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Raising the Performance of State-Owned Enterprises

The government is concerned about the financial performance of state-owned enterprises.

Many of them appear to have been achieving low returns on the large amounts of capital tied up in them. The same is true of some local government assets, such as shareholdings in port companies.

Poor financial performance is a sign that scarce capital is being used inefficiently or being allocated to the wrong uses.

As a consequence, potential economic growth is sacrificed and the living standards of New Zealanders are lower than would otherwise be the case.

In the private sector, poor returns are a signal that the businesses should be restructured or taken over by management teams that could do a better job. The ultimate sanction is bankruptcy.

So the government's concern is warranted. For years the Business Roundtable has been urging the Treasury to no avail to monitor and report on the financial performance of SOEs, as the Productivity Commission does in Australia.

Last year the Commerce Committee of parliament made similar recommendations. At last the government seems to be taking action. It would make sense to engage experienced and qualified private sector analysts to monitor SOE performance.

The government has also taken steps to appoint new directors to SOE boards. Under the previous government, many appeared to be appointed for political reasons only. While governments will always be tempted to make such appointments, the test of the commercial competence of SOE

directors should be whether they would be appointed to major public company boards.

A number of suggestions have been made on other ways to improve SOE performance.

To reduce the risk of political influence on appointments, one is that an independent commission be set up to handle the appointment task.

Another is that shareholding ministers only appoint the chairs of SOEs, with the chairs being responsible for appointing other directors.

Director remuneration is clearly an issue, and impacts the availability of competent directors.

Like it or not, remuneration also affects the commitment of directors to their roles and responsibilities.

SOE directors' fees compare poorly with fees paid by major public companies. As a rough rule of thumb, they should probably be doubled.

At the same time, there is a strong case for better processes to monitor the performance of SOE directors and remove under-performers.

SOE policy adviser Rob Cameron has suggested an advisory panel be set up to support ministers in their assessment of board effectiveness and director compensation.

SOE performance suffers from the lack of continuous monitoring associated with sharemarket listing, reporting by analysts and the possibility of takeover.

These are powerful disciplines. If the government were prepared to require SOEs to issue non-voting shares, as is provided for in the State-Owned Enterprises Act, it would expose them to most of these disciplines (though not the threat of takeover).

But if it chooses to require full economic (rather than voting) ownership of SOEs, the weaknesses in the SOE model are insuperable.

Another insuperable problem relates to business strategy. Over time, businesses need the freedom to make acquisitions, diversify, go international and so forth. Inevitably, governments have to limit such freedoms to avoid exposing taxpayers to greater risks.

In the final analysis, trying to achieve superior performance in SOEs is like trying to make a cat bark.

Because they are subject to political control, SOEs will reflect political imperatives, not commercial imperatives. Many top business people will not want to work in a political environment – the reputational risks are too high.

Improved performance may occur for a while with demanding ministers, as was initially the case with SOEs, but over time it will deteriorate as experience has shown.

The nationalisation of KiwiRail was a purely political move. The chances that it will be commercially profitable are close to zero. It will be a drain on taxpayers and living standards.

There is now abundant evidence that, on average and over time, privately owned businesses outperform state-owned ones – that is to say they create greater wealth and contribute more to economic growth. This is an empirical, not an ideological, point.

A Business Roundtable study suggested the benefits of moving SOEs to the private sector could be as large as 1 percent of annual GDP.

The government has a commitment not to sell state-owned assets in its first term, and governments should not lightly break election commitments.

An alternative which may not be in breach of its commitment would be to give shares in SOEs to their true owners, New Zealand taxpayers.

The gains from shifting commercial entities to the private sector and allowing politicians to focus on the roles that only governments can undertake would be large.

Ultimately the government will need to recognise that not following such a path is likely to be inconsistent with its higher commitment to raise New Zealand incomes to Australian levels by 2025.

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