

Invest Malaysia 2005 Conference
Luncheon Address
22nd March 2005

Executing the Remaking of Khazanah
and the GLCs –
A Progress Update

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**Views of the speaker are strictly his; usual caveats apply in that the views may or may not reflect those of Khazanah's.*

Distinguished audience, ladies and gentlemen

Introduction

Thank you for inviting me.

Almost six months ago I spoke in public for the first time¹ about Khazanah and the remaking of GLCs. At that time, we used the occasion to outline the framework behind the revamping of Khazanah and GLCs; our new mandate, how we defined success, the *why* behind what we were doing, and most importantly the *how* in terms of how we were planning to execute. Notably, we had described a five-pillar engagement framework of how Khazanah would work with GLCs and an eight-point execution framework for GLC transformation. We left that evening last October with the words *execution, execution, execution* and the only half-joking rejoinder of *execute, or be executed* ringing in our ears.

Progress Update of 2004 Measures → Execution into 2005

Six months on, we are a little older and a little wiser, and nine months after I started, the phrase that it is not possible to be half-pregnant also comes to mind. We are indeed fully pregnant with the task at hand and we can update that the progress on the implementation of what we have now started referring to as the 2004 measures are either completed or well on the way, and that the building blocks for sustainable value creation into 2005 are indeed being put in place.

The thus-called 2004 GLC Measures, including the introduction of KPIs, performance contracts, performance-linked compensation, changes in board and senior management

¹ Refer “*Remaking Khazanah and the GLCs – A Capitalist’s Approach*” at the Kuala Lumpur Business Club, 3rd October 2004. Available on www.khazanah.com.my

composition, principles of board formation including the exit of regulators on boards of listed companies have been mostly implemented among GLCs, and certainly totally implemented among the large and major companies under the purview of Khazanah.

Although we have set three years – matching the length of performance contracts - as the first major milestone, I am reasonably happy that there have been several early wins that gives us great encouragement. At two key focus companies, Tenaga and Telekom, there have been some quick wins on both the organic and strategic fronts. At Tenaga for instance, notwithstanding the power disruption in January, we have begun to see early organic improvements in better operating margins, and improved average collection period and receivables management for example. Strategically, third and fourth generation IPP terms continue to improve while the recent decision by the government to grant Tenaga a financial package to address structural losses in Sabah Electric to our minds reflect a mood shift towards better allocation of excessive social responsibility. At Telekom, for example, amidst often quite intense international competition, we have been able to quickly build a footprint into key regional markets. Meanwhile, at home, a collaborative approach to labor, for example, has resulted in the launch of a significant voluntary separation program. As its major shareholder, we are also pleased that Telekom has demonstrated better capital management by first disclosing a dividend policy and then paying higher payouts. There are several other examples at other GLCs under our purview and those under other investment holding companies.

In addition, the 2004 GLC Measures you would recall also called for the revamping of Khazanah into a more active major shareholder, as an active macro-manager, as we described it, driving change and transformation among its investee companies domestically and beginning to open new frontiers of growth for Malaysian companies regionally and internationally. In the months past, my colleagues and I have been busy building capacity at Khazanah, as described in our framework of building human, financial, knowledge and indeed social capital.

In this regard, we believe we are on track on all fronts; we are trebling our staff strength to about 100 by middle of this year with an establishment for 180 by 2007. I am thankful and extremely gratified that many talented Malaysians have answered the call to join, including several senior people who have come forward to serve as our nominee directors on various investee companies. My colleagues and I have even been called *body snatchers* and we fear that some business partners are reportedly hesitant of putting their best people in front of us now. To them, I assure that as our mandate is to ultimately build the nation through superior value creation at the firm level, we do not intend to crowd-out the market and any hires will have to pass through what we call the optimality (for the nation) test.

We have also begun for the first time to tap the international capital markets and late last year we successfully issued a USD 414 million of Exchangeable Bonds into PLUS, the largest Malaysian exchangeable bond issuance to date. Our work on the restructuring and reorganization of several investee companies including SilTerra, Malaysia Airports and UDA Holdings have gathered pace as has work on rebalancing our investment portfolio. Early manifestations of the portfolio rebalancing work include the transfer of listed companies from MOF Inc., the raising of our stakes in EON Capital and in Proton for example. Regionally, we have been actively mapping out several new markets and have played a not insignificant part in helping key investee companies including Telekom for example in building its regional footprint.

KRIS – Khazanah’s Research and Investment Strategy unit has begun to take shape and its knowledge formation has been launched with among others, a lecture series, study focus groups and the hiring of domain knowledge experts in key sectors such as telecommunications.

