

Objective, rationale and output of enhancing GLIC M&M capabilities and processes

ENHANCE GLIC M&M

Enhance GLIC M&M capabilities and processes

**Number
III.3.1.1**

Objective

- Reinforce the role and enhance the organisational structure, processes and capabilities of the departments within GLICs which monitor and manage the GLICs’ investee companies. This includes establishing “nominee director term sheets” in order to clarify the nominee directors’ roles and interaction mode with the GLICs

Rationale

- In order for GLICs to catalyse the transformation of their investee GLCs, it will be key for them to drive high standards of corporate governance and focus the GLCs on long-term financial performance, in line with the GLIC’s mandates and determined level of active ownership
- In order to play this role, GLICs need best-in-class Monitoring & Management departments, as well as clear interaction modes with their nominee directors

Output

- Organisational blue print and implementation plan which GLIC’s can use as guidance for their Monitoring & Management department, as well as syndicated term sheet for the GLIC’s nominee directors

TERMS OF REFERENCE



Pre-conditions for success and risks for enhancing GLIC M&M capabilities and processes

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Number III.3.1.2

Prerequisites for success

- Strong drive from GLIC's head with a commitment to implement the agreed-on organisational blue print
- Sponsorship from a senior executive from the GLICs
- Buy-in from the existing head of Monitoring & Management
- Full time team, composed of 2 to 3 members with appropriate skills and access to the existing Monitoring & Management department
- Ability to hire staff with appropriate skills and experience

Risks

- Difficulty in sourcing or lack of availability of personnel with the appropriate required profiles
- Nominee directors resistant to implementation of term sheet

TERMS OF REFERENCE



Next steps for enhancing GLIC M&M capabilities and processes

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**Number
III.3.1.3**

Next steps for GLICs

- Review existing organisation and plans of Monitoring & Management function (structure, capabilities and processes) and any existing Guidelines for interactions with nominee directors
- Based on the GLIC's mandate and investment objective, determine segmentation principles for the GLIC's investee companies into categories requiring a similar Monitoring & Management approach depending on the GLIC's level of active ownership on the GLC.
- Identify core Monitoring & Management functions and process
- Determine preliminary sizing of staff to carry out functions
- Lay out organisational options for the Monitoring & Management functions
- Develop a draft nominee director term sheet
- Evaluate options and detail preferred option
- Establish and execute implementation plan



INITIATIVE 3

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GOVERNMENT-LINKED INVESTMENT COMPANY MONITORING & MANAGEMENT FRAMEWORK





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Background



In July 2005, the Putrajaya Committee on GLC High Performance (PCG) launched a set of Policy Thrusts, Guidelines and 10 Initiatives as part of the Government-Linked Company (GLC) Transformation Programme. This booklet is an output from Initiative 3 of the GLC Transformation (GLCT) Manual. It serves to enhance the Government-Linked Investment Company (GLIC) Monitoring & Management (M&M) function.

As each GLIC has a different mandate, and even those with similar mandates may have different styles, it is for each GLIC to develop and implement practices that are relevant to them. As such, this Framework is not intended to be prescriptive but serves as a collection of M&M ideas and best practices.

GLICs play a critical role, particularly as catalysts or triggers of change. In many cases, GLICs are controlling shareholders with Board representation and therefore have significant oversight responsibilities. Where GLICs are small shareholders, they are increasingly active, even if this is merely through exercising their shareholder rights. As detailed under Policy Thrust 1 of the GLCT Manual, GLICs are the key conduit for Government to support and influence GLCs.

There is a clear rise in active shareholding across different types of institutional investors around the world, for example, pension funds, private equity, Government investment companies and conglomerates. These institutional shareholders have found that increased levels of 'activeness' have been required in order to enhance long-term shareholder value creation and deliver superior returns to their fund holders.


This has taken the form of selecting Directors with more time and relevant expertise, equipping these Directors with perspectives on the industry/company, setting clear expectations on targets, and ensuring the right consequences/rewards for the CEO.




However, most importantly, active management does not require nor equate to bypassing good Board governance practices or taking management actions. In fact, it reinforces the true role of Boards, namely to effectively govern and oversee management.

