

# The Treasury

## Briefing to Incoming Shareholding and Responsible Ministers

December 2020

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# Briefing to Incoming Shareholding and Responsible Ministers

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# 1 Your responsibilities, and how the Treasury assists you

This briefing provides information on certain Crown companies and entities (CCEs), to help you meet your Ministerial responsibilities and to support your early engagement with officials.

The CCEs in this briefing are mainly State-owned enterprises (SOEs) or other companies and entities that carry out commercial activities and for which the Treasury provides ownership and governance advice. The CCEs can have different arrangements between shareholding or responsible Ministers, as outlined in the table below. This briefing has been sent to all Ministers referenced in the table.

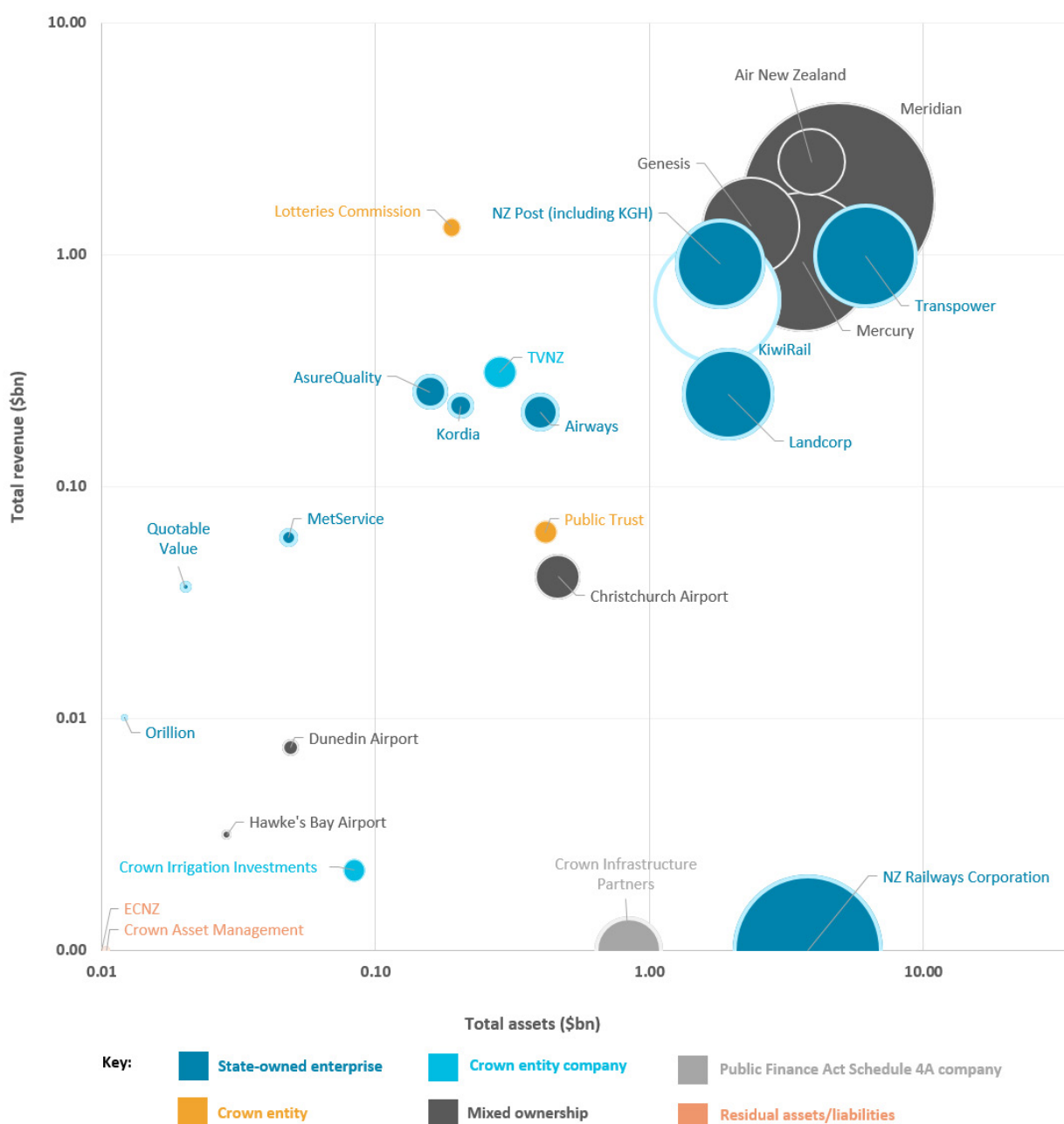
**Table 1: Companies and entities within the scope of this briefing**