Last October, we had also identified the building of social capital – that is the network of trust, reciprocity, and conditions for collective action amongst the various market players, stakeholders and business partners - as crucial prerequisites for success in executing our

mandate. We are happy to report that we have and continue to engage with various key government and investment agencies including agencies such as NEAC, MOF, EPF, the SC, Bursa, PNB, Bank Negara, MIDA, various other ministries as well as other external stakeholders including current and prospective business partners, the press and investors from both local and foreign, and public and private sectors. We believe this is important to ensure a commonality of understanding in that as far as practicable and within what is allowed, the execution of our mandate is done in a spirit of consultation and support rather than in isolation and potential conflict. This consultative spirit we believe is both the glue and the lubricant to allow us to move forward.

Execution at GLCs – into 2005 and beyond

Thus, to our minds the 2004 measures have begun to be executed, although we recognize that the desired results and outcomes are still some way away from being achieved to a satisfactory level.

This brings us to the crux of my address this afternoon. To focus our minds on three key questions that I would like all of us to jointly consider.

- The first question is “**How do we monitor and sustain the momentum of implementation of the 2004 measures?**”
- The second question is “**Are the 2004 measures enough?**”
- The third question revolves around the hard grind of implementation and “**What are the key obstacles in executing transformation that is focused on delivering greater shareholder value?**”

The stakes are indeed high but they are achievable and indeed it would not be unprecedented. In such study of large-scale state-owned enterprise transformation programs attempted around the world, New Zealand over the last twenty years is an interesting albeit not wholly replicable case, where approximately 50% of its state-owned

enterprises moved from the bottom quartile to the top quartile of performers on a variety of financial and operational measures while the productivity of the country moved from being more or less flat to just under 4% p.a. This is by any measure an amazing transformation that required careful thinking in the first instance, the syndication of a national consensus, political steadfastness to stay the course and dogged execution.

In answering these three pertinent questions I am reminded of a quote from a rather streetwise commentator who lived some five centuries ago who said

“ ... there is nothing more difficult to arrange, more doubtful of success, more dangerous to carry through than initiating changes ... The innovator makes many enemies of all those who prosper under the old order, and only lukewarm support is forthcoming from those who would prosper under the new.”²

I never thought I would ever be espousing Machiavelli to an august gathering of fund managers and market players but his words are indeed insightful and remain fresh. Nonetheless, to be completely Machiavellian about it, – he was after all a sometimes misunderstood idealist, although his ideals may be questioned - we are treating this as a challenge not an obstacle, a reminder, not a warning.

To the first question of **sustaining the momentum of the 2004 measures**, we have since the start of the year instituted a monitoring mechanism, whereby the implementation of these measures are being program-managed through a high-level committee for GLC High Performance at Putrajaya chaired by YB the Second Finance Minister. The committee reports ultimately into the Prime Minister with membership consisting of various GLICs (Government-Linked Investment Companies) including PNB, EPF, Tabong Haji, LTAT and Khazanah, with Khazanah as the secretariat and driver of the Joint Working Team consisting of working level representatives of the various GLICs. This Putrajaya committee meets religiously on the second Saturday of every month. The

² Nicolas Machiavelli, *The Prince*, 1513

committee will, among others, monitor the progress of implementation through the various GLICs and discuss and resolve any implementation issues. In addition, a Roundtable consultative forum consisting of GLICs and several heads of major GLCs has been formed to meet on a quarterly basis, also chaired by YB the Second Finance Minister.

This brings us to the second question of whether the 2004 measures are sufficient. The answer is of course no. As we have said, 2004 was just the beginning and that the measures are but building blocks, albeit important ones and measures that had to be sequenced in first before further instruments are introduced. Hence, in **2005, more measures and instruments are being formulated** by the Putrajaya Committee **and will be** gradually rolled out in the second half of this year. We have already alluded to several build outs; for example, companies will be expected to announce to the market what we have termed Headline KPIs by which they will be tracked, indeed some already have. Second, for example, having KPIs alone is not enough; the next stage will be benchmarking work to pit these KPIs to achievable best in class performance targets. Other modules would cover several areas of focus that we have already identified in addressing key systems such as procurement, introducing value-based management and economic profit monitoring and measurement systems, ways to reduce excessive social obligations and better capital management.

Increasing Shareholder Value through Stakeholder Management

In dealing with **the third question of addressing the trade-offs and obstacles to shareholder value creation**, I am often bemused as to how close the words Shareholder and Stakeholder are and that I am sometimes tempted to conjoin a new word Shakeholder to reflect the often conflicting even muddled objectives that one encounters on the path of executing for shareholder value.

