Fallen heroes

In Thatcher's Britain the spiv is hero and the profit-gouger is king. But, awkwardly for the Tories, the new captains of capitalism keep getting caught up in scandals. Paul Demuth reports.

Keep the box well locked if the City whizzkids are around

One of the oddities of the Thatcher years is that they have never produced a great business leader who can represent in the public imagination the strengths of the enterprise culture which will, some day at least, lead to the industrial rejuvenation of Great Britain Inc.

There have been no lack of contenders. Sir Ian MacGregor staked a claim early on, but he was too aggressive, too old, and anyway he was American. Graham Day and Michael Edwardes have a MacGregor problem — they are better known for closing old industries than opening new ones. Clive Sinclair showed early promise, and indeed was the official candidate for a while, but went the way of his three-wheel electric car. His successor, Amstrad's Alan Sugar, looks too much like a second hand car salesman. Richard Branson could get the youth vote, but might not go down so well in the shires. And anyway, airlines have a terrible tendency to go bust, as another failed candidate, Freddie Laker, can attest.

It must be considered a major failure of the Thatcherite public relations machine that at the end of eight years the best-known businessman in Britain is Ernest Saunders, sacked chairman and chief executive of Guinness, now facing charges of attempting to pervert the course of justice and the target of outpourings of moral indignation from leading Conservatives, industrialists and financiers alike.

Merchant bankers and stockbrokers in the City are only too happy to pin the blame for the scandal which propelled Saunders onto the front pages on its leading protagonist. Guinness itself is currently attempting to do much the same thing in the courts. The truth is rather different - while the Guinness scandal was not inevitable, it took off from a mood in the City of London which had been fostered by six years of a booming stock market, a feeling that the unfettered pursuit of profit could leap over any obstacle and an equally strong feeling that the referees who were supposed to keep order were all part of the winning team.

Merger mania took off in Britain in a big way towards the end of 1985 when a string of bitterly-fought takover bids drove the stock market to fever pitch. While the phenomenon itself was not unusual — powerful companies generally snap up weaker ones in the aftermath of the kind of economic recession Britain suffered between 1979 and 1981 — the stakes grew higher and higher, with several offers breaking the £1 billion barrier. The value of the bids was ratcheted up because the booming stock market allowed strong companies to issue new shares to buy weaker ones. The price of failure could be a short sharp shock to the share price, which could leave the bidding company itself open to takeover.

If the stakes were high for the companies involved, they were no less so for the financiers in the City. Merchant banks advising victims and predators were in for millions of pounds in fees, with their reputations on the line. The big financial institutions would underwrite share offers, often with an added fee if the bid was successful. The sums involved were enormous: it cost Argyll Group over £30 million in fees to fail to take over Distillers — the eventual (legitimate) cost for Guinness was £122 million to the merchant bankers and underwriters.

The feverish mood was encouraged by government policy on mergers. In times gone by, the Monopolies and Mergers Commission might call a halt to a takeover on the grounds it was "against the public interest". For the present government competition alone would be the only deciding factor and it went out of its way to make its view public. As many of the bids involved conglomerates angling for new business areas where they were not involved already, the road seemed

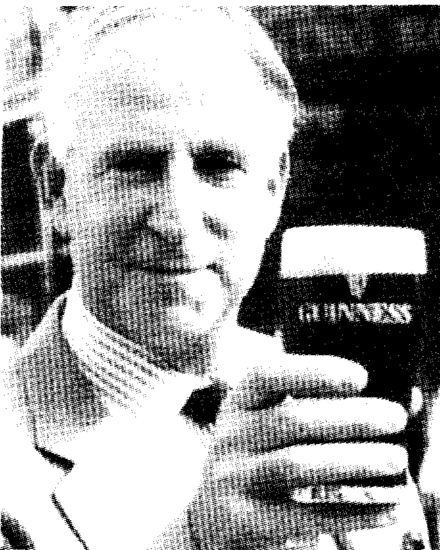
clear. Since 1985 only one major bid — the £1100 million tilt at Plessey by GEC — has been blocked by the Commission.