Company or entity type	Company/entity (Crown shareholding if not 100%)	Shareholding or responsible Ministers		
		Finance	SOEs	Other Ministerial portfolio <sup>1</sup>
State-owned enterprises	Airways Corporation	x	x	
	Orillion	x		Biosecurity
	AsureQuality	x	x	
	KiwiRail	x	x	
	Kordia	x	x	
	Landcorp Farming	x	x	
	MetService	x	x	
	New Zealand Post (incl. KGH)	x	x	
	Quotable Value	x	x	
	Transpower	x	x	
	New Zealand Railways Corporation	x	x	
Crown entity companies	Crown Irrigation Investments	x		Agriculture
	Television New Zealand	x		Broadcasting and Media
Public Finance Act Schedule 4A companies	Crown Infrastructure Partners	x	x	
Statutory Crown entities	Lotteries Commission			Internal Affairs
	Public Trust	x		Justice
<b>Companies with mixed ownership</b>				
Publicly listed companies	Air New Zealand (51.9%)	x		
	Genesis Energy (51.2%)	x	x	
	Meridian Energy (51.0%)	x	x	
	Mercury NZ (52.6%)	x	x	
Council-controlled trading organisations	Christchurch International Airport (25%)	x	x	
	Dunedin International Airport (50%)	x		
	Hawke's Bay Airport (50%)	x	x	
<b>The following companies and entities have residual assets or liabilities</b>				
	Crown Asset Management	x	x	
	ECNZ	x	x	

<sup>1</sup> Portfolio allocations as at October 2020.

The diagram below provides a visual representation of the CCEs, with assets and revenues on the x and y axes, and the estimated commercial valuation<sup>2</sup> of each company or entity (as at 30 June 2020) represented by the size of the 'bubble'. The exception is KiwiRail (marked white), where the bubble represents the size of KiwiRail's negative commercial value. The commercial valuation reflects each board's estimate of the fair market value of the Crown's investment in the company. The scale is logarithmic.

**Figure 1: Relative size of companies and entities**



<sup>2</sup> With the exception of Crown Infrastructure Partners, Crown Irrigation Investments, Lotteries Commission, Crown Asset Management, New Zealand Railways Corporation and ECNZ, where the size of their bubble corresponds to their net asset value.

Some CCEs have been impacted by COVID-19, and Crown support has been provided in certain instances. Some companies pay the Crown an annual dividend; the majority of this dividend is received from a small sub-set of the companies, such as Meridian, Genesis, Transpower and, before 2020, Air New Zealand. The annual dividend is expected to be relatively resilient to the impacts of COVID-19. The Crown received approximately \$734 million in dividends<sup>3</sup> for FY20, compared to \$770 million in dividends for FY19. We expect the dividend to decrease in FY21 as the effects of COVID-19 continue.

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<sup>3</sup> Excluding a special dividend of \$38.9 million from Crown Irrigation Investments, which was as a result of the refinancing of its loan with Central Plains Water Limited.

## 1.1 Legislative framework

Each company or entity type is set up under legislation that outlines its purpose and aspects such as expectations around financial performance.

- SOEs are companies set up under the State-Owned Enterprises Act 1986 and are expected to operate as successful businesses, including being as profitable and efficient as comparable businesses not owned by the Crown.
- Crown entities are set up under the Crown Entities Act 2004. In general they are expected to act as successful going concerns and to operate in a financially responsible manner. Some Crown entities are companies.
- Public Finance Act (PFA) Schedule 4A companies are set up under the Public Finance Act 1989 and their expectations vary in accordance with their constitution. PFA Schedule 4A companies can be jointly owned by the Crown and other parties, but the Crown must have a majority shareholding.
- Airport companies are set up under the Local Government Act 2002.
- The three publicly listed energy companies were set up under the Public Finance (Mixed Ownership Model) Amendment Act 2012. The Crown must retain at least a 51% shareholding and no other party may own more than 10% of the shares.
- Air New Zealand does not fall under any overarching Crown ownership legislation. The Minister of Finance is the sole shareholding Minister.

