Proposal to merge GBEs

I have a background in GBE monitoring and governance as a former Assistant Commissioner, Economic Infrastructure, at the Productivity Commission. Some of the content in this note is drawn from the Commission's 2003 and 2004 reports on financial performance of government trading enterprises (GBEs) prepared by a team under my supervision. This submission contains some re-presented material contained in these reports.

The governance issues raised are focused on the three GBEs under review—TasPorts, Tasrail, and TT-Line. However, they apply to all GBEs and SOCs.

Summary

- One of the problems with the existing GBE governance arrangements is the corporatisation model itself. It is a model developed to limit government interference, introduce financial market disciplines, and establish competitive neutrality. The practical issues of effective external governance and accountability were not fully addressed or understood.
- One problem with the model is that requiring GBEs to act commercially does not fully replicate financial market disciplines as intended. Unlike in the private sector, the threat of bankruptcy or takeover does not function as a discipline on the governance of GBEs.
- Incomplete private market disciplines on GBEs and market failures reinforce the importance of governance and oversight.
- External governance—the interaction between the government and the board—is the main source of weakness of the model. It is a significant issue because GBEs represent a market intervention in the public interest.
- Shareholder ministers must resolve the many conflicts between their economic, social, financial, environmental, and public safety objectives so that they can provide unambiguously clear directions for the GBE to fulfil the government's requirements.
- The arrangements must also include provision for regular reviews of objectives and ongoing scrutiny because the boards' statement of corporate intent (SCI) in response to the minister's directions is inevitably an incomplete contract in a dynamic and complex environment.
- Without a complete statement of government objectives or how conflicting objectives are to be resolved by the GBE, accountability to parliament for the market intervention and its outcomes is diminished. Indeed, the GBE cannot be held fully accountable for outcomes either because of the unclear separation of responsibility for decision-making.
- Attribution of responsibility for safeguarding the public interest is made more difficult where boards and ministers are jointly involved in drafting and approving SCIs. Responsibility is further diffused where regulators and supervisory bureaucracies become involved.
- A fundamental question is whether the benefits of requiring GBEs to act commercially and fully recover cost outweigh the allocative efficiency cost if it involves setting prices above short-run marginal costs.

- Most governments have chosen to recover all costs and set prices at long-run incremental costs. However, as recognised by the ACCC, all price increments above short-run marginal cost distort consumption decisions and give rise to economic inefficiencies.
- Serious governance issues arise when governments impose constraints that affect the GBE's ability to operate commercially. These constraints can be either formally set out in the SCI or informally through interactions between the minister and board.
- The way to strengthen safeguards is to achieve a clear distinction between external and internal governance, to clarify and make all objectives (financial and non-financial) more transparent, to make boards as independent as possible, and to enhance accountability.
- It would be prudent to improve the external governance arrangements before a decision to merge GBEs is made. The external governance arrangements will remain, and a merger, if anything, will make it more difficult to achieve the public interest.
- Reforms to internal governance might help improve efficiency. However, it is the quality of the boards and the CEO that counts. High-calibre appointees would be expected to recommend best-practice corporate governance, such as tenures, in any case.
- The to be resolved in considering a merger is whether the objectives for each business are compatible to be delivered by a single commercial entity and whether external governance and the selection of boards would be improved by the merger.
- A consequence of inconsistent objectives is that the responsible minister(s) could be faced with greater complexity in providing external governance. Any inconsistencies would have to be addressed to ensure there are no perverse incentives to hinder the achievement of the public interest in each subsidiary.
- The merger of the three entities being considered have diverse public interest features that will increase the complexity of establishing objectives for a merged single entity. The merged businesses have different economic characteristics, and their non-financial objectives differ. Furthermore, a single entity would bring limited co-ordination benefits to improve the overall logistics chain.
- The absence of synergies also implies that there are few business savings to be made by merging the businesses and an increased risk that something will slip through the cracks.
- There would be limited transactional governance cost savings of a single entity instead of three. Indeed, the workload on a single responsible shareholder minister could increase to unmanageable levels to the extent that more than one shareholder minister would have to be involved.
- Merging businesses such as those proposed would also make the internal governance role of the board more difficult. It is contrary to the business management maxim of 'sticking to your knitting' because the activities are not inherently complementary or substitutes.
- It is also unclear whether the cost of internal governance for a merged business will be offset by the savings of having to appoint fewer high-calibre board members.

