



Khazanah's quiet revolution

How much difference can one institution make? *Nick Lord* reports on what Azman Mokhtar is doing to remake Khazanah – in the process revolutionizing Malaysia Inc

Encik Azman Mokhtar sits in his office in Khazanah and sips sweet, milky Malaysian tea. “This is not an easy job,” he says. “I have spent a lot of time syndicating my views. We do touch many parts of Malaysian society and we are trying to make changes to the work culture, to how things are done, and to find and delineate roles. So this is a quiet revolution. We are doing this for the good of the country.”

Azman's quiet revolution has not gone unnoticed, however. Remaking Khazanah – Malaysia's national investment agency and in the process revitalizing the government linked companies (GLCs) – has been met with huge

approval from analysts and investors. Since he has come to Khazanah, the share prices of the GLCs in which it has a stake have gone up by 20% while the broader market has traded flat. “It is fantastic what is going on at Khazanah,” says Stephen Hagger, head of research for CSFB in Malaysia.

Khazanah sits right at the heart of Malaysia Inc. Its offices are atop the United National Malaysian Organization's building, which is in the heart of Kuala Lumpur. Yet until Azman brought a new pacemaker to that heart, it was beating rather feebly.

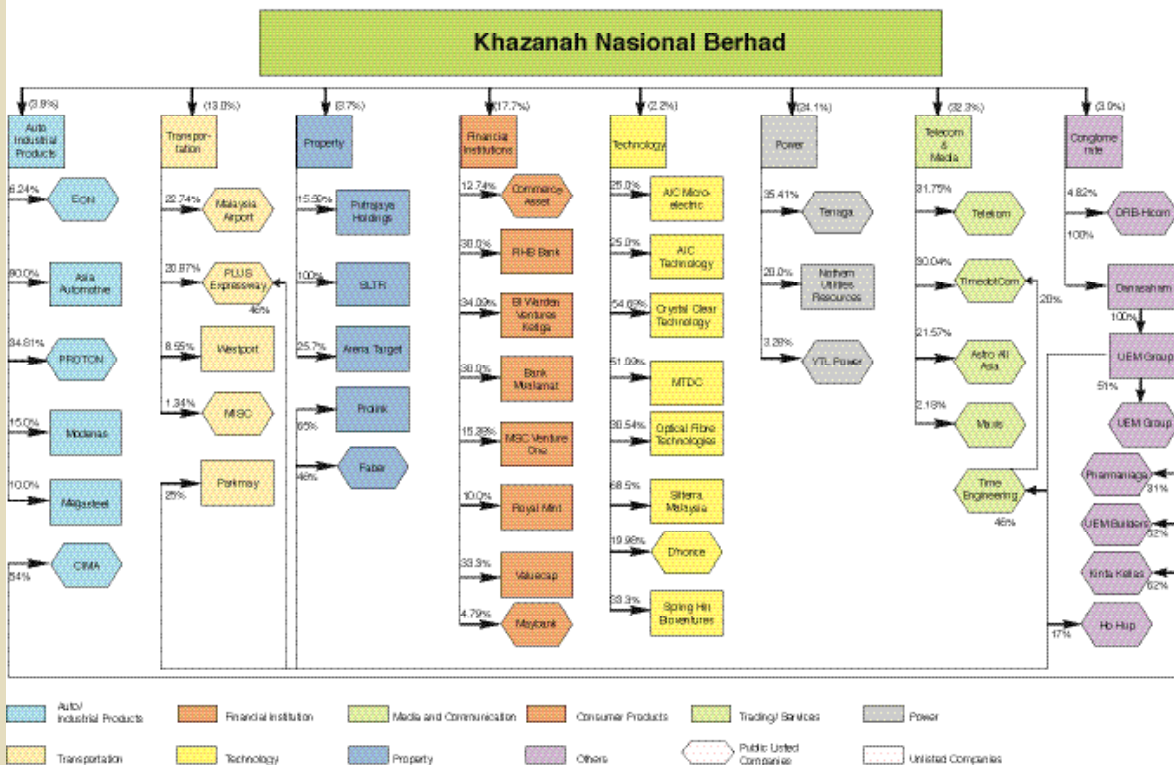
Prime Minister Badawi appointed Azman in June with the task of using Khazanah to remake Malaysia Inc.

