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Transforming State Owned Enterprises

A Presentation to the Public and Administrative Law Conference

Rob Cameron

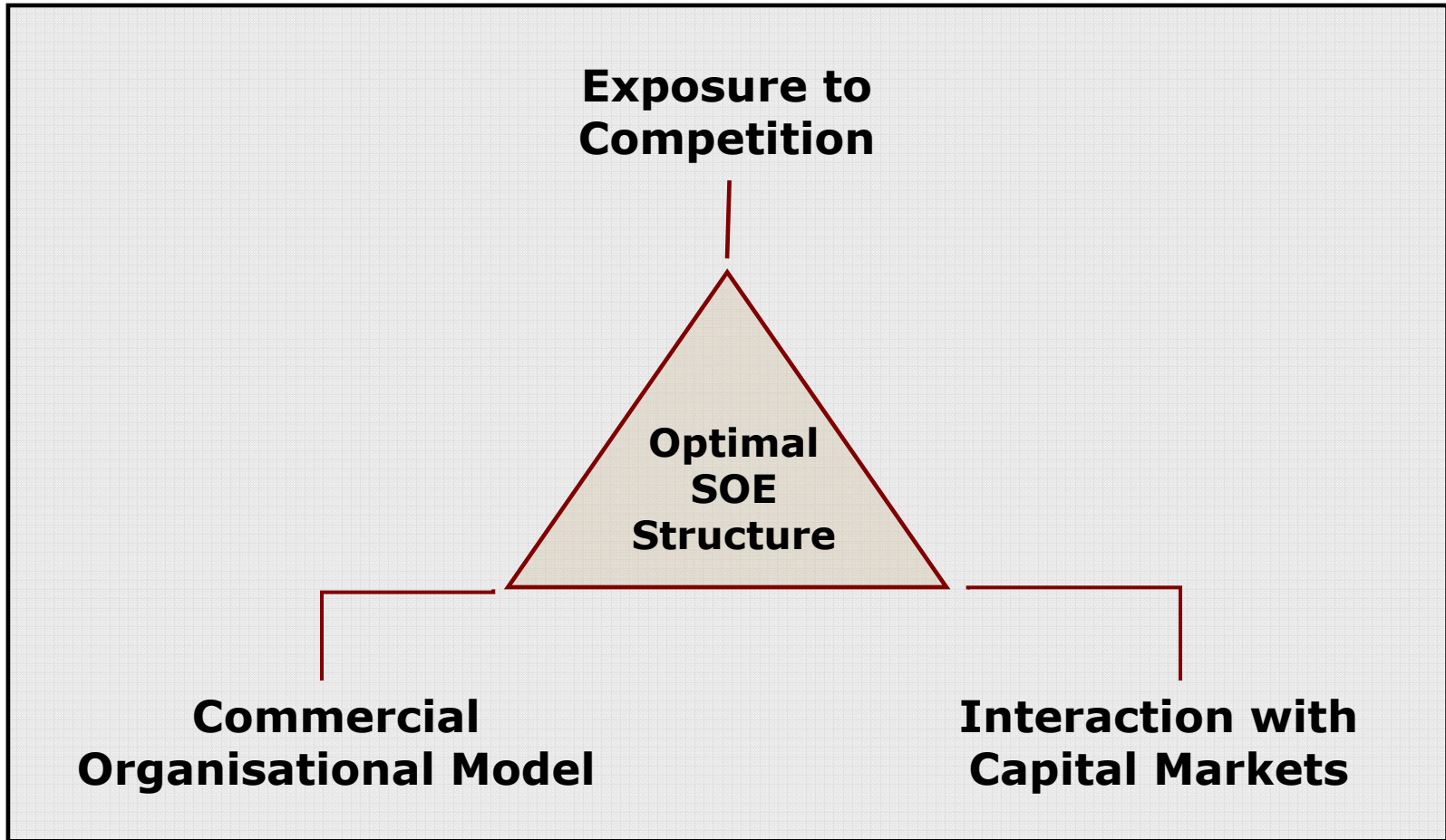
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Presentation Agenda

- The Ideas Underlying the SOE Model
- The Prepare for Sale Approach – An Early Application
- Towards an Optimal SOE Model
- Recent Developments – The Long Term Hold Approach
- Future Directions for Transforming SOEs

