

Remaking Khazanah and the GLCs –
A strategic framework



KHAZANAH NASIONAL BERHAD

March 2005

- **Khazanah Nasional:**

The new mandate and capacity building

- **Setting the landscape for restructuring:**

Historical context, sequencing and division of duties

- **Khazanah and the GLC transformation program;**

Framework, roles, modalities, early scorecard and way forward



KHAZANAH NASIONAL BERHAD

- Wholly-owned strategic investment holding company of the Government of Malaysia
- Central economic agency chaired by the Prime Minister with board members including the Minister of Finance II, the Minister in charge of economic development and the Governor of Bank Negara
- Assets under management in excess of RM60 billion. Market capitalization of companies under control or where Khazanah is a major shareholder is in excess of RM200bn or a third of Bursa Malaysia capitalization
- Controlling or major shareholder of key strategic national companies including Tenaga Nasional, Telekom Malaysia, PROTON, UEM Group, PLUS, RHB Bank, Malaysia Airports, PMB and Malaysia Airlines. Key holdings in strategic sectors including infrastructure, utilities, financial services, aviation, technology and media
- Key agency mandated to drive shareholder value creation, efficiency gains and corporate governance in GLCs
- Key agency to invest in new strategic sectors and drive cross-border strategic investments.



A NEW MANDATE AND FRAMEWORK FOR KHAZANAH

“... decisive action requires nothing less than a remaking of Malaysia Inc...”
 “The Government would like to see Khazanah emerge as one of the biggest and most dynamic investment houses in the region... emerge stronger, more nimble and able to create more value”

*Dato' Seri Abdullah Ahmad Badawi,
 Prime Minister of Malaysia
 14 May 2004*

Key themes of our Mission...

- Strategic investment house
- Sustainable value creation
- Nation-building and national competitiveness
- Performance culture

... via four Strategic Pillars ...

Legacy investments	Streamline, restructure
GLC transformation	Increase value: shareholder + strategic
New investments	New sectors, cross border
Human Capital Mgmt	Active leadership development

and success measured by KPIs

Financial metrics as primary KPI: TSR and economic profit, ROE

Strategic value creation: capability building in customer acceptance, sectoral and geographic exposure, market penetration, human and knowledge capital, technology

Institution building: processes, charter, systems and controls, work culture, brand equity



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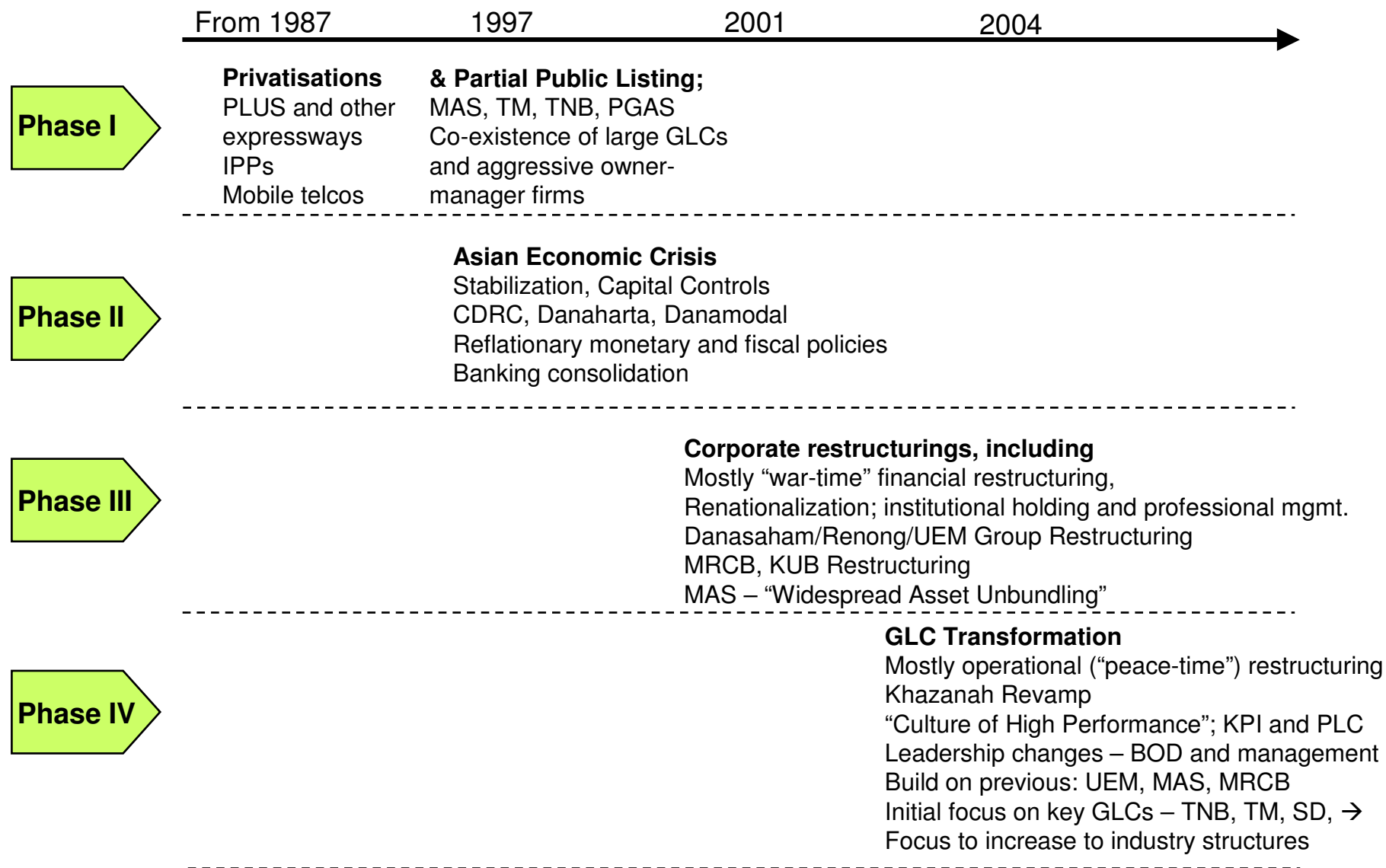
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THE HISTORICAL CONTEXT OF MICRO-ECONOMIC RESTRUCTURING



