STATE SERVICES COMMISSION
Te Komihana O Ngā Tari Kāwanatanga

Occasional Paper No. 21

Crown Entities: Organisational Design

This, and other, Occasional Papers are available through the State Services Commission's website :

http://www.ssc.govt.nz

The State Services Commission welcomes any comments and suggestions you have about this paper. If you require further information about this paper please let us know. In both instances please contact:

Derek Gill, Branch Manager
Strategic Development Branch
State Services Commission
Email: derek.gill@ssc.govt.nz
Facsimile: +64 4 495 6699

ISBN 0-478-08974-0
September 1999

STATE SERVICES COMMISSION
Te Komihana O Ngā Tari Kāwanatanga

Occasional Paper No. 21

Crown Entities: Organisational Design

Summary

The Government owns a wide range of organisations, each of which has different characteristics and responsibilities. There is a range of options available to Government regarding the classification and design of each organisation. This paper discusses the conditions and criteria under which an organisation should fall within the legal Crown (i.e. a Public Service department), and whose under which the organisation should be outside the Crown. In the latter case, the paper explores options available and points to a way forward through some of the 'grey areas'.

Contents

Acknowledgements

An earlier version of this paper drew extensively on the analysis of Michael B Hyndman (a consultant) – contained in two as yet unpublished reports to the Treasury: *Optimal Institutional Arrangements for Public Sector Activities*, and an Overview report, both of 31 July 1999. That analysis was developed in consultation with the State Services Commission.

This version of the paper draws upon both that analysis and subsequent work undertaken by the SSC on machinery of government principles.

Introduction

Governments can use a range of means to achieve their public policy objectives, one of which is the ownership of organisations. There are many ownership-related questions that a government must address, and this paper does not attempt to answer all of them. Rather, it takes as given that a government has decided to involve itself in some way in an activity, and that its involvement requires it to own one or more organisations.

On that basis, the paper addresses the issue of what type of organisation a government should employ to carry out a particular function. It focuses on two questions:

- should the organisation be inside the legal Crown (i.e. a Government department), or should it be outside the legal Crown - some form of Crown entity or a State Owned Enterprise); and
- if the organisation is to be outside the legal Crown, should it be a statutory corporation, a company, a trust, or something else?

The paper has three parts. Part 1 identifies the available organisational design choices. Part 2 addresses the question of whether the organisation should be inside or outside the legal Crown. The third part of the paper examines the organisational choices that available if the organisation is to be outside the legal Crown.

Part 1: Organisational design choices

New Zealand governments may choose from a wide range of organisational design options if they wish to establish an organisation to carry out a particular function. The choices are:

- departments operating under the State Sector Act 1988, i.e. Public Service departments;
- departments operating outside the State Sector Act;
- Officers of Parliament;
- companies operating under the State-Owned Enterprises Act 1986;
- Crown entities that may be:
    - companies;
    - corporations sole;
    - statutory corporations;
    - trusts;
- Statutory organisations that are not Crown entities; and
- Ministerial advisory committees.

Government bodies that are trusts, statutory corporations, or corporations sole are usually Crown entities, although there are exceptions to this (e.g. the Reserve Bank is a statutory corporation but is not a Crown entity). Crown companies are usually either Crown entities or State-owned enterprises.

In practice, only four organisational design options are used frequently, and only these are regarded as being significant from an organisational design point of view. They are:

- Public Service departments;
- Crown entities that are statutory corporations;
- Crown entities that are companies (CrOCs); and
- State-owned Enterprises (SOEs).

This paper focuses on this subset of significant organisational forms (**Appendix 1** discusses the less frequently used organisational forms.) In taking this focus, it is necessary to acknowledge the variability among Crown entities that are statutory corporations. The set of options for such entities is larger than is implied by the preceding list of commonly used organisational designs.

Public Service departments[1]

Public Service departments are part of the legal Crown and, in general, do not have the status of separate bodies corporate. They exercise important legal powers in the name of the Crown. Most departments are funded by the Crown, although some also receive revenue from third parties. The governance arrangements of departments centre on the direct Minister/chief executive relationship. This relationship is established within a wider framework - notably the statutory role of the State Services Commissioner, who acts as the employer of chief executives, and who reviews the performance of departments and their chief executives.

