9th OECD-ADBI Roundtable on Capital Market Reform in Asia

27th February 2008

“Governance Through Transformation”
Agenda

- Historical Context of Transformation
- Khazanah’s Mandate
- GLCT Transformation
  - Thrust 2: Governance and Boards
  - Thrust 3: Government Linked Investee Companies as Shareholders
  - Thrust 4: Adopting Best Practices
  - Results so far
- Working within the wider governance framework
History and Evolution of GLCs…
The First 50 Years

1951
EPF established

1957
Independence of Malaya

1962
LTH established

1970
Launch of New Economic Policy (NEP)

1971
1957
Maybank becomes government owned

1972
LTAT established

1978
PNB established

1978
Launch of Heavy Industrialisation Programme

1979
Sime Darby is Malaysianised

1981
Launch of Heavy Industrialisation Programme

1983

1985
Proton launch first model

1987
Jabatan Telekom Corporatised

1987

1990
Lembaga Letrik Negara Corporatised

1992
Malaysian Airport and Postal Department privatised

1994
KNB began operations

1997
Bank Bumiputra merger with Commerce Bank

1998
Danaharta established

1999

2000
2001
Financial Sector Masterplan announced

2002
MAS widespread asset unbundling exercise

2004
14 May 2004
Government announced remaking of Malaysia Inc.
…in the Context of Micro-Economic Restructuring

Phase I

Privatisations & Partial Public Listing;
PLUS and other expressways, IPPs, MAS,
Telekom, Tenaga, PetronasGAS, Mobile telcos
→ Co-existence of large GLCs* and nimble owner-manager firms

Asian Economic Crisis
Stabilization, Capital Controls
CDRC, Danaharta, Danamodal
Reflationary monetary and fiscal policies
Banking consolidation

Corporate restructurings, including
Mostly ſar-time ſinancial restructuring,
Renationalization; institutional holding and professional mgmt.
Danasaham/Renong/UEM Group Restructuring
MRCB, KUB Restructuring
MAS Ṣ Widespread Asset Unbundling

GLC Transformation
Mostly operational (peace-time) restructuring
Khazanah Revamp
Culture of High Performance KPI and PLC
Leadership changes Ḑ BOD and management
Build on previous base: UEM, MAS, MRCB
Initial focus on key GLCs Ḑ TNB, TM, SD,
Focus to increase to industry structures

Phase II

Phase III

Phase IV

From 1987 1997 2001 2004 - Present

GLCs* = Government Linked Companies
The Case for Transformation

“…the 40 public listed GLCs … that comprise only 5% of the number of companies on Bursa Saham (Stock Exchange), together make up 34% of the total market capitalisation of the Bursa.”

“GLCs also make up the backbone of the country’s economy. Through the provision of ‘mission-critical service’ such as transportation, energy, telecommunications and financial services, GLCs serve a pivotal role in the operation of every commercial concern in Malaysia”

“…decisive action requires nothing less than a remaking of Malaysia Inc…”

“…it is imperative that we shift the basis … to that of tangible achievement and performance”

“The Government would like to see Khazanah emerge as one of the biggest and most dynamic investment houses in the region… emerge stronger, more nimble and able to create more value” “

Dato’ Seri Abdullah Ahmad Badawi,
Prime Minister of Malaysia (14 May 2004)
The Role of Government in Economic Management – The Right Objectives in the Right Boxes

**GOVERNMENT OF MALAYSIA**

**Developer/Public Goods**
- Provider of public goods, infrastructure or services
- Provision of law and order
- More socio-economic in nature

**Regulator**
- Providing level and conducive playing field
- Protection of public interest
- Enforcement

**Financial**
- Some entities remain majority by Government for historical reasons
- Create sustainable economic value

**Khazanah as Government’s strategic investment arm**
- Focus on shareholder value creation
- Careful not to crowd out private sector
- Optimal and evolving holdings in companies and sectors
- Strengthen management capabilities
- Financial returns as principal measure of KPIs
Khazanah’s Mandate since 2004

1. **Legacy investments**: Streamline, repair, restructure portfolio

2. **GLC transformation**: Increase shareholder value, strategic value

3. **New investments**: New strategic sectors and geographies

4. **Human Capital Development**: Active development of Human Capital for the nation

