

“The GLCs cannot expect a free lunch any more, although neither should the private sector begrudge them their meal.”

The Reformer

AZMAN MOKHTAR, CFA

When a nation's government has stakes in domestic companies that account for a third of the traded market capitalization, an occasional board seat might be expected. But Khazanah Nasional Berhad, the strategic investment holding company of the Government of Malaysia, would have none of it. Khazanah's mission since its founding in 1994 was to be a passive investor in its portfolio of about 50 companies, most of which provide infrastructure services to the country. The performance of such entities tends to reflect their special status as government-linked companies (GLCs) shielded from full market forces.

So when Azman Mokhtar, CFA, 44, was handpicked by Prime Minister Abdullah Ahmad Badawi to turn Khazanah into an active investor, more than one observer took a deep breath. In measured fashion, Khazanah would transform the GLCs from inefficient enterprises into competitors as well run as any in the private sector. Khazanah, whose controlling stakes in the GLCs range from 35 percent to 100 percent, would advise but not micromanage them, motivate their management teams without second-guessing them, use Khazanah's diplomatic leverage to forge deals on behalf of GLCs but then limit its involvement to administrative support, and give corporate leadership a chance to execute or be executed.

“These reforms will take time to implement because they involve changing the culture,” says Lee Kha Loon, CFA, head of the CFA Centre for the Asia-Pacific region. “It requires patience and careful, thorough planning and execution,” he says, “but so far, the public and investors' perceptions are positive.”

Khazanah was set up in the boom years, when Asia's economies were growing at a torrid pace and Malaysian state enterprises underwent a period of privatization. Some of Khazanah's early holdings were essentially government departments that became listed, such as utilities, toll roads, and financial services. As the state moved into the market, Khazanah acted as a buffer between the two.

Mokhtar wasn't doing too badly himself as head of research at Union Bank of Switzerland in Malaysia. “My period with UBS coincided with a time of tremendous growth pre-crisis,” Mokhtar recalls. “Up to 1997 were the boom years. The Asian financial crisis of '97 was a traumatic event. I think we learned many things then.”

GDP growth plunged, and the ringgit lost more than a third of its value in 12 months. Mokhtar, meanwhile, had become a founding director of Salomon Smith Barney, which was chosen as financial advisor to the Malaysian government. This gave him the chance to work closely with the state on restructuring the economy. The intensive role that he and his colleagues played steering the country back into prosperity gave him crisis management experience. Although the Malaysian economy bounced back in 2000, many of the GLCs were still in trouble. Mokhtar and other advisers continued to rehabilitate key GLCs, a period that he refers to as war-time restructuring.

When the dust settled, it was clear that Khazanah had to change its stance of sitting back and letting the GLCs operate with impunity. With a growing industrial sector and thriving export economy of rubber, tin, petroleum products, and electronics, Malaysia had achieved one of the highest standards of living in southeast Asia. Now was the time to make the GLCs accountable for their performance and transform them into efficient operating companies serving the country.

In mid-2004, Mokhtar was appointed chief executive of Khazanah and its peace-time restructuring, as he called it, was kicked into high gear. The mandate: to re-invent Khazanah as

an active, strategic investor. Key performance indicators (KPIs) were put in place at each company. The goal was empirical evaluation of financial and operating performance for each company. Senior managers at the GLCs, who could often thank the crony system for their positions, were replaced with seasoned professionals. Mokhtar and his team crafted an incentive system that was carefully calibrated to give managers a chance to build equity stakes in their companies while discouraging undue risk taking to achieve their benchmarks. As Khazanah's CEO, Mokhtar himself took board seats on the fund's two largest investments.

"All these things are captured in what we call the GLC operations manual. We are quite proud of it," Mokhtar says. "It gives a very clear framework of how to handle social obligations. In the most laissez-faire markets, there's corporate responsibility. We try to articulate in each case the social obligation, and then we need to quantify it. Next is a negotiation, a political process. We discuss whether the government should bear any of the cost, share it, or fully compensate."

So far, Mokhtar has kept Khazanah on course, satisfying the interests of the various stakeholder groups it must serve. There is its sponsor, the government, which is looking for a return on its investments. There is the labor pool, for which GLCs are major sources of employment. There are the customers, who get their electricity, telephone, and other infrastructure services from the GLCs. And then there are the suppliers, who must now confront a new way of business based on merit. Mokhtar cites the case of one GLC, a telecommunications provider that took bids electronically from competing suppliers. In the impartial arena of the electronic auction, which eliminates the chance of bribery or otherwise unduly influencing an intermediary, one vendor dropped its price from 150 million to 15 million ringgit. "You can imagine that doing this, there's a lot of so-called vested interests that we have to wrestle with," Mokhtar says wryly.

The private sector is concerned that it will be crowded out by Khazanah, which has the strong arm of the government behind it. But, says Mokhtar, Khazanah simply wants to create a level playing field. As he sees it, the GLCs cannot expect a free lunch anymore nor should the private sector begrudge them their meal.

Today, Khazanah operates like a private investment firm, with clear investment hurdles and strategies developed in conjunction with the GLCs. After a year in the job, Mokhtar called in the local media to give an accounting of his stewardship: Working teams had been created with representatives from the GLCs and Khazanah, along with McKinsey consultants. Performance contracts for top management, KPIs, and pension schemes had been put in place at all GLCs. One or several targeted activities were undertaken at eight companies, including capital management, dividend policy, and even rebranding programs.

With Khazanah's extensive portfolio of 50 companies and hundreds of subsidiaries, Mokhtar has much to do and relatively little time before his contract runs out in two years. "Given the audacious goals that we've defined, I will need two to three terms to do it properly," he says. One senses that he will succeed. ▀

Susan Trammell, CFA, provides business plan writing and market research services through her New York-based consulting firm.



"You can imagine that doing this, there's a lot of so-called vested interests that we have to wrestle with."