

HON. RICHARD PREBBLE – PRESENTATION TO ADB LEADERS RETREAT NADI MARCH 2011

"I have been asked to this retreat because I am the first ever Minister of State Owned Enterprises. I am one of the architects of the idea of reorganizing government business activities into commercial companies now known as state owned enterprises.

I wish that I had had a benchmarking study like the ADB paper "Finding Balance 2011". It is excellent paper. I thought the first ADB study published in 2009 was good but this paper is even better.

It is now over thirty years ago that I found myself Minister of Railways that was losing a million dollars a day, Minister of Aviation which meant I was in charge of Air New Zealand that was profitable and Minister of Transport which meant I was in charge of the government owned shipping corporation that was the only other government business that was reporting an annual profit.

All the other government businesses of which there were many ranging from the Post Office that had a telecommunications monopoly, an insurance company, a bank, half the country's commercial forests, a number of farms, a computer business, the country's airports, air traffic control, the nation's largest civil engineering enterprise the ministry of works, all electricity generation and the electricity network and a printing company all running at a loss.

In the areas like telecommunications and electricity where the government had granted itself a monopoly every year, the government just put up the prices to cover the loss. In 140 years, no government business had ever paid the taxpayers any dividend.

Each year, the government paid in money to meet losses and to fund new capital expenditure. There was never enough money so service standards were at a level you would expect in the Congo Republic. The country's civil aviation radar that kept planes safe was based on WWII valve radios, which would have been funny except it was so scary.

The government businesses were absorbing 20 percent of the total capital of New Zealand and providing just 10 percent of the GDP.

The level of service was so bad that it was holding back the country. A simple example: In the central business district of Auckland, there was a six month waiting time for a telephone, so if you had a wonderful idea for a new business it was six months before you could open.

When we meet as a government to discuss what to do I said:

"Air New Zealand and the Shipping Corporation are not a government departments. They are companies registered under the companies act with directors who are businessmen. Their employees are not civil servants. They are the only two government businesses that make a profit and they are both firms registered under the companies act. Lets reorganize all government trading activity into businesses registered under the companies act. Let us appoint competent business people to the boards. Let us remove any competitive advantage the state businesses may have. Lets make the government businesses as close to the private sector as we can."

That is what we did.

Then the government decided to make me the first minister of state owned enterprises in the world. I had 21 businesses, 20 billion dollars worth of assets and tens of thousands of employees. I was the biggest businessman in New Zealand's history. Every business was making a loss.

The results were spectacular. In just three years, all 21 businesses were making profits and had gone from costing the taxpayer hundreds of millions of dollars a year to earning hundreds of millions of dollars in dividends and paying hundreds of millions more in taxes.

The service standards improvements were just as remarkable. The waiting time for a telephone went from six months to a promise that if your phone was not on in 24 hours the first month rental was free. New Zealand Post who had been increasing the cost of postage faster than inflation and delivering only 10 percent of all letters on time cut the cost of stamps by 25 percent, delivered 95 percent of all letters, no matter where posted in the country, the next day and paid for the first time both taxes on their profit and a dividend to the taxpayer.

The railways, which had been run as an employment scheme with a quarter of the staff moved, doubled the amount of freight for a fifty percent price reduction, delivering freight on time and unbroken and made a profit of two million dollars a week.

The whole world noticed that New Zealand Post was the world's only profitable postal service. The World Bank said New Zealand railways were the world's most efficient narrow gauge railways. The State Owned businesses were beating the returns of the private sector.

Academics started writing books. Former advisors set up consultancies to tell governments how they too could have profitable state owned enterprises.

Our Governor of the Reserve Bank wrote a book saying it was all the good work of treasury, all you need to do is incorporate the government business into a company frame work, remove competitive advantages and appoint independent directors and the results will roll in. I get a mention in the footnotes. The consultants agreed the politicians' only role was to set up the frame work, remove competitive advantages and appoint directors from the private sector and then get out of the way.