It is important to restate that GLICs have different shareholders and stakeholders, hence different mandates and different investment strategies (e.g. time horizon, risk appetite, investment objectives). Consequently, GLICs will have differing approaches to monitoring and managing their portfolio companies. The approaches will also vary depending on GLIC ownership level of a GLC, as well as vary over time, depending on GLC performance.

Role Of GLICs in the GLCT Programme



GLICs must play a critical role in the GLCT Programme. As shareholders, it is via their Nominee Directors that oversight and influence over GLCs is obtained. Many GLICs have embarked on their own transformation journey, and are continuously enhancing their own capabilities. That said, they need to accelerate the capabilities to be active shareholders and role model many of the changes expected of GLCs.



To date, the Programme has focused on launching Initiatives for adoption by GLCs. However, the next phase between 2007 and 2010 is focused on delivering tangible and sustainable results.

Therefore, the responsibility of monitoring performance of GLCs to ensure that results are being delivered should fall predominantly on Boards and to a lesser extent GLICs – that are represented on the Board and are significant shareholders. GLICs' level of involvement will vary depending on their respective mandates, however, in all instances some form of effective monitoring will be required.



The primary objective of the M&M function is to increase shareholder value. However, GLICs should also drive GLC value creation for other key stakeholders.

The GLCT Programme is a subset of broader national development strategies that include the principles of growth with equity, improving total factor productivity, the development of human capital and the development of the Bumiputera community.

GLCs are key drivers of the Malaysian economy. They provide mission critical services, are a significant employer and make a substantial portion of investment in Malaysia.

However, their performance is lagging that of their private sector counterparts.

GLICs therefore play an important role in ensuring that their GLC performance improves and that they contribute to the nation's development and create value for other key stakeholders as shown in Exhibit 1.

Exhibit 1: GLC Value Creation for Other Key Stakeholders

Other Key Stakeholders	Benefits	Relevant GLCT Initiatives
Customers	Higher service and quality levels Better value-for-money propositions from more productive and efficient GLCs	Programme on the Framework for Continuous Improvement (Yellow Book)
Labour force	Better job prospects and human capital development at more dynamic and rapidly growing GLCs	Blue Book on Intensifying Performance Management Practices Orange Book on Strengthening Leadership Development
Private sector	Increased pressure for private sector to maintain competitiveness and skill levels, thereby increasing overall industry standards	Overall GLCT Programme
Suppliers	Increased transparency with merit-based procedures favouring the highest value-for-money suppliers Reduce leakages, inefficiencies and corruption	Red Book on Procurement Guidelines and Best Practices
Community	Create sustainable contributions to the society	Silver Book on Achieving Value Through Social Responsibility
Bumiputeras	Uplift in GLC performance will support the continued development of a more competitive Bumiputera community, through better skilled Bumiputera employees and more capable Bumiputera suppliers	Overall GLCT Programme Red Book on Procurement Guidelines and Best Practices Orange Book on Strengthening Leadership Development

To effectively perform the M&M function, GLICs need to continuously improve their internal capabilities.

GLICs, as professional shareholders, play a critical role in guiding and influencing GLCs. It is therefore critical that GLICs are fully equipped with the necessary skills, functions and processes to effectively play this role.

Based on a GLIC’s mandate (and corresponding strategic and performance targets), GLICs should review and align their internal organisation, processes and capabilities to relevant benchmarks.

These peer benchmarks should include private equity firms, active or passive institutional investors (including pension funds), or a mix of the above depending on the nature of a GLIC’s mandate.

Additionally, in the same manner that PCG is urging all GLCs to accelerate transformation, GLICs must execute the GLCT Policy Guidelines and Initiatives quickly and effectively within their own organisations, especially where relevant to enhancement of their M&M function.

Relevant GLCT Initiatives are shown in Exhibit 2.