Background to commercialisation and corporatisation

The government business enterprise (GBE) model is a reform initiative conceived in concerns about government failure and the belief that only markets provide the disciplines to achieve economic efficiency.

It is unlikely that the practical issues of effective external governance and accountability were not fully considered or understood in formulating the model.

Current governance arrangements for GBEs reflect the various reforms introduced to improve the performance of government infrastructure providers and to increase their exposure to competition. These reforms followed concerns in the late 1980s about the quality of their goods and services, high prices, levels of indebtedness, lack of transparency and high public subsidies. The poor performance of the departments and statutory authorities providing these services came to be viewed as a major impediment to economic growth.

Governments responded to these concerns by commercialising many GBEs, replicating private sector principles and practices, shedding non-core activities, and placing greater emphasis on cost recovery.

The next round of reforms involved corporatisation. These reforms were subsequently adopted in the 1995 Competition Principles Agreement, whereby governments agreed to adopt a corporatisation model for significant GBEs (and major agency business activities and public financial enterprises) to the extent that the benefits of corporatisation outweighed the costs.

Under the agreement, each jurisdiction undertook to remove from monopolies any responsibilities for industry regulation before introducing competition. The competitive neutrality principles required governments to impose full tax (or tax-equivalent systems) and debt guarantee fees while also subjecting the corporatised entities to normal private sector business regulations.

Under the agreement, each government was free to determine its own timing and scope of the structural reform of its public monopolies, including whether to privatise them.

Each GBE is expected to operate in a manner consistent with sound commercial practice and achieve a sustainable commercial rate of return that maximises value in accordance with its corporate plan and the economic and social objectives of the government. However, on the request of the 'portfolio minister,' the treasurer may exempt a GBE from the requirement to maximise its sustainable commercial rate of return.

Another aim of the agreement and the adoption of the GBE model was to ensure governments did not have to be concerned with the day-to-day running of the GBE. This served to prevent ministers from intervening for political reasons. Despite this intention, ongoing scrutiny is necessary for the reasons set out below that might necessitate intervention.

Public interest issues

GBEs were corporatised, as a step beyond commercialisation, to enable them to operate 'semi-independently' as if they were private sector businesses. The intention was to bring to their operations the efficiencies spurred by a commercial imperative, competition (where it exists), an expert and accountable board, and the incentives and sanctions that apply to their private sector counterparts.

On the other hand, government ownership brings with it ministerial political and policy intervention, whole-of-government policies, the stewardship of public funds and assets, and protection from bankruptcy. Governments have decided, however, that there is a 'public interest' that warrants ongoing ownership of the enterprise rather than proceeding with privatisation.

The overriding objective of private sector businesses is to maximise the long-term value of their owners' investment. Nevertheless, private sector businesses must accept social responsibility where this is consistent with that principal objective (even, potentially, at the expense of short-term profitability).

Private businesses are subject to laws and regulations designed to ensure the public interest is protected. For GBEs, shareholder minister(s) imposes public interest requirements through controls.

Ministerial recognition of the public interest is influenced by the values and policy platforms of their political party. This can become evident in a range of matters, from the selection of board members to the sponsorship of community activities. Ministers might also wish to influence decisions that could be politically 'contentious.'

A further public interest issue is that GBEs have stewardship of public monies and the community 'owners' are unable to withdraw their capital. Consequently, the parliament, auditors-general, media, and the broader community typically scrutinise whether public monies are being spent effectively and efficiently.

Risk

There is also likely to be public interest issues in the approach to commercial risk, particularly in high-risk-reward activities. These differences arise because:

- governments are constrained in the extent to which they can align the material incentives of board members to those of the public owners; and,
- control of public rather than private funds and assets potentially affects the incentive for wealth creation.

