Formula One: A Race To The Bottom?

Case Overview

In early 2012, Formula One Group (F1) made public its intention to list on the Singapore Exchange (SGX). Approval for the Initial Public Offering (IPO) was granted by SGX in May 2012, with the Group proposing to raise S$3.8 billion[1]. However, the European Debt Crisis and allegations of bribery involving Chief Executive Ecclestone delayed the IPO. Plagued by all these issues, the proposed IPO was repeatedly shelved, and the Group has yet to list at this time.

The objective of this case is to highlight the various issues faced by F1 in its proposed listing, with a specific focus on the bribery allegations faced by its Chief Executive. This case also brings to light other related issues such as potential conflict of interests faced by stock exchanges, as well as key man risks and the importance of succession planning.

Formula One Dissected

F1 is a group of companies responsible for promoting the FIA F1 World Championship, which is the world's premier auto racing competition. The Group has a complicated structure with a total of 31 entities[2]. Bernie Ecclestone has been at the helm since 1978, when he became the chief executive of the Formula One Constructors Association.

This is the abridged version of a case prepared by Jin Jianqing, Law Chun Fung, Melody Lim, Oh Wei Ying, and Tay Guang Liang, under the supervision of Professor Mak Yuen Teen and Dr Vincent Chen Yu-Shen. The case was developed from published sources solely for class discussion and is not intended to serve as illustrations of effective or ineffective management or governance. The interpretations and perspectives in this case are not necessarily those of the organisations named in the case, or any of their directors or employees. This abridged version was edited by Amanda Aw Yong under the supervision of Professor Mak Yuen Teen.

Board Of Directors

In planning for the upcoming listing on SGX, the F1 group intends to restructure its current Board to eventually comprise 16 directors post-listing. This new board would be headed by the newly-elected Chairman Peter Brabeck-Letmathe, and will consist of representatives from various interest groups.

Prior to his appointment as Chairman of the F1 board, Peter Brabeck held various positions on boards such as L'Oreal, Credit Suisse and Nestlé. In May 2012, he announced his acceptance of a supervisory role in F1 as an Independent Non-executive Director[3]. In contrast with Ecclestone's operational focus in F1, Brabeck would focus on business succession. Current Chief Executive Ecclestone, having spent 50 years working for F1[4], will continue to manage the company after the proposed IPO.

Singapore Independent Directors

Singaporeans Liew Mun Leong and Kwa Chong Seng were slated to sit on the board to satisfy the requirements specific to foreign issuers (i.e. two Singapore Resident Independent Directors)[5] in the SGX listing rules. Liew Mun Leong has been an Independent Director of SGX prior to the approval of F1's flotation. He also sits on both the Audit and Remuneration Committees of SGX[6]. Kwa Chong Seng was Deputy Chairman of Temasek Holdings Pte Ltd until May 2012[7]. Temasek owns SEL Holdings, who in turn had a 23.5% stake in SGX[8]. Up till his retirement in July 2012, Kwa was also an Executive Director of the DBS Group Holdings Ltd and DBS Bank Ltd, one of the advisors for F1's IPOs[9].

Road To Listing

In March 2012, news of F1 preparing for a US$1 billion flotation on an Asian Stock exchange (likely to be either Singapore or Hong Kong) began spreading[10]. The reason cited was to tap on the "Asian enthusiasm for international sporting brands"[11]. Ecclestone recommended Singapore as the best place to float to CVC Capital Partners (CVC)[12]. CVC was a substantial shareholder of F1, holding 42.5% of its shares in January 2012[13]. Ecclestone, holding a far less substantial ownership, thus had to gather the support of F1's largest shareholder.

A month later, SGX appeared to have beaten the Stock Exchange of Hong Kong (SEHK) to the listing, and the IPO process was ready to kick-start. The IPO was expected to be valued at US$1.5 billion and was tentatively planned for July 2012[14].