All companies are subject to the Companies Act 1993. All companies and entities (except for the publicly listed companies) are subject to other public legislation such as the Official Information Act 1982, the Public Audit Act 2001, and the Ombudsmen Act 1975. They are also subject to public scrutiny through the select committee process and parliamentary questions addressed to Ministers.

## 1.2 Key Ministerial levers

Ministers have broad ownership oversight for each company and entity. However, governance is the responsibility of boards appointed by Ministers subject to Cabinet approval (with the exception of the publicly listed companies). Boards operate at arm's length from Ministers to develop the overall strategy for their company or entity and appoint a chief executive officer, to whom they delegate management decisions.

Given the arm's length model, the **two most important levers** available to Ministers to influence the performance of entities and companies are the:

- appointment of effective boards
- annual business planning and reporting process.

### The board appointments process

As shareholding and responsible Ministers, you are responsible in most cases for appointing directors to the boards of your entities. The Prime Minister should be consulted on major appointments before they are submitted to Cabinet, and all appointments must be confirmed by Cabinet. The exception is for Mixed Ownership Model (MOM) companies, that follow NZX rules.

Entity/company type	Process and Ministerial involvement
MOM companies	<ul style="list-style-type: none"><li>• Subject to NZX rules.</li><li>• Boards recommend candidates for appointment as directors. New directors are then elected by all shareholders at the Annual Shareholding Meeting (ASM).</li><li>• Existing directors must be re-elected by a majority of shareholders every three years at an ASM.</li><li>• Directors would typically serve for 8-10 years, but it is the board's and the individual's choice when they stand down.</li><li>• As the Crown is the majority shareholder, the Crown's vote determines the outcomes of resolutions to elect or re-elect directors at ASMs.</li><li>• Well before each ASM, Ministers are consulted regarding the election and re-election of directors, and Ministers consult their colleagues through the Cabinet process.</li><li>• Boards choose their own chairs, who must be approved by the Minister of Finance.</li></ul>
Non-MOM companies and entities	<ul style="list-style-type: none"><li>• Ministers appoint and remove board members, subject to Cabinet confirmation.</li><li>• Ministers appoint the chair and deputy chair.</li></ul>

The Treasury's Governance and Appointments Team provides advice and administrative and nomination support throughout the appointments process, and prepares the Cabinet documentation to confirm appointments.



This advice and support enables Ministers to make decisions on the:

- retirement or reappointment of existing board members
- size of the board
- skills requirements for vacancies
- shortlist of candidates for due diligence interviews
- preferred candidates for appointment and length of term.

There are currently more than 80 individual Crown director positions across the SOE boards and three regional airports. All directors are 'independent' in that Ministers and officials are not appointed to boards, and directors rarely have the benefit of an indemnity from the Crown for their actions.

A key focus for appointments has been to increase the mix of gender, ethnicity, demographic and cognitive diversity around board tables. Research has demonstrated that diverse appointees can add value to a board's efforts to drive strategy and performance. Directors also need some governance experience, and knowledge that can help to challenge but also assist the management team.

Finding candidates who can bring the range of skills and governance experience needed by a board is helped by considering individuals from a large pool of candidates. Public notification of vacancies can help to find new candidates, and also increases public confidence that appointment processes are fair and open. In addition, you may seek nominations from your colleagues, and the Treasury seeks nominations from other government departments that hold databases of diverse candidates.

Your engagement in specifying the skills and experience required for a board is an important step, as it:

- gives candidates a greater understanding of what is required before they decide whether to apply for a board appointment
- helps stakeholders to nominate candidates with relevant skills and experience
- provides you with benchmarks against which to measure the attributes of candidates
- reinforces the principle of appointment on merit.