Public Service departments operate within an established statutory and conventional framework. This framework requires a close and hierarchical relationship between Ministers and their departments, and makes each department an instrument of government policy (subject to any statutory requirement for officials to act independently in some matters - which can be quite significant). Ministers have extensive powers to direct departments, as long as such directions are consistent with the law. Each department has clear obligations to the Government as a whole.

Crown entities

Crown entities are not a homogeneous group of organisations. However, four important features set them apart from departments. First, they are not part of the legal Crown, but are generally bodies corporate in their own right. This means that they contract, employ staff, hold property and engage in legal proceedings in their own name. Those that receive Government funding normally do so by means of a non-departmental output class, through a

[1] There are a number of departments under the Public Finance Act which are not departments under the State Sector Act, namely the Police, the Defence Forces, Parliamentary Service, Parliamentary Counsel Office, and the Office of the Clerk.

Vote. Typically Crown entities are governed by a board, which is appointed by the Crown. The board in turn appoints the chief executive.

Second, Crown entities operate at arms-length from their Responsible Minister. Usually, specific legislation is used to set up each Crown entity, and this legislation, together with the relevant parts of Public Finance Act 1989, defines the relationship between the Minister and the entity. As a result, there is nothing comparable to the shared legal and conventional framework under which Public Service departments operate. Consequently the role played by the Minister varies much more from entity to entity than is generally the case for departments (or SOEs).

Crown entities range from those that are basically agents of the government of the day, e.g. Health Funding Authority (HFA), to those that are quite independent, e.g. Police Complaints Authority. In recent work, the labels Crown Agent, Autonomous Crown Entity and Independent Crown Entity have been used to capture the observed range within the overall Crown entities category (refer to **Figure 1,** p.10).

Third, Ministers' formal powers of direction are far more structured (and public) than is the case for the Public Service, and may be constrained or even non-existent. Some Crown entities may not feel bound by the conventions that apply to the Public Service, and may, for example, disagree publicly with Government policy.

Finally, unlike departments and SOEs, Crown entities have not been subject to a common monitoring regime. Recent Cabinet decisions now mean that wider range of common provisions will apply.

State-owned enterprises

State-owned enterprises (SOEs) are corporate bodies, outside the legal Crown, governed by boards appointed by shareholding Ministers, and managed by chief executives appointed by the boards. In these respects they are similar to Crown entities, including Crown owned companies (CrOCs). However, as compared with Crown entities generally, but also CrOCs, SOEs are a much more homogenous group. They all operate under the common framework of the State-Owned Enterprises Act 1986. They share a common monitoring regime. They share clear commercial objectives. And, finally, the Government's interest in them tends to be limited to an ownership interest in a commercial sense. This is quite different from the situation with most Crown entities, including CrOCs, where other interests are likely to predominate, and the Crown's ownership interest must be seen against those interests.

Part 2: Inside or outside the legal Crown?

This part of the paper will outline the considerations involved in determining whether an organisation should fall inside or outside the legal Crown. However, it is important to note that legal separateness from the Crown is neither a necessary nor a sufficient condition for independence from Ministers.

Organisations that are outside the legal Crown operate at arms-length from their Ministers, but Ministers are able to exert influence over what they do and how they do it. In most cases, the mechanisms available to Ministers include the power to appoint the governing body, and the power to influence (even dictate) the content of the annual statement of intent. In addition, some organisations are required to 'give effect' to the policy of the government of the day as advised by the Minister, e.g. the HFA and the ACC. Conversely, some functions carried out by departments (which are within the legal Crown) are undertaken with a significant degree of independence from Ministers because Parliament has chosen to give designated departmental officers certain statutory powers. Examples of departmental officers with statutory powers include the Commissioner of Inland Revenue and the Government Statistician.

The approach taken in this paper to organisational design choices stems from three general principles:

- *Effectiveness and efficiency* - organisational design choices should be made to best achieve the Government's desired objectives (effectiveness) and the low-cost production of outputs (efficiency).