The problem is no country that has copied the SOE model has replicated our results.

The service and the financial returns of SOEs have exceeded the performance of government trading departments but the results are still disappointing. Few SOEs meet return targets set by treasury for investment. Even fewer SOEs make the return private investors would expect.

Consultants have decided that maybe the politicians have a role and the reason for the lack of results is a lack of commitment by politicians. Ministers appointing cronies to boards, giving SOEs instructions to carry out tasks for political reasons and Ministers refusing to let SOEs charge market prices.

Consultants are often puzzled as to why politicians cannot see the logic of the SOE model or the huge benefits from having efficient businesses.

Let me explain. The first rule in politics is to get elected. SOE reform is often unpopular. Machiavelli who wrote the textbook on politics advised the Prince never to do any reform. There are always winners and losers from any reform. Machiavelli said that the losers never forgive and the winners are never grateful.

When it took six months to get a telephone, constituents would approach me as their local MP. There was a clerk in the Post Office who decided if you got priority. He had a tick list. I was an expert in putting in an application that got all the ticks. Voters I got phones for were very grateful. They voted for me. They told their friends and family what a great MP I was and to also vote for me. Before I was Minister of SOEs I had the biggest general seat majority of any in parliament.

When Telecom made its offer to supply a new phone connection within 24 hours or the first month was free, not one constituent ever thanked me.

It is the problem that we value individual entitlement over common benefit. When the phone system was run as a government department, politicians gave free phones to worthy causes like schools and hospitals. Then all postal workers got a free phone and then a free phone became a retirement benefit. It was seen as a cheap way to pay staff. Of course the politicians gave themselves free phones.

It was not free. All other telephone users paid for it. Those who had the individual privilege valued it and fought for their perk. It is human nature to quickly decide that any privilege, no matter how outrageous and unearned, is one's right. The cost to the public of subsidizing a few thousand free phones over two million subscribers was small. So unions conducted concerted campaigns for privilege and no one spoke or campaigned for the public.

When looked at from the politician's viewpoint, the reluctance to support SOE reform is perfectly rational. Politicians' objective is to win votes not run businesses.

But there is a further problem. In New Zealand, there is a broad consensus support for the SOE model. Ministers do not issue instructions to SOEs to provide non-economic services. The chairs and most directors are selected for their business experience. A lot of attention is given to the governance of SOEs, which follows the best international practice; Regulations have been reviewed to ensure SOEs have no regulatory advantage.

According to the consultants, New Zealand's SOEs should be earning returns similar to the private sector.

The Crown agency that monitors SOE performance reported last year that New Zealand's SOEs over the last three years earned less than half the average return of the companies listed on the New Zealand stock exchange. As New Zealand's SOEs are worth billions of dollars, this represents a massive loss in potential earnings and taxes. The difference in results is even more remarkable when one considers that the companies on the New Zealand stock exchange include property and finance companies who have had an awful three years and the Crown's companies include power generators that are resistant to recessions. The last thing you do is turn off the lights.

The performance of New Zealand SOEs is so bad that it is affecting the country's economy. Service standards are falling and the price of electricity which is a sector dominated by the SOEs is rising rapidly. Only one of the electricity SOEs has been privatized and it has outperformed the state owned generators.

It is not correct that the private sector always outperforms the state, private companies can fail and sometimes spectacularly.

What is true, and this is worldwide, and has been established in repeated studies is that on average private companies outperform SOEs.

The fact is that it is not possible to replicate all the features of a private company in a government owned company. Some of those features are important.

I have now served as a director of a number of government and local government owned businesses. As a director, one tries to regard every issue as if one was the owner of the company. In reality, it is not possible. I own some companies myself, I am a director of New Zealand's largest privately owned construction company and I am a director of Mainfreight, a successful New Zealand owned multinational logistics company.