Appointments occur throughout the year, and can be driven by the board's composition, term end dates, the length of time directors have been on boards, and whether board members seek reappointment. A typical appointment round can take four to six months, from identifying upcoming vacancies, working with the chair to develop a skills profile and calling for nominations, to new board members commencing in their role.

The initial term for newly appointed directors is usually three years. Directors are typically reappointed for a further three years if they have performed well and their skills remain relevant to the company's or entity's needs. Directors have been reappointed for a third term in exceptional circumstances.

You are also responsible for setting director fees in accordance with Cabinet Minute CAB-16-MIN-00678 (which applies to SOEs and some other commercial entities) or the Cabinet Fees Framework (which applies to statutory Crown entities). [33]

## The business planning cycle

### *Setting clear performance expectations*

Ministers send a letter of expectations to each board at the end of each calendar year outlining what Ministers expect of that board. The letter may refer to overall expectations for the Crown company/entity sector depending on government priorities of the day, as well as company-specific expectations. For example, Ministers may express their expectation that a board will appropriately manage its strategic change process or address emerging strategic or financial concerns.

In addition to the annual letters of expectations, generic expectations for all boards are outlined in the Owner's Expectations document issued by the Treasury. This document includes expectations in areas such as financial and non-financial performance, board conduct, business planning, reporting, engagement with the Treasury, and public accountability.

### *Business planning and reporting*

Boards hold an annual strategic session to develop their strategy. They are expected to bear in mind the expectations outlined in your annual letter of expectations. The Treasury encourages boards to invite Treasury officials to attend relevant parts of these sessions to enable us to develop a better understanding of company and entity strategies.

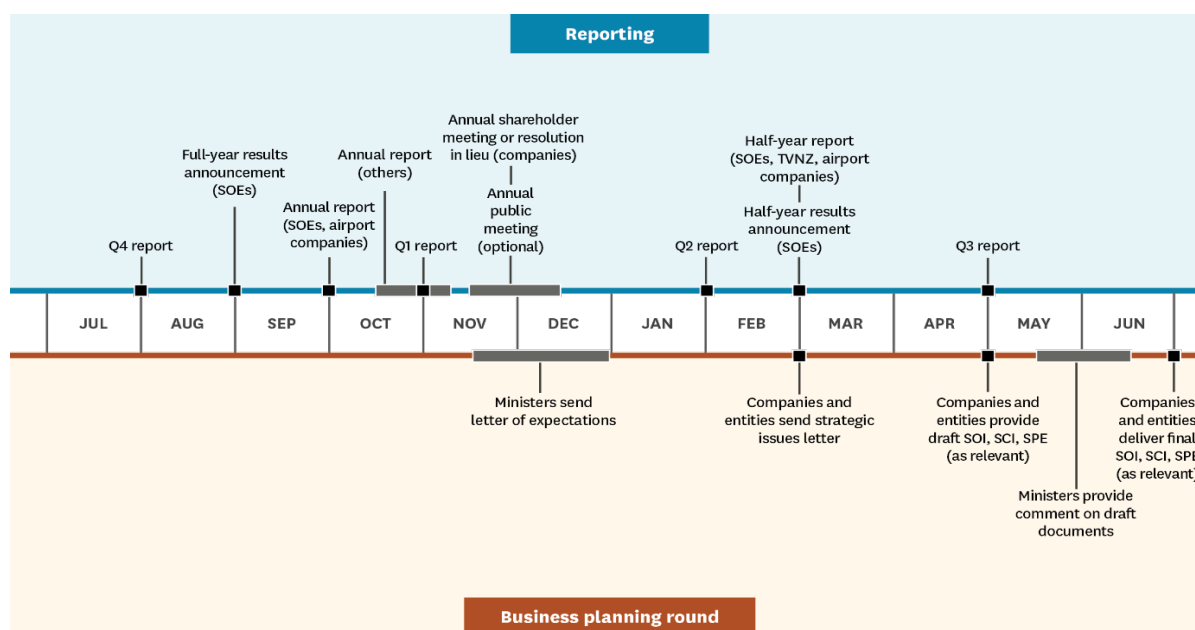
Boards set out their plans and strategies in the form of a Statement of Corporate Intent (SCI) or Statement of Intent (SOI), and also a Statement of Performance Expectations (SPE) for some companies and entities.

