



During the course of the last year a debate on private equity funds has erupted in Denmark, mainly due to the takeover of the Danish telecommunications incumbent TDC by five large private equity funds. One of the most outspoken participants in the debate is Poul Nyrup Rasmussen, former Prime Minister of Denmark and current member of the European Parliament and President of the Party of European Socialists (PES).

Private Equity Funds and the TDC Case

Interview with Poul Nyrup Rasmussen

Interviewer:

How do you see the TDC case?

Poul Nyrup Rasmussen:

If we look at the facts and compare TDC before and after the takeover by the private equity funds, then first of all the strain of debt on TDC has risen notably. My information is based on findings that have all been published. Today TDC probably has a net debt of about 60 billion DKK and a strain of net interest somewhere between 3.5 and 4 billion DKK, which is almost parallel to – or at least close to – the annual earnings of about 4.7 to 4.9 billion DKK. This

means that TDC now finds itself in a considerably depreciated competitive situation, compared to its situation before the takeover.

Second, shortly after the new owners stepped in, they withdrew an extraordinary dividend, an amount in the region of 43 billion DKK. This as such is not illegal, but it is pushing the boundaries of the law, simply because it was not foreseen that such a situation would suddenly occur. It would have been more within the boundaries of reason, after a takeover, to have done a share addition. So here we have a situation in which TDC's

internal economic cash flow has been reduced considerably.

These are the facts and are beyond discussion, if you like. If you ask if TDC is in a stronger situation than before, in terms of the challenges of globalisation but also with regard to the renewal process that TDC is constantly witnessing, then by looking at the financial situation, the answer is no. TDC is in a deteriorated situation compared to before because its internal financial strength has been decisively weakened. Net capital has been reduced to a tiny size. As a result, financial capability of investment

has been lowered to a level that is unacceptable in comparison to the level of investment by the company seen until now. Furthermore, TDC will have to borrow money on the market to maintain the previous annual level of investment, or else will have to postpone its plans.

Interviewer:

However, TDC says that its plans for investment in the years to come are the same as previously, and that they pretty much will continue as before.

Poul Nyrup Rasmussen:

Sure, but it will inevitably be at a different price, which means that it will be harder for TDC. Having to invest at the same level as previously will cost the company. It will have to borrow the money, as it does not have a cash flow to match the level of investment. Either TDC will have to borrow from a bank syndicate or will have to borrow the money from the new owners. And, knowing the new owners, I highly doubt it will be for free.

You could say that the way these private equity funds persuaded TDC is consistent with a number of cases around Europe. They start off by contacting a group of foreign banks to get their consent for providing liquidity to take over the company in question. The banks can see that the company is well consolidated and the money lent will quickly be returned. As a result, the company takes over the debt financed by the banks, and we know the rest of the story. So what we have in this case is not an unknown way of operating. As is also typical, the first thing said by the new management of TDC is that now it is important to

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Former Prime Minister of Denmark from 1993 until 2001

Leader of the Danish Social Democrats from 1992 until 2002

Member of the European Parliament and President of the Party of European Socialists (PES) from 2004

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sell off everything abroad as quickly as possible. This is the next natural step for them. Not that I think it is natural, but we can see from other European companies, that it is the move that has been used in similar situations.

DENMARK HAS BEEN UNPREPARED FOR THE PRIVATE EQUITY FUNDS

Interviewer:

Why did TDC catch the attention of private equity funds?

Poul Nyrup Rasmussen:

There is no doubt that private equity funds have been drooling over TDC's financial and market strength in the IT business in Denmark. It is not a monopoly but almost – TDC has a very dominant status. It has the copper and a crucial part of the telecom market in Denmark. Plus TDC has had optimal cash flow management, if you choose to believe the retiring management. It cannot be true that TDC was taken over due to bad financial management when, at the same time, you can see in the annual accounts that they used the most modern optimisation methods and had exter-

nal experts to control their cash flow to the optimum. Both claims simply cannot be right. So my point is that in reality, the story of TDC underlines the naivety that still marks the Danish political climate with regard to the trades and industries – this new phenomena of large private equity funds – the so-called leveraged buyouts (LBOs).

The way the LBO takeover took place in cooperation with the management of TDC merely underlines my point. The payment methods and levels and, therefore, the questions of competence which could be asked of the management of TDC in the case of the takeover are very serious. This is very consistent with cases of other takeovers around Europe. Private equity funds have scouted around to see whether management are willing to cooperate, which is to say, whether they are willing to listen to the persuasions of the funds.