Exhibit 2: Relevant GLCT Initiatives for Enhancing GLIC M&M Function

Relevant GLCT Initiatives	Description
Green Book on Enhancing Board Effectiveness	Revamping of Board practices and processes, especially where it relates to evaluation of investee company performance
Orange Book on Strengthening Leadership Development	Improving GLICs' capabilities in attracting, developing and retaining leadership talent
Blue Book on Intensifying Performance Management Practices	Adopting performance management best practices at GLICs
Programme on the Framework for Continuous Improvement (Yellow Book)	Enhancing operational efficiency and effectiveness through the adoption of the Framework for Continuous Improvement
Malaysian Directors Academy (MINDA)	Development and enhancement of Directors' capabilities to become high-performing Boards

A GLIC's M&M approach will depend on its mandate and investment strategy.

The GLIC's M&M approach towards its investee companies will depend on its investment strategies (e.g. time horizon, risk appetite, investment objectives).

Typically, companies where the GLIC is a controlling shareholder, or owns a large stake, will be monitored and

Exhibit 3: Different Levels of Shareholder Involvement

	Level of Shareholder Involvement		
	Low	Medium	High
	Portfolio investments	Near active ownership	Active ownership
Typical level of ownership and scenario	GLIC has less than 20% stake and no Board representation	GLIC has Board representation but is not the largest shareholder	GLIC is the largest shareholder
Main influence lever	Formal: Vote at Annual General Meetings (AGMs)/ Extraordinary General Meetings (EGMs) Informal: Work with other GLICs to form a common view	Formal: Board and Committee representation Informal: Alignment with other GLICs, GLCT Secretariat	Board representation Alignment with other GLICs via GLCT Secretariat Targeted engagement
M&M guiding principles	To manage these companies like an equity portfolio manager would, based on information publicly available to all shareholders	Via role on Board, to support management of the company, to challenge management plans and objectives, to catalyse performance improvement and to promote value enhancement for shareholders Level of involvement will depend on GLIC strategy and company performance, among others	Shareholder engagement
Implication	GLIC, in its capacity as minority shareholder, will only: <ul style="list-style-type: none"> • Perform "light" monitoring against reference targets • Exercise influence through voting at AGMs/EGMs and collaborating with other shareholders 	GLIC has a limited ability to influence through the Board In-depth monitoring is performed against targets after syndication with Board and management Main influence lever is through Nominee Directors	GLIC has a significant ability to influence through the Board Actively monitor and engage with management GLIC's performance and market value will be directly impacted How to engage with management

managed more closely than companies where the GLIC only owns a very small stake. Apart from the ownership level, other factors may also determine the GLIC's level of active ownership, e.g. the company's performance or whether the company belongs to a priority industry sector, following the GLIC's mandate and objectives.

Exhibit 3 below illustrates different levels of shareholder involvement and the corresponding M&M approaches.

of Shareholder Involvement	
High	
Active ownership	Restructuring ¹
<p>GLIC has significant stake and can catalyse performance improvement. Necessity for GLIC to intervene in management decision-making is on a case by case basis</p> <p>Board and Committee representation</p> <p>Appointment of CEO and Board members, via the Nomination Committee</p> <p>Target setting with management, via Board</p>	<p>GLIC has significant stake and financials/business model of company is untenable</p> <p>Similar to active ownership but with Board approval, GLIC can define strategic plan for the company, make management changes and undertake restructuring through special teams</p>
<p>Same as "Near active ownership"</p>	<p>With Board approval, GLICs can take the lead in strategising and operationalising the necessary steps required to turnaround the company</p>
<p>GLIC can exercise a high level of influence</p> <p>Active monitoring approach where Board and management plans are challenged</p> <p>GLIC will propose targets, backed by in-depth research and industry knowledge, and syndicate them with Board and management. Company's performance will be assessed against these targets</p> <p>However, level of involvement dependant on company's performance</p>	<p>Cases of active ownership where state of the company justifies GLIC, with Board approval, sending special team to oversee/ conduct restructuring initiatives based on predefined criteria</p>

¹ In determining whether investee companies need to be restructured, GLICs may exercise "judgment call" based on a number of criteria. For example:

- Negative Economic Profit for current year as well as 3 to 5 years forecast;
- Interest coverage ratio below sector-specific threshold for current year;
- No return to shareholder for current year as well as 5 years forecast;
- No credible turnaround plan presented by management; and
- Others.