Source: KNB analysis

THE ROLE OF GOVERNMENT IN ECONOMIC MANAGEMENT – *THE RIGHT OBJECTIVES IN THE RIGHT BOXES*

Roles of Government

Developer and Public Goods

- Provider of public goods, infrastructure or services
- Provision of law and order
- More socio-economic in nature
- Clustered under MOF Inc. – public transport, sewerage etc.

Regulator

- Providing level and conducive playing field
- Protection of public interest
- Enforcement

Investor

- Government owns and operates enterprises
- Creates economic value
- Differentiated investment focus between Khazanah, EPF, PNB, KWAP, TH due to differences in return objectives, risk appetite, investment horizon, liquidity requirements, and beneficial owners

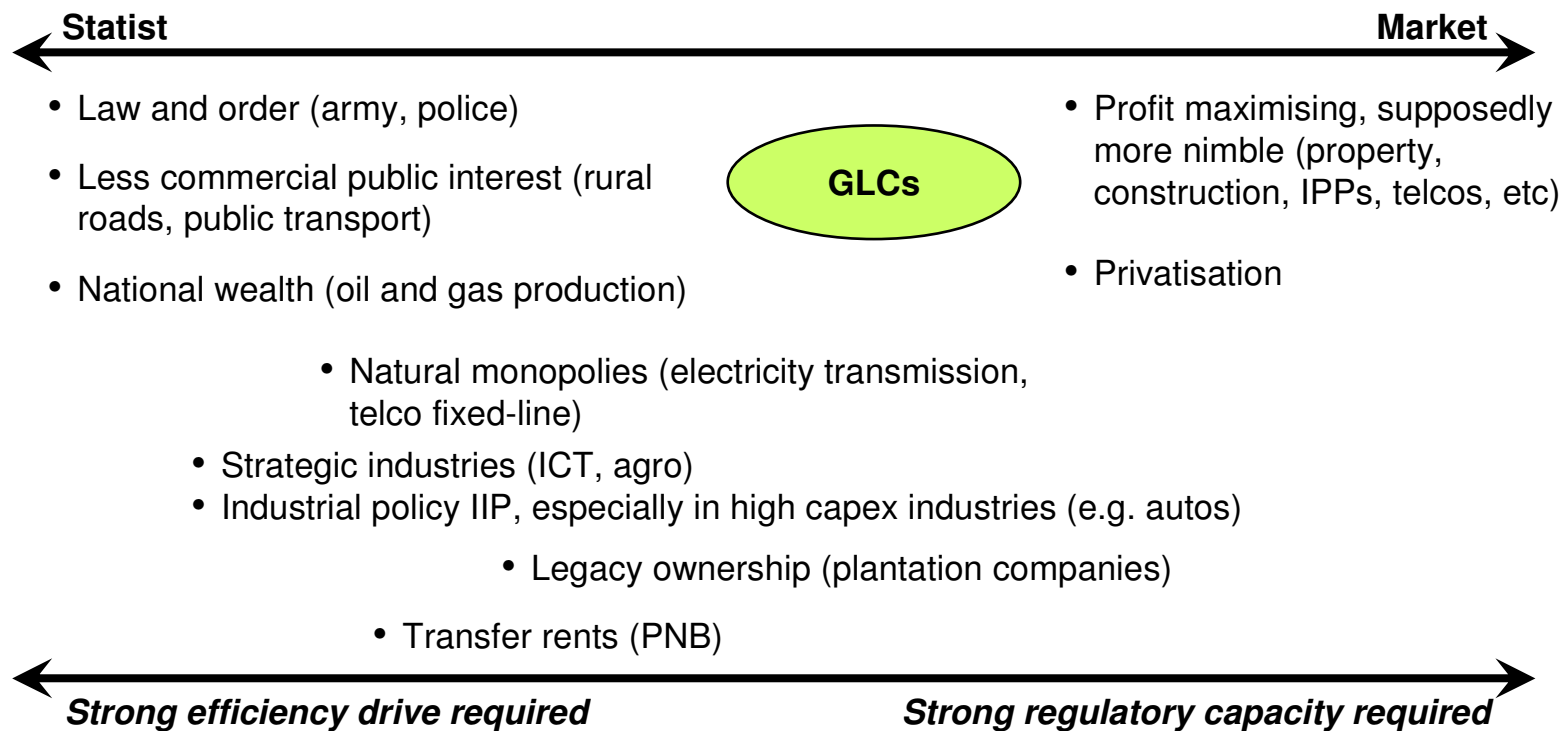
Khazanah as GOM's strategic investment arm

- Necessarily the risk taker among government agencies
- Focus on shareholder value creation, both majority and minorities
- Careful not to crowd out private sector. Balanced co-existence with GLCs
- Optimal and evolving holdings in companies, sectors and holding levels reflecting changes in strategic emphasis



THE ROLE OF THE GOVERNMENT AND THE ROLE OF THE STATE IN THE MALAYSIAN CONTEXT

- Balanced and multi-track approach of not crowding-out the private sector, nor allowing misplaced or excessive regulatory capture by private firms
- Key is a balanced and multi-track ecology that creates value by assigning resources and mandates according to the respective strengths of private, public and GLC sectors
- Market failures, low-level equilibriums and public interest justify state presence/ interventions, but challenge is how to drive performance in the absence of profit motive



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KHAZANAH'S 8-POINT FRAMEWORK FOR GLC TRANSFORMATION

1. Separation of roles of Government in micro-economic management

2. Mandating Khazanah to macro-manage, GLCs to micro-manage

3. Clear terms of engagement with GLC; Khazanah's 5-pillar TOE framework*

4. Holistic KPIs for GLCs to drive operational and strategic restructuring; primary focus on financial value creation, followed by strategic value and institutional capability building*

5. Aligned incentive structures – performance linked compensation

6. Macro-managing synergies for value creation* – capital management, financial engineering, core focus, group synergies, industry restructuring, reduce excessive CSR, cross-border diversification

