

Irish Congress of Trade Unions

Privatisation

Learning from the
Eircom debacle

Spring 2011



STRONGER TOGETHER

CONGRESS

Irish Congress of Trade Unions





"The privatisation of Eircom in 1999 must rank as the biggest single economic mistake made by an Irish Government - until the disastrous blanket bank guarantee of September, 2008."

Privatisation: Scope for Enrichment of the Few

The potential for self-enrichment around the privatisation of public assets is high. It can operate at many levels. The scale of money involved in privatisation can be so large that even a small shaving off the margin can give huge sums to 'insiders'.

In the Eircom debacle, one change in ownership cost over €200m in transaction costs in 1999 or €240m in today's prices. So even if trade sales (straight sale to another company) cost less, it is reasonable to estimate that the transaction costs of the company's six changes of ownership probably cost around €1 billion. And at each turn, a small number profited handsomely.

It is clear that the Valentia consortium made almost €1 billion net out of their ownership. The ESOT has made over €750m in cash payments, own lots of Vodafone shares and still owns 35% of the company.

Conversely, a lot of people lost money. Certainly a large proportion of the 600,000 people who bought shares on privatisation lost one-third of their money. As a consequence, 'popular capitalism' is dead in Ireland.

Bosses gain immensely from privatisation. While the pay of the top bosses of the state companies soared in recent years as they chased the private sector (it used to be controlled at set maximums until the early 2000s), they can fare even better in

total 'remuneration' through share options after privatisation.

'Share options' are the great confidence trick imposed by executives and boards on stakeholders of companies. Share options can make top executives seriously rich within a few years for simply doing their job. It was share options which were the perverse incentive for bad management during the boom, especially in the banks.

The beneficiaries will make the case that it "aligns management performance with the shareholder interests" and other guff, but tell that to the shareholders of Anglo, AIB or Bol or Lehman Brothers! It will be seen that the top four Eircom executives were paid a staggering €29m in the 29 months of Valentia ownership. Such rewards can act as a strong incentive for privatisation.

Privatisation results in asset-stripping: selling off the Eircell mobile phone operation and the Yellow Pages are just two examples. Indeed one Eircom owner - Babcock & Brown - went so far as to sell off its brand new headquarters and telecom masts in order to extract cash from the company.

There is always a case to review the operations and structure of the commercial state companies, and for restructuring. However, with the gaping enterprise deficit in Ireland after the banking collapse and the collapse of others, it would be extremely short-sighted to sell off any of

these Irish companies or parts of them, particularly with unemployment at such persistently high levels.

That the private sector is superior to the public is a myth which has been cruelly exposed by the banking collapse. These banks were run into the ground by the incompetent elite of private Irish business.

The privatisation of Eircom shows how a change in ownership led to the decline of what was the largest commercial company operational in Ireland at the time, a leader in technology, innovation and modernisation. It was investing heavily and was virtually debt free.

Eircom was worth €8.4bn at the time of its privatisation. By early 2011, it had an 'enterprise value' of €4.6m and huge debts - leaving a net value of just €39m!

Ireland has been near the bottom of the league on broadband for a decade which is shocking when you consider that broadband is now an essential infrastructural component of modern life and business. Our competitiveness has been well below par, in terms of the 'Smart Economy' for the past decade. Meanwhile, huge sums have been doled out, willy nilly, in subsidies to private providers to try and bring our systems up to speed. For ideological reasons direct state involvement in provision of these services seems to have been ruled out.

The lessons from the privatisation of Eircom must be taken on board by a new Government. A small island economy must have a strategic industrial policy. Classical economics has failed miserably globally and as a small economy we have been particularly badly hit.

Regrettably, the terms of reference set by the old Fianna Fail/Green Government for the Review Group on State Assets seemed like an attempt to pre-determine the outcome and compound the Eircom mistake. To sell off working, employing, value-adding, tax-paying commercial state companies to pay off a tiny part of the national debt or to sink the money into the banks, would be economically criminal.

Introduction

The privatisation of Eircom in 1999 must rank as the biggest single economic mistake made by an Irish Government - until the disastrous blanket bank guarantee of September 29, 2008.

But it seems that virtually nothing has been learned from this grave mistake.

Eircom - or Telecom Eireann as it was then called - was the largest operational company within Ireland, even slightly larger than the ESB. It was a company that was rapidly modernising, relatively efficient, investing heavily, debt free and had the dominant and fastest growing mobile subsidiary, then a new business area!

