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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

CABLE AND WIRELESS

Memorandum by the Secretary of State for Industry

E(DL) agreed in correspondence in January that the Government should aim for a sale of just less than 50% of its shares in Cable and Wireless (C & W) by next September. This proposal and the reasons for it were explained in E(DL)(81)1.

2 Arrangements have gone ahead in preparation for the sale and consultations have taken place with the overseas governments concerned. If we are to meet the autumn deadline we need to press on with the arrangements within a timetable that is already tight. Delay in making the sale imposes an additional cost of about £1m a month in interest on the moneys borrowed in lieu of the proceeds of the sale of shares. The Treasury have, however, intervened to suggest that we should aim to sell 66% of the shares instead of the proportion previously agreed and it has been argued that we could continue to exercise all the control we need with a shareholding of 25% plus one share.

3 I am entirely sympathetic with the Treasury's wish to obtain more money, and hence greater relief to the PSBR, from a sale of more shares. I would prefer to bring about the greater degree of denationalisation involved in selling more of C & W's shares. These considerations are in my view outweighed by practical imperatives and I consider that we need to stand by the earlier decision to sell just under 50% of the shares at this time.

Overseas considerations

4 First, it is clear that overseas governments want a continuing close relationship between HMG and C & W, backed

up by a degree of control which, in the eyes of those governments, would be sufficient to protect their local interests. Unless local Governments are given reassurance about control there is a clear risk that they might decide not to go along with our privatisation proposals and might choose this opportunity to secure local control. Account has to be taken of C & W's dependence on revenue from abroad (99%), most of which comes from a few principal concessions, in particular Hong Kong and Bahrain, and of the risk that an adverse reaction from some could lead to a far reaching chain reaction. We must also not neglect the local political importance of C & W's operations. This attitude accords with the reason why C & W was taken into public ownership in 1946 which resulted from a Commonwealth initiative by countries who felt that the ownership and operation of their international telecommunications ought not to be left in private hands.

5 The consultations which have taken place with overseas governments have therefore been on the basis that HMG would be able to use its majority holding to protect, if necessary, local interests even though the Government did not intend to interfere with the commercial management of the company. The 50% less 1 share formula, is intended to keep C & W's international network intact and at the same time to place C & W in the private sector. Most of the overseas governments have replied and with a handful of exceptions have unreservedly endorsed the proposals. We would certainly need to consult all the governments again if it were decided to retain less than a 50% holding and we would certainly expect their reaction to become more negative the more our residual shareholding diminished. Without the assurance of the obvious influence provided by our ownership of half the shares it would almost certainly be very difficult to convince overseas governments that we would have the ability to protect their interests.

6 Many of the governments are sensitive about foreign shareholdings in C & W. It would be impracticable for each of the governments to have shareholdings proportionate to the value of their concessions. Although these sensitivities arise with my proposal to sell 50% minus 1 of the shares in C & W, they can be contained because Governments can rely on our 50% plus shareholding. The difficulties would certainly become more acute if more than 50% of the shares were sold because in the eyes of these governments we would have crossed the point at which shareholdings equal to ours would become possible.

7 There are special problems in Hong Kong and Bahrain. The Hong Kong concession expires in 1987 and the royalty agreement in 1983. Negotiations with the Hong Kong Government (HKG) to renew these arrangements are at a

delicate stage. The Chairman of C & W and Mr David Young have just returned from Hong Kong and have reported that local interests would like to gain control of C & W's concession and that the Governor has agreed to new arrangements in principle only on condition that we as a Government retain strategic control of C & W on lines "analogous to BP". Negotiations are still incomplete and, if the concession is not renewed all prospects of a successful flotation will fail. In Bahrain the concession expires in July 1982. Michael Marshall discussed our flotation proposals with the Government last month. The Bahrain Government have said that they attach considerable importance to our retaining a dominant influence in the company and have appeared to accept our proposals with this assurance.

8 For these reasons the Chairman of C & W and his Court of Directors feel strongly that it would be a mistake for the Government to try to sell more than half of our shares, at least in the first instance. There is no doubt that it would be extremely difficult, if not impossible, to persuade them to agree to do otherwise. The Court are anxious to ensure that privatisation and its consequences in Hong Kong, Bahrain and elsewhere are managed in such a way as to ensure an orderly transition and thus the future of the company.