Once a company or entity presents its draft planning documents, the Treasury analyses them and provides comment to the company or entity, and advice to Ministers. You then have the opportunity to comment on the draft plans. In line with legislation, boards are expected to consider your comments, although they are not required to reflect those comments in their final documents. Boards submit their final documents for tabling in the House of Representatives (except for the SOIs for airport companies, because they fall under the Local Government Act and so are primarily accountable to local authorities rather than central government).

Boards provide quarterly, half-yearly and annual reports outlining progress against their plans and broader performance. The Treasury uses these reports to analyse company performance and to brief Ministers. We also provide advice to Ministers for regular and one-off meetings with chairs. Serious or ongoing performance concerns can be discussed at these meetings, or you may choose to express your concerns in writing.

The business planning and reporting cycles are outlined below. This is a generalised diagram. While the steps apply to most company and entity types, there are some exceptions.

**Figure 2: General business planning and reporting cycle**



## Other Ministerial levers

Other levers available to Ministers include the following.

- **Shareholder approval for transactions:** You must be consulted or, rarely, give approval, when a board proposes a transaction with a value above certain thresholds. Consultation thresholds are normally set through shareholder expectations while shareholder approvals are less common and are based on a particular transaction, or series of transactions, being a 'major transaction' under the Companies Act 1993. Such transactions are normally asset purchases or disposals and may reflect a change in a company's or entity's strategy. To seek approval, boards prepare a business case for Treasury analysis. In some cases, Ministers must also be asked to approve some financial operations such as investing and borrowing.
- **Amendment of company constitutions:** Shareholding Ministers can amend constitutions when they wish to change the purpose or objectives of a company.
- **Contracts for purchase:** Ministers can enter into contracts to provide funding for a company or entity to deliver certain goods or services.

- **Information requests:** You can also request information from a board, for example if you have concerns about a company's or entity's performance.
- **Directions:** Ministers can also issue directions to groups of entities subject to the Crown Entities Act to support a whole-of-government approach, for example to improve public services or to secure efficiencies. Such directions have been infrequent. An example is a direction in 2018 to implement the New Zealand Business Number.

There are varying powers for Ministers to give specific directions to particular entities, in some circumstances, and with specific limitations or exemptions. For Crown entities, the responsible Minister:

- can issue specific directions to a Crown agent to give effect to a government policy that relates to the entity's functions and objectives
- can direct autonomous Crown entities to have regard to a government policy that relates to the entity's functions and objectives
- cannot issue directions to independent Crown entities or Crown entity companies, unless specifically provided for in other legislation (which is rare). Most of the Crown entities for which the Treasury provides ownership and governance advice are Crown entity companies.

For SOEs, shareholding Ministers can direct them to include or exclude specified matters from their Statements of Corporate Intent (eg, to make changes to their nature or scope of business), or to pay a dividend or provide information. Ministers cannot direct SOEs to carry out (or not carry out) particular actions. Because the power of direction for SOEs is very limited, it has been used very rarely.

Shareholding Ministers have no powers to direct the listed companies.

## 1.3 How we advise on company and entity performance

The Treasury provides advice to Ministers in the following areas:

- **Ownership advice:** what is the Crown seeking to achieve through ownership of its Crown companies and entities?
- **Performance advice:** how is a company or entity delivering against its objectives?
- **Commercial advice:** how can the Crown best deliver a commercial outcome through its ownership, for example as a potential means of intervention in certain sectors, or what are the ownership implications and options if market disruption significantly affects some business models?

For each company and entity, we appoint a lead and support relationship manager (RM). The RMs become familiar with the operations and strategy of each company and entity through regular interactions, most often with senior managers. Each RM drafts an entity assessment plan that:

- analyses each company's or entity's performance
- identifies priority areas that need development or strengthening
- assesses what will be required for successful performance engagement, for example regular performance-focused meetings
- outlines key deliverables, for example reports and relationship meetings.