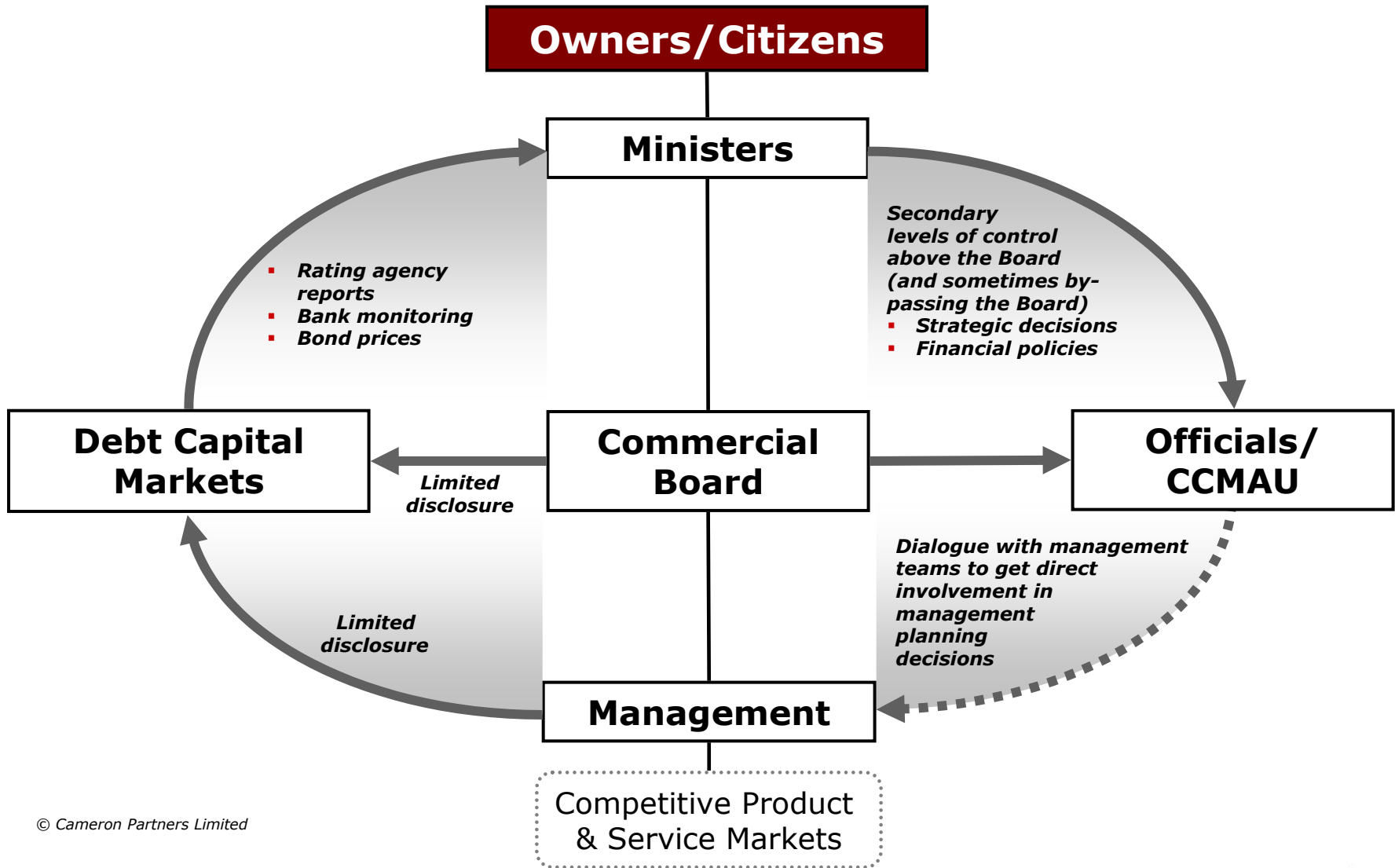
Key Ideas Underlying the SOE Model



Prepare For Sale Approach – An Early Application

- Long term value-creation was put aside.
- Tight controls were imposed.
- Impact on SOEs and value mitigated because:
 - Short timeframe expected until sale.
 - SOE markets were in early stages of deregulation (less competitive).
 - In some areas there had been significant over investment in capacity in pre-SOE period.