These different incentives can either promote increased or reduced levels of risk aversion. Although stewardship of public funds can lead to conservatism, implicit government guarantees for borrowings, or the ability to borrow at a lower cost than the private sector, can increase risk-taking.

Boards are expected to address commercial risk as part of their internal governance—with the management of political risk remains a matter for ministers. Ministers take a whole-of-government perspective on what constitutes the public interest when making decisions on issues such as GBE dividend policies, subsidising goods and services, terms of employment, and industrial policies.

This can range from decisions on balance sheet restructuring and special dividends that assist the annual budget, or the government might want a say in the terms and conditions of employment of GBE staff.

Replicating capital market disciplines

Governments have endeavoured to replicate capital market disciplines by requiring GBEs to be profitable as well as to pay dividends, taxes, and debt guarantee fees. However, the threat of bankruptcy or takeover faced by private businesses is not present and does not function as a discipline on good governance.

Furthermore, failure to meet the replicated disciplines does not have the same consequences as those facing private enterprise in a competitive market. Indeed, governments have clearly been prepared to accept rates of return in the past that would be unsustainable under commercial market conditions.

Non-commercial objectives
Judgements about welfare outcomes, efficiency, and other matters within the purview of the public interest are more properly made if information is available about public preferences. In relation to GBE services, however, there are limited avenues for preferences to be identified. Typically, there are no alternative service providers to switch to, and there might be limited substitutes for some services.

Governments have addressed broader welfare issues, though they never fully achieved this, by establishing sound governance procedures that clearly define the non-commercial objectives and their weightings relative to commercial objectives. Without such clarification, it is not possible to assess whether the corporatisation model is the best way of promoting the public interest.

Ministers, as elected representatives, have responsibility for resolving the inevitable trade-offs between conflicting commercial and other public interest objectives. Holding ministers accountable for their performance in this regard requires transparent and unambiguous governance processes and substantive performance reporting. It is also important that there is clarity of vision and agreement across all arms of government about the objectives to be pursued by GBEs.

Ministerial accountability
There should be a requirement for ministers to publicly provide reasons for their decisions, to improve transparency, and assure accountability. This would improve the quality of the decisions and reduce the possibility that preferences of minority interests or political considerations were given undue weight. In some instances, public consultation may be appropriate prior to ministerial decision making.

There can be limits on the accountability for ministers because of the difficulties in obtaining a clear public view on what will maximise community wellbeing. However, even if the public is widely dissatisfied with ministers regarding the objectives of GBEs, accountability through the ballot box is likely to be weak because election outcomes are usually determined by broader government policies and performance.

Ministers should not be held accountable for the actual performance of the GBE itself. This is a board responsibility (differentiating the GBE model from the departmental model). However, ministers may be seen as responsible for failures of a GBE if the external governance processes were inadequate or unsound, or if they failed to act after becoming aware of problems with the governance of the board.

In the event of a significant failure of an essential service, it is probable that governments would be held responsible regardless of governance arrangements. In cases of extreme failure, the public might even hold the government accountable irrespective of whether an essential service is in public or private ownership.

Attribution of responsibility for safeguarding the public interest is made more difficult where boards and ministers are jointly involved in drafting and approving a SCI. Responsibility is further diffused where regulators and supervisory bureaucracies become involved. For example, various regulatory acts require regulators to assess the public interest. Further, there is increasing reliance on quasi-regulation such as licensing agreements and memoranda of understanding.

Governance issues

The SCI instrument of governance is an incomplete contract because government objectives are not clearly defined and there is no basis for describing all contingencies in their existing form. Typically, it sets out the general approach and includes measures of performance on operating and financial goals.

Governance issues arise when governments impose constraints that affect the GBE's ability to operate commercially. These constraints can be either formally set out in the SCI or informally through interactions between the minister and board.

Commercial disciplines and accountability for outcomes are also compromised when governments demand specific dividends, restrict borrowing for capital expansion or asset renewal, require subsidised services without full compensation, require financially unviable assets to be maintained, oppose stranded assets being written down to their deprival value, or intervene on location, employment, and investment decisions.

