilts and equities, in which case the monetary effect would probably be a small proportion of the total value of the shares sold. Alternatively, if the sale were to a company, it might issue more shares itself, it might borrow more from the banks, or it might (particularly if the purchaser were an oil company) run down its holdings of Certificates of Tax Deposit and in all these cases the monetary effects would again be small. On the other hand if the sale were financed by running down liquid assets, and in particular bank deposits, the beneficial monetary effects would be greater.

16. However, some purchases of shares by domestic residents might be financed by borrowing from overseas, and the shares might also be bought by foreigners. There would be less risk of displacing gilt sales or other equity sales (ie crowding out) and, assuming a floating exchange rate the incipient capital inflow would pro tanto cause an appreciation of the exchange rate which in turn would directly reduce the UK price level and hence the demand for money. In the case of a fixed exchange rate, the capital inflow resulting from sales overseas would largely offset the beneficial monetary effect that would ensue if the rate were floating.

17. National Enterprise Board

As the Secretary of State for Industry has pointed out (in his letter to me of 12 June) we shall need to treat each of the NEB sales on its merits, and it may well be that different solutions are required to match the capital structure and present ownership of each particular company. In each case we shall need to estimate the likely yield from





the various possible methods of sale. An offer to the general public may be the easiest way of permitting preferential application arrangements for small or existing shareholders and/or employees. On the other hand it may not lead to the best price or offer the best solution in industrial terms or for introducing better commercial discipline into management. In some cases we could do better to agree to a sale to another company; for example, I understand that a good deal of interest has already been shown by other companies in Ferranti; and the best price for the Brown Boveri Kent holding could probably be secured by sale to the parent company. We shall also need to take into account the costs of a sale, and unquoted companies such as Fairey or United Medical Enterprises would require a prospectus.

18. We cannot take decisions on these questions until the Secretary of State for Industry has considered the options and the NEB and the companies concerned have been consulted. In the meantime I understand that it is now hoped to accelerate the new legislation and to introduce the Bill before the Summer Recess. I very much welcome this and the progress generally towards the sale of the NEB holdings.

19. BGC and BNOC

Different considerations may apply to sales of BGC and BNOC assets, particularly this year. These will have to be considered when decisions have been taken on which assets are to be sold.

20. Conclusions

I invite the Committee to note the position on the NEB described in paragraph 17 above; and to agree that:

(i) Preference should be given in the allotment of BP stock to small shareholders and to Company employees (with the extent of the preferences being decided later);

(ii) I should consider with the Bank and the Company the case for giving preference to existing BP shareholders and to sub-underwriters;

(iii) BP stock should be marketed in London and in New York and possibly in at least one other centre; the amount to be sold abroad should be decided later in the light of the assessment of the market;

(iv) The Chancellor of the Exchequer should agree the timing of the BP sale with the Prime Minister.

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ANNEX

BP STOCKHOLDERS

| Amount of £1 units held | Number of Stockholders* |
|---|---|
| 1 - 50 | 54,918 |
| 51 - 250 | 76,166 |
| 251 - 1,000 | 32,446 |
| 1,001 - 10,000 | 5,730 |
| 10,001 - 100,000 | 707 |
| 100,001 - 1 million | 233 |
| Over 1 million | 17 |
| | 170,217 |

* As at 31 December 1978