New Zealand Corporate Structures Must Change

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As we are all too well aware the New Zealand economy is struggling from the devastating effects of two earthquakes and the excesses of a credit boom which has left us with a private-sector debt as a percentage of GDP totalling 166% as at 30 June 2010 according to The Treasury. (http://www.treasury.govt.nz/publications/reviews-consultation/savingsworkinggroup/finalreport/19.htm)

We are increasingly dependant on the strength of the Crown balance sheet. Unfortunately, this does not provide us with an infinite supply of funds and comes at a significant long-term cost to us all, but particularly our children (should they choose to stay in New Zealand).

The latest financial disaster to impact the New Zealand economy is the near collapse of AMI Insurance. The Government has executed the only option it had by providing bailout funds which some are now suggesting could see upto NZ$ 1bln of total support. While the Government has done the right thing this situation again highlights a major failing within our business structures.

The real issue we must all consider, using AMI as an example is, are most of the major corporates in New Zealand really geared to be able to quickly access capital during times of duress? I refer specifically to the major parts of our economy, which operate under mutual or co-operative structures. Many of these companies are exposed to environmental / disease risks which are difficult to gauge / control, and with expanding global trade are arguably increasing at an exponential rate by the day. An example most recently of this risk is the discovery of PSA in the kiwifruit industry, an industry which contributes circa1.5% to our GDP and had largely been disease free since its inception in the 1970's.

In most other developed nations an insurance company of AMI's size (and market share) would have had access to the public capital markets to enable it to easily access new capital from investors, when required. However, AMI did not have access to the public capital markets as it had chosen to remain a mutual. Such decisions seem fine during the good times, when the profits are rolling in so to speak, but during times of maximum duress we pay a steep price for not considering the downside. AMI has just paid this price – with the New Zealand public potentially footing the bill.

However, AMI is not the only company in New Zealand that could suffer this fate. All businesses both large and small face a wide spectrum of unknown and difficult to quantify risks on a daily basis. However, in New Zealand our reluctance to trust or understand the capital markets (stock and bond markets) has left us very exposed at a time when we can ill-afford it.

We have lived in fear of the foreign investor entering our stockmarket yet seemingly unknowingly a large proportion of our population has instead mortgaged (read ransomed) themselves to foreign investors such as foreign banks via over investment in real estate. When these investments go bad, the banks want their money back and sell to whoever can afford to buy - generally foreign parties. We can secure capital from local and foreign investors - although limit foreign ownership to sensible minority levels to ensure local head office infrastructures and control remain here. This is why the government's proposals for mixed ownership (and access to capital for growth) for State Owned Enterprises (SOE's) is so important and sensible.

The latest financial disaster in AMI should lead every New Zealander to sit up and think about how sustainable our reluctance to allow public investors to provide key industries with more permanent capital really is. We are a population of circa 4.32mln people with a savings track record that makes a compulsive gambler look seemingly prudent when he makes an each way bet on #3 at Ellerslie every Saturday.

I implore New Zealander's to begin to think about these issues, to become increasingly prudent and look to diversify their savings and seek out sensible avenues to invest in the stock and bond markets both domestically and internationally. The Government cannot continue to provide lifelines to everyone that falls victim to either the business cycle through imprudence or because a disaster has found that "the emperor really has no clothes".

I also implore those of our businesses that remain in mutual ownership to think about the benefits of accessing public capital much like Fonterra is moving to do. This does not have to come at the expense of control - but having access to capital when debt, members' funds and generous governments run out is an option all responsible directors need to consider.
If we do not begin to acknowledge and address the risks / limitations in our corporate and government structures then I personally fear for New Zealand's long-term outlook.

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Note: This Elevation Capital Insights was created from an Open Letter to the NZ Public written by Christopher Swasbrook on 8 April 2011.

Disclosure:

Elevation Capital Management Limited is a New Zealand-based global funds management company.