Objective setting

There are difficulties in setting clear objectives because the economic, social, and environmental trade-offs required to specify them are complex to resolve. However, without a complete statement of government objectives or how they are to be resolved by the GBE, accountability to parliament for the market intervention and its outcomes is diminished. Indeed, the GBE cannot be held fully accountable for outcomes either because of the unclear separation of responsibility for economic decision-making.

Current GBE objectives can be summarised as:

- Guiding principles: objectives set out in corporatisation acts to guide boards in their strategic planning.
- High-level objectives: objectives contained in SCI in the form of goals which support mission statements.
- Performance indicators and targets contained in the SCI and corporate plans that are subordinate to higher level objectives.

Guiding principles and high-level objectives are not directly measurable. Targets that must be achieved if their antecedent objective(s) are to be met are more specific and more likely to be measurable. However, achieving the intended high-level objectives with targets depends on the effectiveness and completeness of the chosen target.

Guiding principles in corporatisation legislation typically provide only broad guidance on the types of objectives that should be set, such as requiring that there be objectives relating to a GBE's commercial operations. Further, there is limited guidance as to the relative importance to be given to financial objectives when they conflict with, or are modified by, non-financial objectives.

Objectives are typically recorded in a form of generality that is an unsuitable basis to hold the government accountable for its market intervention. For example, TasPorts cites its intention to 'facilitate freight and logistics solutions to benefit the community and create value for customers.' TT-Line states its aim is 'to provide Bass Strait services built on a reputation of excellence in safety, reliability, and exceptional passenger and freight services' and to 'maximise value and deliver consistent financial results.' Also listed are some broadly defined strategies to achieve this.

Economic efficiency

Another key issue is the tension between commercial and economic efficiency objectives. Requiring a GBE with large sunk costs, such as TasPorts, to operate commercially and fully recover these costs results in an allocative efficiency loss with economy-wide consequences.

Most governments have chosen to recover all costs by setting prices at or above long-run incremental cost, which is a forward-looking average costs. However, prices set this way do not promote allocative efficiency in resource use if prices diverge significantly from marginal cost.

Short-run marginal cost pricing does not necessarily allow for recovery of fixed costs. However, as recognised by the ACCC, all increments above marginal cost in the price distorts consumption decisions. Further, the costs (and benefits) of externalities, while important to assessing the public interest, may be difficult to measure and internalise through prices.

Requiring tax-equivalent and debt-guarantee payments (the difference between government and private rates of borrowing) do not enhance financial disciplines and are unlikely to increase contestability by being competitively neutral with non-existent private-sector competitors. However, these requirements reduce economic efficiency by increasing prices further above the economically efficient level. In effect, they are unnecessary and a hidden form of taxation.

The level of overall State debt affects its credit rating and the cost of capital. However, it is unclear whether government financing decisions are in the public interest under the GBE model because they fall outside the governance arrangements.

Financing and capital structures

The decision on how to finance GBEs has implications for their capital structure and the public interest. Governments can inject equity capital or require the GBE to take on debt. Debt is tax deductable in the case of GBEs, which influences their optimal capital structure.

Capital funding can be financed from government taxation revenue or borrowing, whereas GBEs are provided with debt finance by the government at its borrowing rate. However, they are required to pay at a commercial rate for competitive neutrality reasons.

Another form of weakening economic efficiency is imposing an inefficient market reference price. An example of this is the decision to set wholesale electricity prices at the Victorian long-term market price as the opportunity cost of supplying into Tasmania instead of the NEM.

This benchmark is well above the marginal cost of supply in Tasmania and leaves scope for profit-taking and inefficiency. Moreover, the Victorian contract price is not an efficient benchmark because of mainland generation capacity shortages, transmission constraints, and a market-bidding system that has been 'gamed' to secure higher prices.

Market failure issues

The structure of the market and the nature of competition are important considerations in determining the public interest. It also determines which of the suite of options before the government—privatisation, franchising, corporatisation, commercialisation, and departmental control.