'Big Bang' in the City added to the pressure. Big Bang meant two things — the cosy cartel of stockbrokers charging fixed rates for trading in shares was abolished and the giant securities houses from Japan and United States were allowed free rein in the British market for the first time. The merchant bankers in the City pocketed huge commissions they received as they were snapped up by one or other of the international banks and muttered darkly about falling standards when the foreigners were allowed in. Those who were not taken over were under even more pressure to win that next takeover bid on which they had a lucrative contract to provide advice.

Big Bang exploded on 27 October last year and the signs were not auspicious from the start. Stock Exchange chairman Sir Nicholas Goodison appeared on breakfast television to tell a bemused public about the wonders of the new computerised stock market just as the new computers went on the blink. The stockbrokers sniggered and started trading like mad. Within days, the turnover of the stock market had breached the £1 billion per day barrier.

But more ominous developments were on the horizon. Engineering firm Turner and Newall lost a £260 million bid for the car components group AE, but it turned out that AE's merchant bank advisers had indemnified two shareholders for losses if they supported AE's defence and had not told anyone. The failure to disclose was cheating. The Takeover Panel, the City body responsible for fair play in mergers, stepped in and allowed Turner to make another bid, which it won.

More ominously still, the merchant bank involved was not American or Japanese, but Hill Samuel, a high flyer in the Square Mile. And the broker involved was none other than Cazenove, broker to the Queen, whose power to fix deals was whispered in tones of awe by its rivals. But the new regulatory system, which allowed panels of City participants to referee the match, appeared to be working. After all, the Takeover Panel had acted quickly and any nonsense had been firmly nipped in the bud.



Saunders: 'pure genius'... and a bit of cheating

But within days, the whiff of scandal was once again wafting around City streets. One of the two leading securities traders at the most blue blooded merchant bank, Morgan Grenfell, resigned. It was alleged he had used the confidential information he gained from his position in the firm to make profits by trading shares on his own account, which since 1979 has been a criminal offence. He was later charged with insider dealing.

Attention then moved across the Atlantic, as Wall Street watched in horror while one of its heroes, Ivan Boesky, was publicly arraigned on insider dealing charges. Boesky was what the Americans call an arbitrageur, a professional share dealer who made his money by taking positions in companies before a bid was launched. But his natural flair turned out to have been assisted by insiders in the merchant banks who gave him tip-offs. In return, they got a slice of the profits, some literally delivered in the form of suitcases stuffed with $100 bills.

From Wall St to Throgmorton St

Things were becoming serious. If some of the top bankers on Wall Street had their already inflated salaries boosted by illicit payments, what of the City? The bankers and brokers shrugged and consoled themselves: this was not America, whose brashness was the polar opposite of the genteel respect for the rules that prevailed (a few minor transgressions aside) in Throgmorton Street, where the dealers collected every day to exchange gossip, but only in the most legal possible way.

When Department of Trade inspectors moved into Guinness on December 1, London tumbled down the same chute as Wall Street. What on earth was going on? Guinness was one of the best-performing companies on the British stock market under the dynamic leadership of Ernest Saunders, whose belief he could do no wrong was echoed by grateful shareholders, for whom he had made a fortune. And the credentials of Guinness's advisers were impeccable. Its merchant bankers? The same Morgan Grenfell which had just shown its uprightness by clamping down on insider trading. Its brokers? The sacred Cazenove once again.

There was another outbreak of nerves a few days later when Saunders announced that the previous May Guinness had invested $100 million in a fund run by the same Ivan Boesky who had just coughed up $100 million in penalties to the US government for insider dealing. What was a British beer and whisky company playing at by investing huge sums of money in a shady Wall Street dealer without bothering to tell its shareholders until forced to by newspaper leaks?

As Saunders helpfully explained the money was just a good investment and Boesky might have been useful to Guinness in making a major acquisition in the US, the financiers shook their heads in stunned disbelief. This was just too much to swallow — there was trouble on the way.