---

**3rd**: **Building capacity** in talent, social capital, financial capabilities, processes, knowledge and infrastructure

**2nd**: **Core values**: integrity, diligence, teamwork, professionalism, mutual respect

**1st Foundation**: a focus on long-term **nation-building**
Five Policy Thrusts Structured Around Four Key Participants: Government, GLC Boards, GLICs* and GLCs

Underlying Principles of GLCT:
- National development foundation
- Performance focus
- Governance, shareholder value and stakeholder management

Policy Thrust 1: Clarify the GLC mandate in the context of National Development

Policy Thrust 2: Upgrade the effectiveness of Boards and reinforce the corporate governance of GLCs

Policy Thrust 3: Enhance GLIC capabilities as professional shareholders

Policy Thrust 4: Adopt best practices within GLCs

Policy Thrust 5: Implementing the GLCT Programme

Supported by 10 overarching themes of initiatives (now commonly referred to as coloured books)

*GLICs = Government Linked Investment Companies
GLC Transformation – Long Term Program Over 10 Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Phase 1: Mobilisation, Diagnosis &amp; Planning</th>
<th>Phase 2: Generate Momentum</th>
<th>Phase 3: Tangible Results</th>
<th>Phase 4: Full National Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>14 months</td>
<td>12-17 months</td>
<td>2-5 years</td>
<td>5-10 years onwards</td>
</tr>
<tr>
<td>2005</td>
<td>5/2004 PCG formed</td>
<td>29th July 2005</td>
<td>Phase 3: Tangible Results</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Diagnosis Manual Launch</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>KPI and PLCs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Performance contracts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Board composition reform</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Revamp of Khazanah</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>GLC leadership changes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>2004 Measures</td>
<td></td>
<td>Phase 3: Tangible Results</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- KPI and PLCs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Performance contracts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Board composition reform</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Revamp of Khazanah</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- GLC leadership changes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>2004 Measures</td>
<td></td>
<td>Phase 3: Tangible Results</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- KPI and PLCs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Performance contracts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Board composition reform</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Revamp of Khazanah</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- GLC leadership changes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Targeted outcomes:**
- Diagnosis of GLCs conducted
- Determination of Policy Principles
- Initial 2004 Initiatives launched
- 2005/6 Initiatives implemented
- Full roll-out in place
- Key policies endorsed and executed upon
- Early fruits of sustainable improvements
- Maintain momentum
- Tangible & sustained benefits across GLCs
- Visible benefits to all stakeholders, e.g., customers, vendors, employees, etc.
- Large scale strategic and financial changes made
- Material changes to Boards
- Several regional champions
- Most GLCs performing at par with competitors
GLCT Transformation Program Initiatives
- The Coloured Books

1. Enhancing Board Effectiveness (GREEN), Apr 2006
2. Strengthening Directors Capabilities (MINDA), Dec 2006
3. Enhancing GLIC Monitoring & Management Functions, Dec 2006
4. Improving Regulatory Environment, Sep 2006
5. Achieving Value Through Social Responsibility (SILVER), Sep 2006
6. Reviewing and Revamping Procurement Practices (RED), Apr 2006

11. Enhancing Operational Efficiency and Effectiveness (YELLOW), Sep 2006
Policy Thrust 2 focuses on high-level performance based on Principles of Corporate Governance

Underlying Principles of GLCT:
- National development foundation
- Performance focus
- Governance, shareholder value and stakeholder management

Policy Thrust 1:
Clarify the GLC mandate in the context of National Development

Policy Thrust 2:
Upgrade the effectiveness of Boards and reinforce the corporate governance of GLCs

Policy Thrust 3:
Enhance GLIC capabilities as professional shareholders

Policy Thrust 4:
Adopt best practices within GLCs

Policy Thrust 5:
Implementing the GLCT Programme

Supported by 10 overarching themes of initiatives (now commonly referred to as coloured books)
INTRODUCTION TO GREEN BOOK – ENHANCING BOARD EFFECTIVENESS

