STATE OF THE NATION

BUSINESS IN 2003

A New Zealand Herald special report

INSIDE

Chief executives tell what is on their minds in our Herald Corporate Survey — The Mood of the Boardroom

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Forecasts

'Out of sync' in 2003

Ulf Schoefisch
Chief economist, Deutsche Bank NZ

The remarkably strong performance of the New Zealand economy during a period of difficult global conditions — described by Finance Minister Michael Cullen as being 'favourably out of sync' — is ending.

The income effect of falling commodity prices is hitting the regions, and the strengthening dollar is hurting the export sector.

Strong inward migration is acting as a counter-balancing force, particularly in Auckland, but its impulse on construction and the housing market will reduce.

As a result of these influences, growth is expected to slow to around 2 per cent next year — at a time when the global economy is likely to show renewed strength.

The good news is that the Reserve Bank should be able to reduce interest rates in the second half of next year, as inflation pressure subsides. However, a black spot is the rapid widening of the current account deficit, showing more work is needed to address underlying structural imbalances.

Good year for domestic sector

Tony Alexander
Chief economist, Bank of New Zealand

The contrast between the export and domestic sectors becomes even greater next year.

In theory the expectation of trading partner growth, accelerating to 3 per cent, should boost exports.

But in practice growth could be about the same as this year, and margins could be squeezed as the currency consolidates between 50-55USc and currency hedging near 42USc runs out.

Patchy export growth will slow domestic growth, but momentum of the housing sector should ensure domestic activity underpins economic growth at near 2.5 per cent for the year.

Below-average mortgage rates, strong population growth, investor preference over equities and a tight labour market will underpin housing. Along with the retailing industry, it will see good activity levels, but with growth rates down from this year.

We see little scope for the labour shortage to ease, so wages pressure will add interest to monetary policy considerations.

The rising currency and wobbly world growth outlook will stay the Reserve Bank's hand. Each extra cent rise in the New Zealand dollar will increase the chances of a small easing mid-year.

Our fruit still too small

The economy can be likened to an apple orchard where seedlings are unlikely to flourish.

Business Herald editor
JIM EAGLES

THE New Zealand business scene is rather like an apple orchard full of trees which somehow never grow more than a metre tall.

They do produce fruit but there is not much of it and it is mostly too small to be sold.

As a result the orchard has to rely for its economic survival on a few big old trees, some of which are past their best, and they no longer produce enough fruit to pay for all the goodies the orchard owners have come to expect.

The statistics behind this analogy are clear.

The latest statistics suggest there are 277,965 businesses in this country. An overwhelming 86 per cent, 239,544, had five staff or less. Less than 0.5 per cent of business, just 1307, were big enough to employ more than 100 people.

Of all the businesses in the country only 4 per cent export at all. A mere 151 companies produce 78 per cent of our exports.

New Zealand may be one of the most entrepreneurial countries in the world, as the latest Global Entrepreneurial Monitor has just confirmed, but too few of our thousands of start-ups reach significant size.

That is why the number of companies listed on the Stock Exchange has barely changed in 10 years.

It is why so few businesses develop the resources and expertise needed to really crack the export scene so that we consistently fail to pay our way in the world.

And it is also one of the reasons why the New Zealand economy is falling behind other developed countries so that, for example, we are unable to pay internationally competitive wages to the likes of radiographers, software engineers and rugby players.

The Government, of course, has promised to change all that and get the country climbing up into the top half of the OECD wealth ladder.

Several conferences and seminars, a couple of new advisory boards and councils and countless reports and discussion papers have looked at how that might be done.

But it is difficult to find anyone who seriously believes that the economic strategy which has emerged to date will actually double the rate of growth.

That is not to say it is all bad.

Finance Minister Michael Cullen has been a rock of consistency on fiscal policy.

The Government has done better than expected on the trade front.

Much effort has been put into building closer links between research organisations and business, developing an immigration policy which benefits the economy and working with industry groups in key sectors such as wood processing, textiles and food.

A lolly scramble of grants has been scattered over selected businesses, regional development groups and sector organisations to finance studies or assist with new ventures.

The Venture Investment Fund has been set up to help the country's meagre venture capital resources go a little further.

There is also a huge and sometimes confusing array of programmes designed to assist start-ups and encourage established businesses to expand.

The full list of Government programmes is a long one and includes some which will certainly have a positive effect over time.

But it is dominated by a tendency to opt for easy, flashy responses — such as one-off grants for particular companies or projects — which avoid the need for difficult policy decisions.

That approach flies in the face of general business opinion, which was summed up neatly by entrepreneur Sir Gil Simpson when he proposed a Government Help Act which would prevent any New Zealand government from trying to help his business.

Its risks have been illustrated by the fact that the two flagship ventures, the Ericsson Synergy technology joint venture in Wellington and the Sovereign Yachts development at Hobsonville, have both gone wrong.

The point is that while it is nice for a few individual projects to get special help, it is far more effective for the Government to change the economic environment in a way that makes life easier for all businesses.

But any proposals for fundamental change are usually sidelined by setting up a new advisory body which conducts a longwinded consideration and consultation process — offering the twin benefits of giving an impression of constructive activity while avoiding the need to take difficult decisions — and if any recommendations do eventually emerge they can be safely cherrypicked.

In the meantime the economy has continued to bubble along very nicely, largely because of historically high commodity prices and high levels of inward migration, but there is nothing to suggest that it has actually been transformed.

On the contrary, even the three sectors singled out by the Government for special attention — biotechnology, information and communications technology (ICT) and creative — have been finding the going difficult.

The biotechnology sector has been hamstrung by the restrictions in the Hazardous Substances and Modified Organisms Act and has already seen research work and scientists go offshore as a result.

Embarrassingly, a draft ICT sector task force report has called for more attractive tax rules for investment, tax changes to make it easier for firms to retain key staff by giving them share options and moves to encourage R&D by at least matching the tax rules in other comparable countries.

Even the creative sector has suffered through the tightening of the tax rules which previously helped attract foreign film makers here.

Nor do international comparisons suggest the economy is moving the right way. The latest GEM report identified a 23 per cent drop in entrepreneurial activity since the previous year, well above the global average fall of 2.22 per cent, though nowhere near as severe as Australia's 46 per cent decline.

The World Economic Forum's growth competitiveness index for this year shows New Zealand falling from 10th to 16th, well behind Australia on 7th.

The accompanying Microeconomic Competitiveness Index, developed by Harvard Business School guru Michael Porter, has New Zealand down from 20th spot last year to 22nd this year, while Australia is on 14th.

Perhaps most important of all, the latest productivity figures point to New Zealand continuing to fall behind.

Last year, according to Porter's calculations, GDP per head (adjusted for purchasing power parity) in New Zealand was 78 per cent of the Australian figure and 59 per cent of world leader the United States (and the figures for GDP per hour worked are even worse).

That represents a worsening of the situation five years earlier when New Zealand productivity per person was a slightly less dismal 88 per cent of Australia and 64 per cent of the US.

If our GDP per head is about three-quarters that of Australia it is not surprising that we find it hard to afford the pay levels, standard of living and social services enjoyed across the Tasman.

Australia itself is far from being the most efficient economy in the world, but its productivity growth did more than double in the 90s after concern about slow growth prompted a range of reforms.

How was that achieved? A recent paper by Dean Parham, assistant commissioner with the Australian Productivity Commission, a body set up to monitor the progress of the reforms, attempts to answer that question.

Parham concludes that greater involvement in education, upskilling and increased use of ICT did help.

But, he says, "Policy reforms have been the major drivers and enablers. Reforms have enhanced competitive pressure; opened the economy to trade, investment and technology; and allowed greater flexibility to adjust all aspects of production, distribution and marketing."

Unfortunately on most of those fronts New Zealand has actually moved in the opposite direction.

While the Government has made much of cutting some red tape it has, in fact, been far busier adding even more, especially in the workplace. A survey of Auckland Chamber of Commerce members earlier this year found that 85 per cent thought red tape had worsened and only 1 per cent thought it had improved.

The Government has also turned its face against Australia's moves to boost the economy by reducing the tax burden. New Zealand's company tax rate of 33 per cent is now the highest in this part of the world and the gap is growing. Total Government spending in New Zealand is around 40 per cent of GDP compared with 33 per cent in Australia.