- *Risk management* - organisational design choices should be made to best manage the risks posed for the Government by the activities to be undertaken by a Crown-owned organisation.

- *Constitutional conventions* - organisational design choices should be made to best protect established constitutional arrangements and conventions.

Appendix 3 (p.20) provides more detail on the propositions that fall under each of these principles.

More specifically, the decision as to whether an organisation falls inside or outside the legal Crown is based on the activities it undertakes. The organisation would be *inside* the legal Crown (i.e. a Public Service department) where the activities it undertakes:

- are not readily "contractible" because of difficulties either in specifying the nature of the outputs required or in assessing whether the outputs have been produced, or there was likely to be a need to frequently re-specify the outputs required; or

- are "material" in the sense that they are of high strategic relevance to the government or to society, and the risks associated with them would more effectively be managed if the provider were subject to direct Ministerial oversight; or

- involves the use of significant coercive power (e.g. policing, defence or tax collection) or otherwise is in some sense an inherent function of the state (e.g. the conduct of foreign

policy), so the principle of political accountability requires Ministers to have direct oversight and responsibility.

Where an activity is inside the legal Crown, the relationship between the organisation and the Minister would be a close one. But, where departments exercise significant coercive powers, it is common for their relationship with the Minister to be carefully structured to minimise the possibility of ministerial abuse of those powers. For example, collecting taxes is of such importance, and so closely associated with the State, that it is difficult to regard it as suitable function for an organisation outside the Crown, but the Minister of Revenue cannot direct the Commissioner of Inland Revenue in respect of individual taxpayers.

Conversely, an organisation would be *outside* the legal crown where the activities it undertakes:

- are readily "contractible"[2];
- are not sufficiently "material" or risky as to require direct Ministerial oversight;
- must be, and must be seen to be, undertaken independently of Ministers, e.g. because the Government itself may be bound by decisions, or because it is important to signal publicly that an activity is carried out free of political interference. The Commerce Commission is an example of such a body.

The desire to signal independence could also be relevant in circumstances where it was intended to co-opt resources from the private sector (this is an application of the effectiveness and efficiency principle). The governance arrangements of schools, for example, reflect this, with their emphasis on involving parents in the governance of schools.

The Crown undertakes different sorts of activities - strategic/policy advice, regulatory, taxation/transfers, purchase of services from third parties and direct delivery of services. Contractability concerns mean that the departmental form is the presumptive form for organisations that provide policy advice. Considerations of direct ministerial oversight and accountability suggest that the departmental form is the presumptive form for organisations that collect taxes and make transfers. On delivery of services generally, and on purchase, there is no presumptive form. Some service delivery is an integral function of the State (e.g. Defence) so the departmental form is the default option. A measure of independence may be required (and be perceived to be required) for purchase, but independence could be assured through the departmental form. Regulation is the main function where legal separation from the Crown may be desirable.

[2] The use of the term contract also includes agreements or understandings that are not legal contracts.

In thinking about the implications of regulatory functions for organisational design, it is important to note two things:

- the fact that something is a regulatory function does not mean it must be carried out independently of Ministers - in fact Ministers themselves are often decision-makers in respect of some regulatory functions; and

- if a measure of independence from ministerial direction is desirable for a regulatory function, this does not necessarily imply using an organisation outside the legal Crown. The relationship between a Minister and a department can be structured in such a way as to preclude Ministers directing departments in respect of particular decisions (e.g. IRD, Police and the Serious Fraud Office). Where major coercive powers are involved it is important to have direct political accountability and oversight.

The practical difficulty of shifting a function back inside the Crown once it has been established outside the Crown is an important consideration in deciding whether to carry out an activity inside or outside the Crown. A department offers greater strategic flexibility because of the relative ease with which functions can be moved outside the Crown. This suggests that if there is a fine judgement between establishing a function as a Crown entity or a department, the departmental form should be used.

Part 3: What sort of organisation outside the Crown?