Target setting serves as a foundation for the achievement of GLIC's investment objectives.

Why should GLICs define targets for its investee companies?

Setting company targets allows GLICs to monitor and manage investee companies with a direction (instead of operating “in a vacuum”). Making these targets consistent with GLICs’ overall portfolio management objectives allows alignment of M&M activities with GLICs’ overall investment objectives. This objective is also in line with the spirit of the Blue Book.

What type of targets?

These targets can be financial (e.g., Return on Equity, Economic Profit) and non-financial (e.g., market share, customer satisfaction, leadership development), and should cover the dimensions of performance and sustainability, and those required to ensure that the basic foundations of the organisation are in place. A defined strategy for the company should be in place and the targets set should reflect the objectives outlined in this strategy. Documentation of this strategy could take the form of a Value Creation Plan (VCP).

What do these targets mean for GLICs with different investment mandates?

Where GLICs operate on a portfolio investment basis, these targets are a reference for GLICs internally, to monitor companies against. Targets for companies where GLICs have low levels of influence would generally relate to dividend yields and total shareholder return (TSR) only. At the other extreme, where GLICs have a high ability to influence, these targets are tools to direct and challenge the management’s strategic plans.

How do these targets tie-in with GLIC's portfolio targets?

Company-specific targets should be based on GLICs’ macro assumptions which are used to determine the overall target for the portfolio. If the company targets are not in line with GLICs’ target for that company, the team needs to justify this discrepancy and outline the strategic value of the investment.

Monitoring involves keeping track of and reporting on investee companies and the consolidated portfolio.

What is the purpose of the monitoring function?

Monitoring function should:

- Report on performance of investee companies;
- Guide actions to be taken by the “management” function (which is described further on page 12 and 13); and
- Formulate a consolidated view of the portfolio.

What are the different monitoring approaches for GLICs with different investment mandates?

For portfolio investment GLICs, only minimal monitoring is performed, e.g. comparing TSR against targets and/or comparative companies.

For GLICs which operate at near active ownership (typically where they have Board representation but are not the largest shareholders) and active ownership, monitoring entails understanding the underlying factors for the company’s performance. It should include Key Performance Indicators (KPIs) such as TSR, Return on Invested Capital/Return on Equity, Economic Profit and/or Non-Performing Loans for banks and a series of benchmarking analyses. Forecasting future performance can also be performed based on a thorough financial forecasting model and an extensive benchmarking approach, including industry-specific indicators.

For companies under restructuring, the monitoring approach will have to be defined depending on the state of the company and the role of the special team. The approach might be similar to the approach taken for companies under active ownership, and include some metrics specific to the on-going restructuring effort.

Monitoring of GLCT Initiatives

The monitoring of progress on the implementation of GLCT Initiatives, and the company’s performance with regards to these Initiatives also fall under the purview of GLICs.

The management function entails outlining and driving a VCP to operationalise GLICs' role as an active shareholder for its investee companies.

What does “management” mean?

“Management” does not mean getting involved in the day-to-day running of the company – it means:

- Governing the company as a shareholder, through a range of influence levers; and
- Operationalising the targets outlined in the VCP.

What are the different “management” approaches for GLICs with different investment mandates?

For portfolio investment GLICs, the main influence lever is to vote at AGMs/EGMs.

Where GLICs have Board representation, influence will be exercised mainly through their Nominee Directors on the Board.

This involves managing the relationship with Nominee Directors on the basis of a term sheet, where appropriate, and supporting Nominee Directors in their on-going role.

In certain cases, this could also involve developing a working relationship with the company upon introduction by the Nominee Director and approval from the Board.



For companies in need of restructuring, GLICs may form a dedicated team (upon Board approval) to strategise, oversee operations and implement changes in the company, and if necessary, be based at the company’s premises.

This may also involve the secondment of GLIC staff at the company for a period of time.

This level of involvement would be on a temporary basis only, usually for the duration of the restructuring, after which the company would be managed under active ownership.