1. Raise overall effectiveness of Boards
2. Consistent with Malaysian Code of Corporate Governance, Bursa’s Listing Requirements, and all other rules, regulations, etc.
3. Different from existing materials as the Green Book is:
   - Focused on Boards, which is at the heart of corporate governance
   - Tailored to address biggest challenges that GLC Boards face
   - Practical and action-oriented, instead of just guidelines

INTRODUCTION TO MINDA – STRENGTHENING DIRECTORS CAPABILITIES

1. Partnerships with both international and local institutions.
2. Engage best case writers to prepare examples most relevant to Directors
3. Aims to provide world class programs, tailored specifically for Directors.
4. The learning interventions to be designed and developed by MINDA would cater for the differing roles and issues relevant to each category
Policy Thrust 3 focuses on catalyst effect and supporting role of major shareholders

Underlying Principles of GLCT:
- National development foundation
- Performance focus
- Governance, shareholder value and stakeholder management

Policy Thrust 1: Clarify the GLC mandate in the context of National Development

Policy Thrust 2: Upgrade the effectiveness of Boards and reinforce the corporate governance of GLCs

Policy Thrust 3: Enhance GLIC capabilities as professional shareholders

Policy Thrust 4: Adopt best practices within GLCs

Policy Thrust 5: Implementing the GLCT Programme

Supported by 10 overarching themes of initiatives (now commonly referred to as coloured books)
**Khazanah’s Five-Pillar Terms of Engagement Framework with Its Investee Companies**

**Leadership Bench**
- Ensure professional, capable, experienced and appropriate
  - Board of Directors
  - Senior Management team

**Strategy**
- Drive through the Boards and management, high-quality implementable business strategy

**Systems and Controls**
- Place key systems and controls to underwrite growth and value creation: e.g. Governance, Risk Management, Performance Management, Talent Management, Procurement, Internal Audit, Investor Relations

**Industry Structure**
- Drive or give inputs to how industry structures evolve
  - Optimal competitive environment and regulatory structure
- Government remains responsible for regulation

**Monitor & Empower**
- Once the above in place, do not micro-manage
- Continuous monitoring of progress
- Empower management to carry out its job

**Policy Thrust 3**
**GLIC Monitoring & Management Framework requires the right level of governance**

- Investment strategy and mandate
- Level of ownership
- Company’s capability and performance
Policy Thrust 4 is about performance initiatives at the GLCs which need to implement them.

**Underlying Principles of GLCT:**
- National development foundation
- Performance focus
- Governance, shareholder value and stakeholder management

**Policy Thrust 1:**
Clarify the GLC mandate in the context of National Development

**Policy Thrust 2:**
Upgrade the effectiveness of Boards and reinforce the corporate governance of GLCs

**Policy Thrust 3:**
Enhance GLIC capabilities as professional shareholders

**Policy Thrust 4:**
Adopt best practices within GLCs

**Policy Thrust 5:**
Implementing the GLCT Programme

Supported by 10 overarching themes of initiatives (now commonly referred to as coloured books)
Best practices guidelines for GLCs - What they comprise

BLUE BOOK – INTENSIFY PERFORMANCE MANAGEMENT PRACTICE

1. Overarching objective is to strengthen performance management in GLCs.

2. As corporate performance is driven by senior management, it was necessary to tighten performance management systems and link compensation to performance.

3. Further, the Book also provides best practices on managing non performers.

RED BOOK – REVIEWING AND REVAMPING PROCUREMENT PRACTICE


2. The Red Book was one of the first few books to be launched as procurement spending across the GLCs is significant and CEOs viewed it as one of the priority initiatives.

3. It focuses on five best practice areas, aimed at improving cost efficiency and increasing transparency.

PURPLE BOOK – OPTIMISING CAPITAL MANAGEMENT PRACTICES

1. Intended to provide a guideline to GLCs on improving their capital management.

2. The two main levers considered necessary to achieve this optimal capital structure are dividend payments and share buybacks.

3. Upon full implementation, any capital hoarding should be minimised, thus increasing the attractiveness of GLCs in the capital markets.

ORANGE BOOK – MANAGE AND DEVELOP HUMAN CAPITAL

1. Outlines best practices on attracting high performance individuals recognising that talent is the key competitive advantage of an organisation.

2. This Book will provide guidelines on addressing issues on GLCs’ value proposition to attract and retain the best talent, and ensure their development.