Any gardener knows that seedlings are unlikely to flourish if they are choked with weeds, or overshadowed by large unproductive trees which block the sun and soak up most of the fertiliser and water.

Corporate seedlings are not so very different.

Out of the comfort zone, please

New Zealanders need to learn a bit of discontent, writes Scott Perkins

SO, ARE we in a comfort zone or a danger zone? One measure wraps it all up. Living standards.

On average what wealth do we share between us? I am sure polling would suggest we think we are in line with our 'traditional peer' countries such as Australia, Singapore, UK, and Scandinavia.

We are not. In fact, we are far from it. Australians are 59 per cent more wealthy than us and the peer group above 60 per cent.

So, is the glass half full or half empty?

If we consider the impediments that our traditional peer countries have faced over the past decade as they have improved living standards — New Zealand looks easy. No wars, virtually no corruption, streamlined regulatory regimes, broadly competitive (but not compelling) tax regime, reasonable (but falling) education and skill standards and a can do attitude that consistently impresses those who come here to work or live. So, what do we need to do about this contentment? Here are six ideas.

■ Think bigger. It is all about aspiration. If our world is bounded by the shores of New Zealand, we will fail to generate the jobs, living standards and sense of global relevance and pride that defines success. Think about New Zealand's icons, they are all world-beaters. They are people, companies and teams that have made it on the world stage — not just in our back yard. How relevant would Team New Zealand, the All Blacks, Sir Edmund Hillary, Fonterra, Carter Holt Harvey and *Lord of The Rings* be if their competitors, challenges and audiences were limited to New Zealand.

■ Get help. We need some shortcuts to developing new areas of the economy and providing capital, expertise and contacts. One of the quickest ways to secure these is through attracting foreign investment. New Zealand has way under-achieved in this area. Foreign companies have fuelled the performance of our traditional peer countries — but they have been aggressive in seeking them out. We need a pro-active, focused, resourced, skilled and agile investment promotion agency to shout New Zealand's business attributes from the global hills. The recent BCG report has the detailed roadmap there — ready to go.

■ Free trade agreements. These have the potential to be the "transformational step." A free trade agreement with the USA and enhanced trading relationships with Asia would propel our living standards forward dramatically. It might even be time to reconsider our defence policy with the US to see whether there are ways of removing this impediment within the constraints of the anti-nuclear stance. Politicians are unlikely to lead a balanced rational discussion on the anti-nuclear issue. We all should.

■ Treasure education. So many discussions loop back to education. Crime, family violence, industry productivity, innovation and research and development, and feasible businesses for venture capital. Raising our expectations in terms of the adequacy of our own training and the performance of schools and tertiary providers will drive better outcomes.

■ Improve Government productivity. Every corner of the global economy is subject to productivity pressures. We are all trying to get better value from limited resources. We all face competition. How is the Government going? It is pretty hard to tell. Maybe it should set productivity improvement targets and be transparent about the processes that identify the least efficient spending and measure action. For example — why shouldn't the least effective 10 per cent of social welfare spending be identified and tested to see whether New Zealanders would be better off by allocating those resources to, say, education.

■ Get discontented. We need to give honest and clear signals to our politicians and fellow New Zealanders that our living standards need to improve. As importantly, they need to improve dramatically and quickly. A sense of urgency and "make it happen" is needed. Every day the gap is widening and politicians naturally prefer incrementalism — which will not get us there. The present path takes us out of the developed nations in a dangerously short period.

Contentment is a comfortable feeling, but a dangerous one if we want this to be a country for future generations. There is plenty of evidence that our comfort zone will not last forever.

The messages we should be sending our families, employees, employers and policy makers are ones directed at being part of a competitive, successful, winning New Zealand — one that is well out of its comfort zone.

■ Scott Perkins is managing director of Deutsche Bank and a trustee of the Knowledge Wave Trust.

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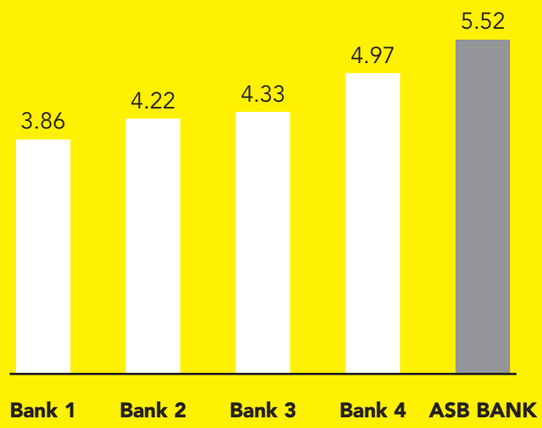

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What our chief executives think

Peter Hubscher
Montana Wines
Growth is up to individuals not the Government. But New Zealand needs more skilled staff for long-term success.

Chris Liddell
Carter Holt Harvey
If we are going to embrace exporting as a real opportunity then we need to be worldclass in everything we do.

Craig Norgate
Fonterra
A small island economy cannot outperform without learning how to win and win well on foreign soil.

Hugh Burrett
ASB Bank
Priorities are important . . . We all need to focus to get to the nub of issues and get results.

Ralph Norris
Air New Zealand
It is important that we do not end up creating greater incentives for good quality people to go offshore.

Matthew Cockram
Bell Gully
The trend towards greater regulation and Government participation emphasises a distrust of the private sector that is unhealthy.

Geoff Vasey
Ports of Auckland
You cannot have a knowledge economy and innovative businesses and ''no risk'' labour regulation.

Gavin Cormack
Beca
We need to minimise Government intervention in business and private choice and use savings to reduce taxes.

Geoff Hunt
Alstom
No one is clearly describing what sort of country New Zealand will be in 10-20 years' time.

Ann Sherry
Westpac
We need to create an environment that encourages and inspires entrepreneurs and risk takers. These people will drive growth.

Let's start with a plan

The Government talks often of growth, but CEOs say action is long overdue.

WHEN fifty of New Zealand's top chief executives declare that the country has no growth strategy — it is time to sit up and take notice.

The Government is ambitious for New Zealand to once again take its place in the ranks of first-world nations at the OECD "rich man's club".

Relative living standards are slipping against our nearest neighbour, Australia.

But to do that, the economy must take a big leap and score repeated economic growth rates of nearly four per cent a year.

Trouble is, after a lot of talk — the target to get back into the top half of the OECD was first floated two years ago — business is fast coming to the view that there is no real game plan.

A *Herald* corporate survey — which went out to 120 top CEOs and company chairmen this week — featured a simple question: Did New Zealand have a growth strategy to sustain business success? The answer was a resounding 'No'.

Only three players conceded that there was a strategy — or the beginnings of one.

One even pointed to the 1980s economic reforms and called them a growth strategy.

We received a response rate of close to 50 per cent.

By press time on Wednesday, the faxes were still coming back from busy chief executives determined to get their message across.

Alstom's Geoff Hunt speaks for many when he says there needs to be a long-term vision for New Zealand.

"No-one is clearly describing what sort of country New Zealand will be in 10-20 years' time,'' said Alstom, whose survey was among the first to be returned.

"If no one is painting the future, then it is unlikely that all the necessary steps will be taken to get us there. Even worse, without a clear view of the longer-term future, it is probable that short-term decision making will in many cases compromise progress towards that better future."

Adds Bell Gully's Matthew Cockram: "There is a lack of coordination and vision at a national level about what we stand for as a country — the notion of people living here for lifestyle reasons — the impression given is that we do not value hard work and success."

In fact, Finance Minister Michael Cullen does lay claim to a growth platform.

But it has yet to feature some of the elements business wants to put it on an internationally competitive footing such as lower taxes, a kinder regulatory regime and an end to creeping policies — particularly at the labour level — that chief executives say are "anti-business".

Sprinkled through the survey responses are strong suggestions from chief executives that the Government is "playing favourites" by holding confidential dialogues with a select few and closing the door to established representative organisations.

Which to some degree it has.

When Growth and Innovation Advisory Board chairman Rick Christie invited a select group of business players to the recent ''Goverment-Large Businesses Forum" he said there was "no quick fix".