It also has a bearing on the external governance arrangements. Some of the main consequences are outlined below.

Fixed and sunk costs

GBEs have varying degrees of fixed and sunk costs. TasPorts provision of wharf infrastructure has a high fixed cost component. It is also largely sunk because it does not have an alternative use other than providing berthage for ships. TT-Line, on the other hand, has significant fixed costs, such as its ships and crewing costs. However, these costs are not sunk because there are alternative uses for the ships and the workforce.

Tasrail falls somewhere in between. Its track is a significant fixed cost that is sunk. Its locomotives and rollingstock are fixed but might not be sunk because they could be sold elsewhere.

The implication of high fixed costs is that the businesses have some degree of market power to set prices above marginal cost. The public interest implication for external governance is whether to place limits on any market power being exercised or whether to subject the GBE to independent government regulation.

Setting prices above marginal cost is usually necessary to recover all costs and pay dividends. However, this decreases overall economic performance. The public interest implication for external governance is whether the efficiency loss of charging above short-run marginal costs—for the purpose of reflecting a price that would make the business equivalent to a contestable private business or for budgetary and user-pays reasons—can be offset by increasing the incentive for good internal governance based on commercial objectives and replicating factor market disciplines.

Manifestly, governments decided in favour of applying the discipline of requiring full cost recovery. However, it can be expected that GBEs have improved their performance since the model was introduced, and the balance between allocative efficiency and operational efficiency might have changed since the reforms were implemented.

This is a significant issue for TasPorts because the efficiency of its wharf infrastructure investments is irrelevant once made because the investment is sunk. Furthermore, the government must have been heavily involved in the investment decision in the first place and provided access to loans.

Requiring a GBE to recover fixed costs, usually at the depreciated current discounted replacement cost, does not actually impose financial discipline, but it can come at a cost if the assets are sunk.

Some of the economic performance loss in setting prices to recover fixed costs can be reduced by price discrimination. Price discrimination is made more difficult if the price sensitivity of customer demand is unknown.

Monopoly business services, such as TT-Line car-carrying, can be affected by delays in providing sufficient capacity that require new investment to increase. However, in demand peaks where there is under-capacity, higher charges clear the market and improve profitability. They also provide the market demand signals for capacity augmentation.

The implication for external governance is that there is a trade-off between service quality and economic efficiency loss and the appropriate timing of investment for additional capacity.

Demand characteristics
The demand for GBE services is usually derived because they are inputs to final demands. Consequently, the demand for their services is not as price sensitive as businesses facing final demands. However, with intermodal competition, the price sensitivity of derived demand increases.

Assets are typically indivisible and long-lived. Consequently, investment is 'lumpy,' and its capacity cannot be adjusted continuously in response to demand growth or volatility. They are typically designed to meet growth in demand over a substantial part of their lives.

The size of these investments has broad implications for fiscal decisions because of their effects on the budget and the state's credit rating. The implication is that capacity investment is a critical external governance issue. It can have significant implications for the State economy, and the government should have a role to play in setting investment objectives.

Where demand is variable, such as the demand for port services, there are economies of massed reserves. A competitor with a single berth in a port is less able to provide the same level of service to customers as those with many berths because they must queue ships proportionately longer when there is more than one in port. This has implications for market power and the justification of government monopoly ownership.

Essential services
Many GBEs provide what the government and public regard as essential services. Typically, they provide services that are required for the efficient operation of the economy. As such, governments have a role in determining the level and standard of service provided.

This affects both the investment and operational cost decisions of GBEs. It is essential, therefore, that the government's objectives for the level and quality of service are fully resolved and set out in its objectives.

Governments typically fund below-cost services by providing community service obligation (CSO) payments to the GBE. In doing so, the GBE can operate as a commercial business. However, the model is compromised if the payments do not fully cover the cost of the subsidy.

Essential services might also have social dimensions other than price. For example, they might include environmental and public safety considerations.