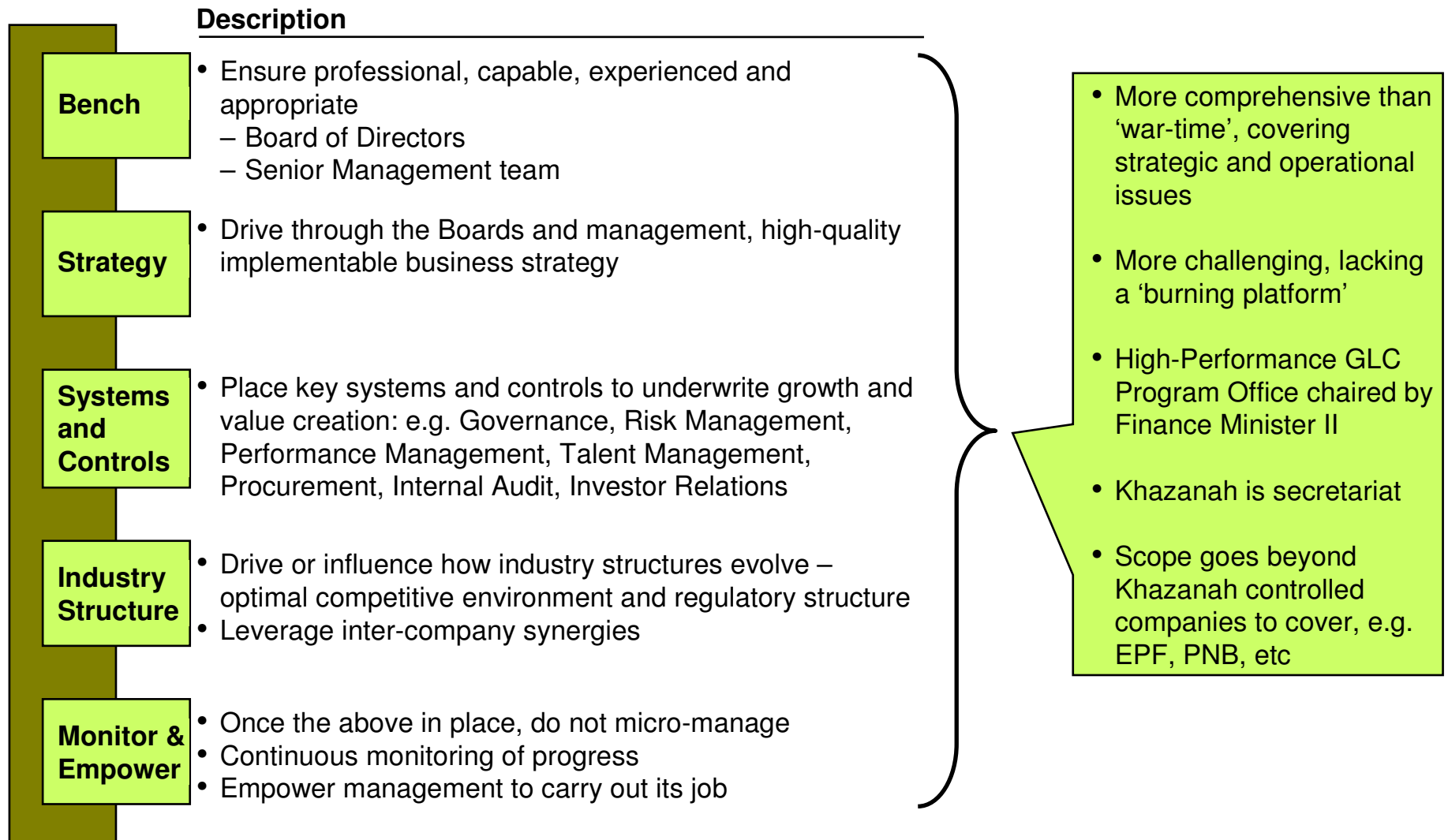
7. Build a strong Khazanah: financial capital, human capital, knowledge capital, social capital and brand capital

8. Execution focus: performance contracts of top teams – “*execute or be executed*”



* Elaborated further
Source: KNB analysis

5-PILLAR TERMS OF ENGAGEMENT FRAMEWORK WITH GLCs: *KHAZANAH AS ACTIVE MACRO-MANAGER, GLCs AS FRONT-LINE MICRO MANAGER AND EXECUTOR*



DRIVERS OF PERFORMANCE FOR GLCs

- SIX MAJOR CONDITIONS FOR SUCCESS

1) Clear industry and regulatory structure and reporting lines

2) Professional management and Board working in unison

3) Independence in key decision making

4) Strong internal culture of performance and emphasis on systems and controls

5) Focus on financial discipline in addition to service delivery

6) Disciplined access to credit and orderly competition



KPIs FRAMEWORK FOR GLCs

- **Financial Measures**

- Principal measure
- Focus on TSR, capital management, ROE
- Per strategy, focus on growth and profitability
- Per strategy, also focus on costs and reducing vulnerabilities to business cycles: e.g. using unit procurement costs and medical costs as proxies, breakeven load factors, etc

- **Strategic Value Creation**

- Track changes in strategic value, e.g. market share, customer satisfaction, brand equity, stakeholder alignment
- Also for national strategic value, e.g. linkages for industry cluster development, technological capability