The Prepare for Sale Approach – the Way the Model Worked



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 Until 2pm, Tuesday 20 February 2006
 PAGE 5

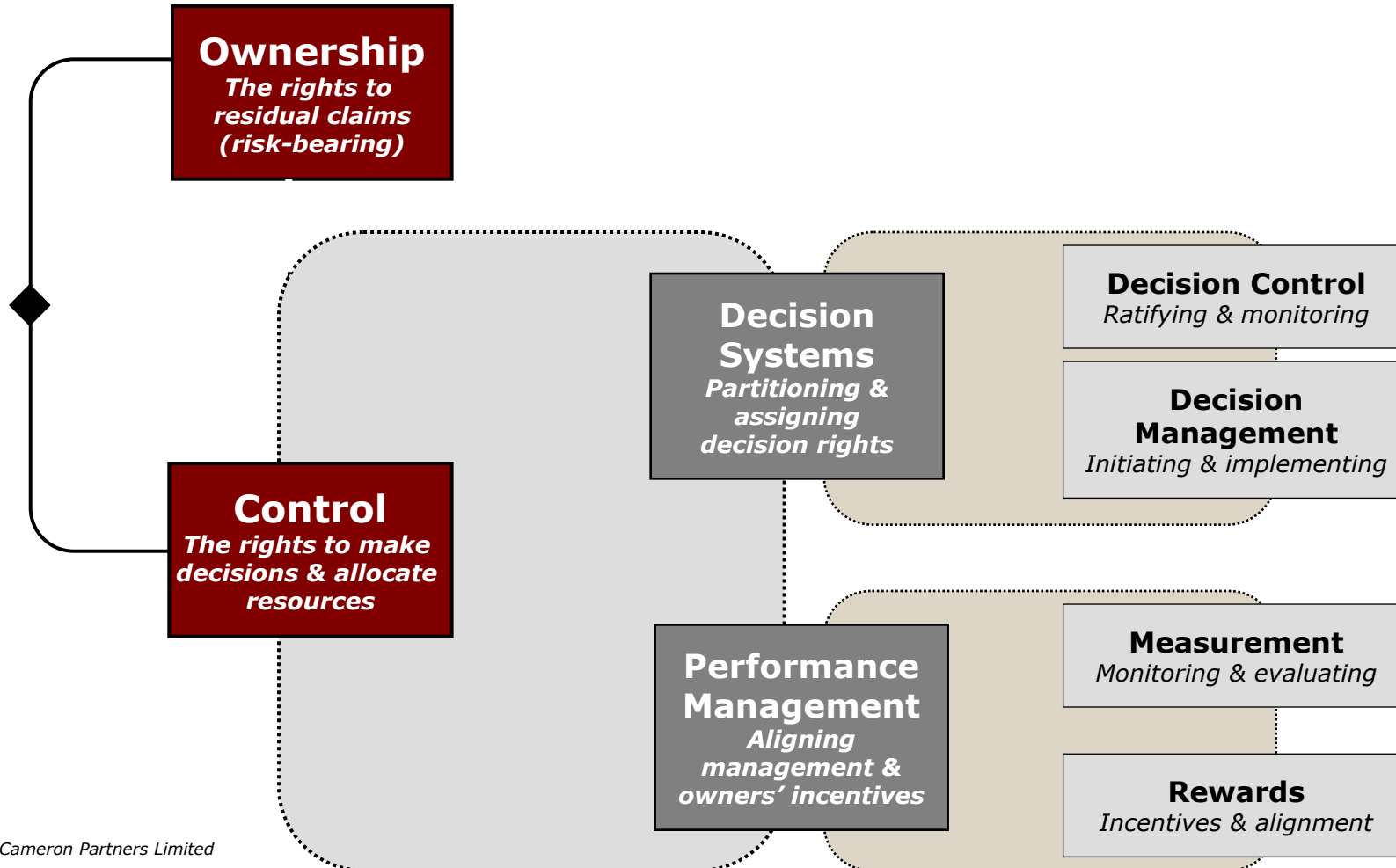
Towards an Optimal SOE Model

Organisational Architecture

- Organisational Architecture is concerned with:
 - Allocation of decision rights to those with specific information and capability.
 - Control arrangements to ensure alignment of decisions with shareholder interests:
 - Decision systems.
 - Performance measurement and rewards.

