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Closing the Deal

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Corporate legal adviser Andrew Harmos gets an inside look at some of this country's largest corporate deals, but he also keeps a patriotic eye on the national trends in foreign ownership, savings and investment.

Interview by Kevin Morris

Could you paint a picture for us about the increased activity in your industry over the past decade, and explain how and why it has developed?

We are a specialist mergers and acquisitions (M&A) firm and there is no question that demand for quality services in our area is at unprecedented levels. However, the reason it has grown, is not necessarily a good reason for New Zealand. M & A activity has grown because a disproportionate amount of wealth has been created offshore by our trading partners, and not in New Zealand.

With the weight of money that savings strategies, government and economic policies have created in other countries, companies have access to lower cost funds (and lower cost of capital than New Zealand firms face), so they have the buying power to grow. And that's not buying power that we have in New Zealand because we have a low savings record, a shallow private equity market and more importantly a lack of depth and understanding of the benefits that access to the public markets through the stock exchange, can bring. We're not helped by an unsophistaced government policy that fails to recognise that economic prosperity results in social prosperity. There is a backward preference to reallocate wealth rather than grow the pie.

Our nation has a savings mentality that is based on real estate—and generally passive residential real estate—rather than a preference for investing in businesses that can grow. And we have people that look to exit through private sales, rather than utilising the equity markets. We also have a paucity of business leaders. We have an "I've done well enough, that's enough" attitude, rather than people like Graeme Hart, for instance, who continue to be active because they enjoy what they do, not because they need the money. Some people would rather go off and sit on the beach, which I guess is fine, but too much of that attitude doesn't help the nation.

Combining those attitudinal factors with our weak currency, and the tendency for NZ shareholders to readily fly the white flag, means that we are a soft target for corporations that wish to grow through acquisition. It's easy to set up business here, it's not difficult to understand the business environment and we've removed many of the protections and barriers—unlike for instance Australia. It's easy for foreigners to get approval to buy our companies, which are typically well-managed. Our people are well-educated and happy to travel to work in head office abroad, contributing to the hollowing out of many of our key sectors.

This is all a convoluted way of saying that our sector has grown for the wrong reasons. It's grown because our country is a soft target, our government seems accepting of a "branch office" mentality, and we're exporting our wealth.

So what do you see as the fastest solution for the country in terms of retaining higher levels of ownership and wealth?

Well, I should say the country has made some progress in terms of elevating the national conversation around the savings debate. I'd like to see New Zealand move to an individual account-based superannuation system. There is some telling anecdotal evidence from Australia about the percentage of households that invest in shares – about the cleaner with the spring in their step because they can log-on and check how their individual accounts are doing. They have an interest in the financial markets. That drives a level of financial sophistication that encourages a culture of self-reliance, rather than a culture of dependence. A change in the tax system could be dramatically helpful and give people incentives to save in particular directions. The current proposal to tax off-shore investments is again backward looking—its hard to see what it is aiming to achieve and its likely second order affects are very negative for the country. A general "New Zealand Inc." conversation about what's good for the country long-term needs to be the primary focus of those in leadership positions. Australian politicians have it—they regard the Stock Exchange and the local capital markets as something to be guarded and fostered—they understand and use the markets rather than fear them.

Keating's single biggest contribution to Australia was the creation of the savings pool through Australia's superannuation policy. Australia is going from strength to strength as a consequence. Not following that is just going to really hurt our long-term position. We've got an opportunity to attract some good corporations here now through restructuring the tax base. Second to Ireland, we have the largest proportion of graduates who are semi-permanently abroad. Well that's okay to a point, but if they never come back all we're doing is exporting talent and we've got to find ways to turn that around.

The good thing about New Zealand is that our problems are able to be addressed and turned around in 10 minutes with the right government policy, whereas problems that some of the other nations face, including the U.S., are very significant and very hard to turn around. With the right attitudes and leadership, we can really be spring-boarded into a very bright future.