The question of whether a function should be carried out by an organisation outside the legal Crown cannot be separated in practice from the question of what form of organisation it should be - SOE, Crown-owned company, or one of the possible types of statutory corporation.

The SSC's preliminary view is that some type of statutory corporation is the presumptive organisational form for regulatory functions undertaken outside the Crown, or for functions that are not commercially productive. A devolved purchaser would be an example of a non-regulatory body which was not commercially productive. This view is predicated, however, on a more disciplined and consistent approach to the establishment and governance arrangements of statutory corporations through a general regime for different types of statutory corporation.

A company would be the preferred way of organising activities that are commercially productive, or where ease of exit was desired (although a trust would also be a possibility in the case of non-commercial activities). In general, an SOE is the preferable form for arranging Government-owned commercial enterprises because they have a clearer commercial focus than CrOCs. A CrOC might be considered where the organisation was to have both commercial and non-commercial objectives, or for technical reasons (e.g. allowing less than 100% Crown shareholding). The choice between SOEs and CrOCs is discussed in more detail in **Appendix 2** (p.17).

Allowing a private organisation to carry out a regulatory function would be unusual for constitutional reasons, but it is not inconceivable that this might be done. For example, some professional bodies exercise statutory powers in respect of their members.

Different types of statutory corporations vary significantly from each other in terms of their powers, accountability arrangements and the relationship with their Minister depending on the type of function they undertake, as well as the context in which they operate. Is the organisation expected to be independent of the Minister (e.g. Police Complaints Authority), or is it merely separate from the Minister but still subject to significant ministerial control (e.g. the Careers Service)? **Figure 1** (p.10) sets out presumptive governance arrangements for statutory corporations on this basis. These may need to be tailored to the circumstances of particular organisations.

Another key aspect of the governance arrangements for any organisation is the scope of its activities and its powers. In general, these bodies will have the powers of legal persons. However, it is common for them to be constrained in terms of some of those powers, e.g. the power to borrow. The desirability of doing so is clearest perhaps, for small regulatory bodies. For example, a regulatory body like the Police Complaints Authority should not need to establish subsidiaries or have the power to borrow.

Figure 1: Presumptive governance arrangements for statutory corporations

	Independent Crown Entity	**Autonomous Crown Entity**	**Crown Agent**
Type of organisation likely to have these governance arrangements	Small regulatory bodies where there must be independence from the Minister Devolved funders / purchasers where there is a requirement for independence	Service delivery bodies	Bodies that mix regulatory functions with other functions, or where there is no requirement for a regulatory body to be independent of Ministers Devolved purchasers that operate according to parameters set by the Government
Relationship with the Responsible Minister (RM)	Independence	Separateness	Separateness
Current Legislative Framework	*Public Finance Act* + Specific Legislation	*Public Finance Act* + Specific Legislation	*Public Finance Act* + Specific Legislation
Governing Body	Board	Board	Board
- *Appointment*[3]	*Governor-General*	*Minister*	*Minister*
- *Dismissal*	*Hard*	*Relatively easy*	*Easy*
Accountability Documents			
- *Purchase Agreement?*	Yes (but need to respect independence)	Yes	Yes
- *State of Intent (SOI)?*[4]	Yes	Yes	Yes
Reliance on regulation-making power for entity to function?	No	Quite possibly, particularly if funded by levy	Quite possibly, particularly if funded by levy
Required to give effect to Government policy?	?	Must have regard to Govt. policy affecting area of business	Must give effect Govt. policy affecting area of business
General Ministerial power to direct	No, (with some exceptions possibly)	Yes, within limits (e.g. not in respect of individual cases)	Yes, within limits (e.g. not in respect of individual cases)
Example	Police Complaints Authority	Film Commission	Health Funding Authority

[3] Appointment by the Governor-General is almost always on the advice of Ministers. In the case of some entities stakeholders are directly involved in the board (e.g. schools and tertiary institutions).

[4] Size is likely to be a key factor in determining whether an entity has an SOI.