Nonetheless it is important to resist, to strongly reiterate our view of looking at shareholder value creation as the primary measure of our mandate at Khazanah, notwithstanding that this is to be done within the framework of fairly addressing the interests of other stakeholders. In this regard, in line with Malaysia's holistic development approach embodied in Vision 2020, the challenge will be in finding the golden balance. Call it *Al-Mizan*³, Pareto Optimality, the Golden Mean or just the simple magic of value creation, history has shown that any lasting, sustained and robust value creation are indeed those arrangements that most fairly distributes the spoils of success in a manner that is fair and equitable, between the various stakeholders while allowing dynamic efficiency to be driven through powerful disciplining mechanisms such as shareholder value creation.

Let us address what we see as four main stakeholder groups, in the context of addressing our central focus of shareholder value creation. The four categories are customers, labor, suppliers, the Government in its role as regulator and developer/policy-maker.

For **customers**, especially for service oriented companies such as Tenaga, PLUS and Telekom, we believe the right approach is value creation by essentially a quid pro quo arrangement that simultaneously promotes both increased efficiency and service delivery and contingent economic pricing. Examples include arrangements such as customer charters that are linked to the wallet of the service provider. Late bullet trains in Japan for example grant refunds or partial refunds. Contingent tariff increases linked to efficiency factors have been instituted on electricity tariff formulas in various regimes. Indeed under Rapid KL, the new transport operator for Kuala Lumpur, there is mechanisms where the operator's wallet will be directly linked to performance on several operating and service KPIs. For errant customers, we believe the right approach is to be firm and tough, as they are essentially free riders on the system that the rest of us will have to carry. In this regard, we are encouraged by the Cabinet's recent endorsements to allow our companies to fine highway cheats on PLUS and to allow Tenaga to disconnect large errant debtors.

³ Balance, (*Arabic*)

For **labor**, the key is productivity; as value is by definition created when productivity or more precisely output growth outstrips wage growth. For management, performance-linked compensation and contracts were instituted with this in mind. For down line staff, under incentive plans, pay will increasingly be performance-linked. VSS schemes in consultation with labor representatives have been instituted that we believe will benefit all parties in the long run.

For **suppliers**, we have identified procurement and vendor development programs as priority areas for GLCs to improve upon, given the preponderance of many GLCs with large annual spends. The scope to stem leakages is large and recent introduction of electronic bidding at major GLCs have begun to result in large savings, while simultaneously helping to allocate jobs to the most-efficient-in-class suppliers including Bumiputera suppliers under the vendor development programs. Further out, the focus and incentive structures on such vendor development programs will be on ensuring that the most efficient vendors are selected with a bias towards the upgrading and graduating of capabilities.

For the **Government** itself in its role as regulator and developer/policy-maker, we laud recent trends that to our minds are an increasing recognition of what we had described as putting the right objectives in the right boxes. This would include removing excessive social responsibilities away from listed companies – such as the recent financial package for Tenaga in respect of Sabah Electric, providing for more level playing fields – such as more balanced IPP terms in 3rd and 4th generation IPPs and, to our minds, more balanced development policy making for example in the recent decision to develop a low-cost terminal at KLIA instead of Subang.

In addition to the above stakeholders, we reiterate that the private, non GLC sector is also a stakeholder of Khazanah and in this regard, we maintain that we advocate a multi-track approach of both GLCs and the private sector as multiple engines of growth. We also

advocate a corporate ecology of Malaysia where neither the private sector nor GLCs are crowded out and that competition policy are balanced with a level playing field that neither favors nor prejudices GLCs. Internationally, and into new growth sectors, as Khazanah ventures further out, part of our mandate is also to help our companies – both GLCs and non GLCs – to participate in new sectors and geographies that represent the growth frontiers for Malaysia.

In summary, focus on meaningful and sustainable value creation

Six months ago when I first addressed the market at large, the stock market was getting a little too frothy, too quickly amidst some unduly high and even irrational expectations from some investors and – I should add – quite rational behavior of some of my ex-profession of brokers and analysts. We continue to maintain that we accept as very much par for the course that the investor base and the citizens of this country should have high expectations of Khazanah and the GLCs, as long as these expectations are realistic.

Six months ago, I had ended my address with the words “... *to cut the hype and judge us strictly on fundamentals; to let’s all focus on meaningful and sustainable value creation*”. This, to my mind, is even truer today. Much of the hype I believe has settled, replaced by a realism of the challenges ahead. To my mind, this is a good base to go forward from and I have tried to outline how we are addressing these challenges. I believe we have a realistic and workable plan to move forward and the political will to drive this process has been unwavering. This program remains a mammoth yet worthwhile undertaking that cannot be delivered by Khazanah and the GLCs alone. Let me be the recruiting sergeant to call on all of you as market players to play your parts as responsible market participants that we may all focus on long-term sustainable value creation.

Thank-you.