"The forum is a valuable opportunity to explore what else has to be done to markedly increase New Zealand's productivity and create the kind of inclusive economy from which all New Zealanders can benefit" said Christie.

Papers presented by the Knowledge Wave Trust suggested three elements must be embraced to accelerate economic growth: Adopt a growth lens against which all policies should be evaluated, adopt a growth mindset and a growth programme of action-oriented initiatives.

Former Treasury secretary Alan Bollard suggested that weak government policy, weak business acumen, weak social consensus and a weak country might have something to do with New Zealand's poor growth.

Growth mattered, said Bollard, because capital, people and firms had one thing in common. They were mobile.

Growth would be driven by better labour utilisation and productivity.

It would be hard. There were no silver bullets. We needed to get focus on investment, innovation and global connectedness.

"Roosters may Crow, but Warriors battle on!" said his presentation slide.

It is the latter point that the chief executives are finding difficult to grapple.

If this is the case, where is the strategy?

Six weeks later the frustration is palpable even among some forum participants, who are concerned about the lack of progress.

"We need to improve competitiveness and productivity in order for New Zealand to change our ability to attract and build globally competitive industries,'' wrote Deutsche Bank's Scott Perkins.

"The elements of this would be dramatically improving government productivity — which would ultimately involve tax reductions, and increased private participation in core social services, reversing anti-entrepreneurial regulations (recent labour reforms such as those dealing with stress). Stepping up targeted immigration, attracting foreign direct investment, securing free trade agreements and improving Government and private sector R&D outcomes."

There are fears that New Zealand is fast losing competitiveness against Australia.

JB Were's Clark Perkins writes of an urgent requirement to understand that a strategy "must be compelling when compared to Australia".

"We are regionally competing for foreign direct investment and need to be able to demonstrate a pro-growth policy bias which can deliver superior returns when compared to our major competitor for dollars and talent."

Others from the Knowledge Wave Trust camp say growth should be a "lens" across all initiatives. "The Government has sort of got their head around making growth a lens for economic initiatives and policy, but then do not apply it as a lens to other areas such as local government, environment, labour market.

■ **Continued on D4**

CEOs in fear of free-trade shutout

US-Australia trade door, deflation and treaty obstacles add up to an anxious time for NZ.

A SCENARIO of Australia bagging a free-trade agreement with the United States and New Zealand being sidelined is ranked by chief executives as the biggest potential knock to business confidence.

Their concerns should give food for thought to Prime Minister Helen Clark and Government officials who have advised that such a scenario would be a temporary "setback" to the economy.

The risk of global deflation is also high in the minds of CEOs and company chairmen who responded to the *Herald's* survey this week. There are strong concerns about the decline in US business investment.

Consumers are still spending, but personal debt is rising. CEOs fear that if the Federal Reserve cannot work its magic, a global deflation scenario may emerge.

Despite the Bali bombing and threats against Australia, top business players rate the impact of a US retaliation in Iraq as significantly more negative than the threat of further terrorism in the region.

"I think it is going to be really damaging to the world economy, bugger it," said the EMA's Alasdair Thompson.

'The real issue is that we don't get into a situation where it seems the norm to obstruct activities just to get some form of rent'

Ralph Norris
Air New Zealand

Riposted a tourism chief: "Frankly we should relax and get on with life. War on Iraq will have an impact on our business . . . but focus on this front will undoubtedly hold businesses back."

The *Herald* asked CEOs to rank which of seven issues had the most significant negative effect on business confidence today (see table). Insurance costs and the continuing effects from US accounting failures were of concern, but it is the proliferation of the Treaty of Waitangi into more areas of business that really riles.

''We have to be concerned about whether some of the actions being taken in the name of the treaty are not a form of greenmail or corruption," says Air New Zealand's Ralph Norris. "There are obvious injustices that need to be recognised, but the real issue is that we don't get into a situation where it seems the norm to obstruct activities just to get some form of rent."

The Government cannot do much to shield New Zealand from international risk. But Clark emphasised this week that it will step up focus on its own push for a US trade agreement and try to persuade Congress that the integration of the transtasman economies makes the move essential.

Risks nominated by the CEOs included the economic performance of our largest export and investment market, Australia.

Says JB Were's Clark Perkins: "A slowing domestic economy, further impacted by a major drought may be more significant than the relatively benign commentary we are reading from Australian economists."

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Enron model not ours, say directors

Have we got the right corporate governance framework? It is a matter of asking the right questions.

ENRON may have cast a shadow over corporate governance internationally, but New Zealand's top chief executives are on song about their own companies' standards.

Virtually all survey participants said they either "got the model right', exercised "robust" or "conservative oversight"or were adopting best practices.

"It is important that we recognise that New Zealand/Australian companies are generally not following the shonky US practices, as our regulatory regime does not permit this," said an experienced company chairman.

Think again, said Warwick Hunt, of PricewaterhouseCooper.

He was adamant that New Zealand should keep pace with best international practice and not seek to "lead the world".

But there were mandatory requirements: Listed companies should have properly constituted and effective audit committees composed entirely of independent directors.

Audit committee members should be appropriately qualified; at least one must be financially expert.

Importantly, directors must be willing and up to the job to assist and constructively challenge management.

Some survey respondents said they had moved — pre-Enron — to ensure proper governance by increasing the number of independent directors and separating out auditing and consulting advice.

In general, those who inhabit New Zealand's boardrooms believe they have the mix right.

But, Hunt said, the board chairman must not also chair the audit committee. Nor should the chief executive hold the dual chairman's role.

It was also important for New Zealand to adopt International Financial Reporting Standards (IFRS) so that financial statements met standards adopted elsewhere.

"To do otherwise is to handicap New Zealand corporates in international capital markets, with higher cost of capital being the inevitable result," said Hunt.

The Accounting Standards Review Board (ASRB) recommended that New Zealand listed issuers be required to adopt IFRS by 2007 — two years after its proposed adoption in the European Union and Australia.

"It is essential that our corporates at least be permitted to adopt the same timetable as the EU and Australia, but my preference would be for mandatory adoption to be moved forward, at least to 2006," Hunt said.

"All New Zealand reporting entities should be required to report to the same IFRS standards, whether listed or not.

"While that may require legislative changes, this should not be used as an excuse for dragging our feet."

Chief executives pointed to a credibility issue over Tranz Rail's controversial sale and leaseback arrangements. The Stock Exchange's market surveillance panel, chaired by Bill Falconer, had still not reported on its investigation into Tranz Rail's disclosure practices when this article went to press.

Deloitte Touche Tohmatsu chairman John Hagen said the accounting profession as a whole had been seriously damaged by Enron.

"In the international meetings that I have been to in the last couple of months, the stress that we as a firm are placing on the need for professional services firms to win back trust has been pretty prominent."

Hagen headed a team from the "big four" — Deloitte, PricewaterhouseCoopers, Ernst & Young and KPMG — who examined the local auditing environment post-Enron.

They quickly tightened governance rules.

But shareholders' advocate Bruce Sheppard claims he was the tail that wagged this dog.

Hunt said a commitment to transparent, open and timely communication with shareholders was needed.

"We have seen both here and overseas how the market punishes unpleasant surprises.

"The other issue that is becoming more important is the scope of reporting. Increasingly, corporates are reporting additional, voluntary information in terms of strategy and triple-bottom-line reporting.

"The message is that the more the market understand a particular company, the more confidence in it the market has, and this is rewarded by a lower cost of capital and higher share price."

Expert Joseph Healy, in his book *Corporate Governance and Wealth Creation in New Zealand*, argues that directors should be focused on what really matters: creating wealth for their shareholders and the economy.

TRANSPARENCY CALL: Warwick Hunt.

WAGGING TAIL: Bruce Sheppard.

DAMAGE CONTROL: John Hagen.

MARKET WATCHDOG: Bill Falconer.

Businesses sick of waiting at altar for Government

Public-private partnerships have been much-touted but slow to materialise, say sceptical business interests.

THE Government and businesses need to speed up the courtship phase and finalise their nuptials if their partnership model is to bear fruit.

Despite a plethora of charm offensives, talkfests, steering groups and confidential forums in the past two years, chief executives believe there is little evidence to show the concept is working.