The decision to privatise was taken without strategic analysis of the long term public interest. It has proven to be a most unpopular political decision regarding a business taken by a government, (until NAMA) because most of the 575,000 investors lost some 30% of their investment. Yet ironically, the esoteric reason given for privatisation was that the Government wanted to increase “popular shareholding” i.e. popular capitalism as Margaret Thatcher called it.

KPN/Telia, a Nordic telecoms partnership, held 35% of the shares, along with the employees’ ESOT which had just increased its stake from 5% to 14.9%, by purchasing additional shares on the same basis as KPN/Telia.

The privatisation meant that the state had lost control over a key utility at a time when the telecoms sector had become extraordinarily important in the economy.

Eleven years later and Ireland still suffers with poor broadband provision and other related deficiencies. For example, OECD figures for October 2010 show that Ireland was 29th out of 30 for broadband speed, ahead of Mexico. Penetration was only at 20.3% of population by June 2010 – 22nd in the OECD.

But that the Government sold off a monopoly shows the blind adherence to ideology of both the FF/PD cabinet and the myriad of ‘professional’ private advisors. The ‘public interest’ was secondary, if considered at all.

The terms of reference for the *Review Group on State Assets & Liabilities*, – chaired by Colm McCarthy – are so narrow that recommendations for privatisation seem almost pre-determined: three of the four terms refer to selling off state assets.

From a public interest perspective, it is deeply disturbing that the senior civil servants in the Department of Finance, especially after mistakes made on the blanket bank guarantee and NAMA – and most especially in light of the Eircom debacle - did not set more strategic terms of reference that would have comprehended the development potential of the commercial state companies.

This lack of strategic vision shown in relation to such a key strategic asset by Government and its advisors has proven to be of great cost to the Irish people as owners of the company, as investors, as consumers of the now privatised utility and for the business sector.

Indeed, it casts the notion of the previous Government placing the ‘smart economy’ at the heart of any recovery in a somewhat farcical light.

Eircom's Six Phases of Ownership

There have been six phases of ownership of Eircom.

The first was when it was state-owned and controlled, including when part of it was sold to telecoms consortium, KPN/Telia in 1996. The next phase was when it was floated on the stock exchange in 1999; the third phase was when it was taken over by a group of Wall Street Venture Capitalists led by Sir Anthony O'Reilly. The latter kicked out many of the IPO management, sweated the company's assets and made a fortune for themselves and the other shareholders.

The fourth phase occurred when the company was sold back onto the stock market in March/April 2004 for a brief period. In the fifth phase, it was taken private again by Babcock & Brown in

August 2006, who also sweated the company's assets, selling off some for cash.

Its parent company collapsed in March 2009, but the Irish subsidiary was sold as a going concern. The sixth and current phase of ownership was its takeover by Singapore state owned STT in January 2010. (See the table below.)

Eircom received capital investment from the state in the 1980s and early 1990s, which enabled it to jump from old technology to the latest then available. It began building a modern company, cutting its prices and offering a wider range of services.

When it was privatised in 1999, it was performing very well. It had cut its prices progressively, was investing in modern equipment and was making large profits, on which it was remitting dividends to the state.

Ownership Phases of Eircom

Phase 1	State Co
1996	State sells 20% to KPN/Telia
May 1999	Sale of 14.8% to ESOT
Phase 2	Privatisation 1st IPO
July 1999	Privatisation of remaining share on Stock market
May 2001	Eircell Demerger
Phase 3	Taken Private
Nov 2001	Valentia takes it private & ESOT goes to 29.9%
Phase 4	Taken Public 2nd IPO
April 2004	Second IPO on stock exchange. ESOT 23%
Sept 2005	Eircom buys Meteor
Phase 5	Taken Private
August 2006	Babcock & Brown Taken private again. ESOT at 35%
Phase 6	Sold on
January 2010	Singapore Technologies Telemedia. ESOT at 35%

The privatisation provided a huge windfall for the Exchequer at the expense of close to 600,000 people

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Popular Capitalism Turns Sour

There was great party political support for the massive IPO of Eircom in 1999, the largest in Europe that year. Over 575,000 people bought in at a price of €3.90 per share, on July 8, 1999.