Complexity in setting public interest objectives

Determining the public interest and distil it into unambiguous objectives is extremely complex. It requires many decisions that only governments can make. It also involves balancing the conflicts in the many financial, economic, social, environmental, and public safety considerations.

This complexity raises the question of whether the GBE corporatisation model is effective and efficient. It necessitates expressing the public interest in a concise number of objectives that provide a basis of both achieving both financial and public interest objectives, which might not even be achievable.

Moreover, only governments can be held accountable for public-interest decisions. Consequently, it is essential that their statement of requirement expressed in the form of objectives that open to public scrutiny. There should be no ambiguity or public interest decisions left to the GBE board because shared responsibility weakens accountability.

This represents a potential weakness of the GBE model because governments do not always want to be fully accountable by making their public interest decisions transparent. There are political reasons for obfuscating the decisions, especially if there are winners and losers or very polarised views about what is in the public interest.

Governance transaction costs

A consequence of monopoly and market power is that there is scope for 'feather bedding' and misplaced investment decision affecting allocative efficiency. This increases the importance of effective governance and its transaction cost.

There are significant transaction costs in the external governance and ongoing performance oversight of GBEs. Governments face a decision on whether any performance gain outweighs the cost of oversight by ensuring that their (possibly unresolved) objectives are met.

Typically, the resultant governance agreement between the shareholding minister acting on behalf of the community and the GBE board being an incomplete contract requires trust. The greater reliance on trust, the higher the risk implicit in the governance arrangements and the higher degree of shared responsibility for public interest matters, for which neither the government nor the GBE can be held fully accountable.

The agreement between the shareholding minister and the GBE board is a form of franchising. Franchising involves a significant transaction cost in negotiation and contract preparation. Some of these transaction costs are avoided under GBE external governance arrangements. However, without contractual control, the minister must be involved in important decisions. Failure to do so can result in significant political and financial costs if something goes wrong. Furthermore, unlike franchising involving the private sector, there is no legal redress.

There are practical difficulties in freeing the GBE to just operate commercially without government involvement. Ministerial interventions are necessary if contingencies arise when there are changes in the assumption underpinning the SCI as an incomplete contract. Indeed, ministerial vigilance is necessary on an ongoing basis to ensure that the business remains on track to fulfill the agreed plan.

That said, there is the transaction cost of the minister exercising scrutiny and control. The cost of active scrutiny is increased by setting objectives in a form of generality that is unsuitable to hold the GBE fully accountable for its performance.

This looseness of the 'pseudo' contract also poses risks to public interest because the ministers and the government are unaccountable. In some cases, this can lead to decisions that have adverse consequences that are not in the public interest.

Another consideration is the role and extent of performance monitoring. Performance reporting imposes additional costs on the GBE and the government because if it requires more than the usual annual reporting of private businesses. However, given that this is necessary for both government and private provision of businesses with market power, it is unavoidable in the public interest.

In practical terms, the metrics used for monitoring must provide information relating to the government's objectives. This might not always be possible, and supporting and comparative information is required for their interpretation.

There are significant problems in arriving at suitable metrics to monitor GBE performance and then adequately interpret them or find comparable benchmarks. Notwithstanding the problems of unclear objectives, shared responsibility for outcomes, and uncertainty, there cannot be accountability if performance cannot be measured.

Improving external governance

The relative strength of the Australian model is that ministers are more accountable for their governance of GBEs on behalf of the community than would be an independent entity engaged to perform the governance role. If governance is contracted out and reports to a minister, it is in effect another layer of bureaucracy.

The way to strengthen safeguards is to achieve a clear distinction between external and internal governance, to clarify and make all objectives (financial and non-financial) more transparent, to make boards as independent as possible, and to enhance accountability.

Ministers bring to the objective-setting process their responsibility to act in the public interest. However, as the reasons for the determination of objectives are not published in any Australian jurisdiction, there is no transparency as to how the public interest is identified, what it constitutes, and how it relates to the objectives of GBEs.