The difference is risk. My own companies, I run for fun and take huge risks. In government owned businesses, there is the political risk. No SOE announces a price rise the week of an election. In a private company, while we are very keen not to upset our customers because most business is repeat business, if we have to make a price increase we make it regardless of whether it's election year.

The next crucial difference is ability to sell. One of the companies I am on is in property. Three years ago our CEO became convinced that a property correction was coming. We directors decided to sell down our property interests, a decision that saved the company but one no SOE can do.

This difference is crucial. Private companies are forever buying and selling businesses. You have an activity that no longer fits or is one you feel you cannot add value to or a business that you receive an attractive offer for and you believe you can use the money better elsewhere, in the private sector you sell sometimes the whole company.

When I became Minister for SOEs, I interviewed the CEO of every company and every one said, "This year's results are disappointing and we urgently need a capital injection. If we get a new computer system, a favorite request, I can turn the company around." When I added up the capital request it was more than the government's total budget and I did not think the cabinet would ever agree.

I was curious. How does the private sector handle this demand for capital? I had one of my assistants take the top twenty companies on the American share market and look at their requests for capital in new share issues against their dividends. Over a ten-year period, I found the companies requested more new capital than they paid in dividends. How do shareholders make money? By selling shares that have gone up in value.

If government decides it is never going to sell a business, two things happen. Government continues in a business well past the time that the business makes any sense. Once there might have been a reason for government to be in airlines or telecommunications but now that is nonsense. As an aside minister, I privatized New Zealand Telecoms. Commentators regularly write, "Government sold too cheap". We got nearly four and half billion dollars in 1990. Today in 2011, Telecom is worth just two and half billion. We sold at just the right time before competition and new technology like mobile phones and Skype has driven down the value. Put it another way, if we had kept ownership we would have lost nearly two billion dollars. Never selling means government is never going to get a return from its investment.

What I noticed when we did the study of the top twenty companies was how few companies in the top twenty were in the top twenty twenty years later. If you are never going to sell, eventually you will end up with a portfolio of duds.

Then there is the question of selection of directors. Under the SOE model after setting the framework and ensuring competition, the only thing a politician can do to influence SOE performance is director selection.

The textbook advice is to pick an experienced director from the private sector. Appoint for just a three year that after a performance review can be extended to second term and maybe a third term for a director who has become chairman.

Such a board is going to be an improvement of a board made up of the minister, or civil servants or political appointees who have never run a lemonade stand.

Politically, just appointing a board of experienced businessmen is very difficult. Unemployable ex politicians want a job, fellow MPs want to appoint people who can help them get elected, if civil servants can earn more by being on boards, then they recommend each other, and, if politicians themselves can earn directors fees, the boards are full of politicians.

Some things can be fixed by making it the law that politicians cannot be appointed. A law that civil servants cannot be paid. (I note that this rule is not being applied. The Auditor-General needs to publish that the following civil servants have been incorrectly paid and the amount. The media will love it. Civil servants will start refusing appointment).

Even in New Zealand, the government has found it impossible not to use the directorships for ex politicians and to reward. The former Labour government appointed the party president to a string of SOE appointments. No doubt he was a man of some ability but interestingly no public company has appointed him.

Then there are the interest groups. Governments feel that boards must represent the country geographically, ethnically and gender.

The department of Woman's Affairs say in their annual report that they regard the appointment of women directors as a high priority and the ministry of ethnic affairs lobby for a diversity of directors. The background of the directors has become more important than the SOE performance.

Realising the government is going to appoint directors for non business reasons, the agency that monitors SOEs runs courses for directors. Such courses can teach directors the difference between governance and management, the importance of budgets and audit, but they cannot teach business experience.

Academics concentrate on the forms because there is no way to measure judgment yet judgment is what you are looking for.

