TAKEOVERS ON THE HIGH SEAS
THE CORPORATE RAIDERS

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National debate on the takeover of BHP has largely focused on the cost to taxpayers of debt-financed takeovers. The equity of the tax system is of great importance, but the broader implications of the takeover have been largely ignored.

There was an initial flurry of concern about whether or not Holmes a' Court would close down the steel division, but John Halfpenny's comment that Holmes a' Court could be no worse than the Melbourne establishment indicated that the metalworkers had accepted his assurances about maintaining the company as an integrated group.

More importantly, however, the takeover points to profound changes in both ownership and financing which are under way, and which affect the basic stability of Australian industry.

The new entrepreneurs

Robert Holmes a' Court has always fostered an image of himself as a maverick in business circles. The man who has made the biggest capital gains in Australian history described Keating's capital gains and fringe benefits taxes as courageous and progressive. He has never indulged in the union-bashing oratory or monetarist pontificating common among his peers in the business world.

However, his fellow raider Alan Bond gave the lie to this image of a sort of corporate Robin Hood when he revealed to the Australian Broadcasting Tribunal that Holmes a' Court had tried to persuade him to combine their media forces to bring down the Burke government in Western Australia.

At the time of writing (mid-May), BHP appeared to be headed for an auction between Holmes a' Court and John Elliott's Elders IXL. It is easy (and accurate) to portray Elliott as the chosen son of the Melbourne establishment. At various times in his career he has enjoyed the patronage of Rod Carnegie (related to the Clarke family), Gordon Darling, Baillieu Myer and Ian McLennan.

In quick succession, this establishment has handed him control, first of Elders, then of Carlton and United Breweries, and is now trying to do the same with BHP, rather than see them fall to Holmes a' Court (or, in the case of CUB, to the New Zealander Ron Brierley).

Yet Elliott has far more in common with those he is fighting than he has with his mentors. He is also one of the new entrepreneurs. They are quite a breed, as can be seen from the accompanying table. They have built their empires with extraordinary speed. Ten years ago, none was a force in Australian business. Today, they are reshaping a wide range of Australian industries, covering retailing, whitegoods, brewing, flour-milling, food-processing, property, media, import-export, and resources.

Their style of operation has been to seek to take over companies which are undervalued by the stockmarket. Those companies may be undervalued because their assets have been poorly used, or because their strategic significance to competitors in the same product market has not been recognised by share investors.

It is too simplistic to describe them as asset strippers, though several of their corporate prey have been left as empty shells, notably Tooth Breweries and H.C. Sleigh, both of which were bought by John Spalvins' Adelaide Steamship Company.

They are not merely after the short-term profit. Bond has invested heavily in new brewing capacity, Spalvins has substantially upgraded David Jones, and Elliott has turned an old pastoral company into a modern trading and finance group. The improvements have not been uniform — Waltons (Bond) and Clarke Rubber (Spalvins) are still in the doldrums — but in general they have surrounded themselves with highly capable managers, and have committed themselves to further development of their companies.

They differ from the traditional chief executives of large public companies because all have significant equity stakes in their empires. In the case of Holmes a' Court and Bond, those stakes are worth hundreds of millions of dollars.

They behave as owners of their empires, rather than as managers of empires that belong to someone else. Spalvins, for example, was able to commit a sum of money equivalent to more than three-quarters of Adelaide Steamship's net assets to secret purchases of BHP shares, without any reference to the public shareholders of the company, in what amounted to a personal game of poker with Holmes a' Court.

On past form both Elliott and Holmes a' Court could be expected to use the enormous cash flow of BHP to
support further ventures into even bigger takeovers overseas. Neither has given any indication of a coherent project for the future of the company. Last year, Holmes a' Court was talking about splitting BHP up, on the basis that having separate steel, oil, and minerals companies would allow institutions greater selectivity in their investments. Anyone wanting to hold oil stocks would not have to make an investment in steel and minerals as well. He now denies that this is his intention.

There is a powerful argument for keeping the three major divisions together. After years of lobbying by BHP, the Fraser government altered the tax act in its last budget to allow losses in one part of a company to be offset against profits in another, for tax purposes.

Nor is BHP a badly managed company, by the standards of Australian industry, and it is unlikely that any change in ownership would make much difference to its overall operations in the short term.

The company could be expected to play a larger role in national politics than it has in recent years. During the crisis of 1981-82, it played a rough political game, at one stage threatening to pull out of steel altogether, effectively shutting down Wollongong and Newcastle. In general, though, it has kept aloof from business organisations and broader political issues, pursuing only its own interests. This has reflected a conscious effort to avoid being seen as a sort of corporate bully, the reputation it had under Essington Lewis before World War II.

Robert Gottliebsen has made the point that a BHP controlled by either Holmes a' Court or Elliott would mean a greater concentration of personal power in a national economy than existed anywhere else in the world, rivalled only by the Oppenheims in South Africa.