- **Institutional Capability Building**

- Business sustainability
- Measures include employee engagement, people development, capacity and infrastructure building of systems and processes

- **Target setting**

- Combination of improvement over historical performance and vs best-in-class
- Benchmarking necessary starting point for some companies



MACRO-MANAGEMENT LEVERS FOR VALUE CREATION

- Capital management
- Core focus – operations, assets
- Khazanah group synergies, M&A
- Industry restructuring
- Reduce excessive CSR
- Cross-border expansion and diversification



EARLY SCORECARD AND THE WAY FORWARD

Progress to date

- Strong backing for revamp as part of Government's thrust for efficiency gains
- A syndicated strategic framework for execution has been set by MOF and Khazanah
- Good momentum to date; KPI-PLC, leadership changes, strategic framework
- Early market reaction has been positive; Khazanah's listed portfolio up 21%+ against KLCI of +16% since changes announced

Expectations and horizon

- Need to avoid short run hype and unrealistic expectations → need to focus on building the conditions for sustained value
- Focus on medium term investment horizon to target building the foundations of institutional change

Way forward

- Build on early wins
- Reciprocal, control and coordination mechanism: Program Management Office
- Further sharpening of strategy and more quick wins in the first 12 months
- The key to sustainable value creation will be both strong macro-management (strategy, governance, synergizing) and strong micro-management (execution, execution, execution)



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- APPENDIX I: GLC drivers of performance
 - APPENDIX II: Definition of a GLC
 - APPENDIX III: Khazanah Nasional Investment Holding Structure
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APPENDIX I: GLC DRIVERS OF PERFORMANCE (1/2)

Performance Driver	Performing GLC - Petronas	Inhibited GLC
Clear and orderly Industry and Regulatory Structure	<ul style="list-style-type: none"> • Reports directly to YAB PM • Clarity on most regulatory issues • # of industry players well planned. No oversupply 	<ul style="list-style-type: none"> • No clarity on key issues such as tariffs, capacity planning • Industry plagued by bouts of overcapacity and shortages • Overlicensing in mobile telcos
Professional management and BOD	<ul style="list-style-type: none"> • Very stable management and BOD with clear succession history • Pays reasonably competitive compensation packages • Performance pay in place 	<ul style="list-style-type: none"> • Short tenures of CEOs • Unstable (or worse) dysfunctional and antagonistic BOD/Senior Management teams • Till now, uncompetitive pay, with little performance element if any
Decision Making	<ul style="list-style-type: none"> • Relative autonomy – reports directly to YAB PM 	<ul style="list-style-type: none"> • Multiple “regulators” • Quite common in the past to use listed GLCs for social objectives



APPENDIX I: GLC DRIVERS OF PERFORMANCE (2/2)

Driver	Performing GLC - Petronas	Inhibited GLC
Internal DNA and culture – performance, systems and controls	<ul style="list-style-type: none"> • Strong, almost overbearing culture of systems and controls • Culture of performance and empowerment is rising • Reasonably good HCM 	<ul style="list-style-type: none"> • Degree of systems and controls generally low • Greatly bureaucratic generally, very low empowerment. • Generally poor HCM • Note: UEM has relatively strong controls and systems, empowerment
Financial discipline in addition to service delivery	<ul style="list-style-type: none"> • Relatively strong financial focus – ROI, project evaluation • Strong financial position gives long run orientation crucial for strategic development of industry 	<ul style="list-style-type: none"> • Generally poor financial or ROI focus • More service delivery focus, with little attention to “at what cost”
Access to credit and orderly competition	<ul style="list-style-type: none"> • Strong funding capacity has generally not resulted in lax financials • Well managed industry – oligopolistic • International competition has sharpened Petronas 	<ul style="list-style-type: none"> • Easy money contributed to financial indiscipline • Overcompetition has damaged financials • More global and regional competition should sharpen performance (MAS)