I am on two of the most successful boards in the country. On one board, our oldest director is 84 and has been on the board 36 years. He does not intervene often but when he does its decisive. One of his pieces of advice is to remind us that for the good of the business we must be rid of arseholes. The average length of tenure on both boards is around twenty years. On one board, we have around the table two hundred and

twenty years transport experience and around the other two hundred and forty years construction experience.

When the recent recession hit we had experience of how to run the company in a recession. Our chairman would say to our young managers "Recessions are good for the company. Now you can implement the reforms you know are good for your branch."

On one of my community owned boards, I have been on six years, and I am the most experienced in the electric line business including management because when our CEO resigned and his deputy did not get appointed, there was a complete turn over in management. At one point, the total experience in the electric line business was less than twenty years. When the recession hit, no one on the board or management knew what effect it would have. It had minimal effect and we had a record year. Our business is driven by the weather. A cold winter means more electricity sales.

If it were no policy to only allow six-year appointments, we would have had directors who knew this. The private sector values this industry knowledge.

It is what happens when you appoint by a formula and fashion. People used to say that directors with their money invested made the best directors and now some argue that to be truly independent you should have no money invested.

I am sorry this does not sound modest but I need to say it to make my point. In results I am the most successful minister of SOEs in my country's history and I do not know of anyone anywhere who on a per capita basis can beat my record.

None of the consultants has ever asked me how I did it.

Of course I did not do it, the directors I appointed did it and they appointed managers who lead the SOEs into profit.

So the question I should be asked is "how did I know whom to appoint"?

The answer is it is very difficult. I found reputation and private sector record did not always translate into results. Some of the directors with the best reputations turned in the worst results.

But this is what I did. First I went to my fellow politicians and said, "These businesses are a mess. I cannot afford to give directorships as a reward. I must be able to appoint regardless of political affiliation". One of the directors I appointed was a big donor to my political opponents.

As an aside, none of these directors who were known opposition supporters were ever disloyal. I only had trouble from a few directors I was forced to appoint from my own party. It is always your own side that causes trouble.

The second is I had a very clear objective. "I will handle the politics" I said "Your job is to get this SOE back into profit and paying a dividend. Give me a plan. If I do not like your plan, I expect your resignation and I will get someone else".

In the case of Coalcorp, the directors all resigned because they said it was impossible to get the company into profit.

Once we have agreed on a plan, then I would say you must deliver, no 'if' or 'buts'. Sir Ron Trotter, a captain of industry taught me "There are always plenty of excuses, oil socks, earthquakes. There is no excuse for not meeting the plan". So I would say, "If you do not meet the plan, I expect your resignation."

I fired, in my first three years, half the directors I appointed and in one case the whole board. I would say, "I do not know enough about business to know if this is your fault. It probably isn't but we agreed that if you did not meet the plan, you would resign so you have to."

The chairmen were always men of ability so I could say let me find another job. Does your wife like opera? Would you like to be chairman of the Opera Company? There will be a song in the New Year's Honours. If I have done you a disservice, I am really sorry. I don't know enough to be able to tell".

It is important to give clear instructions. I looked at the results of Post and told the chairman his results were awful and he should resign. "The results are exactly what the previous Postmaster General told me he wanted, no post office closures, no redundancies, no fuss. If you want a profit and an efficient postal service, I can do that". I had to admit that is what the previous Post Master General had asked for, so I gave him another year and he produced the result I asked for. If you do not ask for results, you won't get them.

We never had a public fuss. I suspect some of the directors I fired were doing a good job but keeping on a chairman who is not up to it is very, very expensive.

Keeping chairmen who were not performing as I did on a couple of occasions cost millions of dollars. I do not regret any firing but I deeply regret keeping one director who was not up to it. It is easy to fire useless directors. They are usually into power and often unpleasant bullies. The hard directors to fire are almost good enough. You keep hoping they will improve and some do but most do not.

I have gained a reputation for being a good judge of people. Actually, I find it very difficult. I have been helped by the work of the late Dr Clay Lafferty who studied tens of thousands of executives to try to determine why some businesses succeed and others fail.