Towards an Optimal SOE Model

Organisational Architecture



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Towards an Optimal SOE Model

Organisational Forms to Consider

Closed Corporate

Overlap of Ownership and Control



Open Corporate

Separation of Ownership and Control



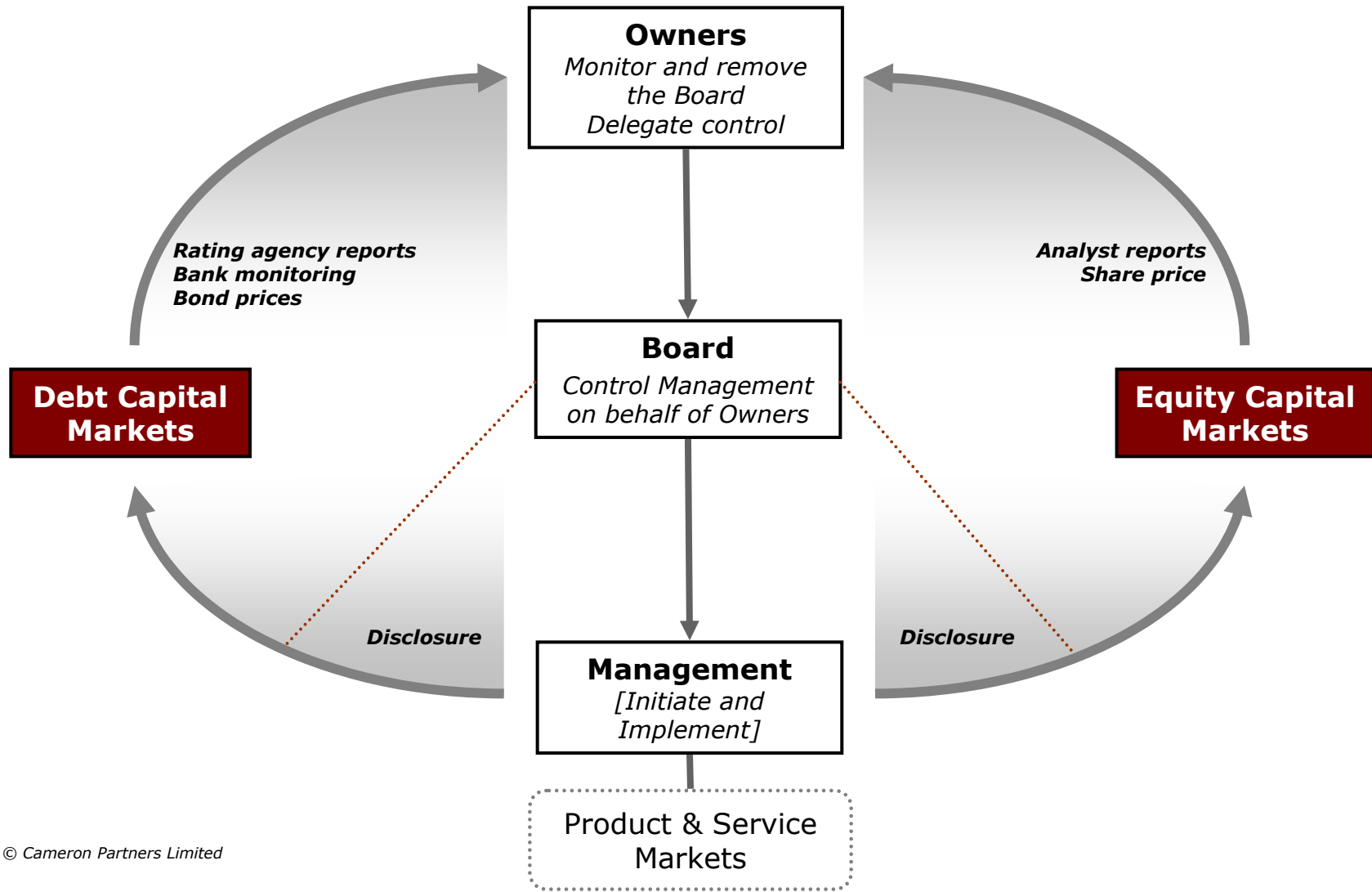
Requires

- Allocation (delegation) of decision rights
- Performance management system

Improved by

- Interaction with capital markets

The Open Corporation Model



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Until 2pm, Tuesday 20 February 2006
PAGE 9

Towards an Optimal SOE Model

The Open Corporation Approach

- An optimal SOE model should be based on the open corporation model, and incorporate the following elements:
 - Decision-rights allocated along public company lines focusing particularly on the relationship between Ministers and the Boards of SOEs.
 - Effective measurement and monitoring of organisational performance.
 - Exposure to the disciplines of equity capital market to the greatest extent practicable.