But although London's financiers threw up their hands in disbelief, they really had little excuse. The same takeover bid which had sparked off the DTI investigation had already caused a major City scandal, and the City had backed Saunders to the hilt.

Guinness launched its massive £2.6 billion bid for Distillers in January 1986 after Saunders had received a desperate plea for salvation from the Distillers board, whose management credibility was less than zero in the City. The Distillers management were desperate to fight off a rival bid from James Gulliver's Argyll Group. Although it dominated the Scotch whisky market, Distillers stood for everything the new yuppies in the Square Mile hated. It lacked flair, its major brands were, they said, going astray and it needed nothing more than a wholesale bout of sackings among the executives to lick it into shape. Distillers had never really recovered from its disgraceful behaviour during the Thalidomide scandal almost 20 years previously.

Saunders won his bid, but only after some adept political footwork to win over the so-called 'Scottish lobby' — the great and the good of the Edinburgh financial world, who did not like the idea of the management of a major Scottish company moving south of the border. Saunders promised he would move the Guinness headquarters to Scotland and promised to make the eminence grise of Scottish finance, Sir Thomas Risk, chairman of the merged company.

No sooner had Guinness won the day than Saunders went back on his word. There was now said to be no place for Risk on the Guinness board and references to the moving of the Guinness headquarters became so vague as to be meaningless. While the City could not have cared less about the wounded pride of a few greying Scots worthies, or about where Guinness had its offices, there was an important principle at stake. The Guinness commitments had been made in an official document proposing the issue of new shares to finance the Distillers bid. Listing documents have biblical status in the City; to break proposals made in them is to strike at the very heart of the Square Mile's central ethic — "my word is my bond".

It also looked blatantly unfair. After

all, it only took a small number of Distillers shareholders to be swayed to the Guinness cause by the broken promises, not a majority. So to hold a meeting of shareholders to rubber stamp the changes hardly settled the matter. But Guinness did, and did it with the support of all the major City institutions which owned its shares. They also voted to replace the jilted chairman Risk with none other than Saunders himself.

Still, that was small beer compared with some of the other things which began to emerge from December onwards. To beat Argyll, Guinness had relied on keeping the value of its shares up. Allegations began to pour in that to do that it had organised an enormous support operation both to indemnify people who agreed to buy its shares (which is illegal) and even to commit itself to buying its own shares (even more illegal).

As the allegations poured in to Guinness's West End office building, Saunders first stood down and then within a week was unceremoniously sacked, with no compensation for the loss of his £350,000 a year salary.

Heads roll

Respectable heads began to topple like ninepins. Guinness's finance director Olivier Roux resigned. Roger Seelig, the Maradonna of Morgan Grenfell's takeover team, resigned amid allegations that he had arranged for Guinness to buy a tranche of its own shares owned by clients of another merchant bank, Henry Ansbacher. A top official of Ansbacher followed close behind. Then the Bank of England stepped in and said it was not enough to heap opprobrium on Seeling. Morgan's chief executive and head of corporate finance were forced out and the bank told to tighten up its internal rules.

A series of tearful confessions began to arrive at Guinness headquarters. An obscure Geneva bank, Bank Leu, admitted it had 41 million Guinness shares (five per cent of the total issued) and claimed that Guinness had said it would either have them bought by others or would buy them back itself after the dust had settled. Guinness had put a £50 million deposit into the bank's vaults as a token it would keep its word. Bank Leu protested it had done nothing wrong. The Swiss Banking Commission launched an investigation.

Gerald Ronson, boss of the Heron car hire and property group, said he had been buying Guinness shares for a "success fee" of over £5 million, which he returned. As the City watched in disbelief, the affair grew more and more bizarre. Another Guinness director, American lawyer Thomas Ward, was alleged to have been bought a flat in the Watergate complex with some of the money paid to another participant in the alleged share support operation. The $100 million invested in Ivan Boesky's fund was said by Olivier Roux to have been a pay-off for his support during the Distillers bid.