Most were to lose one-third of their investment just over two years later, when the company was bought over by Tony O'Reilly led US venture capitalists, through a company called Valentia which took it off the stock exchange.

In August 1999, things looked well initially. Eircom replaced AIB in the top slot as Ireland's largest quoted company on the Stock Exchange when its share price rose to **€4.77**. Its market capitalisation then was €10.25bn. But it was to be bought just two years later by the Valentia consortium for just €3bn – 36% of its value at floatation. Ten and a half years later, STT offered \$57m (€39m) for Eircom. The deal valued the company at €3.94 billion, but its buyers took on its €3.87 billion debt.

The privatisation provided a huge windfall for the Exchequer at the expense of close to 600,000 people, who were duped into buying a company they already owned as citizens.

Prior to the IPO, there was a minority shareholder – KPN/Telia. The ESOT deal was good negotiation by the unions in the run up to privatisation. Later, the union was to do even better in leveraging its 14.9 per cent in the subsequent contested bid up to 29% and later to substantial monies for members and former employees.

The total invested in Telecom by the state prior to 1999 was €562m.¹ In addition, the Government had to pay €1,015.8m to the Eircom pension fund in December 1999 for former staff of the Department of Posts & Telegraphs and their survivors as it had maintained liability for such payments. However, the taxpayer *netted* a total of €5,636m on the sale of Eircom, an extraordinary capital profit (because the pension payment was a liability which the state would have had to pay in any case, it must be excluded).

Fortunately, the proceeds were invested in the National Pension Reserve Fund (NPRF).

¹ Sweeney, Paul 2004, *Selling Out: Privatisation in Ireland*, TASC New Island.

Cost of the Flotation

The cost of the flotation for the taxpayer was €98m, of which €74.4m went to the global coordinators: US bank, Merrill Lynch and AIB Capital Markets.

It was originally expected that the fees would be a much smaller €40m, the sum put aside in the Government's Estimates. The float cost to the company is unknown, but with the huge advertising campaign etc, it was probably far higher than this €98m. Thus the total cash cost of the 50.1 per cent IPO was at least €200m.

With six changes of ownership of Eircom in the decade, it is not unreasonable to assume that over one billion was spent on costs relating solely to the sale and acquisition of this former state asset.

These costs added no value to the company. But it was great money for a coterie of accountants, lawyers, valuers, stockbrokers, bankers, underwriters and other professionals. Thus it can be seen why these interests form a powerful lobby in Ireland in favour of privatisation. On the other side, opposed to privatisation are the Trade Union movement and some civil society groups.

The Privatisation of Eircom was a Total Failure

Mary O'Rourke was the minister who drove the privatisation of Eircom. The previous Fine Gael, Labour/DL government had sold an initial 20% holding as part of an agreed strategy to bring in new management and technological skills, to KPN/Telia.

This was in agreement with the trade unions which had argued for the need for new management skills and new technology.

Under this strategy, the state was to retain 50.1% of the company.

Indeed, the Fianna Fail/ Progressive Democrat coalition that succeeded the 'Rainbow Government' could have sold a further percentage and still held on to a large block of shares. This was the experience in many other countries - apart from Britain under Thatcher. This would have allowed the Irish state to retain seats on the board and to maintain influence, especially over investment policy.

It was a great surprise when Minister Mary O'Rourke decided to dispose of the entire state holding in Eircom. The ESOT was at least able to take a longer term perspective and mitigate some of the worst excesses of the new majority owners.

To allow such a critical asset fall into the hands of predators with no interest in the welfare of Irish citizens or business was to prove a grave mistake.

Had Eircom remained even partially in state hands, the board would have taken a longer term outlook and would not have been spooked into such bad decisions.

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Flogging off the best bits - the Eircell 'Demerger'

The first task undertaken by the newly privatised board was to asset strip the company.

The decision to 'demerge' the mobile division of the company - Eircell - and to sell it to Vodafone, in May 2001, deprived Eircom of its fastest growing cash cow, while simultaneously enriching the shareholders.

The new board was under severe pressure due to the short term outlook of shareholders. The company had been sold at a high price and when the share price fell, the half million shareholders were not happy.

This populist campaign, led by commentators Shane Ross and Eamon Dunphy, shook a weak management who compounded the problem by selling off pieces of the company for short-term gain, in a bid to appease shareholders. In the longer term, this just made it easier for the Private Equity Group to take the company private. In short, had Eircom remained even partially in state hands, the board would have taken a longer term outlook and would not have been spooked into such bad decisions.