We're seeing a number of foreign private equity funds pay large multiples for some of our businesses. Will local buyers ever compete?

Overseas buyers are feeling the pressure of having a lot of money and competing to try and spend it. We're not by any means at the end of that trend. We don't have a well-developed deep set of private equity participants in New Zealand. What people don't realise—and I think what the government doesn't really understand—is that capital or assets generate wealth more than labour. I mean labour is simply rewarded on a market-based hourly basis and you don't generate real wealth through being the provider of wage workers to the world. You generate it by being the owners of the assets—so we need to understand the real value of assets and jealously guard them from being sold at under value—or in some cases—sold at all.

One of the things that people don't think about is that if your house is worth $400,000 and somebody comes along and offers you what it's worth, would you sell? No, not necessarily, there are a lot of other factors you take into account. But if a share is trading at $2 and it's really worth $3, and someone comes and offers you $3, most people would take it simply because the price is in the fair value range.

So you need to consider other reasons why you might sell it. How are you going to reinvest the money and is it really appropriate to be selling it? What can I replace it with, what will it be worth in a year or two years? The winners today are the people who are taking the long-term view.

What are some of the strategic reasons driving buyers in an acquisition?

There are a wide range of commercial reasons, including: buying growth that a company can't achieve organically; buying market share; to take a competitor out of the market; combining for synergies and efficiencies to take costs out; trying to get scale to enable the group to compete more effectively on the global stage; access to people at companies with high levels of entrepreneurship and skill. The only way often to access those people is to buy the company and give them similar incentives in a merged group.

Another scenario is where there's been dramatic over-investment in an industry. An example of that might be the wine industry. Are any of them actually making any money? Some of them clearly are, some probably aren't.

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decision. If my daughter were to ask me today for a new car, there would be a pretty obvious answer: forget about it. But if through the course of 3 months or 6 months I'm conditioned to the reality that I'll have to do it, then I'm more likely to do it. Kids know how to do this intuitively, by constantly reminding us what their friends have, for example.

You see the same kind of strategies adopted in the buying and selling process of companies. A buyer wanting to minimise price is going to apply the strategies and tactics like: "If you don't accept the offer within this period then it's withdrawn and I'm not coming back." Vendors can also get much better terms through creating an atmosphere of competition and urgency.

When you're talking about sale, there is only one real value—and that is whatever someone's prepared to pay, which is generally an amalgam of a valuation assessment and a number of psychological factors.

To what extent does New Zealand follow international trends, and are the deal mechanics different in this part of the world?

Whatever happens abroad generally gets transported here reasonably quickly. For instance: the contestable sales process; the concept of exclusivity; directors duties and their requirements; whether they're legal or market-based to maximise value; the break fee debates that arise when a transaction doesn't proceed. The takeover legislation is different everywhere, but there are a number of core concepts that apply through the world about equal treatment and fairness.

If we're asked for a formal opinion on how a board should behave, for instance, if faced with a takeover, we won't restrict our thinking to the current law in New Zealand. We think that the courts here, because these areas are always evolving, will have regard to practice in other jurisdictions. We are always checking the international trends, because ultimately they will come here. The massive over-reaction to Enron spread through the world with some excessive practices, with boards spending far too much time on processes and compliance—without actually focussing on strategy and why they're really there.

But other global trends, like consolidation in financial services, stock exchanges and the ports sectors are all emerging. The consolidation of infrastructure, like toll

But the reason for consolidation can also be defensive. If there's been too much investment in an industry, it's often the second or third owner that actually makes the money. They combine businesses, get rid of surplus assets and run the operations more smoothly.

How big is the grey area related to valuations and the ultimate sale price?

You can establish a valuation within a range using standard methodologies, but psychology and tactics can determine whether you finish within or outside that range. There's a lot of psychology. I never use to believe that it was real, but now I'm absolutely convinced. The behavioural psychology of the market is just becoming more and more apparent. You want what you can't have, and that's just a fact.