The long term performance of the company would depend on the quality of investments made from the enormous cash flow generated by BHP. BHP has to invest in the region of $1,000 million each year if it is to avoid building up idle cash reserves. A corporate raider could use that cash flow together with borrowings to make purchases ten times the size. However, this would tie the survival of BHP to the success of the ventures purchased.

At the moment, the new entrepreneurs appear to have the midas touch. It is very doubtful that they would be supported for long if things turned sour. None of them are establishment born, with the exception of Holmes a' Court, whose establishment is South African. Most are immigrants, and Brierley retains his NZ citizenship.

Their rise to such positions of wealth and power has roots far deeper than their individual talents. It is related to changes in the nature of institutional ownership of companies, and to the revolution under way in the world of banking.

Since World War II the big life insurance companies have been the dominant shareholders in Australian public companies, and their share portfolios have been managed on behalf of their thousands of policyholders. They have drawn their boards of directors from the establishment families, and through a web of cross-directorships, control of the corporate sector has been kept within a narrow circle.

Life insurance provided nearly all the funds, and the tax act encouraged such institutions to hold their shares for the long term, since any profits made from share sales were fully taxable. In the event of takeover bids, which were comparatively rare among the top fifty companies, the institutions always supported the existing management.

Perhaps nothing symbolises the marriage of corporate and institutional establishments quite so well as Melbourne's junction of William and Bourke Streets, where the BHP and AMP towers face each other. It is but a short walk for Sir James Balderstone, who heads one board and is deputy of the other.

In the 'seventies, inflation and the growth of independently-managed superannuation funds began to change things for the life offices. Inflation brought high real interest rates, and anyone wanting just a steady income was much better off holding government bonds rather than shares. At the same time, share portfolios which were not actively managed had their value eroded by inflation.

Superannuation made a difference because shares held by super funds could be traded without attracting capital gains tax. The life offices began to sell shares as well as buy them. As well, some merchant banks began bidding for superannuation business, and with surveys of super fund performance being published in the press every three months, the heat was on the managers of share portfolios to make profits.

CSR's takeover bid for Thiess in 1979 was a turning point. Bjelke-
Petersen attempted to legislate to protect the company for one of his cronies, but the institutions bailed out, accepting CSR’s money. It was the first time that such institutions had deserted a company facing takeover. There have been hundreds of cases since.

In the ‘eighties, funds management has become a highly sophisticated industry in Australia, handling in excess of $80,000 million, of which $50,000 million is in superannuation. Fund managers around the world are looking at each other’s markets to find those with the best performance. This search for performance has favoured highly leveraged, aggressive entrepreneurial managers, and the resulting footloose character of institutional capital has profoundly shaken the stability of the institutional ownership of Australian industry.

**High risk banking**

While institutions still dominate the market, radical changes under way in the world of banking have enabled the individuals to rival institutional abilities to marshal capital. When Bond bid for Swan Brewery, the local merchant banking subsidiary of the Hong Kong and Shanghai Bank made him a personal loan of $150 million. (The bank’s Australian manager resigned in protest — a few months previously Bond had been seen driving his Rolls with bald tyres, and he was rumoured to be near bankruptcy.) Three years later, the same bank lent him another $1,000 million, and Bond had half the Australian brewing industry.

Ten years ago, banks would only lend against the collateral of an asset, and then only if the borrower put up at least 25 percent, and the asset was worth at least 50 percent more than the loan. Since then, banks have discovered “cash flow lending”. They support a loan if the borrower can show that the project it is used for will provide the cash to service the loan. Bankers used to see their business as accepting deposits and re-lending funds at a higher rate of interest but, today, they see themselves as risk managers who receive interest and fees in proportion to the risks they take. They no longer limit themselves to providing overdrafts to supplement the working capital of a company. The lines between debt and equity are becoming blurred as bankers take on what are fundamentally equity risks.

The nature of banking is shifting so fast that it is impossible to define clearly where it is heading. Market practices are outpacing both theoretical analysis and the legal framework. And clearly, banks are taking greater risks than they ever have before — they are lending on the security of shares when sharemarkets are at record peaks.

There is concern, even within the banking industry itself, that loans to companies which are secured by future cash flow, can become a major new problem for the world banking industry. Such lending to oil companies is already taking its toll among US banks.

The area of takeover finance is particularly risky as the banks are advancing money on the assumption that the bidder will not only get control, but also that the target company will be able to generate enough cash to cover the cost of servicing the debt.

The new entrepreneurs are thus being carried to their positions of wealth and power by forces which tend to destabilise the capital base of the corporate sector. Institutional shareholders no longer have a long-term commitment to the companies they own. And while institutional capital still tends to be long-term in character (e.g. superannuation funds), that provided by banks is quite different. The deposit base of banks is basically available at call and the banks can generally withdraw their lending whenever they need.

This is not to say that the banks are about to pull the rug from beneath Australian business, or that the new entrepreneurs are setting themselves for a fall. However, it does not augur well for the future of Australian business — or the rest of Australia — that its ultimate owners, the banks and financial institutions, have so little commitment to it.