The Treasury assesses performance across the following four dimensions:

- strategy, investment and alignment
- leadership
- organisational performance
- results.

We start with an assessment of company or entity strategy; that is, we ask whether the strategy is clear and focused, sufficient to address the changes we are seeing in the company's or entity's industry, and whether it is able to be executed. We examine the track record of major investments and the rationale behind current/planned investments. An ongoing track record of low returns or business cases with unclear rationale will be factored into our assessment. We assess not only whether a company or entity is performing well commercially but also whether it is aligned with legislative and Ministerial expectations.

We assess the effectiveness of the board and management. We look at organisational culture and aspects such as structure, asset management, and disclosure.

We look at whether the company or entity has achieved growth and performed well against forecasts. For those companies and entities that compete in open markets, we consider factors such as growth in market share and the development of a competitive advantage.

The Treasury identifies areas that each company or entity may need to develop or strengthen and adopts a risk-based approach. This means that in-depth analysis or strategic reviews may be appropriate in some cases.

**Figure 3: General engagement by the Treasury with companies and entities**

**Level of engagement**



Various levers are available to influence performance, including closer interaction between the Treasury and boards, Ministerial meetings with chairs or entire boards to discuss specific issues, and expression of concerns and expectations through formal correspondence, annual letters of expectation, and feedback on draft annual accountability documents.

We report to you on entity performance six-monthly, against both financial results and key performance indicators. We use a Performance Assessment Framework to help identify and report against the factors underlying a company’s success. The next of these will be on the half-year results, which we aim to provide to you in March 2021.

Where performance does not meet expectations, various actions are available, including, for example:

- a requirement for additional or more regular reporting
- a request for a board action plan to address performance issues, or commissioning of an independent report
- withholding of Ministerial support for significant or major transactions

- Ministerial directions for some CCE forms (as mentioned above, this has limited scope and is very rarely used)
- Crown financial support with conditions, or closure or substantial reconfiguring of a company's or entity's business
- non-reappointment of directors at term end, or dismissal of a chair or entire board.

#### *Different approach for listed companies*

The four publicly listed companies are subject to NZX Listing Rules, under which they release regular updates to all shareholders. We receive the same level of information as other shareholders in normal circumstances. We rely heavily on market analysis and the company's share price as an indication of performance. Air New Zealand is not currently in normal circumstances, and there are different arrangements in place for it.

We maintain a relationship with boards and management and engage with them regularly on matters requiring shareholder approval (director appointments and fees and, rarely, on major transactions) and to discuss strategy and performance.

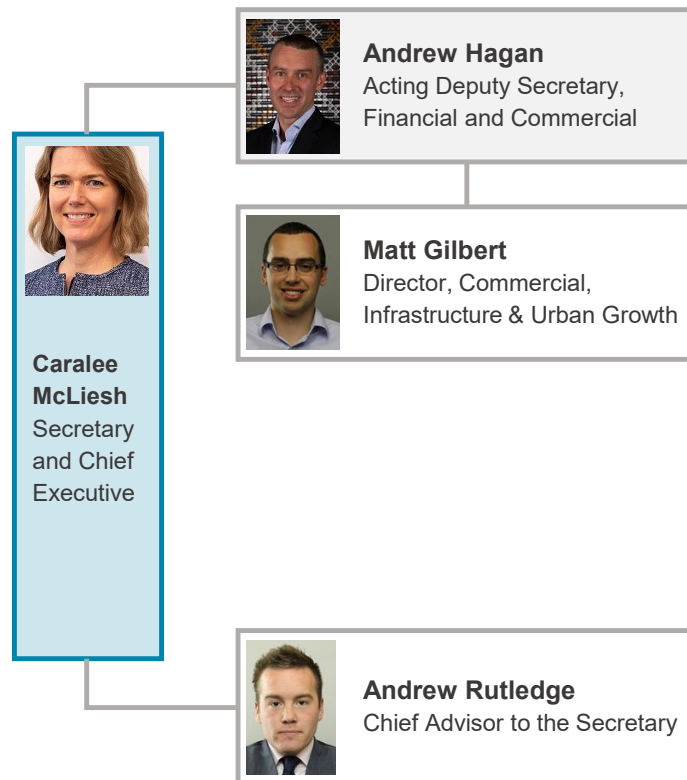
#### *Secondary advisory role*

For some companies and entities the Treasury has a secondary role in providing performance advice. For example, the Ministry of Business, Innovation and Employment has lead responsibility for providing advice to shareholding Ministers on the Crown research institutes. We are involved in a secondary advisory role where required, often when significant financial matters are concerned.

