

thebigpicture

guideposts for the private investor

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thebigpicture guideposts for the private investor is published by *thebigpicture* Economics (ABN 71 040 787 936). The author, John A Robertson, while working in Australia, London and New York, has over 20 years experience in international financial and commodity markets, corporate strategy, financial and business evaluation and government policy. He has been Chief Economist and a director of a leading Australian investment bank. He has been a top-rated institutional equity analyst and has marketed investment advice in all the major international financial centres.

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TELSTRA: SETTING THE TONE

Telstra has hit the headlines again as it fights to extricate itself from a web of poor governance practices, structural failings and populist policy making. The bigger picture is that its behaviour will have an impact on how people around the world judge the Australian market.

Telstra's size means that its influence extends beyond its own immediate problems. With some 1.7 million shareholders and a role as flagship company for the Australian market, its conduct influences judgements about the quality of Australian companies and the performance of their managers.

How Disclosure Should Not Work

The Telstra board seems to have much in common with the Federal Parliamentary Labor Party. Neither can keep a discussion confidential. There had been market speculation over the last several weeks that Ziggy Switkowski's days were numbered despite having been reappointed for a further five year term barely 15 months ago.

However, on the morning of last week's board meeting, there were definitive statements in the financial press that his departure was imminent. The detail in the stories extended to where the Telstra directors had dined the night before.

This is only one of a long line of disclosures to selected journalists about Telstra board happenings.

Subsequently, another daily paper had as its front page story details of a decision supposedly taken at the same board meeting to separate Telstra's wholesale activities from its retail business for reporting purposes to make it more attractive to potential investors as the government seeks to sell its shares.

This important change in policy, which the company had rejected publicly as a desirable option on earlier occasions, was not announced formally by the company to the market.

Unfortunately, now, the front pages are establishing a reputation for being more reliable than Telstra's formal ASX disclosures including an annual meeting held barely a month earlier which was misleadingly stage-managed to show Mr Switkowski in charge.

How Companies Use Spin

Telstra's recent annual meeting was stage managed to remove any sense of division between the chief executive and the non-executive directors.

The chief executive and the chairman took the stage (with the chief financial officer and company secretary) leaving the directors in the audience. More than any other company annual meetings, the Telstra meeting emphasized the executive in charge.

thebigpicture does not disagree with this unconventional staging of the annual meeting in principle. It has always been incongruous to have directors sitting muted in front of the shareholders they are supposed to represent. Better to get them out of the way and let the people really running the company show their wares.

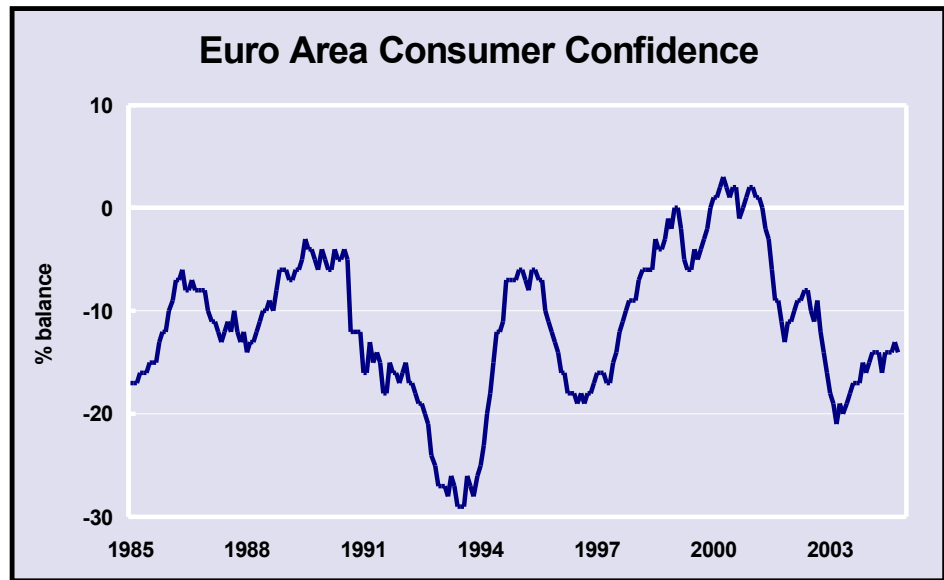
However, we now see that this set-up highlighting a commitment to Mr Switkowski concealed a view that he was an inappropriate choice for the job he held.