The total spending on supporting the Guinness share price could have been as high as £250 million. The new-look Guinness board, under a team of non-executive directors appointed at the time of the Risk affair, tried to recover the fees paid out by the company. The DTI investigation drags on and might not report for another year. Argyll Group has threatened legal action for damages following its costly failure to win control of Distillers.

The affair has already moved to the courts, however. Guinness is pursuing Thomas Ward through the High Court for the return of a £5.2 million payment said to have been for his services during the bid, while Saunders himself was charged with attempting to pervert the course of justice and destroying and falsifying documents.

Behind all the headline stories, there are two crucial aspects of the Guinness affair. The first is that it is alleged that a major company which is listed on the London Stock Exchange systematically abused both the City's Takeover Code and possibly the law to win a takeover bid. That moved the scandal to a higher plane than the insider dealing affairs, which concerned individuals working for their own gain who could safely be dismissed as 'bad eggs'.

The second is that although the alleged support operation pre-dated Big Bang, none of the organisations which have become the bedrock of the new system of self-regulation in the City did anything about it. The Takeover Panel was silent, as was the Stock Exchange. Nothing has been done that really convinces anyone matters will be different in the future.

There have been a series of minor reforms: the Takeover Panel's rules have been toughened up, the Bank of England stepped in to reorganise Morgan Grenfell and the government brought forward powers to interview witnesses under oath, with the threat of prosecution if they do not cooperate. There has also been a marked change of emphasis — the government used to stress that the system for policing the City was one of self-regulation, now it stresses that self-regulation is backed by law.

Who polices the City?

But the fundamentals of *who* polices the City have not been changed; the Takeover Panel and the Stock Exchange, the courts of the City system, are made up of insiders appointed by the practitioners themselves. And there is no investigative branch — outside the Fraud Squad, there is no body charged with getting to the bottom of dirty dealing in the Square Mile.

Investigations run by the Department of Trade and Industry are run by appointed inspectors (usualy a QC and an accountant) with no specific training for the task, and take aeons to produce a report. The system is in stark contrast to that in the United States, whose Securities and Exchange Commission is staffed by young lawyers eager to make a name for themselves. The American Justice Department official prosecuting Ivan Boesky cut his teeth chasing the Mafia.

But underlying the problems of regulation is a deeper problem of enforcing any sort of restraint on financial markets. The City works on the principle of Adam Smith's hidden hand — everyone goes hell for leather after their own interests, which balances out at the end of the day as in the best interests of everyone. While, for the Tories, the same theory underlies the operation of industry, it is in the City, with its over-paid yuppies pocketing vast commissions and going into a frenzy over every movement in the FT index, that it finds its purest expression.

The trouble is that, apart from the abstract consideration that if all the rules are broken all of the time no-one profits, there is no compulsion to keep any of the rules. This is particularly the case when those you are cheating are themselves driven by the same motives of greed. Sucks to them if you can con them.

Rules in financial markets have only technical, not moral force. It is unclear, for example, who suffers by the activities of insider dealers. It has been the subject of much erudite debate, but there is some truth in the argument that it is "a crime without a victim". The most convincing 'victim' is the smooth operation of financial markets (though some argue insider dealing *helps* the operation of the market), but that means little to the merchant banker in a takeover bid whose credibility is on the line. In the case of malpractice in takeovers, one set of rich capitalists is merely cheating another set, who stick to the rules.

It is also difficult for many people to see why some practices (insider dealing, supporting a company's own share price) are breaking the rules while others are not just sanctioned, but lauded. Asset-stripping — buying a company, beefing up the bits you don't want, selling them off and then keeping the bit you do want having covered your costs — which more often than not leads to widespread redundancies, is considered a virtue almost second to none, because of the effect it has on a company's share price.

As the system cannot rely on consent to police its rules, it must rely on coercion. That means scaring the hell out of any would-be transgressors. There is little to show that the shake-up in the City has gone beyond the cosmetic. While it will be more difficult for the specific abuses which allegedly took place during the Guinness affair to be repeated, the endless ingenuity of the City whizz-kids will soon come up with some new tricks. As matters stand, there is little to stop them trying them out.