Towards an Optimal SOE Model

The Key Elements

- **Decision-rights allocated along public company lines focusing particularly on the relationship between Ministers and the Boards of SOEs.**
 - Ensure that SOE Boards have the authority to make strategic, financial and investment decisions.
 - Focus the role of the Shareholding Ministers on removing the Chair of the Board where necessary, ratifying high-level ownership decisions and monitoring Board effectiveness.

Towards an Optimal SOE Model

The Key Elements

- **Effective measurement and monitoring of organisational performance.**
 - Acquire an advisory capability which will assist Ministers in monitoring the effectiveness of SOE Boards.
 - Adopt a disclosure regime comparable to that of large publicly listed companies.
 - Make use of experienced and qualified private-sector analysts for monitoring SOE performance.

Towards an Optimal SOE Model

The Key Elements

- **Exposure to the disciplines of equity capital market to the greatest extent practicable.**
 - Provide for SOEs to partner with third-parties who provide external equity.
 - Issue and list non-voting equity in selected SOEs.

Recent Developments – The Long Term Hold Approach

- Recognition that:
 - The 'prepare for sale' approach will not work in a long term hold environment.
 - SOEs are now confronted with significant threats, opportunities and change in their markets.

- SOEs now encouraged to play actively in their markets.

- Decisions rights have been progressively transferred to Boards and CEOs:
 - Business strategy.
 - Financial strategy.
 - Investment decisions.
 - Organisational arrangements to undertake activities.

Recent Developments – The Long Term Hold Approach

- The survey of SOE Directors indicates that Boards have been in control of strategy and investment decisions since mid 2005.

- Policy announcement on SOE diversification on 2 June 2006 formalised this development.

- The empowerment of SOE Boards and management teams has been accompanied by:
 - Developments in measurement/monitoring of SOE performance involving private sector equity analysts.
 - Organisational arrangements which introduce 'outside' ownership, with equity and monitoring incentives.

Recent Developments – The Long Term Hold Approach

- Examples include:
 - New Zealand Post's divestment of 50% of Express Couriers Limited into a joint venture with DHL.
 - Mighty River Power's gas exploration joint venture with Swift Energy.
 - Genesis Energy's partnerships in two oil and gas field developments – Kupe and Cardiff-2.
- **These changes represent a significant evolution of the SOE model beyond the 'prepare for sale' approach and towards an optimal model.**

Future Directions for Transforming SOEs

- Four issues:
 1. Where should (and should not) the SOE model be applied?
 2. Should more decision rights be allocated to Boards?
 3. Can measurement and monitoring be enhanced?
 4. How can SOEs be exposed to equity capital markets?

Future Directions for Transforming SOEs

Issue 1: When Should the SOE Model Be Applied?

- Should the SOE model be applied to organisations which don't face competitive markets, such as Airways and Transpower?
- We question whether Transpower should continue as an SOE given its regulated and controlled environment.
- Better outcomes at lower cost may result from giving Transpower a more proscribed mandate to operate, build and maintain a core transmission network and more powers and decision rights to fulfill such a mandate.
- Are there other organisations such as TVNZ, where the SOE model **should be** applied?

Future Directions for Transforming SOEs

Issue 2: Should Boards Have More Decision Rights?

- Ministers should retain the right to remove the Chair, but decision rights on other governance matters should be allocated to SOE Chairs and Boards with Ministers 'ratifying' those decisions:
 - Board appointments.
 - Director succession.
 - Directors' tenure.
- Ministers should ratify Director compensation, but this area needs urgent attention – and Ministers should get professional outside advice.

Future Directions for Transforming SOEs

Issue 3: Can We Enhance Measurement and Monitoring of SOEs?

- Measurement and monitoring could be enhanced by:
 - Focusing Ministers on Board effectiveness.
 - Introducing a standard disclosure regime that matched that of publicly listed companies.
 - Encourage/permit private sector equity analysts to monitor and report on SOE performance/value and make these reports widely available.

Future Directions for Transforming SOEs

Issue 4: How can SOEs be Exposed to Equity Capital Markets?

- By issuing and listing non-voting shares:
 - Would enable monitoring and measurement of SOE performance/value by the share market.
 - Would enhance SOE access to capital.
 - Is already provided for in the SOE Act.
 - Does not compromise Crown control of SOEs.
 - Would significantly enhance the quality, depth and attractiveness of the New Zealand capital market.