Nearly 90 per cent of the 55 chief executives who responded to the *Herald*'s survey said the politically promoted model did not exist.

Several senior business figures claimed that the Government had "tame favourites" who had the limelight and inside running.

Even those who automatically go on the invitation list when the Government wants to do business are showing signs of disenchantment.

But fewer than a third of survey respondents were prepared to talk on the record.

Deutsche Bank's Scott Perkins, who is on the "A list", said the Government should be encouraged to liaise with business, as the state sector was not generally very experienced with business.

"However, the normal rules of probity do apply. This reduced the scope for special interests.

"The Government should also in its political dealings demonstrate that there is no scope for political special interests and the merits of rigorous, well-informed, factually based policy analysis should drive policymaking."

Perkins cited LEK's immigration initiative and Boston Consulting's foreign direct investment study as examples of the partnership model that produced world-class analysis.

He has a point. LEK's recommendations for talent visas and other mechanisms to attract world-class immigrants are being implemented. But a large lump of the FDI report's main planks have been ignored.

Ports of Auckland's Geoff Vazey said the model was working "considering it only really started about two years ago".

But chief executives' overall impression was that if it is working — which they fundamentally do not believe to be the case — it is in select areas only.

Michael Winter, from burgeoning IT company The Atlantis Group, was blunt.

"It's all talk and no action whatsoever. There has been much interference and manipulation from the Government recently."

Another saw the process as a "soft engagement model aimed at short-term management of business issues out in the public domain".

"The Government has a limited appetite for confronting restructuring issues based on 'Why do we need to? Our position is secure without a credible opposition'."

Business leaders were conscious that they stood to become a target for political point-scorers if the partnership model is not clearly defined.

National leader Bill English's recent charge that some business leaders' coziness with the Government is at the expense of the wider commercial community's interests has clearly pricked a nerve.

"Bill English's point to the Institute of Directors was reasonably valid," said Deloitte chairman John Hagen. "But you do have to get on with these people.

"If you are trying to negotiate something, calling them a 'bloody idiot' or telling them they are 'absolutely mad' just before isn't a very good idea. That's what the Rugby Union did and look at what happened to the World Cup."

Northern Employers and Manufacturers Association chief executive Alasdair Thompson agreed.

"But I am highly peeved he implied our organisation was under the Government's thumb. I don't know any organisation apart from Roundtable which has been more forceful in opposition."

Hagen said business still must fight for the policies it believed in.

"But it is difficult. There are not many people who are prepared to take a position that the Government does not like because they think 'Somewhere down the road I'll get kicked by the Government'."

Thompson added: "I don't think the relationship between business and the Government is crash-hot at all.

"We have seen a number of organisations such as the Business Council for Sustainable Development and various business leaders who have tried to have an amicable working relationship with the Government in order to influence certain directions — I think many of them are somewhat disappointed that their supportiveness for the Government has been used for it to claim endorsement from the wider business community."

Business Roundtable executive director Roger Kerr warned that the Industry New Zealand style of picking winners (or rewarding losers as Act NZ claims) took the focus off neutral policy settings and policies that were hurting business, such as the explosion of industrial and employment legislation.

Business New Zealand's Simon Carlaw took part in the recent Government-Large Business confidential forum, but his organisation's 20-point recipe for growth has been largely ignored. "Too many anti-business aspects to legislation are being passed or proposed," said Hagen.

A head of a large manufacturing concern stressed that the Government must take a stronger strategic stance on the policies that matter: investment incentives and tax rates.

The Treasury is aware of the issue. It cautioned the Government this year that a growth and innovation policy, which encourages specialisation in a few parts of the economy rather than having a spread-out economy, carries risks.

There is not a lot of empirical evidence to link this with improved economic performance, the Treasury said.

"A targeting approach can infect the general business climate with greater uncertainty about which sectors are, or will be, in favour or not with the Government.

"It can divert firms from growing their businesses to lobbying for assistance."

Alstom's Geoff Hunt said simply that policies leading to growth would automatically provide the best environment for business.

Beca's Gavin Cormack said he had yet to perceive an effective partnership across the areas covered by his own international consulting business.

"The advantages some are receiving will undoubtedly be at the expense of others.'

Chief executives were concerned that efforts to establish public-private partnerships (PPP) to invest in infrastructure projects, along the Australian lines, were being frustrated.

Former Television New Zealand chairman Ross Armstrong's gaffe in offering "first-mover advantage" to potential investors was seen as a setback.

The lack of real progress on roading was typically described as "woeful", but the Government needed to look wider than transport.

Minter Ellison special counsel Lex Henry said the solution was to widen the engagement.

The chief executives' sentiments should tell the Government that it needs to make discussions more transparent and broaden the engagement if the model is to work.

Both sides tried to form a working relationship after a disastrous fallout in 2000 over industrial legislation.

But the overall impression seems to be — as one respondent summed up — "of two silos with very little crossover".

Roger Kerr

Alasdair Thompson

Scott Perkins

Lex Henry

Fear of war forces contingency plans

The potential for a rising kiwi to encourage more imports and choke exports tarnishes CEOs business optimism.

A BIG factor weighing on chief executives' minds for next year is the relative weakness of the US dollar.

Those taking part in the *Herald's* survey are relatively optimistic about the prospects for their own businesses next year.

But they are certainly less enthused about the outlook for the global economy, with a clear majority less optimistic for the next six months compared with the previous six months.

"The key driver is general levels of activity in the United States," said Deutsche Bank's Scott Perkins. "The current macro economic settings are sanguine — reasonable growth and stimulatory settings."

'It is a " major worry" said a director who chairs several companies. "The ongoing strengthening of the New Zealand dollar has the potential to choke exports and encourage more imports."

Northern Employers and Manufacturers head Alasdair Thompson also cited the "rising kiwi". If that breaches US53c and A$90c — as Thompson expects — "it will have a negative impact on exports, the balance of trade and our economy."

A rural sector player added that currency strengths "misrepresent the real confidence in our country".

"Genuine equity support is minimal. Interest rates hold currency strength and the share index is poor."

Chief executives have some cause for concern. In the past week the New Zealand dollar hit a 32-month high against the greenback, pushing back through the US50c mark.

BNZ chief economist Tony Alexander cautioned that drought could also act as a drag on the Australian dollar.

The local pharmaceutical industry claimed to be insulated from economic risks by corporate parents overseas..

"A key factor for us is negative real growth in health and Pharmac budget," said a local general practitioner.

The 55 chief executives who responded to the *Herald's* survey are leaving little to chance as they plan for next year.

Some are in hiring mode: notably international advisory firms, wine producers, financial institutions, some major retailers and manufacturers.

But a considerable number of chiefs — particularly from industries facing tough competition externally — have the firing button at hand.

Investment intentions remain cautious.

None of the chief executives detailed their plans: Too commercially sensitive.

But company staff are not the only people to face a potential reduction in opportunities.

"Mainstream business is so narrow now that there are not a lot of really top CEO opportunities available,"said an experienced player in the recruitment industry.

"Nor are there plenty of opportunities in the Government and local authority sectors as there have been for the last couple of years."

This view was underpinned by the lack of business activity among large corporates reported by advisory firms.

Global equity markets and increasing political tensions are playing a part in contingency risk planning for 2003.

"War is a big issue for us, and the adjustments amongst our key markets that might take place," said a tourism chief.

Those from US-affiliated companies were more comfortable about prospects in the United States.

"The US is turning the corner," said one pharmaceutical company head.

The economic factors which affect most chief executives' industries are predictable: Interest rates, inflation, oil prices and the strength of the US dollar.

There is concern that if war breaks out in Iraq, oil prices will spiral. Air New Zealand chief executive Ralph Norris said the airline had put caps in place to protect against "calamitous events in the Middle East which could see fuel prices spike badly".

"They come with a cost, but we are prepared to pay for certainty," he said.

The risk of inflation once again getting out of hand was cited by several chief executives who have yet to gain confidence in Alan Bollard's rein as Reserve Bank Governor. Those canvassed in subsequent calls did not hold much hope that the official cash rate would stay at 5.75 per cent for the next two years — too many uncertainties at play.