Indeed, the Eircom board very quickly recognised the stupidity of selling of Eircell, its fastest growing subsidiary, and considered re-entering the mobile market in 2003/04. But in selling Eircell it had foolishly agreed with Vodafone that it would not re-enter the field for three years.

The company also bid for very expensive 3G licences abroad, but fortunately, the bid failed. Many other telecom companies lost a great deal of money in this area.

Prior to its sale, Eircell had a turnover of almost half a billion euro and profits of €57m. It had 1.9 million customers and they were signing up in great numbers. In the half year to September 2000, the profits were a huge 39% higher than for the same period a year earlier.

The hapless shareholders were given shares in UK Vodafone and as soon as the sale was agreed, Vodafone's share price began to slide. 400,000 Irish people were still reluctant shareholders in Vodafone some years later – even though they never sought to invest in the UK telecoms company.

The board of Eircom said it had decided to focus on its 'core' business of fixed lines. It mentioned expanding abroad in its demerger document,² including its plan to reduce costs and to "scale back on its investment in DSL technology for financial and regulatory reasons." In short, the privatised entity planned to save money by reducing investment in broadband.

² Proposed Demerger of the Eircell Business to Eircell (ps8+9), Eircom April 2001.

The Vulture Capitalists

The third phase in the ownership story occurred when Eircom was taken over by a group of Wall Street venture capitalists, in December 2001.

Calling themselves Valentia, the new owners focused on the short term: they sweated Eircom's assets; pushed up its prices; cut investment and extracted the maximum value for themselves. They sold it on in March 2004, having sucked almost a billion euros out of the company.

Valentia, which was headed by Anthony O'Reilly, paid €3.2bn for Eircom. The same company had been worth €8.4bn in July 1999. O'Reilly's bid had been contested by Denis O'Brien, who had made a fortune on Esat Digifone, which was built around the second mobile phone licence that Esat had won after a competitive bidding process and for which it paid the Government a 'small consideration.

The Valentia consortium borrowed heavily to fund the €3.2bn purchase running up debts of over €2.7bn. Valentia even paid itself huge dividends while it was making losses. Thus it was shamelessly asset-stripping value from the company. It sold off more assets, including its 63% share of Golden Pages for €185m, in May 2002. The Government and the Regulator sanctioned the whole process.

The largest Wall Street Venture Capitalist firm, Providence Private Equity invested €314m for its 46.4% stake and made a gain of €232m on the sale. It also paid itself a dividend of €188m. On top of this, the appreciation of the euro between November 2001 and March 2004 gave it an additional gain of 40% on its original investment. This was an additional €126m. This gave it a probable total gain of €564m. Thus Valentia almost trebled its original investment in just over two years.

Table 1 Valentia Takeover and Its Sale (€m)

	Initial Investment		Capital Gain ^e	Dividend ^e	Total Gain
Sir Anthony O'Reilly	4%	25	18.5	15	33.5
Providence Equity	46.4%	314	232	188	420
The ESOT	29.9%	202	149	121	270*
Soros Fund	18.5%	125	93	75	168
Goldman Sachs	1.2%	10	7	8	15
		€676m	€500m	€405m	€906.5

^e estimates based on some figures revealed for capital gains which were applied to all shareholdings. Estimates for dividend for each shareholder made by proportionate allocation of known total, paid in August 2003.

* The ESOT may have received a different dividend as it redeemed preference shares worth €6m and had a complex deal which was not publicly available.

Source: Paul Sweeney *Selling Out: Privatisation in Ireland* 2004, TASC New island, based on Eircom Filing to SEC 30 October 2003, NCB Report on Eircom, various newspapers

It was also revealed that the four executive directors were to receive additional bonuses totaling over €10m.

10 Soros Fund turned its €125m investment into a gain of €93m plus a dividend of €75m. This US fund also made a gain on the currency of a further 40%.

Tony O'Reilly invested just €25m and more than doubled his money.

The ESOT invested €202m in 2001 and this went up by €149m and it received a share of the dividend too. It also bought €247m in preference shares in 2001 and some of these (€181m) were redeemed in 2001, while the remaining €66m was converted to ordinary shares on the second float. The ESOT bought a further €85m worth of shares to avoid dilution of its 29.9% stake. It was the only shareholder to retain all of its shares on the second float.