Where GLICs have crossshareholdings in a company, especially where they collectively have the largest shareholdings but individually do not, they may wish to collaborate and exercise their collective influence whenever they find it appropriate.

How does “management” differ from company to company?

As each company is different, there will undoubtedly be differences in the level of “management” GLICs will have to undertake.

A case by case evaluation of each company will still have to be performed to determine the appropriate steps to be taken.

Degree of “management” will differ depending on level of ownership of GLIC and the company’s performance, among others.



The VCP is an example of how GLICs can drive investee companies to achieve better performance and to challenge them to meet GLICs' targets and objectives.

GLICs which operate as active shareholders will need an internal M&M team to develop an independent perspective of a company's value creation potential and rigorously monitor company performance and implementation of critical projects (including GLCT Initiatives).

The perspective on value creation potential should be codified in a clear plan that serves as a tool to aid Nominee Directors to challenge management's strategy and targets of the GLC's Business or Transformation Plan – as well as problem-solve with management the appropriate levers and/or potential action plans to focus on.

Putting together these VCPs is a formidable task that requires deep knowledge about the sector, strong financial modeling skills, and operational experience to determine the key levers to pull and the time frame in which to expect results. The appropriate capabilities should therefore be built within GLICs to develop these VCPs, and then monitor companies.

The targets and objectives outlined in the VCP are based on GLICs' own assessment of the company and may differ from the company's targets for themselves. The VCP can be based on in-house research and analysis, feedback from the Nominee Director and input from consultants, experts and any other trusted sources.

The plan has to be approved by GLICs' management and requires buy-in from the Nominee Director. Once agreed upon, certain aspects of the plan can be shared with the company's Board and management. Otherwise, this plan acts as an internal strategy for GLICs to claim better performance from its investments.

Exhibit 4 is an example of some elements to be included in the VCP.

Exhibit 4: Example of Elements to be Included in the VCP

	<u>Current status</u>	<u>Goal within 1-5 years</u>	<u>Action points</u>
Financial target			
■ XYZ	■ XYZ	■ XYZ	Action point 1
■ XYZ	■ XYZ	■ XYZ	Action point 2
Operational target			
■ XYZ	■ XYZ	■ XYZ	Action point 3
■ XYZ	■ XYZ	■ XYZ	Action point 4

The VCP should also include an implementation plan. The plan will outline how the VCP will be operationalised, timeframe needed, and the appropriate level of people and skills required to ensure success.

Progress of this implementation should also be tracked and reviewed on a regular basis.

An example of an implementation plan is shown in Exhibit 5.

Exhibit 5: Example of an Implementation Plan

Activities	Levers of influence	Key persons involved	Output	Jan 07				Feb 07				Mar 07				2Q07	3Q07
				1	8	15	22	29	5	12	19	26	5	12	19		
■ Action Point 1			Output 1														
• XYZ																	
• XYZ																	
■ Action Point 2			Output 2														
• XYZ																	
• XYZ																	
■ Action Point 3			Output 3														
• XYZ																	
• XYZ																	

Nominee Directors represent a critical lever for GLICs to manage their investee companies.

A significant contribution that GLICs can make to the Board of a GLC is in selecting an appropriate Nominee Director – that has the relevant skills and experiences required by the company.

GLIC expectations for Nominee Directors should be clearly articulated to them, for example in term sheets. In setting these expectations, GLICs should also ensure that its Nominee Directors are adequately equipped, via training sessions and the support of a team, to fulfill them.

ENGAGEMENT OF NOMINEE DIRECTORS

Nominee Directors should be engaged on the basis of their knowledge, skills and/or experiences, which in turn should be aligned with the needs of the specific investee companies.

APPROACH TO SHARING OF EXPECTATIONS

The sharing of expectations may be done through a written term sheet communicated to and acknowledged by the Nominee Director. GLICs may use this term sheet as a point of discussion with the Nominee Director prior to signing of the appointment letter.