The negative effect of the tough new immigration laws on economic growth was also cited and the oblique message they send to our vital Asian trading partners about this country's attitudes.

Then there was the list of usual suspects: Anti-business regulation, the uncompetitive corporate tax rate which chief executives want reduced but have given up badgering the Government about.

Legislation which makes employers liable for stress and fatigue, without even defining what stress is, had "opened the doors to bounty hunting lawyers", Thompson said.

Verging on hyperbole, he added that the structure of the fines business potentially faced was so high that offending employers

Corporate Confidence in 2003

More than 50 companies responded to the Herald's survey. They included:

ABN Amro	SIMON ALLEN	Chief Executive Officer
Air New Zealand	RALPH NORRIS	Chief Executive Officer
Alstom	GEOFF HUNT	Managing Director
ASB Bank	HUGH BURRETT	Managing Director
Auckland Chamber of Commerce	MICHAEL BARNETT	Chief Executive
Beca Group	GAVIN CORMACK	Executive Chairman
Bell Gully	MATTHEW COCKRAM	Chairman
BMW	GEOFF FLETCHER	Managing Director
Carter Holt Harvey	CHRIS LIDDELL	Chief Executive Officer
Deloitte Touche Tohmatsu	JOHN HAGEN	Chairman
Deutsche Bank	SCOTT PERKINS	Head Global Corporate Finance Aust/NZ
Fonterra	CRAIG NORGATE	Chief Executive Officer
Foodstuffs	TONY CARTER	Managing Director
JB Were	CLARKE PERKINS	Managing Director
Minter Ellison	LEX HENRY	Special Counsel
Montana Wines	PETER HUBSCHER	Managing Director
New Zealand Business Roundtable	ROGER KERR	Executive Director
Northern Regional EMA	ALASDAIR THOMPSON	Chief Executive
Pfizer	MARK CROTTY	General Manager
Ports of Auckland	GEOFF VAZEY	Chief Executive
The Atlantis Group	MICHAEL WHITTAKER	Chief Executive
Westpac	ANN SHERRY	Chief Executive

** Other chief executives who responded on an "not for attribution" basis were represented at senior level from all key sectors of the New Zealand economy.*

HERALD GRAPHIC

NZ regulations make Australia look like a better option

■ **Continued from D3**

"So ultimately a very piecemeal approach and one step forward, two steps back."

This chief executive chose to make the criticism on a not-for-attribution basis.

But others were less shy in coming forward.

Says Ports of Auckland's Geoff Vazey, "You can't have a knowledge economy and innovative businesses and 'no risk' labour regulation."

It is the Government's failure to listen — and act — on business's real concerns that the chief executives find so frustrating.

Cockram again: "The trend towards greater regulation and government participation (e.g. Local Government Act and ACC) emphasises a distrust of the private sector that is unhealthy.

"It reinforces a culture of dependence."

Others spoke on a "not-for-attribution" basis. Here are just three viewpoints from very senior figures.

■ "A growth strategy does not exist. It is politically driven and influenced, also mixed up and muddled over the Maori situation."

■ "The Clark Government is all window dressing and no substance. So far they have been incredibly lucky with the NZ economy they inherited. Not to be trusted as essentially they are anti/do not understand business."

■ "It is very easy to criticise but there are no easy answers. The Government has sought answers by addressing demand and skill shortages. If only they would fix the Resource Management Act and the resulting delays/greenmail."

Auckland Chamber of Commerce chief executive Michael Barnett noted: "Parties across the political spectrum appear to agree on growth through productivity, but there is little understanding of the processes to achieve improved productivity nor an understanding of the consequences of achieving it by the wider New Zealand audience."

All pointed to roadblocks to growing business.

Barnett's counterpart, Alasdair Thompson, from the Northern Employers and Manufacturers, notes, "Right now growth is hindered due to a lack of both skilled and unskilled labour. Yet there are 107,000 people unemployed, many of whom cannot read, write or do sums. Any person unemployed should be tested for their literacy and numeracy skills and given intensive teaching in these areas.

"Likewise, immigration policy should be geared to meet employers' demand for skilled labour.

"With education costing taxpayers nearly $1 billion each year and with nearly $6 billion invested in its capital assets, not to mention the investment in teachers' training, we must demand and get a better result from education.

"We must reduce the rate of company taxation to say 20c to attract more corporate investment. Twelve OECD countries have reduced taxes; none except New Zealand have increased them in recent times".

Thompson's view is supported by Beca executive chairman Gavin Cormack who puts forward a simple remedy: "Reduce costs of compliance with regulation and simplify tax laws, including those with our major trading partners. Minimise government intervention in business and private choice and use savings to reduce taxes."

The difficulty is, as other chief executives point out, that this is part of the Government's pre-ordained mix.

Other roadblocks include:

■ Lack of privatisation of non-essential government businesses.

■ A corporate tax rate that is uncompetitive with Australia.

Carter Holt Harvey's Chris Liddell notes that business also has to adopt a growth strategy — not just rely on cost-cutting.

Says another chief executive: The other key missing ingredient is our ability to price well, and often our own distribution chains determine that.

"In the tourism sector, despite very high volumes and growth at present, the sector within NZ competes too much on price eroding yield when the client is happy and prepared to pay."

The Government is forming working partnerships with some chief executives to drive some major initiatives forward. But the decision not to operate on an inclusive basis is clearly now losing it hard-won trust.

Many of those who responded to the *Herald*'s survey did so with a frank passion to see this country's economy solidly placed on a growth track. But they have been excluded from the inner sanctum.

However, the analysis is not lacking.

CEOs point to:

■ Insufficient private investment in so-called growth industries — like biotech, creative industries and ICT — which have been singled out for Government assistance.

■ Inadequate public investment and poor incentives to encourage private investment and venture capital.

There also needs to be "more urgency and resource commitment" with respect to the growth programmes in place, noted one chief executive who has cut teeth in the Government partnership process.

The executive promotes a review of the welfare system to improve incentives and encourage innovation in welfare delivery.

Raise the free trade agreement push with the United States to the highest priority; Consolidate and simplify government — reduce cost and refocus around outcomes.

Business Roundtable executive director Roger Kerr remains on the outside . . . but his views still carry weight.

"The absence of a credible growth strategy is the highest impact on confidence" he maintains.

Most recent initiatives have been anti-growth rather than pro-growth. As things stand, there is no chance of achieving Government's growth targets.

Another CEO adds, the correct platform for growth was set by the reforms of the 1980s. A growing number of businessmen are now saying the same.

Less is more in risky times

Think the economy is great? Independent economist Brent Wheeler deflates the global bubble.

THE New Zealand economy is on a roll. But the global economy is sluggish and unlikely to spring back quickly. The happy state of affairs for New Zealand will not continue indefinitely. This obliges us to examine the increased risk responsible for the world's economic performance and prospects.

While New Zealand basks in the past few years' GDP, employment, CPI and tax-take figures, arguably some of the biggest changes in economic risk since World War II are taking place. These involve deep-seated issues and some difficult problems, the solutions to which are beyond the reach of left, right and third-way governments.

Inevitably New Zealand is becoming more enmeshed because four related factors — terrorism, markets moving together, investment monitoring problems and the threat of deflation — have joined forces and driven up risk.

Coming to a neighbourhood near you

Being Europe's most distant butchery, dairy and fruiterer has served New Zealand well for more than a century. And that distance has delivered security and the luxury of being able to ignore distant conflict. September 11 and subsequent events changed that.

The World Trade Centre tragedy, in the very heart of the United States, showed that terrorism has no respect for geographic advantage.

Events in Bali reminded the world that Asia is home to millions of Muslims, with more than 160 million in Indonesia alone. It showed, too, that icons of western civilisation, as much as western wealth, are the targets.

On these grounds alone, scoffing at security risks around the America's Cup is unwarranted. On investment grounds it shows that risks associated with terrorism are ubiquitous. Mere disarming of Iraq or taking out Saddam is not the complete solution.

New Zealand, while arguably safer than most in a risky world, is no longer immune purely because of its location. Safer haven perhaps. Safe haven, no.