"...there is no reason for government to be any less influential after the sale of its shares than before."

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THE WEEKLY CHART SPOT

Weak consumer confidence readings are symptomatic of the broader malaise confronting the European economy which has been struggling against high unemployment and weak investment spending to gain significant economic momentum.



Source: OECD

TELSTRA: SETTING THE TONE CONT'D

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The standing of directors is likely to be lowered when their messages are seen to be so misleading. In Australian football, when the club president declares unconditional support for the coach, members have learnt to expect change. The same could become true of the corporate environment with the same unfortunate erosion of credibility.

Messy though it can be, the Labor Party's open discussion of leadership, clearly flagging the nature of the debate, might be a preferred alternative to the less straightforward practices of the football club.

Shareholders were also told at the annual meeting that the board and management were fully focussed on the operating business and that the possibility of the government selling its shares would not be a distraction. Again, this was spin. The reverse is the case.

Telstra now has a lame duck chief executive officer and an executive team whose prospects will depend on an unknown future appointment, an adjustment process that could easily take another 12 months, all for the sake of managing the sale process.

What Sort of CEO?

There is a consensus that one of Telstra's problems is cultural. It is insufficiently customer focussed. The chief executive had engaged in too many attempts at company transforming business acquisitions. That

left him insufficiently attentive to operational matters.

Whether or not that is true, expectations of an outside appointment have been created. The outsider will be better placed to make the necessary changes to an embedded culture. The John Fletcher experience at Coles Myer and John Stewart at National Australia Bank are models for what needs to happen, on this view. Based on the Fletcher model, knowledge of telecommunications would not be necessary.

The Telstra CEO's job is perhaps the most complex executive position in the land. It sits somewhere between Prime Minister and captain of the Australian cricket team in its profile and the weight of expectations which its holder carries.

In recent years, the notion of chief executive as corporate saviour has lost some of its lustre. Peter Smedley at Mayne Group and George Trumbull at AMP, among some others, helped to change attitudes on this.

The Trumbull experiment is perhaps the best model for Telstra – of what not to have happen. AMP is in many ways comparable to Telstra as an iconic Australian enterprise. The Trumbull experience shows that the individual chosen for the task needs to fit both the organization and the country.

Many overseas executives will be qualified for the corporate task but few will have

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GLOBAL GROWTH OUTLOOK CONT'D

Growth moving from 2% to 4% can have a more positive effect on markets than growth being steady at around 3%. Changes in the momentum of activity typically flow into profit growth and commodity market conditions, for example. Usually slowing momentum signals slower profit growth and lower commodity prices ahead.

- Growth rates are not high enough to make a meaningful impact on unemployment. Usually growth would have to be 3% or better for there to be a beneficial employment effect. Growing employment supports consumer confidence helping to maintain household spending and encouraging private investment activity. Labour market weakness is especially evident in Europe where the region's statistical agency has announced in the past week that unemployment was still 8.9% in October.
- US growth remains above outcomes in Germany and Japan where needed structural adjustments are holding back any significant improvement in the momentum of economic activity.

Longer term demographic influences are likely to sustain the growth differential with stronger population growth in the USA able to support stronger economic activity than in either Japan or Germany.

The likely difference in economic performance between the USA and Europe might be especially significant.

- It implies continuing current account pressures for the USA because its export markets will be growing more slowly than domestic demand for goods and services.
- Relatively strong US growth will help the USA to be a more attractive investment destination for international capital in the longer term.

These two influences suggest countervailing effects on the value of the US dollar. However, as long as the investment attractiveness of the US economy is sufficiently strong that capital flows can cover the current account deficit without any other adjustments, the currency impact should not be significantly negative. ■

“The forecasting agencies have also been revising downward the short-term outlook with high oil prices being especially influential in causing them to downgrade expected growth rates for 2004 and 2005.”

TELSTRA: SETTING THE TONE CONT'D

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experienced the profile accorded to a Telstra chief. Almost certainly, whether the appointee has had chief executive experience or has been a relatively junior executive before coming to Australia, the change will be an entirely new cultural experience for any outsider.

Australia's recent experience also shows that individuals who might have become accustomed to the profile and corporate power associated with a strong leadership position might not fit easily into the Australian context. Brian Gilbertson demonstrated during his short and ill-fated tenure as BHP-Billiton chief executive that the Australian politico/business environment requires some special talents.