If somebody else wants what you want, you are prepared to pay more for it—no matter where you start. Conditioning buyers and sellers to an outcome, therefore, requires taking them down a particular path toward a roads, all start abroad and get an element of momentum or legitimacy before arriving here.

Do you see New Zealand as a land of missed opportunities in the business arena?
Historically, there have been some pretty stupid decisions by some of our corporates and governments as well. The decision to sell our banks off-shore was just one of the dumbest decisions in the history of the country. Look at the profitability of those big banks and the importance they have to Australia's economy Australia has its "four pillars" policy that restricts foreign ownership of banks, whereas we happily sold them away. I also think that if some New Zealand companies that have expanded into Australia had re-deployed that wealth in other areas in New Zealand, for instance, then we would have a lot more wealth in the country.

Another example of missed opportunity, which is still capable of being addressed, is the SOE sector. Wouldn't it be great to get some real accountability into some of the SOE's with public money, directors accountable to public shareholders, and business plans based on sound commercial logic rather than political agendas and charters. Share caps could be applied to restrict foreign ownership if necessary. A listing of the SOE's would give the NZ Superannuation Fund some more domestic assets to choose from and other New Zealand investors an opportunity to invest in businesses that add value rather than residential rental properties. The big lost opportunity here really is the lost opportunity to educate the broader public and teach them a level of financial sophistication and independence.

So what are your hopes for the country's future?
I'd love to see a greater appreciation across the country that businesses and successful business is the key to prosperity. The world is a very, very competitive place and whether we know it or not, we don't have any friends out there. Australia is acting completely in its own self interest—which is totally fine—and looking to secure its future as a nation and the future of its people. It will do that at the expense of others and we just don't seem to be noticing.

I'm very disappointed about the acceptance of a branch office economy mentality in New Zealand that some of our current political leaders have adopted—and not understanding that there needs to be a quid pro quo for every deal. For instance on the harmonisation of business, we shouldn't simply be adopting Australia's laws.

We have some huge opportunities—Australia has its resources sector just pumping. It has created a lot of wealth across Australia. Ordinary Australians have participated in it through ASX listings. We need to do the same with our rural sector which is dominated by co-operative ownership at present. Also Government is a lousy owner of assets—it uses valuable trading enterprises as instruments of government policy and so risks destroying value. Party hacks aren't the best directors. Lets see some outside capital in some of our SOE's, lets get them listed on NZX so ordinary New Zealanders can own shares direct and put some governance pressure on them to perform.

I'm really worried about the hollowing-out of our infrastructure and our people resources through lack of opportunity which comes through business investment and growth, and the fostering of a positive environment for business that involves an interplay of attitude, tax, and pro-business considerations. Our politicians just can't seem to address the important issues about where the country is going and where ought we to be driving the strategy of the nation. Too much focus on the soft issues.

How do we prepare the next generation for the challenges this country will face?
The current and past generation have suffered from not suffering. A lot of the success globally, whether it's wealth or asset ownership, has derived from the prior generation's hardship. And a lot of the successful businesses in this country originated with hard-working immigrants.

So I like to talk to my kids about staying well informed from a global perspective, and the importance of a strong work ethic. When education is at your fingertips you don't necessarily value it. But you look at the people in countries that don't have access to it, they are desperate for it. So our children need to have a sense of just how fortunate they are, and that they need to grasp every opportunity. A lot of our young people want more of a life balance. Well now that's fine to a point, but a life balance doesn't start when you're 15 and uneducated, it starts when you've earned it.

China and India have enormous problems that are systemic. But they have created real opportunities for their people. So China has become the manufacturing facility for the world, and India has become the outsourcing/ IT centre for the world. In India's case it's been driven by education and the value that was perceived in education. The government established centres of excellence for particular industries and created an environment of knowledge workers. Where's our niche?