The figures in Table 1, on the previous page, give an indication that the total gain by the Valentia consortium was in the region of €906m: a return on investment of 134%. This substantial gain was to be ultimately paid for by the customers of Eircom.

This would not have happened had the company remained in public control.

The Bosses Gain Too

The top four managers of Eircom were paid a huge €29m in the period of the Valentia ownership.

It was also revealed that the four executive directors were to receive additional bonuses totaling over €10m. Strangely, these were not based on the company achieving any measurable performance targets but rather

were awarded for the directors' role in what was described as "reorganisation and financing."

This was spelt out in greater detail in the Offer Document. Essentially it amounted to the company borrowing €1.1bn in 'senior notes' and 'senior subordinated notes', in August 2003. Around half of these borrowings were distributed to the shareholders. Some €446m in dividends was paid out to shareholders and €66m preference shares were redeemed. The company was loss-making at the time and the dividend and other distributions amounted to over half a billion.

Again, this would not have happened had the company stayed in public ownership - but it will almost certainly happen again if there are future privatisations.

The Role of the ESOT

It has been seen that the employee representatives played a strong role in advancing the level of employee financial participation in the company, doubling it from 15% to almost 30%, by playing two venture capitalists off against each other, to the benefit of the employees.

It has further increased to 35% today. The gains made by the 14,000 employees and former employees of Eircom have been substantial. The ESOT's stake grew from €127m invested in 1996 to over €700m in 2004. And €750m has been paid out to members.

However, it will be seen that the ESOT board was acting in the interests of all its shareholders – including the ex-employees - and not just those of the employees. The shareholders' interest totally dominated those of the stakeholders, which include the employees, consumers and the state. Irish company law forced the ESOT to only act in the interest of shareholders and not to take a wider, nor a longer term view. As the majority of the shareholders had a very short-term view, a minority group might influence it, but could not change it.

Therefore it is essential for the better future governance of all Irish companies that company law be changed from its current narrow focus on shareholder interests, to the de facto exclusion, if management so chooses, of all other stakeholders. This focus on 'shareholder value' was a key driver of the Crash of 2008, both here and abroad.

The ESOT had generated great value for its members with, for example, €70m paid out in year to June 2009. It suffered like others with the Crash of 2008 and its assets fell from €432m in 2008 to €154m due to an impairment charge in Eircom, due in turn, to the economic collapse, a pension deficit and a fall in the value of Vodafone shares.

While employee financial participation was advanced by the ESOT at Eircom at the time of the takeover by the Valentia Consortium, the role of employee representation was not promoted nor enhanced. The increase in the employees' financial shareholding to 35% should have allowed them to share in the future prosperity of the company.

When a Government opts for privatisation, it can rely on some vested interests to voice support. Much of that support comes from within the ranks of professions that stand to benefit handsomely from any privatisation: accountants, solicitors, valuers, stockbrokers, bankers and underwriters. It also makes for good dramatic copy and few amongst Ireland's small pool of business journalists see beyond the immediate drama.

For example, Goodbody solicitors received €8.5m for their advice to Valentia on its takeover of the former state owned company, including 1.3m in preference shares. The €40m cost of the takeover was recouped by Valentia within six months - from Eircom itself. The consortium included a surplus of €206m from the pension fund in the company's assets. The assets were revalued upwards by €865m and it further reduced the goodwill associated with the takeover. Of the total of €40m which was recouped, Providence got €21.6m; the ESOT got €7m; Soros, €10m and Tony O'Reilly, €0.2m.

In essence, Valentia bought the company using debt. It single mindedly reduced this by sweating the company's assets, holding back on investment, revaluing assets and using Eircom to repay Valentia's bills – all legally. But this strategy has not been in the best long-term interests of the company or the state.

Performance of Eircom

The performance of the company before and after privatisation is examined under two headings: financial and operational.

The high level of profits of the state owned company Telecom were maintained for the first few years after full privatisation, but then fell dramatically once the company was 'taken private' or removed from the Stock Exchange.

This clearly arose because the privatised model demanded that it use most of its profits in servicing its increasing debt. The real business agenda of the new owners of Eircom was value extraction for the shareholders in the shortest possible time.