As I said before, the characteristics of these private equity funds tell us that we in Denmark, and in Europe, have to think through how we choose to deal with this in the future. Having said this, I wish to mention that it is wrong to

subject everyone to the same treatment. What I am talking about here are the big LBOs. If, on the other hand, we talk about venture capital funds, then they do a really good job, as they think long-term and on the terms of the companies, whereas private equity funds think in the short-term and on their own terms, and thereby promise the pension funds, especially in the US but also to an increasing degree in Europe, proceeds substantially higher than what the market can traditionally offer.

As an economist, I have to say that you can promise good proceeds that are substantially higher than those on the market for short periods, but not permanently. If you do so, you constantly have to do something which is quite atypical to the market. As a result, you strip the company of all it is worth if you are to maintain an exorbitantly high level of proceeds.

STRATEGY OF PRIVATE EQUITY FUNDS

Interviewer:

So, to the best of your knowledge, the first things they are selling off are the foreign parts?

Poul Nyrup Rasmussen:

They have said it themselves in an interview in the press. The new managing director says that everything abroad is up for sale and now they will focus on Denmark and the Nordic countries. And the new management has already sent the message that there will be further dismissals of staff – something that totally contradicts what was said at the beginning of the takeover process. My

point here is that the movements I see and the declarations I hear constantly seem to confirm what the strategy of the LBOs is. It is focusing cash flow, withdrawing as much liquidity as possible. And it is selling the company again as quickly as possible.

Interviewer:

It is also possible that parts of the Danish operations will be sold off. But then one could argue that this would be good for competition on the Danish market.

Poul Nyrup Rasmussen:

Yes, if they brought new investment thinking and a new boost of investments and new technological development, but that is not how it is. What happens here is not that you get a new opening of technology. Instead you get the destruction of an otherwise well-functioning set of activities tied together in a company. It could be said that in the short term it would enhance competition on the Danish market, but the net result afterwards will be a weakening of the Danish IT market in international competition.

Interviewer:

But would you compare it to the company raiders that we saw in the Danish market in the 1980s and early 1990s?

Poul Nyrup Rasmussen:

If you look at the amount of money being withdrawn from the company and the trading/selling of the company, it does look like the biggest corporate raid in the history of Denmark, at least since the 1960s. If you start from the 1950s when industrialisation really began with

the big agreements on the labour market, and then look at the last 40 years of construction of our industrial and welfare society, then this is the biggest withdrawal of capital from one single, sound and well-functioning company that we have ever seen.

Interviewer:

Turning to a more specific issue, TDC's management has subscribed to shares in NTC (which now owns TDC) for 51.5 million DKK. What do you think of the management subscribing to shares in NTC?

Poul Nyrup Rasmussen:

The offer to buy shares in the mother company is a mix of interests that is ethically offensive. In reality, we can ask whether ordinary rules of competence are handled in the best interest of the company. I do not doubt that there are some, possibly the chairman of TDC, and possibly the board, who will say: "Really, we are fully capable." But that is not the point. The fact that you can question their competence is in itself a problem. The rules of competence in Denmark are such that if by looking at the objective factors one can decide there is basis for questioning competence, then you have a problem.

You do not get the free and direct testing of your dispositions and the testing of the owners' demands of you, due to the fact that you are now part owner. So it is a mix of interests and, therefore, also an enhancement of the image unfolding since the beginning of the TDC case. However, I must say that I still do not know everything about the TDC case. I still feel like there are pag-

es of the book that we have not yet had a chance to read. I hope that in time we will get to read them, but from the moment the story broke in The Wall Street Journal and up until now I feel there are aspects of this case that society has a right to know.

PRIVATE EQUITY FUNDS IN GENERAL

Interviewer:

How do you see the implications of private equity funds in general, and not just in the TDC case?

Poul Nyrup Rasmussen:

There are four observations that make me really concerned. First of all, I think there is a certain risk that it will weaken our long-term response to the challenges of globalisation. If the net result of the operations of the private equity funds – who all openly admit that they operate within a timeframe of three-to-five years and then back out – is that the companies are left in a much worse state than before, which means the companies' long-term globalisation strategies are greatly weakened, because their possibilities for investing in technological updates, employee education and new markets will be considerably weakened.

My second point is tax payment. The tax yields that a society like Denmark is missing out on are quite considerable. This is quite serious for a small country like Denmark that needs its welfare system to function properly.