The country's burgeoning tourist industry faces costs from the perceived tourist travel risk that the Bali tragedy highlighted. A stumble in this sector is doubly costly, as it hits tourism earnings and threatens the diversification of New Zealand's economy.

New Zealand will not escape the risk premium laid on by investors because of terrorism and unsettled international relations.

When markets link arms

Diversification is the most basic and reliable plank of successful investment. Like compound interest, its logic is infallible.

But it depends on all markets not moving in the same direction at the same time — the logic of investing in both the umbrella and ice cream market. In fact, it relies on some markets moving in opposite directions at the same time or at least one market staying on an even keel.

When this doesn't happen markets become correlated. They move in lock step and there are severe problems. Recent events have created such a situation. Widespread uncertainty has created bear markets for umbrellas and ice creams.

Worse, investors seeing this all try to bail out at once. Buyers disappear so liquidity dries up. The price spread between willing seller and willing buyer gapes open, leaving investors saddled with depreciating assets they can't quit except at mind-numbing discounts such as the 40 per cent drop in the S&P 500 US equities index experienced so far this year.

Markets moved in lock step in the 1930s, in 1987 and after the Russian devaluation in 1998. Each time investors were crunched. So too in 2000.

Impotent monetary policy

Monetary policy settings provide no easy fix. The US Federal Reserve gave them its best shot with remorseless loosening all the way down to 1.25 per cent, but to little effect. Now the scope, in the US at least, is virtually gone.

The best economy-wide measure of inflation, the GDP deflator, fell by October to 1.1 per cent, so with the federal funds target (the equivalent of our official cash rate) at 1.25 per cent, real interest rates must be around 0.15 per cent, barely positive. Returns above that simply seek to offset risks.

Two problems bedevil monetary policy instruments. First there is almost nowhere left to go: 0.15 per cent real is as low as it gets. Second, and exacerbating this problem, successive downward adjustments of discount rates tend to produce successively smaller positive reactions. The Fed has become more aggressive in loosening monetary policy, but markets barely flutter.

Private credit and deflation — a bigger problem made worse?

Problematically, lower discount rates drive down costs of consumer credit. Stimulating the economy like this makes it easier for private debt to grow. Economic stimulus frequently comes from consumer spending financed by private-sector credit. This powers growing whiteware, television and DVD sales and the booming retail PC market.

Fine perhaps when real interest rates are positive and inflation is eroding debt, at least in the short term. Not so clever should deflation set in, even in mild form.

Deflation works in the opposite way to inflation. The debt burden swells rather than shrinks. The only way out is through seriously cutting back on spending and selling assets.

Problems with Investment Instruments

Along with problems of where to invest are problems with what we invest in. Governance scandals abound and the problem is damnably stubborn given the current regulatory tools.

The Enron, Global Crossing, and Tyco fiascos emerged from the most regulated capital market in the world — the US — where regulators had by repute eliminated the "cowboys" who apparently pervade only New Zealand markets.

Advocates of more regulation in New Zealand spent decades claiming that regulated markets in the US, Britain and Europe are sophisticated and civilised. But corporate disasters reveal something radically wrong with the idea that enough regulators implementing enough rules will suffice.

Equally flawed is the good guy notion underpinning this. That all of the thousands of employees of accounting firms like (the late) Andersons are crooks is as patently absurd as the idea that more "good guy" government would solve these problems.

Enron, Global Crossing and others show that it is our accounting, not our accountants, that is the problem; our auditing, not our auditors, and our regulating, not our regulators. For investors, these disciplines have not delivered.

This all drives more risk into investing. Governance risk and agent-principal risk seem now to be inherent in investing. They may have, probably did, exist all along. What is different is investor awareness on a scale not seen in the past.

What can governments do?

Not much is the truthful answer — and they ought not to be blamed for this reality. "Lead us not into temptation but deliver us from evil" is as good a policy as any. Monetary policy remains strictly limited in what it can achieve. Regulation of capital markets promises delusion and cost.

Policy and regulation cannot shield investors from risk. Assets must come to reflect their true value given new risks. Regulatory barriers should not impede this process or competitive responses such as capital raising, mergers and takeovers.

Driving down costs of business and costs of reconstructing with new businesses require a hawkish approach to resource management policy, initiatives such as the Kyoto protocol, and to confrontational labour market policy. Less is likely to be more as risks grow.

Finally, governments can recognise that cash is master and mistress in risk management. That means fiscal prudence and high-quality government spending are in while blanket prohibitions on regulatory and tax reform are out.

Finding the boldness to match policy to target

The challenge for the Government for the next three years is to go beyond good politics to innovative economics.

Analysis

COLIN JAMES

AT THE heart of this Government is a paradox: it has set a bold target and a strategy that calls for boldness, but it makes a virtue of "incremental" policy, the very antithesis of boldness.

The target is 4 per cent a year growth in gross domestic product (GDP). That is better put as 2.5 per cent a year growth in GDP per capita, which takes out the impact of migration and workforce changes.

A big net inflow of migrants helped lift GDP in the mid-1990s and a net outflow of migrants in the late 1990s helped constrain growth then. In the past year there has again been a big inflow, as Kiwis cash up and come home and foreigners renew interest, which has helped growth to the present 4 per cent.

Hitting 2.5 per cent per capita is a big step up on the 1990s' average of 1.7 per cent, which was a big step up (thanks largely to Rogernomics) from the 1970s' and 1980s' average of 0.8 per cent. To get to a sustained 2.5 per cent figure, productivity will have to double.

That is a tall order for a developed economy. The sorts of productivity leaps the developing economies of Asia get when peasants leave the paddy fields for electronics factories are not available to New Zealand. Put our "peasants" into factories and their productivity will likely drop, particularly if they are of the new young breed that is transforming dairying.

Finance Minister Michael Cullen, who declined to be interviewed before this article's deadline, is acutely aware of this barrier. He has been careful to dampen expectations of hitting the target quickly. It will be a long haul, he says.

He usually adds that there is no quick fix, no magic bullet to lift productivity.

Even education, a key part of the Government's strategy, is not an elixir. Britain's huge increase in participation in tertiary education, for example, has not lifted productivity dramatically. A growing body of opinion worries it might have perverse effects since the student surge has cut spending per student and quality is threatened. Much the same has happened here.

As Business Roundtable executive director Roger Kerr observed drily in a speech last week: "[Just] because some of a thing is good, it doesn't follow that more of it must be even better".

With no magic bullet in his armoury, Cullen's policy is to push ahead on a wide front of modest initiatives. He has little political choice, at least as he and his colleagues see it. The public is weary, and wary, of dramatic policy shifts. The elections of the 1990s and in 2002 underlined that.

But the codename for the policy line implies something quite different. The "innovation strategy" implies boldness. A timid or cautious person does not innovate.

A senior minister, taxed with this paradox, retorted that it was not up to the Government to do the bold things that amount to innovation. That was business's domain, he said.

Which is more or less true. It is business that must do the innovating and business that must exploit it. That's broadly how it works in the United States, which has long been the leading innovator and the leading economy.

It is not entirely true, however.

The Government is the main researcher. It could be very bold and dramatically increase resources for research. Its record and its forward track: increases, yes, but no drama.

Does it really think indigenous biotechnology can be a beacon for an economic revolution? Yes. Then is it mobilising large resources? Is its approach to cutting-edge genetic modification technology daring? No and no.

But turn this around. If Pete Hodgson were to put another half a billion dollars into biotechnology, where would he get it from? Health? Political suicide. The Budget surplus? That way lie deficits if the international economy stays slow. The super fund, which on 5-6 per cent returns instead of the projected 9 per cent, looks likely to be underfunded anyway?

So there is a case for not being bold. Not much of business would agree with it. But it wins elections. And possession of the Treasury benches is nine-tenths of the law in the political game.

But even if it is business' job, not the Government's, to be bold, the policy environment logically should be set to encourage business boldness.

The Government's case rests on its wide range of targeted business assistance, notably for startups and joint ventures and some investment and exporting. There has been some worthy, low-key work to focus the bureaucracy on business' priority needs. And Cullen has worked hard to build a national consensus, which is worth at least something in the pursuit of higher growth.

But Cullen is also acutely aware that consensus must encourage, not stall, change. Having soothed voters, his job now is to convince them they must, as individuals, embrace lifelong change.