The answer turns out to be how you think. Successful people think in cause and effect. If I do x then y will follow. You might think now "Doesn't everybody think like that?" Actually it is uncommon. Most people have what I call a lotto culture and think that things happen because of luck and chance and their own efforts make no difference. If someone is successful, it was luck or he cheated.

Achievement people think their own efforts make a difference.

Let me give an example. My unsuccessful managers always wanted a new computer system that costs many millions of dollars. The computer was their lotto that would solve all the problems.

I appointed a new manager to an unsuccessful business where they were putting in a multimillion computer system. The new manager stopped the program. Why I asked. "The information we have in the business is junk," he said. "Until I have worked out what are the key indicators for the business and why we are collecting this information, all a computer will do is junk in, junk out".

He found out that they were collecting the wrong information. He started collecting the information he needed to run the business and decided they did not need the computer system.

People who think in cause and effect reveal themselves in a few minutes conversation. They are the people I appointed.

Now let me make a confession. I recommended setting up state trading businesses based on my experience with Air New Zealand and the Shipping Corporation the only government businesses running at a profit. Or so I thought.

After I had been minister for three years, the accountant's society published a new rule that off balance sheet liabilities must be declared. It turned out that all Air New Zealand's planes were leased and the Shipping Corporation had balloon mortgages on their ships so they paid nothing in year one and the most in year twenty when the ships must be written off. It turned out neither company was profitable.

Any reasonable accountant can make the figures say whatever he likes for at least six years, which in the case of a SOE, is the average length of tenure by the CEO. As the CEO of Air New Zealand said to me "Minister, if you have a treasury analyst smart enough to understand the airline business, I will hire him for double what you pay".

Before I was a minister, I was convinced that there was no reason why a government owned business could not be as effective as a privately owned business. All that was needed, I thought, was a minister who appointed good people, gave the business the capital and clear directions. All that was needed was someone like me.

When I became minister of aviation, just 10 percent of Air New Zealand's flights took off on time. The unions took turns on going on strike on the school holidays.

I appointed a new chairman, gave the airline the new planes they had been asking for, and gave the unions a good pep talk. After 12 months, just 10 percent of planes took off on time and the unions still held strikes at Christmas.

Then I allowed Ansett to fly in competition and suddenly overnight 90 percent of Air New Zealand's flights took off on time and service levels improved dramatically.

Competition in weeks achieved what I had failed to do. It was a lesson to me in the limits of political power and the power of the market.

When I found that Air New Zealand had been cooking its books for 30 years and the treasury, the auditor general, parliament and successive ministers had failed to realize the company was actually losing money, I decided the airline and shipping business were too risky to be owned by government. I put up Air New Zealand for sale. The Shipping Corporation was technically insolvent so I put it into liquidation.

While Air New Zealand and the Shipping Corporation fooled me, I gained a reputation within the Treasury for being able to read SOE accounts and to detect trouble sometimes even before the management realized something was wrong. I am actually not very good with accounts. The late Ross Sayers who I appointed to turn around the railways taught me "Watch the cash. Accountants can make the books say almost anything but they cannot create cash. If the cash in the bank is going down, something is wrong".

So I watched the cash in the business and when it was going down I would say, "Something is not right in this SOE, let's have an audit". There was always something going seriously wrong.

So watch the cash and get a reputation for being a financial wizard.

The comparison figures in the study and the results in Tonga do show that good practice is possible in the Pacific.

The challenge is good. SOE performance problem is it requires commitment by key ministers, considerable political commitment and it has to be sustained even in election year. Governments and key ministers have other issues that require attention.

It is my own view that the SOE model over time is always going to disappoint and privatization is a far better solution. The private sector has the money, people and skills to solve the management problems of business. Business is what the private sector does.

Privatization is a permanent solution. The New Zealand government has not had to think about how to manage the privatized businesses.