Eircom's turnover declined as it sold off subsidiaries such as Eircell and later as competition ate into its market share. The company made a loss of €40m in the year to March 2003, and a further loss in the nine months to end of 2003. Yet it somehow managed to pay out a dividend of €472m on the loss to its shareholders that year.

Valentia had recovered most of its outlay costs by 2004 and had also taken a surplus on the pension fund into the group and also revalued its assets up. The board rapidly increased Eircom's debt.

The net effect of this strategy was to seriously inhibit the company's capacity to invest.

Thus in the third phase of the ownership of Eircom - the Wall Street Venture Capitalist phase - the company's financial performance

was extremely poor. This was not because the management was poor or because the skills or capabilities of its workforce had deteriorated sharply, but was due to a blood-sucking ownership. The shareholders did very, very well.

From 2004 the turnover did rise but not rapidly, as the company lost market share. The turnover in 2003 was €1.68bn and while it rose by 18% in four years, to €1.98bn in 2007, it was at the same level two years later.

The company has been most reluctant to give out net profit figures and this is because it appears to be loss-making. It prefers instead to emphasise EBITDA. Yet even that figure has hovered around the €600-700m for many years. Capital investment spending was €312m in 2002, but then cut to two-thirds of this for the following two years.

The figure for investment for the following year is not readily available as Babcock and Brown (B&B) were very secretive. B&B sold off the masts and it is believed that they tried to take money out of the pension fund too, but were unsuccessful.

Operational Performance Falls

The operational performance of Eircom dramatically disimproved in the years after privatisation and especially after the Wall Street venture capitalists (VCs) took control.

This was largely because they and Babcock and Brown used their ownership to ensure that the primary objective of the company was to enhance shareholder value, above any other consideration and in as a short a time as possible. They made the company repay them their investment plus a fat premium.

The company reduced employee numbers in 2002 to 10,529, down from 13,121 in 2001, a substantial drop of 20%. It should be noted that employment had grown after privatisation, having been just 12,163 at the end of 1999. Employee numbers were further reduced in subsequent years to around 7,000 today.

The ownership of Eircom by Valentia and latterly Babcock and Brown was bad for the company. The company even sold off its mast network to Towercom in 2010 for €155 million. The masts achieved revenues of €10.3 million in 2007. Goodbody stockbrokers predicted this would rise to €18 million by 2012. The business was hugely profitable, the stockbrokers claimed.

Eircom incurred an operating loss of almost €500 million in the year to June 2009 but reduced this to €242 million in 2010. It broke even in the quarter to September 2010. It has a very high debt of €3.8bn. The Eircom-owned mobile subsidiary Meteor had pre-tax profits

drop from €49.7m to €37.2m to the end of June 2009, in spite of the firm increasing revenues by 2%, from €480.9m to €491.2m. Babcock and Brown sold its shares in Eircom in September 2009 for just €132.57m, a 20.2% premium on the closing price of A\$1.11 per ERC (Eircom) share on June 24th - the last close before the STT proposal was announced.

In a study of Eircom, economists Palcic and Reeves (2010) noted “significant improvements in pre-privatisation performance.”³ They said that the company had improved its performance prior to privatisation and also even prior to competition. “The threat of competition rather than actual competition drove significant internal reform” generating “improved performance”. They concluded that policymakers should note that “privatisation will not necessarily result in improved performance.”

The Irish State is forced to Re-enter the Telecoms Market

Shortly after privatisation in July 1999, the state’s frustration with the poor state of the telecoms sector was displayed very publicly.

In September 2001 with the bidding war between O’Reilly and O’Brien underway,

3 Donal Palcic and Eoin Reeves, “Organisational status change and performance: the case of Ireland national telecommunications operator”, 2010, International Journal on Knowledge Infrastructure Development, Management and Regulation. Elsevier.

By 2003, the state was waving millions of euro at anyone who would invest to make up the Eircom deficit.

14 the Government announced that it would provide 90% funding to those who invested in telecoms infrastructure and public bodies would fund the balance.⁴ In short, the taxpayer would fund all investments.

By May 2002, Eircom publicly opposed the state's investment plans for the sector: it had announced that it would invest €300m. It had already sunk €62m into a public private partnership deal with Global Crossing, a company which even then was in deep financial trouble.

By 2003, the state was waving millions of euro at anyone who would invest to make up the Eircom deficit. The Government has since spent hundreds of millions trying to encourage investment in broadband.