3. It is also intended to assist GLCs to close the gap with local private sector and MNCs.
How have we fared so far?
G-20 Performance: Headline KPIs and Aggregate Net Profit

Total number of KPIs met by G-20 in FY 2006

G-20 met or exceeded 72% of their collective headline KPIs

- Missed KPIs (16 KPIs, 28%)
- Met KPIs (42 KPIs, 72%)

G-20 Aggregate Net Profit – “The J-Curve”

Net Profit (RM m)

2004 2005 2006 2007F

G-20 is the 20 largest listed GLCs

Notes:
1. 2007F numbers are based on consensus IBES estimates for companies with research coverage
2. For companies without research coverage, interim earnings was annualized

Source: Khazanah analysis
Value Creation: TSR and Market Cap Increase

As of 24 November 2006

Market Capitalization of G-20

Total Shareholders Return (TSR) Index

RM
bn

G-20 has outperformed
KLCI by 2.4%

90% or RM131 billion
increase in market
capitalization

RM276 billion

RM145 billion

90 = 14-May-04

CAGR**

24.8%

22.4%

G-20* Index

KLCI ex G-20

May-04 Nov-04 May-05 Nov-05 May-06 Nov-06 May-07 Nov-07

Source: Khazanah analysis; Bloomberg

Note: % increase in market capitalization is calculated based on reweighted market cap of the GLCs in which GLICs are the controlling stakeholders

* A selection of 20 GLCs controlled by the GLIC constituents of PCG

** Compounded Annual Growth Rate for the period 14 May 2004 to 31 December 2007
Working within the Context of the Corporate Governance Framework – Institutional Development & Policy Interventions

1998
- Listing requirements
- Strengthens Rules on RPT

1999
- New Malaysian Code on takeovers and Mergers

2000
- Amendments to securities and company law to harmonize the regulatory regime for prospectuses
- Malaysian Institute of Corporate Governance formed
- Guidelines on Issue/Offer of Securities facilitate equity participation by independent directors
- MAICSA best practice guidance of company secretaries
- Minority Shareholder Watchdog Group (MSWG) formed
- Major revamp of KLSE Listing Requirement: new chapter 15 on corporate governance
- Assurance of guidance for directors on statement of internal controls
- Director’s Mandatory Accreditation Program commences

2001
- Introduce Merit-demerit incentives in Guidelines on Issues/Offer of Securities
- Bank Negara Malaysia issues Guidelines on Corporate Governance for Licensed Institutions
- Institutional Shareholders Pro-tern Committee formed led by MSWG

2002
- Introduce Merit-demerit incentives in Guidelines on Issues/Offer of Securities
- Director’s Continuing Education Program commences
- Issuance of guidance for directors on statement of internal controls
- Director’s Mandatory Accreditation Program commences
- Major revamp of KLSE Listing Requirement: new chapter 15 on corporate governance
- AIA issues guidance for internal audit function

2003
- Introduction of provisions governing:
  - Whistle-blowing
  - Enhancing enforcement/redress mechanisms for breeches of securities laws
- Launched “Best Practices in Corporate Disclosure”
- High Level Committee on Corporate Governance established
- Issue guidelines to facilitate shift to post-vetting of prospectuses
- Bank Negara Malaysia issues Guidelines on Corporate Governance for Licensed Institutions
- Institutional Shareholders Pro-tern Committee formed led by MSWG
- Revised Malaysian Code on CG to strengthen board, audit committee and internal audit function
- Listing requirements mandate disclosure of state of compliance with the Code (above)

2004
- Amendments to Companies Act 1965, focusing on director responsibilities

2005
- PCAOB formed
Summary and What Next?

- Good Corporate Governance practices are essential to value creation on a sustainable basis.
- Best practices are adopted from developed nations as well as applying new practices where none exist.
- The market reform for best practices will continue to evolve.
- Khazanah, as the Government’s Strategic Investment Arm (although not necessarily a Sovereign Wealth Fund) continues to work within the existing governance framework to drive the adoption of best practices at its investee companies.
- Sensitive to global economic trends, shifts in regional economic developments, pace of liberalization, environmental stresses, changes in social mobility and shortage of global talent.