A daunting role in a restructuring industry answerable in an ill-defined way to the national polity will require a uniquely talented individual if Telstra shareholders are to ever get the value which is embedded in its assets.

Government Sells But Stays

In the swirl of expectations around Telstra there is a view that sale of the govern-

ment's shares will be a transforming event which somehow unleashes value.

However, in reality, there is no reason for government to be any less influential after the sale of its shares than before.

The government's ability to exercise influence over Telstra comes from its lawmaking capacity and not its shareholding. The shareholding is symbolically important and the government can always threaten to vote its shares at a meeting but the key obligations imposed on Telstra by the government arise through legislation.

Operational issues will not be dealt with at shareholder meetings and fighting the board publicly in such a forum would be the least palatable way to influence Telstra's business outcomes.

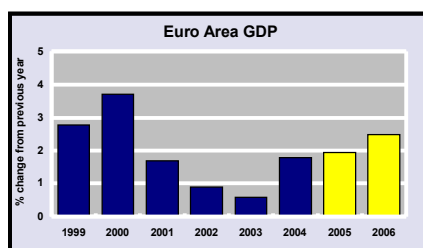
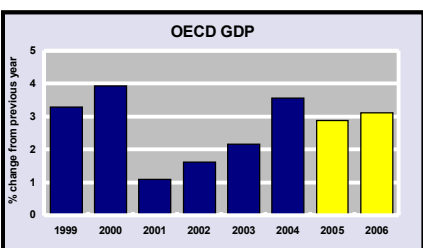
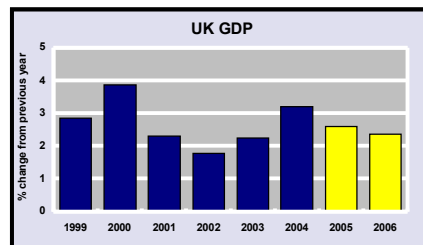
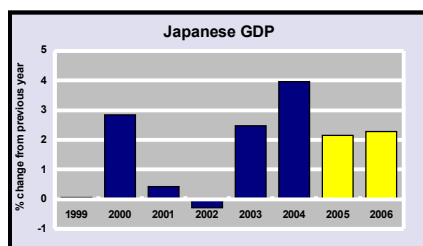
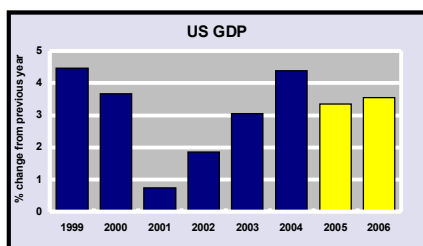
Telstra's prominent position in the Australian telecommunications market and its iconic status as supplier of last resort throughout the nation will ensure that the regulatory environment continues to be an unfriendly one. The constraints which prevent it from realising its profit potential may be no less without a government shareholding. ■

GLOBAL GROWTH OUTLOOK

Official international economic agencies have been reviewing their forecasts and coming up with the same conclusions. The global cycle is decelerating and Europe is still struggling to achieve acceptable growth outcomes.

The set of charts summarises the economic activity outlook for the principal industrialised economies. They show six years of actual outcomes (including 2004) and forecasts for 2005 and 2006 (depicted in the yellow bars).

The charts use recently updated esti-



mates of prospective economic activity from the OECD. The growth trajectories are similar to those published by a range of other agencies and show that:

- an upturn in activity has been underway for three to four years;
- a cyclical peak in activity is occurring in 2004;
- forecasting agencies are expecting 2005 and 2006 to be cyclically weaker

with 2006 very slightly stronger than 2005;

- growth in Europe will continue to accelerate in 2005 and 2006 based on better outcomes in Germany after three years of recession-like conditions; and,
- US economic growth is likely to remain above the outcomes in Europe and Japan.

The forecasting agencies have also been revising downward the short-term outlook with high oil prices being especially influential in causing them to downgrade ex-

pected growth rates for 2004 and 2005.

Macroeconomic forecasts are usually remote from most investors' day-to-day considerations but aspects of these forecasts will have an impact on investment performance.

- Changes in momentum usually have an impact on markets. A change in the rate of growth is often more important than the rate of growth itself.

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