APPENDIX II: DEFINITION OF A GLC

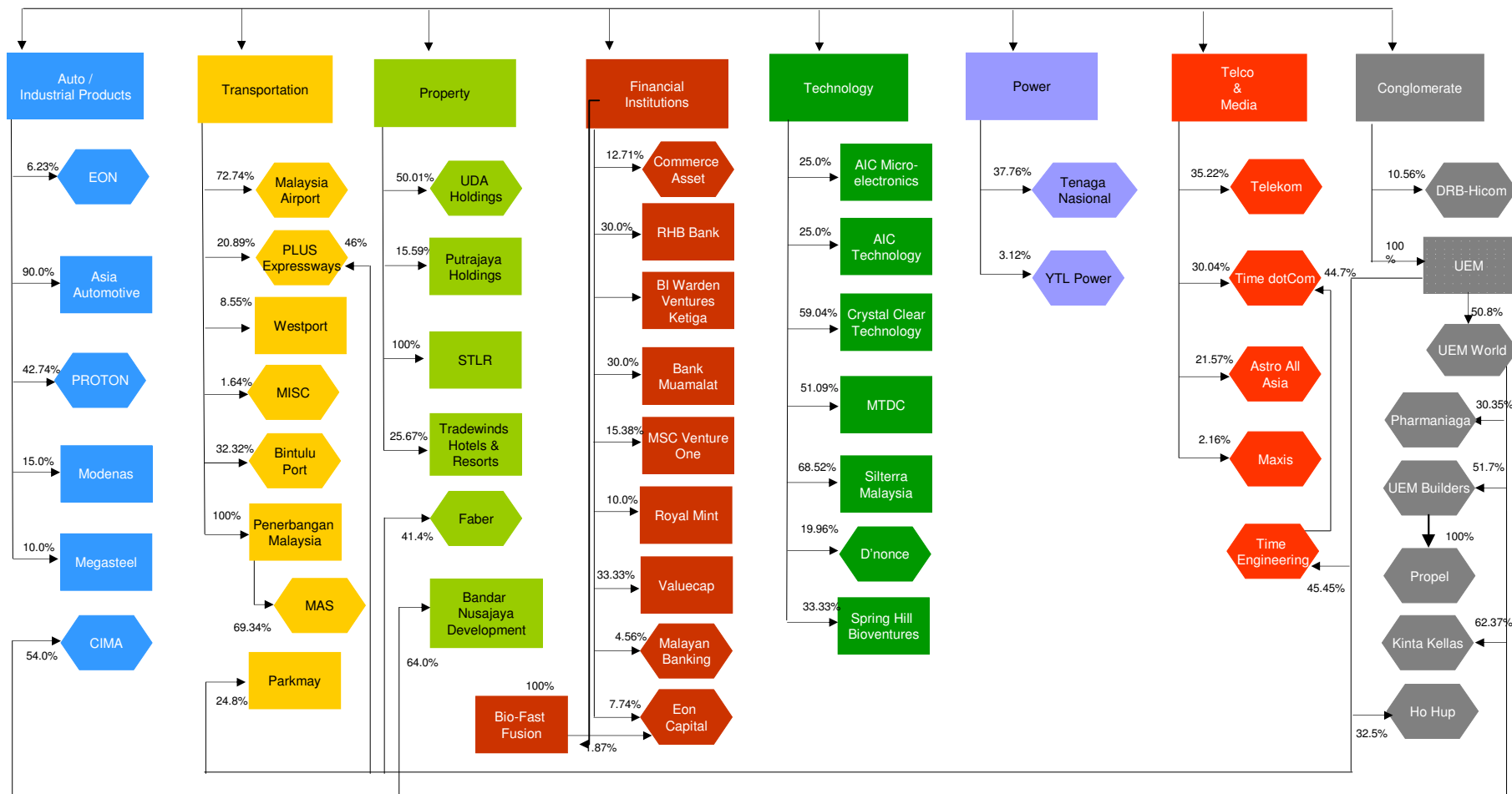
- Khazanah's test is control rather than % ownership. Control is defined as the ability to appoint BOD members, senior management, make major decisions (e.g. contract awards, strategy, restructuring and financing, acquisitions and divestments etc)
- Definition # 1: Where Government of Malaysia ("GOM") controls directly – through Khazanah, MOF Inc., KWAP, and BNM
- Definition #2: (and) where other federal Government linked agencies controls – PNB, EPF, Tabung Haji (technically owned by depositors, but capital (and some income) portion guaranteed by GOM)
- Definition # 3: (and) where state agencies controls (Selangor, Johor, Pahang, Perak, Sarawak, Terengganu are particularly active)
- Khazanah's usage to date has been limited to # 1 and # 2



Investment Holdings Structure

(as at 10th March 2005)

Khazanah Nasional Berhad



Auto / Industrial Products	Financial Institution	Media and Communication	Power	Public Listed Companies
Transportation	Technology	Property	Others	Unlisted Companies