There is a compelling case for governments to make public their rationale for ongoing public ownership of each GBE, including a statement of the perceived public interest benefit, the objectives to be pursued through ownership and the prioritisation or weighting of financial or other public interest outcomes.

Under current governance arrangements, it is difficult to determine the extent of ministerial involvement in shaping SCI objectives. Boards submit their SCI to ministers before the start of each fiscal year. The minister can then ask the board to reconsider some aspects of the statement.

Typically, ministers can then direct the board to modify their objectives if the draft has not been agreed one month before the beginning of the fiscal year. In addition to formal consultation processes, ministers and staff can interact informally with the board.

As these informal interactions may not be open to public scrutiny, the effectiveness of the process cannot be observed, and the participants cannot be held directly accountable. Measurable objectives contribute to greater clarity of purpose and accountability.

The most effective way of making objectives measurable is to define them in terms of outcomes. Examples of quantifiable outcomes are ‘maintain an accident-free workplace’ and ‘be profitable and maximise long-term value.’

The public availability of a timely, informative, ministerially agreed SCI that includes objectives expressed in terms of target outcomes would strengthen ministerial accountability.

Performance indicators and targets.

Performance indicators are widely used by governments and the GBEs. In some cases, they relate to the same high-level objective. In most SCIs, however, objectives and performance indicators are not themselves linked, consequently their relevance is not always clear.

Where objectives are ambiguous (for example, ‘to improve financial performance while … meeting community and environmental responsibilities’), it is difficult to establish meaningful subordinate performance indicators other than for component parts of the objective.

Moreover, the use of performance indicators relating to ambiguous objectives can lead to perverse outcomes if those indicators are poorly designed. For example, performance indicators focused on a GBE’s short-term financial performance could undermine the long-term value of the enterprise.

Merging the logistic GBEs

The decision to merge the logistic GBEs should be based on whether this is in the public interest. In considering this, the relevant questions are:

- are the objectives for each merged entity similar enough to be captured in a consistent set of public interest objectives; and
- will internal governance be improved by having a single high-powered board recognising that the services provided by each are significantly different in character?

A single entity would bring limited co-ordination benefits to improve the overall logistics chain. TasPorts, as an infrastructure provider, has a broader role than the provision of wharf infrastructure for TT-Line. Tasrail operates service that are unrelated to those of TasPorts and the TT-Line.

Better internal co-ordination of a merged business would be expected to have helped ensure the timely construction of a Devonport berth for the new TT-Line ferries. However, shareholding ministers are already able to ensure co-ordination is achieved through ministerial directions.

The three entities have diverse public interest features that will increase the complexity of establishing objectives for a merged single entity. The merged businesses have different economic characteristics, and the non-financial objectives differ.

There are also difficulties inherent in the expectation that the merged entity would act commercially. For example, a combined business would be expected to have differing levels of profitability across its subsidiary businesses. This could give rise to incentives to focus on the area that is most profitable or cross-subsidise one or more of the businesses, which might be contrary to the public interest and effective governance.

A consequence of inconsistent objectives is that the responsible minister(s) could be faced with greater complexity in providing external governance. The directions would require accommodating the same objectives that applied to each business prior to the merger. Any inconsistencies would have to be addressed to ensure there are no perverse incentives to hinder the achievement of the public interest in each subsidiary.

The shareholder minister would have to provide non-commercial objectives for each of the original businesses. This could give rise to tensions between the non-commercial objectives of each subsidiary and the overall requirement to run the merged business commercially.

The shareholding minister would also be faced with increased scrutiny and performance monitoring. This would not necessarily lead to savings in ministerial support because expertise in each subsidiary business would have to be maintained.

It might be easier to appoint a high calibre board to a single entity instead of three boards. However, difficulties could arise in forming a board with experience in directing a diverse business operating across sea transport and land transport, as well as the provision and operation of specialised infrastructure such as wharves, associated cargo or passenger handling facilities, and navigational aids.

Merging businesses such as those proposed would also make the internal governance role of the board more difficult. It is contrary to the business management maxim of ‘sticking to your knitting’ because the activities are not complimentary or substitutes.

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