Goldman Sachs and UBS were revealed to have been appointed as joint global coordinators[15].

In late April 2012, Ecclestone, with the bosses at CVC, gave a presentation to a room of analysts, indicating that the IPO plans were being stepped up. Morgan Stanley was revealed to be the third lead book runner. The F1 group was valued at US$10 billion, with up to 30% being publicly offered, with the majority ownership remaining with CVC. Most of the share issue was to come from the Lehman Brothers Estate, which held 15.3%. Furthermore, CVC apparently secured US$7.1 billion of revenue, which were mostly from long-term racing contracts. With refinancing in mind, CVC undertook another loan of US$2.3 billion. From this loan, US$1.1 billion would be paid out to Delta Topco, which is the holding company of the F1 group[16].

By May 2012, however, things were not looking good. Even though SGX had given the approval for the share sale[17], instability in the global markets slowed the progress of the plan. The European Debt Crisis and huge trading losses that JPMorgan Chase had incurred contributed to this[18]. Given that F1 holds almost half of its yearly races in Europe, this uncertainty in the Euro zone would significantly affect its IPO valuation[19]. In addition, an agreement with Mercedes had yet to be reached with regards to its long-term future in the sport. Without Mercedes' commitment, the flotation would unlikely to be able to proceed[20].

On 23 May 2012, it was announced that shares to be sold would be stapled with a loan note, which is first of its kind in Singapore. The purpose of this was purportedly for F1 to enjoy tax benefits in the UK, which allows interest expense on shareholder loans to be tax deductible[21].

In late May, Brabeck, the then newly-appointed Chairman, expressed that F1 had yet to decide whether to list or not. Reasons cited by others included the failure of Facebook's listing (which involved both Goldman Sachs and UBS) among others[22]. Facebook's failure was notable as it was similar overhyped[23]. Finally in September, Ecclestone conceded that the float was not going to happen in 2012[24]. In October, CVC postponed the flotation to 2014, in light of market turmoil and the ongoing bribery case Ecclestone was implicated in. Ecclestone similarly commented that 2014 was the more likely date[25].

In March 2013, Ecclestone changed his position, stating that within the next three months, a decision would be made as to whether the listing will occur at the end of 2013[26].

Allegations Of Bribery

In June 2012, former Bayerische Landesbank's (BayernLB) Chief Risk Officer, Gerhard Gribkowsky, admitted to receiving bribes from Ecclestone in 2006 when the sale of shares in F1 Group took place between BayernLB and CVC. Gribkowsky claimed that Ecclestone offered him US$44 million in bribes to facilitate and approve the sale of 47.4% shares in F1 to CVC[27]. This confession was ostensibly prompted by the possibility of a shorter prison term in exchange[28]. Gribkowsky was officially sentenced to eight and a half years in jail for his charges on 27th June 2012[29].

Motivation For Accepting Bribes

According to Gribkowsky, he had accepted the bribe from Ecclestone because he was unhappy that his employer, BayernLB, did not grant him a bonus he believed he deserved for the successful sale, as well as for his hard work over the years. Thus, when Ecclestone presented him the offer, he accepted it without hesitation[30]. In addition to the bribe, Gribkowsky also claimed that Ecclestone offered him a job as a consultant in F1 upon the conclusion of the sale to CVC[31].

What Ecclestone Stood To Gain

The reason Ecclestone was so concerned about the sale of BayernLB's stake in his company lies in the belief that Ecclestone wanted BayernLB out of F1. Ecclestone was in fact sued in London over changes of corporate governance rules in the company that limited BayernLB's influence. The resulting animosity had a clear part to play in Ecclestone's desire to hasten the sale of BayernLB's stake.

In addition, CVC had an agreement with Ecclestone that would retain him as the Chief Executive after they become the largest shareholder of F1. Even though another bidder – Bluewater Communications Holdings (Bluewater) – presented an offer higher than that of CVC's, CVC remained Eccelstone's preferred choice and the bribe was thus presented to Gribkowsky to steer the sale toward CVC.