The task ahead is threefold: to remake the GLCs that Khazanah controls; to remake Khazanah itself; and to add to the overall development of the Malaysian nation. It is not about pure free markets: Khazanah is going to stay at the heart of Malaysia, but the intention is to get that heart beating more forcefully.

Khazanah's role

Khazanah is essentially a holding company with stakes in 48 companies. Other arms of the Malaysian government previously held many of these stakes but early this year they were transferred to Khazanah. It now has assets under management of around

KHAZHANAH NASIONAL BERHAD - INVESTMENT HOLDINGS





A Malaysian Airline System (MAS) plane at Kuala Lumpur International airport

REUTERS/Zainal Abd Halim

MS60 billion (\$15.8 billion) and the companies it controls have a combined market capitalization of over MS200 billion. This is more than a third of the total capitalization of the Bursa Malaysia. It unquestionably has a huge presence in Malaysia.

In May this year it was handed the duty of being more than just a holding company when Azman's boss, Prime Minister Badawi, called for "nothing less than a remaking of Malaysia Inc". He said, "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 value."

Jumping to the task and showing his background in consulting, Mokhtar quickly came up with a plan, based on 'key themes', such as 'strategic pillars' and 'key performance indicators'.

To his mind, Khazanah was to become a 'strategic investment house' that pursues 'sustainable value creation', which 'aids nation building' and 'national competitiveness through a rigorous performance culture'.

The four pillars that would go to building this vision would be the legacy investments, the transformation of the GLCs, new investments and developing the human capital within the group.

As he describes it, he needed to define Khazanah's role, which meant he had to sit down and diagnose the problems. "My predecessor left me in reasonably good shape. But there are some legacy investments that I need to streamline and restructure. The second part is GLC transformation itself."

Overall he says that his mission is to create shareholder value but he admits

that there are slight differences between Khazanah's role as a shareholder and other institutional shareholders. "At Khazanah, we focus firstly on shareholder value. So when I sit down with the Capitals and Fidelities of the world I say to them '95% of what you want is what I want'. The 5% difference is the time horizon where generally Khazanah as a strategic investor would have

longer horizons."

Such a statement will be music to the ears of international investors who have long complained that shareholder rights in Malaysia have come a distant second to national service. But they will be looking closely at what actually happens below the stimulating talk.

The strategies that Azman is looking to use to boost the share price of his

Azman the man

If one man can make an institution then Azman is the personification of the new Khazanah. After an education and firm grounding in Islamic studies at the Islamic University of Malaysia, he began his career as a scholar at LLM, a precursor to state power company, Tenaga Nasional. He then moved into the world of international finance, becoming the head of research first at UBS in Malaysia and then at Salomon Brothers. At this point he gave up his very well paid position to go to Cambridge University to get a masters degree in development studies.



Dato Azman Mokhtar

Well known by the investment community for his previous work on valuations, he then returned to Malaysia in 2001 and shifted his focus to restructuring. He founded a consultancy called Binafikir and spent the next few years working for the government doing work such as the restructuring of MAS and formalizing the concept of key performance indicators, whereby compensation is linked to performance.

It was during this time that he caught the eye of Tan Sri Nor Mohamed, second finance minister and the man charged with remaking the Malaysian corporate economy. Nor formalized his relationship with Azman in June this year when he made him CEO of Khazanah.

He has a three-year contract at Khazanah during which time he knows that he has to perform himself. "We have a new mantra here, 'either you execute or you get executed'," he laughs. Results-oriented and performance-driven, Azman Mokhtar clearly relishes the task of remaking Khazanah.



holdings will clearly differ from company to company: what is right for Proton will almost certainly not be the same as what he prescribes for Tenaga Nasional. Each company is being forced to come up with its own key performance indicators (KPIs), which it will have to start meeting from January 2005. The main KPI will be financial performance – targets will be set in terms of sales and profitability and if they are not met, managers will be held accountable. For instance, Telekom Malaysia has a new dividend payout policy, so if it starts to hoard cash, management will be held responsible.