And a good deal of the Government's programme, particularly in tax, the workplace, environmental law and resource law, makes doing business harder or less profitable — not as much as some of the shriller business complaints would have you believe, but enough to make a difference. In a business utopia the Government would reverse direction boldly. It won't, of course.

Enter United Future. Deputy leader Gordon Copeland calls it a free-enterprise party. Leader Peter Dunne says workplace safety legislation, set to become law by Christmas, is "the lunatic fringe of lawmaking". United Future aims to inject some business-friendliness into Government policy.

United Future's leverage is limited by the fact that Labour can call on the Greens to push through bills United Future disagrees with, so the workplace safety bill will go through, as will the Local Government Bill, another business bugbear. Helen Clark, with an eye on the long term, is careful to insist her ministers are solicitous of the Greens.

Nevertheless, United Future has precedence over the Greens in consultation. It has an influence just by being in the loop. Judith Tizard, speaking on the Motor Vehicle Sales Bill last week, welcomed improvements as a result of Paul Adams' experience as a car salesman.

Moreover, this is not the government which included the left wing of the Alliance. It is one which is determined to do what it takes (short of abandoning the anti-nuclear policy) to get freer world trade and bilateral free-trade deals. And it is one which grasps the importance of business hugely better than three years ago.

That is good politics. The challenge for the next three years, secure in office, is to go beyond good politics to innovative economics. But that requires boldness.

Helping New Zealand companies to grow using local knowledge and expertise and access to the world.

January 2002 DANONE **NZ$299 million** Acquisition of Frucor Beverages Group. Advisor ABN AMRO	*February 2002* **Undisclosed** Sale of the Kiwi Property Group. Advisor ABN AMRO	*February 2002* TRANSPOWER **NZ$100 million** Fixed Rate Bond Issue. Co-Manager ABN AMRO Craigs	*March 2002* TelstraClear **Undisclosed** Sales of 5MHz of paired 3G Spectrum to Vodafone New Zealand and 5MHz of TDD Spectrum to CallPlus. Advisor ABN AMRO	*April 2002* TOWER **NZ$125 million** Capital Bond Issue. Lead Manager ABN AMRO Rothschild. Co-Manager ABN AMRO Craigs	*May 2002* POWERCO **NZ$100 million** Capital Bond Issue. Joint Lead Managers ABN AMRO Rothschild ABN AMRO Craigs	*May 2002* Fonterra **€500 million** Euro Medium Term Note Programme. Manager ABN AMRO	*June 2002* skellmax **NZ$115 million** Initial Public Offering. Lead Manager and Underwriter ABN AMRO Rothschild. Co-Manager ABN AMRO Craigs	*June 2002* New Zealand Dairy Foods Ltd Fonterra **NZ$310 million** Sale of New Zealand Dairy Foods to Rank Group. Advisor ABN AMRO
July 2002 NRG **A$48 million** Sale of investment in Energy Developments to Orion New Zealand and Infratil. Advisor ABN AMRO	*September 2002* vector **NZ$1,500 million** Acquisition of UnitedNetworks. Advisor ABN AMRO	*September 2002* e3p Genesis **Undisclosed** 400MW e3p Project. Financial Advisor ABN AMRO	*September 2002* Freightways **A$188 million** Successful takeover of AUSDOC, the parent company of Freightways by ABN AMRO Capital. Advisor ABN AMRO	*September 2002* vector **NZ$1,005 million** Sale of UnitedNetworks' Eastern and Central Gas networks to Powerco and Hawke's Bay Network. Advisor ABN AMRO	*September 2002* PORT OF TAURANGA **NZ$25 million** Placement of 5% of Port of Tauranga. Manager ABN AMRO Craigs	*September 2002* vector **NZ$3,130 million** Acquisition, Refinancing and Interest Rate Hedging Facilities. Joint Lead Arranger and Provider ABN AMRO	*October 2002* Diners Club International **Undisclosed** Securitisation of Charge Card Receivables for Diners Club NZ. Arranger ABN AMRO	*November 2002* vector **NZ$307 million** Capital Bond Issue. Lead Manager and Underwriter ABN AMRO Rothschild. Co-Manager ABN AMRO Craigs

ABN·AMRO Craigs ABN·AMRO ROTHSCHILD ABN·AMRO

The ABN AMRO Group is present in 60 countries worldwide – with over 250 staff in 12 offices throughout New Zealand. Some of the ways in which we have helped New Zealand companies to grow in 2002 are represented above.

MCD6046

A little local knowledge

Many New Zealand companies have used reduced foreign investment to their advantage.

NEW ZEALANDERS are buying back the family farm as foreign owners pull out.

Since September 11, the Overseas Investment Commission (OIC) reports that net investment in New Zealand dropped to $1.18 billion last year from $5.35 billion in 2000. That is the lowest since 1997, when foreign investment sank to $1.7 billion in the face of the Asian crisis.

Merger and acquisition activity has suffered, but it may be turning around.

Investment bankers say the US and European recessions after the attack on the World Trade Centre have left big foreign companies with little appetite for mergers and acquisitions in far away countries.

The decline, however, needs to be seen in the context of a severe contraction in global mergers and acquisitions activity.

Head of corporate finance for ABN Amro, Robert Boger, said foreign buyers were pulling out because they were either in trouble or had become risk averse.

Boger said as a result companies with far lower share prices, who were finding it much tougher to refinance, were in divestment mode.

"To survive credit downgrades they're selling assets to get their balance sheets back into shape."

New Zealand's markets had not been hit the same way as Europe and the US because they were more fairly valued, Boger said.

"In New Zealand we haven't been in that fortunate position of sustained growth — we had the recession of 97. Our markets were more fairly priced."

Don Turkington, executive director at Forsythe Barr, said merger and acquisitions activity had been at a low level for 18 months. "It's a worldwide phenomenon."

Compounding the situation, New Zealand has had few big listings lately, now that the big privatisations are over.

The busy area, Turkington says, has been in debt — capital notes and capital bonds.

"That's a reflection of the relatively low returns available on bank deposits."

Global investment banks have responded to the global decline in mergers and acquisitions by consolidating.

Merrill Lynch and JP Morgan are gone.

CS First Boston sold out of New Zealand, leaving an affiliation with First NZ Capital and First NZ Securities.

ELINORE WELLWOOD

Deutsche Bank has shifted equities research and secondary trading to Australia, but its New Zealand operation retains a high profile.

But ABN Amro and Forsythe Barr are among the few to expand.

"We see the consolidation as a growth opportunity for a New Zealand based and owned company," Turkington said.

ABN Amro's commitment at a time of flight has increased its prominence.

The bank has expanded New Zealand operations over the past two years, hiring senior equity professionals in Equity Capital Markets and Corporate Finance.

Last year, it took up a 50 per cent interest in Craig and Co, and acquired the private client business of Merrill Lynch.

Rewarding those who stayed, it would appear that the bottom has been reached, and that a turnaround in merger and acquisitions activity could be occurring.

In the six months to June 2002, the OIC reports net investment was $395 million compared with $309 million in the previous six months. Furthermore, activity in the third quarter of this year in the New Zealand mergers and acquisitions market leapt 34.6 per cent over the previous quarter, according to Thomson Financial — a sign domestic corporate activity could be improving.

All investment bankers interviewed said the big growth area for next year was in the debt capital markets.

And a new trend has been spotted: Kiwis are buying back the family farm.

ABN Amro acted for Auckland's ratepayer-owned Vector as it tried to acquire United Networks.

"Aquila, which had expanded hugely over the last few years, saw the impact of the Enron fallout, and had to pay down debt to maintain its credit rating. It decided to sell its offshore assets," Boger said.

Unusually, Boger said, it was a New Zealand owner that stepped in — the Auckland Electricity Consumers Trust.

To raise money, Vector sold $1 billion worth of assets, again to New Zealand owners. Powerco and Hawkes Bay Networks were the buyers.

That is not the only example of Kiwis being more successful in buying assets with reduced foreign investment.

New Zealand Dairy Foods was sold to Rank Group. Pacific Retail Group (advised by JBWere) bought Bendon, and Genesis bought NGC's retail customers.