I think it's a waste of time to tidy up a SOE for sale. It is doubtful that it adds much value and the private sector is better at fixing business. The time is better spent ensuring the regulatory regime promotes competition.

Ministers, MPs and the public often get fixated on the money that is raised by privatization. To me, that is secondary to the long term benefits of, say, a deregulated telecommunications sector.

In retrospect, I wish we had gone straight to privatization.

We were not sure why the government owned the businesses but we thought there must be some social purpose. I have yet to see a business that could not be contracted out to the private sector and I include health, education, and prisons.

So let me come back to what the organizers had hoped I could give insights into, how to make a commitment to the SOE model and privatization politically popular.

If it were electorally popular, governments would be falling over themselves to set up SOEs with strict clear commercial objectives.

So my message is that it is hard.

I used to say to my MPs "Why are we attracted to politics? For two reasons. First it matters and second because it is hard. If there was another game in town that was important and was harder, we would do it."

Real politicians are not put off by the fact that SOE reform is hard. If you want an easy life, do something else.

Real politicians are also attracted by the fact that SOEs is a proven model. The ADB comparative study demonstrates that it is a model that can be transferred to any

country. The study also says privatization brings even more benefit and is a permanent solution.

So how do you persuade your colleagues and the public?

In the end, most political argument is decided by results. It is the problem with the electoral cycle that most reform including SOE reform, the bad occurs first and the good takes time. So the redundancies, the repricing of subsidized goods and services, the ending of redundant operations all occur before the provision of more efficient services.

But the better services will come. Sometimes, the best way to win the argument is to follow the Nike advice and just do it. Simultaneously undertake reform in a number of areas so the reactionary forces cannot get organized. They are under attack from all sides. I favour a general empowering bill covering all government business rather than sector by sector.

Once the reform is passed and implemented, those who were the subject of the reform then want it done to others. Farmers in New Zealand resisted the loss of their subsidies, but once gone, they insisted that other protected areas like transport be reformed too. So vigorous reform can build a constituency.

Politics is the art of persuasion.

If one looks at any great political movement, you find if you look hard enough that it was started by something someone wrote maybe many years ago.

After I had left office, I have written a number of books about SOE reform. The books set out the case for reform and I would have liked to have written the books first but I did not know then what I know now.

As the first step in any reform is to get those involved to face reality, I wrote a book at what I found as Minister of Railways and SOEs. Stories of incredible waste. Whole warehouse of old black telephones just in case dial phones made a comeback.

The book "I've been thinking" was a best seller. It has killed off any attempt to go back to having trading departments.

I have also written a book on how to turn around SOEs, "Out of the Red". I think it is my best book.

There are many maxims of good government. One I like is "Do not pay for what you do not want more of" which is really another version of "Whatever you create incentives for, you will get". Or "No incentive equals no result". And the law of unintended consequences which is that reforms often result in outcomes that were never intended. It is just another version of the fact that you get what you incentivize even if that was not your intention.

New Zealand used to pay civil servants according to how many people reported to the civil servant. The General Manager of the Railways, when it was losing a million dollars a day, was the nation's second highest paid civil servant because railways had 24,000 employees, most of whom had nothing to do. The new directors change the pay to reflect results and the general manager who was part of the old management decided he only needed 5000 employees.

So watch what you incentivize.

Here is another observation. I have never seen successful change without leadership. Leadership is just going out in front and setting a goal.

No one goes out in front of the leader. No one is going to make change is that change if they are not sure that is what the leader wants.

The political maxim “announce only good news and let underlings announce the bad” is a recipe for stagnation as everyone looks for an excuse to evade responsibility.

If you fire people for telling you bad news, no one will tell you the truth. You cannot fix anything until you know what is wrong.

I turned the maxim on its head. “I will announce the bad news. When we get some good news it will be because of your efforts so you can announce it.”

Now that produces good news.

It’s the only thing that does, its leadership.

And that is the conclusion of the ADB study.