Azman is also looking at instigating some internal value measurements such as economic value added (EVA). Indeed on the day we meet, Azman is about to jet off for an annual EVA conference organized by Stern Stewart in Salzburg, Austria. But Azman is not convinced that it is right to apply EVA across the board. He will only say that there will be some form of economic value performance measurement as part of every company's KPIs.

Perhaps more intrinsic to the companies themselves are Azman's plans for changing how they spend their own money. In particular he is known to want to change the way that GLCs procure business. He is a huge fan of Petronas, and one of the levels where he admires the company is the way that it has allowed a clutch of suppliers to become big companies in their own right on the back of the business they do with Petronas. Companies like Sapura Crest and Scmi have become regional players as a result of their links with Petronas.

However, these companies actually perform. They have got to provide goods and services that are on a par with the best international suppliers. If they don't, they don't get the business. Azman wants to roll out this style of what he terms 'vendor financing programmes' for all the GLCs. At the moment many of the GLC suppliers are just rent seekers who buy goods from international suppliers and then just on-sell them to the GLCs with a percentage on top. The deals are smoothed by the oil of corruption.

Azman is unwilling to talk about such a sensitive issue, but observers say that this move, more than anything, has caused most consternation, espe-

cially at this year's UMNO General Assembly, where delegates were vocal about the challenge to "their traditional way of doing things". Judging Azman by his words and actions to date, he is unlikely to be swayed by such mewlings and pukings of jilted monopolists.

An extension of this policy is Azman's desire to see more outsourcing of non-core operations. He says that Tenaga, for instance, has 50,000 acres in its land bank. He is looking for the company to hook up with a property company that knows about property development and is able to extract most value out of these assets.

He also talks – slightly guardedly – about plans to outsource the back offices of many GLCs into one new

sector very well. The government called him in to organize the restructuring of MAS after a failed debt restructuring and government buy-in in 2001 and 2002. The deal that he brokered basically saw him split the assets of the airline from its operations. The government maintained its ownership of the assets while the profitable operations were accorded to the private sector.

This deal shows a lot about Azman's way of thinking about the wider restructuring at hand in Khazanah and the GLCs. "The MAS deal showed some of our thinking. It was forced on us and we didn't have much time. We couldn't do a physical unbundling so we had to do cashflow swaps. It was a unique structure. We unbundled what we thought was the



A worker cleans a sign board of Projek Lebuhraya Utara Selatan (PLUS) at a toll plaza in Kuala Lumpur

company. This could then become a figurehead for Malaysia's own ambitions for becoming a force in the global outsourcing movement.

Another plan he outlines is to enhance group synergies in the airline space. With holdings in both Malaysia Airlines (MAS) and AirAsia, Khazanah is in a unique position to force these rival national competitors to think about cooperation. For instance he suggests that Khazanah could have a role buying planes for both AirAsia and MAS, through a leasing company owned by the government. "There is no reason why we cannot buy planes jointly," he says.

Indeed Azman knows the airline

social element because we thought it was unfair on shareholders to bear this. We argued to the government that it was cheaper for them to do this out of the federal budget. It was more of a financial restructuring rather than an operational restructuring." This balancing of social obligations and the maximization of growth and profit is the crux of what Azman is trying to do at Khazanah.

His view is that markets are not perfect and governments do have a big role to play in national economic development. "There is a role in this ecology for GLCs," he says. "They fill the gap between the state and the market... we are careful not to crowd out



the private sector and we ensure that GLCs, for instance, are not given priority when it comes to winning contracts." He illustrates this point by saying that the order books of the UEM Group are much lower today than they were when the company was in private hands for instance.

He does acknowledge that having government so heavily involved in business is an exercise in compromise, and one that in years past had not worked out so well for the country. "Excessive corporate and social responsibility is something I certainly believe should not happen. It is about assigning what is right for the shareholders and what is right for the taxpayers. In the past, things started on the right footing but often things have a habit of getting a little blurred here and there. Now there is more of a division between various government roles – such as regulators being taken off of boards. There is a danger that the strategic objectives are not properly defined and could be abused under the guise of national service or national objectives. These national objectives can very quickly become black holes."