Ecclestone's Side Of The Story

In contrast to Gribkowsky's allegations,, Ecclestone maintained that the US$44 million paid to Gribkowsky was not a bribe, but rather, a payment in response to the latter's blackmail.

According to Ecclestone, Gribkowsky had “strong designs” on replacing him as the boss of F1. Once Gribkowsky realised he had little chance of fulfilling his F1 ambitions, he began to repeatedly blackmail Ecclestone that he would disclose unfounded accusations to the UK tax authorities about possible tax violations of Bambino, which is a trust set up by Ecclestone and run by his ex-wife[32]. He threatened to report to the UK tax authorities that Ecclestone was the sole controller of the multi-billion Bambino trust. Fearing that the accusation would make him liable for about £2 billion of back taxes, Ecclestone tried to silence him with US$44 million[33]. He weighed that paying the money was more convenient and less financially harmful than risking a costly investigation by the tax authorities[34]. Hence, a scheme was arranged to funnel US$44 million to Gribkowsky through contracts and off shore companies[35]. In 2008, however, Ecclestone received a letter from the UK tax authority that he was cleared of any involvement with the trust[36].

Other Lawsuits

Aside from the main bribery case, Ecclestone also faced lawsuits from Bluewater and BayernLB. The former filed a lawsuit against Ecclestone, BayernLB and CVC, to compensate for its lost revenue from F1 had they bought over F1’s stake in 2006 successfully. Bluewater claimed it was prepared to offer more than other bidders for the 47.4% F1 stake, yet Ecclestone steered the sale to CVC so that he could retain his CEO position. BayernLB, on the other hand, sought US$400 million in damages from Ecclestone[37], claiming that if the bank had known about the bribery, it would not have paid Ecclestone and his family trust any commission for being the middleman of the successful sale to CVC.

In response to these lawsuits, Ecclestone told Reuters he was surprised as he had never heard of Bluewaters[38]. A spokesman from BayernLB also said that the sale of shares to CVC complied with all relevant procedures and the commission fee paid to Ecclestone was reasonable. As a result, it might be hard to claim the losses from Ecclestone.

IPO On The Horizon?

Embroiled in these various high profile lawsuits, serious doubts were cast on the ethics and image of the company, especially the alleged bribery case involving its Chief Executive. If Ecclestone is found guilty, F1 may have to remove him and business operations might be disrupted. With this potential change in leadership and loss of such a prominent leader, would F1 remain profitable? Would shareholders and investors continue to invest in the sport? In light of these problems, it remains to be seen if the planned IPO re-launch would proceed smoothly. All eyes will be on Ecclestone as the market awaits his official announcement in the coming months.

Epilogue

According to a news article on the listing environment in Singapore, F1 has yet to make headway with regards to its IPO as of May 2014. When interviewed, Ecclestone said that they would go ahead "when [they] think the time is right"[39]. Until then, whether the IPO would be successful remains to be seen.

Discussion Questions

1. Discuss the potential conflict of interests for an exchange like the SGX.

2. Should SGX have approved F1's flotation in May 2012 when the alleged bribery case of Ecclestone was still ongoing and his personal integrity called into question?

3. F1 was planning to sell ordinary shares stapled with a loan note for its proposed IPO in Singapore. What are the possible reasons for F1 issuing stapled securities rather than selling them as separate securities? Are there corporate governance concerns with such stapled securities?

4. Ahead of the proposed listing, F1 invited two Singaporean directors to sit on its board in order to fulfill the listing rules for foreign issuers. Do you think there are any possible conflicts of interest resulting from this?

5. To what extent is Ecclestone indispensable to F1? What are the potential ramifications on F1 for relying too much on Ecclestone?

6. What kind of succession plans would you recommend for a company like F1? Evaluate the succession plans of F1, if any.

Endnotes

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