Conclusion

Organisational design is an area in which the SSC's thinking is continuing to evolve. This paper has explored some of the elements that are involved in making decisions about organisational design. Clearly, however, this exploration constitutes a starting point, as it is an area of great complexity with many 'grey areas'.

In order to navigate these grey areas, this paper has used the following criteria, based on the activities of an organisation, have been used to determine whether it should be inside or outside the legal Crown:

- *contractability* – the relative ease or difficulty in which the activity can be contracted;
- *materiality of risk* –the strategic relevance to the government and society of the activity; and
- *use of coercive powers / independence* – depending on the activity may suggest close ministerial oversight (e.g. policing, tax collection) or a degree of ministerial independence (e.g. investigative functions such as those carried out by the Commerce Commission).

Where activities of an organisation are readily contractible and don't pose significant risks, the presumption is that it should fall outside the legal Crown (i.e. Crown entity or SOE). In addition, if a degree of ministerial independence is desirable it should also fall outside the legal Crown. Where the situation is the opposite, the presumption is that it should be part of the legal Crown.

There are number of different Crown entity types. This paper focuses specifically on the different types of statutory corporations that have been proposed as part of the *Crown Entities Initiative*. They vary principally in terms of their relationship with their Minister. This is an area that is currently being further developed.

Appendix 1: Less frequently used organisational forms

This paper has focused on departments, statutory corporations and companies (whether Crown entities or SOEs). A government has available to it a number of other more or less permanent organisational forms, namely:

- Ministerial advisory committees;
- Officers of Parliament and other Parliamentary bodies;
- statutory boards;
- trusts (normally Crown entities);
- corporations sole (normally Crown entities); and
- organisations that are departments under the *Public Finance Act 1989* (e.g. the Police, the New Zealand Defence Force, and the Parliamentary Counsel Office) but are not part of the Public Service.

Parliament has also established a number of organisations that exist at or just outside the margins of the state, and do not form part of the broader Crown estate. Parliament's Finance and Expenditure Committee has developed criteria for determining whether such organisations should be regarded as a Crown entity.

This Appendix discusses each of the types of organisations listed above. It does not consider bodies that are established to investigate a particular matter (e.g. Royal Commissions and Commissions of Inquiry). Nor does it consider the Reserve Bank, a state agency that is *sui generis*.

Ministerial advisory committees

Ministers can set up committees to provide them with advice on particular issues. These would generally be made up of suitably qualified people from the private sector (although officials may be involved as well). The Minister needs no legislative authority to set up such a committee, although some legislation does provide for them. The Minister may seek Cabinet agreement before establishing such a committee, particularly if the Minister is seeking extra resources. Such committees often are established to examine a particular issue, or for a particular time frame. But they may exist for long periods of time, and serve several successive Governments (e.g. the Legislation Advisory Committee and the National Council on the Employment of Woman, the latter having existed for over 30 years).

Ministerial advisory committees are part of the Crown in terms of the Public Finance Act 1989, and usually are funded via a departmental output class, i.e. the expenses of the committee are met by the Minister's department.

The quality and independence of the advice from committees is protected by:

- the quality of the people appointed;
- the terms of reference; and
- the fact that such committees are usually not responsible to the chief executive of the department, and report directly to the Minister.

Ministerial advisory committees have a number of qualities which make them attractive (and frequently used):

- they are easily established and disestablished, with little requirement for formal process - no legislation or regulation is necessary;
- they are a relatively easy way of involving outside experts in the supply of advice direct to the Minister;
- they provide a measure of independence, but ultimately they clearly exist to provide advice to the Government; and
- they are usually relatively inexpensive.

The disadvantages of such committees are that:

- their lack of legal personality and strong formal accountability makes them unsuited to service delivery, purchase roles, or ownership roles;
- the lack of a statutory basis makes them unsuited to regulatory roles;
- their very informality may give them a relatively lower profile than, say, a statutory body such as the Law Commission; and
- their very informality may not provide a strong sense of permanence (even though there are examples of committees which have existed for long periods of time).