Industrial Implications

9 Cable and Wireless are currently engaged in preparations for establishing an additional high speed digital network in the UK in conjunction with BP and Barclays. This is a major new undertaking with substantial strategic implications for UK communications prospects. It requires a strong central C & W grip on its overseas bases and a strong sense of national purpose. If the additional network is successfully set up in the UK, the three partners, all with world-wide bases of operation, will be well positioned to form a global communication carrier in competition with the national PTT's of the world. To throw away this strategic possibility by premature withdrawal of our shield over the company is neither in the Government's short-term or long-term interest.

Control

10 It is clear that we as a Government could retain effective control of C & W by selling off more than 50% of the shares, provided we wrote blocking provisions into the Articles of Association. Kleinworts, the Department's merchant bank advisors, stress that such provisions would make C & W less attractive to investors and would depress the

value of the shares. It is also highly problematic whether such provisions would be acceptable to overseas Governments at this stage; an attempt to renegotiate the existing provisional arrangements could at worst cause a loss of concessions and frustrate the whole sale. I do not want to retain control; I want C & W to be privatised in full. But we have to take account of what is practicable and what will get us the best price.

Conclusion

11 I have no doubt that E(DL) made the right decision in aiming initially for a sale of around half the shares in C & W. A further sale might be possible in due course when overseas governments have become confident with the new regime. I intend to aim for a further sale of shares as soon as this is practicable. If we should decide now to seek to sell more than 50% of our shareholding, it would involve a difficult task of persuading the company and all the overseas governments. This could put in jeopardy the already tight timetable for disposal this autumn. On the other hand, our present proposals should result in a significant contribution to the Exchequer in the current financial year and will amount to, and be seen as, another significant privatisation measure.

12 I invite my colleagues to agree to :

a the sale of 50% minus 1 share in C & W this autumn and

b steps to sell additional shares in C & W as soon as this can be arranged consistently with securing the future of C & W's overseas operations.

Department of Industry
3 March 1981

KJ



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2nd March, 1981

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His Time

CABLE & WIRELESS PRIVATISATION

I have seen the recent correspondence and as I have only today returned from Hong Kong I thought that I should write to let you know some of the commercial reasons which require HMG to retain just over 50% on the initial flotation.

1 About two-thirds of C & W's profits originate out of Hong Kong where we have a concession which expires in 1987 at which time the Hong Kong Government (HKG) would be entitled to buy the assets at written down book value (this could be less than six months' profits). We have now successfully negotiated a new long term concession in a joint company in which HKG will have a 20% interest and is still subject to the payment of a new royalty which is being negotiated. HKG was very resistant to the idea that we would either relinquish control of C & W or even float off a local subsidiary. It was only when I told the Governor that the position would be "analogous to BP", and that is that we would relinquish commercial control but retain strategic control, that the negotiations prospered. Without this new concession there could be no flotation of C & W and even now we are very dependent upon the goodwill of HKG in order to help us with a number of very real local difficulties. Indeed there was a time last week when I thought that we might even have to cancel the flotation but with considerable help from HKG these difficulties have been largely overcome.

2. In Bahrain our concession expires next year and we have only now been able to agree in principle the renewal which will involve giving a 60% share to local interests. Once again, the Ruler expressed concern at our privatisation proposals and it was only our assurance that we would maintain strategic control that won the day.

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C & W acts on a government to government basis in over 30 areas and since 1947 has been regarded as an arm of HMG. I believe that after a year or two of experience as an independent commercial concern, we will be able to place further shares on the market and substantially reduce our holding. To do so at this time would undermine the commercial basis of the flotation since there would then be pressure from local commercial interests to take either an increased share or control of the existing C & W local operation. This I know for a fact as I have just fought a hard battle with the HK Telephone Company who had plans to buy up a substantial stake in C & W in order to obtain a measure of control to improve their own position. David Newbigging of Jardines and Sir Sydney Gordon of China Light & Power are amongst the HK Telephone Company's directors and it was only when I told them that we were retaining strategic control that they modified their ambitions. We will still have to face this problem if and when we dispose of further shares.

Yours ever

T. Law