Are State Subsidies Wiring Ireland?

The Fianna Fail/ Green coalition did not seem to want a state company to be directly involved in the provision of telecoms.

It seemed to eschew direct involvement purely for ideological reasons. In spite of the failure of the Eircom privatisation, it refused to learn from its big mistake. It poured hundreds of millions of our tax euros into private telecom operators in the form of huge subsidies - of up to 100% in some cases.

In 2009, the taxpayer again coughed up for broadband subsidies to the private operators

to ensure that *“every part of the country will have at least a basic broadband package by September 2010 as a result of a €223 million investment which will be part-funded by the state and the European Union.”*

This commitment was made in 2009 by the then Minister for Communications Eamon Ryan, under the National Broadband Scheme (NBS). The Minister claimed this would result in bringing broadband internet access to the 10% of the population, spread over about 33% of the geographic area of the state which had no access.

The cost of the most widely available (fixed) broadband service in Ireland compares favourably with the EU average. However, it offers relatively low speeds. The National Competitiveness Council has pointed out that *“while significant progress has been made in terms of broadband take-up and basic broadband coverage through the National Broadband Scheme, Ireland's broadband infrastructure continues to lag that of most other countries....”*

It continued: *“The proportion of broadband connections above 10 megabits per second in Ireland increased from 5% in July 2009 to 9% in January 2010, but this is still significantly lower than the leading EU countries such as Portugal (61%), Belgium (41%) and Denmark (35%). Importantly only 0.6% of connections in Ireland are fibre compared to 11.3% in the OECD 28.”*

Fibre connections stand at 51% in Japan, 46% in South Korea and 21% in Sweden.

⁴ Irish Times, 28 September 2001

The New Owners of Eircom – A State Company

ST Telemedia, or STT is a wholly owned subsidiary of Temasek, which is the Singapore government's state holding company.

Thus, the end result of the privatisation experience for Eircom is that it ends up back in the arms of the state - except it happens to be the state of Singapore. That is a telling book end to the Eircom saga.

STT is an established telecoms investor, one of several major companies owned by the Singapore state. It appears to have a long term interest in its Irish subsidiary. The ESOT supported the STT takeover of the other 65% of the shares and maintained its holding at 35%. STT is the first telecoms company since KPN/Telia to become involved in Eircom.

Its purchase of Eircom was its first acquisition outside Asia. The FT described Eircom Holdings as “the Irish debt laden group” and said that the deal gives the Irish group an equity valuation of about A\$67m (\$57m). With Eircom's debts, the deal puts a total enterprise value of €4.4bn (\$6.4bn) on the Irish group. Singapore's government, in contrast to our own, has identified telecoms as a growth area and for the past decade has made investments in local Asian markets through its investment arm, Temasek.⁵ Temasek, saw a 42% rise in the value of its portfolio to a record S\$186bn (US\$134bn) in the year to March 2010.

STT says its mission is “to build long-lasting businesses that will bring enduring value to our customers, companies, partners and shareholders, and to enrich the lives of the community that we serve.” This is in stark contrast to the rapacious, short termism of Valentia and Babcock and Brown. It remains to be seen if it will fulfil this commitment. The fall in value of Eircom; the price it paid for it; the regulatory environment; and the crisis in the economy will all influence the achievement of their stated ambition. It is hoped that they will have more success than the four private owners.

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Falling Prices from Competition or Technology?

There has been poorly informed comment on the impact of privatisation and the role of competition, particularly regarding price reductions.

Prices in the sector did fall dramatically, but this was mainly due to the impact of technology. Competition contributed to this, but was of far less importance than changes in technology.

The 1990s saw the introduction of the mobile phone, the explosion in its usage, the phenomenal growth of the internet, the use of fibre optics and rapid technological advances in telecoms equipment and infrastructure etc. It was the technological change which allowed competition to take place in many areas of telecoms where there had been natural monopolies.

⁵ FT, 14 Sept 2009.

Government policy was disastrous for the economy and severely damaged national competitiveness.

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Conclusion

The privatisation of Eircom has been a major policy mistake which has left Ireland at the bottom of the key telecoms league tables for over a decade – on speed, access, etc.

Privatisation of the state owned monopoly was a costly and strategic mistake. In short, Government policy was disastrous for the economy and severely damaged national competitiveness.