#### *Ministerial servicing*

We draft responses to Ministerial correspondence, media enquiries and Official Information Act requests. We liaise with companies and entities to provide information to support Ministers to respond to Parliamentary debates and questions. We provide briefings when you meet with companies or entities, and keep you informed of events such as when a company or entity is to appear before a select committee.

## 1.4 Key Treasury contacts





## 2 Matters of current interest

### Improving performance: enhanced status quo

We wish to engage with you on ownership interests and expectations for each of the commercial entities and companies.

Ministers have previously endorsed our development of an 'enhanced status quo' work programme to appropriately and effectively use the arm's length model. The key elements of the work programme include development of clear rationales for Crown ownership, setting of performance expectations across a broader set of dimensions, and use of a structured assessment approach. We can provide you with further advice on developing ownership policies and strengthening stewardship to give effect to your policies.

This work programme recognises that companies and entities with public benefit objectives must still maintain commercial disciplines, while those with commercial objectives should ideally carry some form of public benefit rationale for Crown ownership. We are working with the Public Service Commission on issues related to company and entity form.

### KiwiRail: review of entity form

Ministers have previously directed the Treasury and the Ministry of Transport to consider KiwiRail's entity form in late 2020. Public benefit expectations and public funding of KiwiRail are increasing, and so the SOE Act may not provide sufficient levers to achieve Ministers' ownership objectives for KiwiRail. We wish to engage with you about your objectives and priorities for KiwiRail, including its corporate form.

### New Zealand Post mail policy and parcel investment consultation

Mail volumes have declined to a point where providing mail services in their current form is no longer a viable commercial service. However, there is still value in mail as a communication service, at least in the near term, and justification for the Government to procure these services from New Zealand Post. Consequently, funding of \$130 million over three years was allocated to New Zealand Post through Budget 2020.

The Ministry of Business, Innovation and Employment is leading policy work over the next six to 12 months, working with the Treasury, to identify options for mail services to be continued once this funding is exhausted. Throughout the work programme, we will engage with you on the options canvassed for mail services in New Zealand and the impacts on New Zealand Post's commercial position.

New Zealand Post is also investing \$170 million to upgrade its parcel processing infrastructure, to improve efficiency as parcel volumes increase. Ministers have previously been consulted on the business case for this investment. However, following the disruption of COVID-19 and new Crown funding in New Zealand Post, the company will seek to re-consult with Ministers on a revised business case.

## New public media entity

We wish to provide an update on work under way on the Strong Public Media business case [33] Currently the Ministry for Culture and Heritage is working towards a report-back to Cabinet on a new public media entity. A new entity would draw on the existing capacity and capability at Radio New Zealand (RNZ) and Television New Zealand (TVNZ). RNZ and TVNZ would ultimately be disestablished.

The Treasury would like to engage with the shareholding Minister of TVNZ and RNZ [33]

TVNZ's current commercial model has been under pressure with free-to-air television revenues declining since FY12 [33]

## Landcorp Farming: strategic review

An independent review into Landcorp Farming (Landcorp) is under way. We wish to discuss this review with you. The review is considering both financial and non-financial aspects of Landcorp's business and risks to the delivery of Landcorp's strategy. It is intended to provide a deeper understanding of the underlying factors contributing to Landcorp's performance outcomes to date.

## Upcoming appointments

The terms of multiple directors are due to expire in 2021. We will provide you with advice on 17 new appointments and 32 reappointments in November, and seek your decisions in December.

### 3 Key upcoming decisions and issues

We would like to engage with you on a range of key decisions and critical issues before the end of 2020. These relate to legislative requirements, your manifesto priorities, and other priority issues. We will provide you with a list of these issues and proposed timeframes for engaging with you ahead of our first meeting.