ABN Amro was involved in $733 million worth of those deals, he said. Last year they did one; this year they did five.

The stock exchange has a new chief executive, who has a strong emphasis on bringing solid New Zealand industrial companies to the exchange.

Finance Minister Michael Cullen's superannuation fund would start coming on stream next year.

Whatever you thought of the fund and whether it was the best way of delivering superannuation, Moore said, the money would provide a boost to the markets.

The NZSE is also trying to stimulate more interest from Australia.

Clark Perkins, chief executive at JBWere, predicted more transtasman activity.

"We're seeing Australian-based corporates looking at New Zealand and New Zealand-based corporates looking at Australia."

Larger Australian and New Zealand corporates' balance sheets were very sound at the moment, so they were able to source relatively cheap equity capital from the hybrid markets, Perkins said.

Rob Hamilton, head of investment banking for First NZ Capital, said one of the key drivers would be overseas corporates bringing their empires back closer to home.

"You would not have seen United Networks sold unless Aquila was in financial trouble. We're likely to see more activity on that front."

Fletcher Building had already gone to Australia, with the purchase of Laminex, and Sky City bought its Adelaide casino.

Hamilton predicted another result of the absence of big overseas purses: the increased presence of private equity firms and private sponsorship.

"There are relatively few buyers with the capital to undertake major acquisitions. Most industrial assets sold over the last few years were sold to international buyers. There's a number of these private equity firms in Australia. I predict you will see an increased presence here."

Deutsche Bank chief executive Brett Shepherd said although most of the capital flow last year had been out of New Zealand, or from bank accounts and equities into debt markets, foreign investment would come back to New Zealand next year.

The insurance industry was restructuring, and the large amounts of forestry due for sale could only be funded by big overseas corporates.

New Zealand's dollar had strengthened, a reflection of the positive risk profile with foreign companies.

Buyers should have plenty of choice next year.

Natural Gas Corporation is selling its assets — although Contact and Genesis are the two main candidates to buy.

Royal Sun Alliance was to list next year.

The Central North Island Forests are unlikely to stay in receivership next year.

Fletcher will sell off its forests.

Transparent reporting key to success of NZ Inc

We need to articulate and measure our values to succeed in the international arena, writes Andy Britton.

IMAGINE New Zealand as a listed company, NZ Incorporated. The Government is the executive team, with the Prime Minister as CEO.

The consumers, investors and suppliers are the New Zealand population.

Like a listed company, the success of NZ Inc's performance depends on its supply of information about its external environment, and the resources and competencies that management can harness to execute strategy.

The challenge NZ Inc's management faces is to present a coherent picture linking strategy to measurable value-creating activities.

In meeting this challenge successfully, NZ Inc's share price will reflect its true business value. It will also show that management's thinking is aligned to and reflected in day-to-day reporting.

The end result would be a marketplace satisfied that management is running the business in an effective and transparent manner and, in theory, NZ Inc's share price would rise.

But traditional financial reporting fails to take into adequate account some critically important information about likely future performance.

What's missing is information about the intangible assets and non-financial value drivers, which are often leading indicators of financial success.

They include management's view of the market, business strategy, and a company's investment in the factors underpinning value — including people, innovation, brand, and reputation.

Management has referred to innovation as a key factor in the country's international success. This raises questions such as: What is the strategy to develop innovation so that it creates an economic benefit? How do we measure innovation? What is our target? What other countries do we benchmark ourselves against? Can our management and the supply chain develop measurement systems that articulate this strategy?

For NZ Inc to maximise value, it must take all these factors into account — not only with innovation but with all value drivers, such as brand and reputation.

This is particularly important given that non-financial drivers contribute more to company value as capital markets mature.

A recent study by PricewaterhouseCoopers of the Australian capital market, indicated that for the top 250 listed companies, only about 25 per cent of market value was directly reflected in book value.

And a recent Standard and Poor's report of 1500 top global companies identified a positive correlation between increased corporate disclosure, lower cost of capital and higher share price.

The market can't value what it can't see, so when companies fail to provide the necessary information, the market relies on other sources, increasing everyone's risk.

A new approach to performance management and reporting addresses this issue by improving corporate transparency. This approach is called value reporting and it can help companies realise their full value in the capital markets.

It does this by addressing gaps between the current financial reporting model and the demand by investors and other stakeholders for better and broader information.

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Mind where you put our money

We've had some good luck, but that won't keep the economy growing next year, writes Adrian Orr

OVER THE past two or so years New Zealand has enjoyed a good run of opportune economic events — and not before time.

These have included good growing conditions, a low exchange rate, supply constraints in major export markets (due to drought and disease), and increased interest in living in New Zealand bringing net immigration back to record levels.

As a result, consumer confidence and house prices have been boosted, the Government's coffers filled and about 4 per cent economic growth generated this year. All of this comes as most major economies dig their way out of recession.

But questions remain as to how much of the recent growth is due to good fortune (cyclical) or good planning (sustainable).

On the cyclical front, most of the recent positive economic events cannot be relied on in 2003. New Zealand remains as exposed as ever to the swings and roundabouts of the global economy and weather.

Meanwhile New Zealand's growth potential has shifted little, as shown by the rising capacity constraints and inflation pressures. It is easy to see New Zealand reliving the mid-1990s during 2003 — a rising New Zealand dollar driven by strong relative inflation pressure at a time when our export markets remain at low ebb.

And, no matter how much 'flexibility' the Reserve Bank claims it now has, we will again be reminded that the cental bank has no tools to influence the 'mix' of monetary conditions.

Clearly the focus of policy must be on raising the growth potential.

The rising capacity pressures next year will be nudged along in part by increased Government spending. Infrastructure is screaming, as are most other areas of government including health, defence, and education. We must ensure next year that any Government spending makes its maximum positive impact on long-term growth.

Part of this Government investment process will involve the private sector in partnership on several major projects. While there is plenty of upside to partnership — including access to capital, expertise and risk sharing — there is also a steep learning curve. In particular, the public will continue to learn about 'return on capital' and various forms of user-pays. The Government will have a job steering us through these new tunnels.

On this note, unfortunately the current fashion of increasing utilities' regulation and capping profits may actually prove counterproductive to some long-term infrastructure investment. The current regulators must take account of New Zealand's sparse population and high fixed costs (and hence high required rate of return) when doing business in this country. Unrealistic profit caps in the name of the law will harm ongoing investment, as evident by the neglected infrastructure in many areas.

Next year the policy heat will also remain on immigration in terms of adding to demand pressures and increasing the capacity to grow. This debate will be run alongside Maori and Pacific Islanders' inclusion in the economy and the role of the Treaty of Waitangi. Property rights must be resolved so that Maori economic activity can continue forward at maximum pace. It is here that enormous progress could be made at minimum cost to the taxpayer.

Another issue will be household investment. Much wealth will again be channelled into housing, the drive to diversify and/or increase 'working capital' taking a back seat for a few more years. Fund managers have a huge task in keeping people focused on the long term.

Perhaps most interesting is the start of the Superfund next year. Where is it going to be put and what are the outcomes? Diversification and long-term gain is the name of the game. This implies investment in areas likely to produce best risk-adjusted returns.

This sounds obvious, but in practice diversification will be hard to ensure. Already cries for investment in New Zealand can be heard, even from the Stock Exchange.

The quantity of investment has never been an issue, rather it is the quality as illustrated by New Zealand's low capital productivity and negative EVA (economic value add) in many parts of the economy.

The Superfund must not be captured by this policy confusion when making investment decisions.

What policies are likely to raise the quality of investment? It's the 'usual suspects'.

These boil down to anything that raises an individual's incentive to be entrepreneurial and reduces the barriers.

The focus falls on tax levels, competition policy, compliance costs, regulation, law and order, welfare, education and so on.

Areas in which New Zealand is still muddling along.

Meanwhile, talk of incubators, clusters, knowledge waves, and picking winners can find their correct place in the economic debate. They are not new, and are at best complements to the usual suspects.

Of course the make or break of next year may simply come down to two cups — the America's Cup and the Rugby World Cup.

Will we be sipping champagne or sucking beer from the saucer?

■ **Adrian Orr is chief economist of Westpac.**