Deals, deals, deals

If the most fundamental changes that Azman is trying to effect are happening behind closed doors, the most public will be the deals that Khazanah will be doing in the international markets. Despite having a full plate of assets to manage and companies to restructure, Khazanah is still looking to invest. He describes the agency as a "state entrepreneur" and he says he wants to move more into technology and financial services. These investments will mainly be domestic to begin with, although Khazanah did team up with Maybank for its failed bid for Bank Permata in Indonesia because it was a deal that dovetailed with his strategy of expanding regionally where Malaysia has a core competence.

To pay for these new investments, Khazanah will have a balance sheet buoyed by revenues of around M\$1 billion a year. Azman says that he is also looking to go to the international bond markets to raise dollars for US dollar-based investments. "As we are going to be more active internationally, then naturally from a currency standpoint we want to match the funding of our assets.

"We are looking to monetize some of our holdings"

So we will be borrowing more foreign currency," he says.

Overall he says he is looking at deals in Asean, China, India and the Middle East, building on Malaysia's historic links with all those regions. He also wants to go into sectors where the investee companies will have an advantage: infrastructure, Islamic banking and agri-business are just some of the sectors in which Malaysia leads the world. Judging by the Permata bid, it looks as if Khazanah will be willing to be a co-investor with its investee companies, although Azman does not dismiss the idea of warehousing investments for the agency's subsidiaries.

Most talk has surrounded the agency's 3.28% stake in YTL Power. YTL is not only a well-run private sector company, it is also a competitor of Tenaga. It is also a direct beneficiary of regulations and tariffs that harm Tenaga. The case for a divestment seems clear cut.

Other assets that analysts are talking about include PLUS, the toll road operator. Since its debt restructuring and IPO, the shares of PLUS have done nothing. Hampered by strict debt covenants and low liquidity in its stock, the case for a divestment is compelling. Observers suggest that a combined debt restructuring and equity buy-in with a well known infrastructure player could be in the offing, although nothing concrete is being confirmed. "We are looking to monetize some of our holdings," says Azman. "We are looking at good ideas for doing this. There will be an orderly sell-down and there are many ways to monetize that are less impactful on the immediate share price than a sale." He goes on to confirm "the investments and shareholdings of Khazanah will be different in three years from what it is today."

Remaking Khazanah

What will also be very different in three years time will be Khazanah itself. The fourth plank of Azman's brief is to transform Khazanah into an institute of excellence for training and retaining the stars for Malaysia's corporate future.

Over the next three years, Azman

aims to build Khazanah into an agency of 200 people from its present roster of only 35. "We are also using Khazanah as an incubator to develop talent for the longer term and to bring back Malaysian talent." People will be enticed into national service with the chance to make a difference and reshape the DNA of Malaysia Inc.

There will also be the development of a cadre of young technocrats who will head the various GLCs in the Khazanah stable. Already key appointments have been made including Abdul Wahid Omar as CEO of Telekom Malaysia, and Che Khalib Mohamad Noh as CEO of Tenaga. Executives such as these are completely different from the likes of Halim Saad and Tajudin Ramli who used to be the faces of corporate Malaysia – and both of whose careers ended in an unseemly demise due to the way they ran their companies.

The new breed are well-educated, rather than well-connected. They believe in meritocracy and integrity when it comes to business. They are not active members of UMNO. And according to one of their friends, "they share a revulsion of how things were done before the crisis".

This changing cast of characters perhaps best demonstrates the changes that Khazanah is trying to make to Malaysia. It is about making Malaysia a more efficient country and it is a central plank of Prime Minister Badawi's vision of a new Malaysia.

Khazanah's quiet revolution is part of the process of making the jump from developing to developed nation status as Taiwan and Korea have done "It is one of the hardest jumps to make as many factors – such as education, human capital, the structure of society and political systems – need to be in place," says Azman. "Khazanah has been rather custodial in nature in its first 10 years. To facilitate the process of making that jump, we have to become a more active strategic investment house." Khazanah's success will be a key performance indicator of the new administration and the eyes of the world are watching closely. **FA**