Eircom's privatisation was the result of an ideology that believes the 'market' will always deliver the best outcome. The Eircom story is conclusive proof that this is not so.

It has cost Ireland dearly in lost competitiveness over 11 years, undermined the Government's own pathetic attempts to kickstart the 'Smart Economy' and has frustrated consumers and businesses.

It is clear from the evidence that of the six phases of ownership of Eircom, it was the first – under public ownership - which was the best for consumers, for its owners - the Irish people - and for the country.

The second, after privatisation, saw a company with a board that did not have a clear strategy, which sold off its key assets as it bumbled along. The board was kicked out when the company was taken private by Wall Street financiers, who sweated its assets and made a lot of money for the shareholders in a very short time. Under this third ownership phase, the company did not reduce prices as much as it could and while still

performing reasonably well, it was loss-making. Yet its shareholders extracted huge returns for themselves and reduced investment to ensure that finance could be re-directed to themselves.

Valentia then sold it back to the market in March 2004, at a huge profit. The fifth phase was when it was taken over by more venture capitalists, Babcock & Brown who again were not good owners.

It is possible that now, with an owner in the telecoms business and with the right regulatory environment, Eircom could power ahead again.

The privatisation of what was once Ireland's largest company failed to deliver on its promise of 'popular capitalism'; half a million investors lost one-third of their money and our telecom sector fell behind the rest of the industrial world.

In addition, the process greatly weakened a strong company's balance sheet and meant that prices remained higher than they needed to be. Ireland's competitiveness was harmed by the lack of high speed broadband and lack of investment. The state attempted to remedy this with millions of subsidies to private operators. Full coverage is still pending and speed is slow.

The overwhelming evidence is that Ireland has a major enterprise deficit and it is in the private sector. The Irish banking system has collapsed and has only been rescued courtesy of vast sums of taxpayers money. All the bank boards included the cream of our supposed 'enterprise leaders' – the luminaries of Irish business - who went on to crash the economy. The need for public sector reform is dwarfed by the need to overhaul the skills and competence of Irish private sector management.

The loss of public influence over Eircom, the dominant utility in the vital telecoms sector of the economy was costly to the Irish economy and to Irish citizens in terms of access to broadband, the high cost base in debt-servicing to pay off the huge debts run up and its consequent lack of investment. The company became less significant in the economy as it lost out to competitors.

The debt-free, publicly-owned company that existed before privatisation was profitable and investing strongly. It would have encountered few problems securing fresh investment and had the capacity to place Ireland at the cutting edge of the European telecoms revolution.

Instead, it was a company distracted by the constant changes of ownership and an obsession with extracting rapid returns from its assets. Of course management was hugely 'rewarded' under Valentia ownership for finding the huge sums of money to 'reward' the owners. This money was sucked out of the core company and left it very weak.

The full privatisation of Eircom was a major mistake of the Fianna Fail/PD Government. It would be a foolish Government that fails to learn the lessons of this debacle. But we have had some very foolish governments in recent times.

The privatisation of Eircom led to the following:

1. A financial bonanza for the Government (when it did not need it)
2. The loss of sovereign control and influence over a dominant national utility.
3. Problems in getting the Regulation regime right.
4. High debts by Eircom in the leveraged buyout by the Wall Street Venture Capitalists.
5. The creation of high economic rents by the company for the new owners by cutting investment and high value subtraction from the company in "dividends".
6. A profitable state company became a loss-maker even after a halving of investment and employee cost reductions, as debts pushed up costs.
7. Little investment by the venture capitalists in broadband and higher prices for Irish consumers as Valentia, and later Babcock and Brown, squeezed the company to pay off its huge debts.
8. The first board was a poor lot compared to the board of the state –largely spooked by the fall in shares. Private ownership has been short-sighted, greedy and incompetent.
9. A Growth in "Unpopular Capitalism" - an increase in share-ownership - an angry group of 500,000 shareholders, who lost over one third of their money after the full privatisation.
10. Poor financial and economic analysis of the Eircom privatisation by most media and virtually all economic and financial academics.
11. Huge financial gains for the Valentia consortium in just over 2 years, not from wealth creation, but largely through value-subtraction from this strategic, dominant Irish company.
12. A major increase in employee financial participation to 35 per cent employee shareholding in the company, the largest employee shareholding in Ireland.
13. Staggering "rewards" for the top management, including an ESOT nominated director, for a time.

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