The third issue I would point out is what I would refer to as the force of coherence. I think that stock options as high as we

have seen in this case will run the risk of becoming like a knife in the wound inflicted on co-responsibility, which has left its mark on labour market collective bargaining for many years. I speak from experience. I have been part of an amazing number of collective agreements and I have been part of introducing income policy and real wage policy in Denmark. Negotiators in collective bargaining are facing people who have taken stock options and paid cheques to themselves that are totally out of coherence with people's daily salaries. We are facing an ethical situation for which it is very hard to convince these people that not a lot can be afforded while they see other parties who have given themselves sums at a whole other level. If it is a general trend that the stock market is rising and as a consequence of this you can add stock options, then those who work with stocks get an exorbitant bonus while regular wage earners can look forward to a couple of percent more. Then you have a pattern that in the long run will have a destructive effect on Danish society. It will work against the concept of Danish solidarity.

The fourth element I wish to mention is pension funds. Pension funds might be tempted by the promise of the very high returns. There is a lot to indicate that the big international banks that are financing these takeovers through the private equity funds are willing to provide financing on very easy terms. This means that the loans market will suddenly pull out of the pension funds, maybe not immediately but within three-to-five years, with losses far too huge for them to deal with because the capital funds have promised them returns that they cannot

deliver. This was the case witnessed in the US in the 1990s when the loans market collapsed.

Looking at these four factors – the ability to handle globalisation, the ability to finance our welfare society in the future, the ability to secure solidarity, which is one of our strongest parameters of competition in Europe, and finally the aspect of the pension funds – the conclusion is clear. I foresee a negative trend in all four of them.

There is also something fundamental. I spend my time travelling around, giving talks on Danish society, about flexicuri-

TDC

Danish telecommunications incumbent

In January 2006, taken over by Nordic Telephone Company (NTC) owned by five international capital funds: Blackstone, Apax Partners, Kohlberg, Kravis Roberts & Com, Permira and Providence Equity

NTC presently owns 88.2% of the TDC shares

Established in 1990 by the Danish government as a holding company for the regional Danish telephone companies

1994: 49% of shares sold on the open market

1998: Totally privatised with Ameritech as major share holder

1999: SBC takes over the Ameritech shares

2004: SBC sells all shares and all TDC shares are on the open market

ty, about the forces of coherence, about mutual understanding, about the sense of responsibility in ordinary people, about the rights and the duties. And everywhere, in Eastern and Central Europe, they are deeply committed, and this will also be the nucleus of the vision I call New Social Europe. I can see the power of solidarity emerging and that is why I speak up.

POLITICAL INITIATIVES

Interviewer:

What do you think can be done about it? What initiatives are being taken?

Poul Nyrup Rasmussen:

The first thing is to ask is what is the prerequisite for optimal functioning of markets. And the prerequisite is to have optimal information about what is going on. This was what earned Stieglitz his Nobel prize. He proved that the optimum performance of the market is conditioned by us having all the information we need. So my first point is that now we have to make decisions through legislation with a provision to ensure that everybody can see what is going on.

Second, there is a lot to be done about stock options, management fees, protecting the companies' net capital, taxation, etc.

We can do something – at a national level as well as within the EU. It is a question of political will and careful regulation.

Interviewer:

Is this something people are attentive to when you travel around? You say the Danish politicians have fallen behind,

but what about the rest of Europe?

Poul Nyrup Rasmussen:

British politicians are very concerned about hedge funds and private equity funds. I can also see that the French and the Italian politicians are very concerned. Regarding the Germans, a lot of people thought in the beginning that this was just the concern of the SPD and that it was part of an election campaign. But from what I hear, it really is a wider concern in the German business world and the German government.

HISTORICAL PERSPECTIVE

Interviewer:

Let's return to TDC and look at it in a historical perspective. Taking the recent developments into consideration, do you think it was right to sell TDC fully private in 1998?

Poul Nyrup Rasmussen:

I do not think it was wrong to modernise, to contemplate a way to renew the telecom sector, the public telecom sector that is; a way to enhance its ability to be more competitive. Everyone could see that in the coming years the pressure of competition would increase drastically, and you could not really say that nobody private was allowed to enter the telecom sector. It was bound to happen. The question in reality was how the conditions of competition were to be between large companies from Europe and the Danish telecom companies. And keeping that in mind, I think it was right to say: Okay, let's see if we can make the transition of ownership in a sensible way. What I can see now is that there was a failure to think five-to-ten years ahead,

and I have realised how important this company is. We did not prepare the framework and the protection of public interest well enough.

Interviewer:

The idea back then was to have a strategic investor. But now it is another type of investor.

Poul Nyrup Rasmussen:

I think there were very few people ten years ago who were able to predict the new phenomenon of private equity funds in Europe. Looking back, I have to say that the state did not set enough rules with respect to putting TDC in a new situation of competition. I did not see the need to do so at that point in time, but looking back, I think there should have been some higher demands set. I clearly remember that we were mainly preoccupied with securing universal service. But there needed to be some additional demands. There should have been some better thinking in the Finance Ministry. ●