CLARIFYING NOMINEE DIRECTORS' ROLE AND MODE OF INTERACTION WITH THE GLIC

- The term sheet should cover the following three main areas:
- Clarify role of Nominee Director;
 - Define overall terms and conditions for Nominee Director, including duration of term, assessment and renewal; and
 - Describe interaction process between Nominee Director and GLIC.



ROLE AS BOARD MEMBER

In line with the Green Book on Enhancing Board Effectiveness, the roles and responsibilities of Nominee Directors are identical to that of all Directors.

One of the roles and responsibilities of a Board member is to generate shareholder value via adoption and understanding of the shareholder’s perspective, including understanding the capital market’s views of the company’s performance and the capital market implications of strategic and financial decisions. In addition, Board members are to ensure that all shareholders are treated fairly.

Board members are also responsible to contribute to corporate strategy development and to set stretch aspirations for management.

Other roles include monitoring of performance and sustainability of the company and senior management and development of senior management to drive succession planning.

Board members should also understand and manage key risk factors of the company. Valid stakeholder interests should be balanced, in line with Government policies and increasing shareholder value.

EXPECTATIONS FROM THE GLIC

To enhance the effectiveness of the Board, GLICs may assign annual “agendas” for its Nominee Directors, given the Nominee Directors’ respective areas of expertise. For example, ensure that a GLCT initiative, such as putting in place a customer charter, is implemented as planned in the company.



Nominee Directors represent a critical lever for GLICs to manage their investee companies. (cont'd)

DUAL ACCOUNTABILITY

A Nominee Director has dual accountability to its shareholders and the GLIC. A Nominee Director is accountable to all its shareholders in ensuring that all shareholders are treated fairly, as well as accountable to the GLIC to take into consideration the GLIC's legitimate interests as a shareholder.

Whenever tensions arise between those two accountabilities, the Nominee Director is expected to give precedence to his/her accountability to all shareholders and to explain his/her position to the GLIC.

ASSESSMENT

There should be a continuous two-way assessment of the relationship between the GLIC and the Nominee Director, conducted through dialogue between the Nominee Director and his/her key contact at the GLIC.

RENEWAL PROCESS

At the end of the term, GLICs should determine, based on the assessment explained above, whether to offer a renewal to the Nominee Director for the following term.



DEFINITION OF GLCs AND GLICs


GLCs

GLCs are defined as companies that have a primary commercial objective and in which the Malaysian Government has a direct controlling stake.


Apart from percentage ownership, controlling stake also refers to the Government's ability to appoint Board members, senior management and make major decisions (e.g. contract awards, strategy, restructuring and financing, acquisitions and divestments etc.) for GLCs either directly or through GLICs.

This definition includes companies where GLCs themselves have a controlling stake, i.e. subsidiaries and affiliates of GLCs.

GLICs



GLICs are defined as Federal Government-Linked Investment Companies that allocate some or all their funds to GLC investments.



Defined by the influence of the Federal Government in appointing/approving Board members and senior management, and having these individuals report directly to the Government, as well as in providing funds for operations and/or guaranteeing capital (and some income) placed by unit holders.

This definition currently includes seven GLICs: Employees Provident Fund, Khazanah Nasional Bhd, Kumpulan Wang Amanah Pencen, Lembaga Tabung Angkatan Tentera, Lembaga Tabung Haji, Menteri Kewangan Diperbadankan, and Permodalan Nasional Bhd.





ACRONYMS AND ABBREVIATIONS

AGM	Annual General Meeting
CEO	Chief Executive Officer
EGM	Extraordinary General Meeting
GLC	Government-Linked Company
GLCT	Government-Linked Company Transformation
GLIC	Government-Linked Investment Company
KPI	Key Performance Indicator
M&M	Monitoring & Management
PCG	Putrajaya Committee on GLC High Performance
VCP	Value Creation Plan
TSR	Total Shareholder Return







Putrajaya Committee on GLC High Performance (PCG)
Transformation Management Office (TMO)
Level 37, Tower 2, Petronas Twin Towers
Kuala Lumpur City Centre, 50088 Kuala Lumpur.
Tel : 03-2034 0000 Fax : 03-2034 0008
Email : pcg@treasury.gov.my Website : www.pcg.gov.my