This suggests that Ministerial advisory committees should be considered as a serious possibility for the provision of independent advice to the Government, but are unlikely to be relevant where the body exercises public powers directly, or where the body needs to have the powers of a legal person. It is important to note that a Ministerial advisory committee is an *advisory* body. It should not be undertaking activities which cut across the responsibilities of the Minister or the departmental chief executive, or for which it does not have the legal authority. It is important, for example, that there is proper authority for the expenditure of public money.

Officers of Parliament and other Parliamentary bodies

This grouping encompasses two types of body - those that provide services to support the operation of the House of Representatives, and Officers of Parliament.

The former group includes the Office of the Clerk of the House of Representatives, and the Parliamentary Service, which is governed by the Parliamentary Service Commission. (The

Parliamentary Counsel Office is dealt with below under non-State Sector Act departments.) The rationale for this type of body in terms of the provision of support to the House and its members seems clear, and they are not covered further.

Officers of Parliament are bodies the primary function of which is to be "a check on the Executive, as part of Parliament's constitutional role of ensuring accountability of the Executive".[5] They are established under their own specific legislation. The Governor-General makes the appointment of Officers of Parliament on the advice of the House of Representatives. There are presently two Officers of Parliament - The Parliamentary Commissioner for the Environment, and the Office of the Ombudsmen, although for practical purposes the Controller and Auditor-General can also be thought of as an Officer of Parliament.

The following considerations should apply to establishing a body as an Officer of Parliament:[6]

- an Officer of Parliament should only be created to provide a check on the arbitrary use of power by the Executive;
- an Officer of Parliament should only be discharging functions which the House of Representatives itself, if it so wished, might carry out; and
- Parliament will consider creating an Officer of Parliament only rarely.

These considerations suggest that "Officer of Parliament" will rarely be relevant as an organisational design possibility.

Statutory boards

Statutory boards carry out a large range of functions within government. They do not have the status and powers of legal persons in their own right (and therefore may not be able to do things like contract, own property and employ staff). The Representation Commission, which draws up electoral boundaries, and the Parole and District Prisons Boards, which decide whether prison inmates should be released on parole, are examples of such boards. As an organisational form they are appropriate in circumstances where an independent body established by statute is needed to carry out a function, but there is no need for the body to have the powers and status of a legal person.

---

5 FEC, Officers of Parliament, AJHR, 1989.

6 FEC, Officers of Parliament, AJHR, 1989.

Trusts

Properly speaking a trust is an instruction attaching to property owned by trustees. The Public Finance Act 1989 provides for trusts to be made Crown entities by order in council. This means that their "constitutions" are effectively provided by the trust deed, read together with the legislation relating to trusts (e.g. the Charitable Trusts Act 1957 and the Trustee Act 1956) and the Public Finance Act. There are only a relatively small number of Crown entities that are trusts. The trust offers three significant advantages as an organisational form:

- legislation is not required to establish them (although in some cases trusts are provided for in legislation such as the blood transfusion trust). Trusts are an alternative to using a company when Ministers wish to establish an organisation without recourse to legislation, an alternative which does not have the commercial orientation of a company and which may enjoy tax advantages;

- the relative independence that a trust would be expected to have from the Minister may facilitate co-opting resources (e.g. money, people) from stakeholders; and

- it allows some significant flexibility, since the deed can be tailored to suit the intended purposes of the trust.

These advantages are not peculiar to a trust - its major advantage is that it is a non-commercial alternative to a company that does not require legislation.

Trusts are only likely to be relevant as an organisational design possibility for relatively small service delivery bodies or devolved purchasers that are relatively independent of the Minister. The logic of the trust form makes it clearly inappropriate for some entities. For example a trust lacks the statutory basis to carry out regulatory functions. The logic of the form is that the trust will be also be substantially independent of Minister, making it a unsuitable for an entity which is expected to carry out Government policy according to Ministerial direction. The assets of trusts are owned by the trust itself, which may make it unsuitable for managing a substantial ownership interest, where the Crown intends to maintain ownership of the property. (In addition trusts do not tend to have statements of intent; nor are they required to pay a surplus back to the Crown.) An additional practical point is that if the Crown wishes to establish a charitable trust, the purposes of the trust must be charitable.

The use of the term trust or trustee in the name of an organisation does not necessarily mean that the organisation is a trust (and conversely the absence does not mean that it is not). For example school boards of trustees are statutory corporations, not trusts.

Corporations sole

There are a small number of Crown entities that are headed by a single person (such as the Privacy Commissioner), and are corporations sole. They are distinctive in not being governed by a board, which is the typical arrangement for Crown entities. A corporation sole is likely to be used only in exceptional circumstances - where it is desirable to have a statutory officer established outside the Crown whose office has the powers of a legal person. Generally this has been limited to a small number of regulatory functions.

Non-State Sector Act departments

There are a number of organisations which are not part of the Public Service as defined in the State Sector Act, but which are part of the Crown by dint of being departments under the Public Finance Act. These include the Defence and Police Forces, and the Parliamentary Counsel Office.[7] In organisational terms, it is sensible to think about these agencies as a specialised type of department, distinguished by their distinctive relationship with the Minister. In terms of decisions to establish new organisations, this will usually not be a relevant organisational form since it is unlikely that we would choose to establish a new entity on this basis, rather than as an ordinary department.

At the margins of the State

There are a number of organisations at the margins of the state that Parliament or the Government have not thought should be included within the broader Crown estate - e.g. the Historic Places Trust and the Crown Forestry Rental Trust.

The Finance and Expenditure Committee (FEC) set out a number of criteria for thinking about whether or not such an organisation should be a Crown entity (and hence clearly a public body). These are helpful in terms of thinking about this issue, and were used as a test for drawing up the 4th schedule to the Public Finance Act, although the criteria themselves were not ultimately included in the Public Finance Act. The FEC criteria are that "Crown-owned entities[8] are those bodies corporate other than SOEs:

- in which the Crown owns a majority of the voting shares; or
- for which the Crown has the power to dismiss a majority of the members of the governing body or where no such body exists, has the power to dismiss the chief executives, and replace the governing body or the chief executive with a governing body or chief executive which is primarily responsible to the Crown; or
- for which the Crown has the right to more than 50% of their net assets on their disestablishment; or
- in respect of which the Crown would be expected to assume any residual liabilities other than pursuant to a guarantee; or
- which Parliament considers to be owned by the Crown and deems to be Crown-owned entities."

The criteria are obviously not exhaustive, given the last point, and Ministers may be influenced by other factors in thinking about this decision. Nevertheless, they provide a useful test for deciding whether or not an entity should be considered as part of the Crown estate.

---

[7] The status of the Parliamentary Counsel Office is somewhat ambiguous. Given its role and statutory relationship with its Minister (the Attorney-General), it is regarded for the purposes of this paper as part of the Executive, rather than a Parliamentary body.

[8] The term "Crown entity" was ultimately preferred to "Crown-owned entity". Another problem with the test is that there are a range of corporate bodies which are not SOEs, and are clearly within the state, but which are not Crown entities (e.g. the Reserve Bank and corporations associated with departments such as the Public Trust Office and the Maori Trustee).

Appendix 2: Crown company or SOE?

The Crown has made extensive use of the company as an organisational form since the passage of the State-owned Enterprises Act 1986. Such companies fall into two major groups - SOEs and Crown owned companies which are Crown entities (here referred to as "CrOCs"). CrOCs are the second most significant category of Crown entity after the statutory corporation.

SOEs and CrOCs share many features in common - some CrOCs represent an attempt to apply the SOE model to entities which do not have unambiguous commercial objectives, or which for other reasons are not SOEs. Both involve incorporating companies under the Companies Act.

SOEs are established under the State-Owned Enterprises Act 1986. They are not Crown entities. Aside from the legislation under which they are established, the basic differences between SOEs and CrOCs are ones of purpose and objective:

- SOEs have unambiguous commercial objectives, whereas CrOCs tend to mix commercial and non-commercial objectives (although there are exceptions to this);
- the Crown's ownership objectives in SOEs are relatively straightforward - being to maximise the return to the shareholders over time. CrOCs, on the other hand, generally are owned to further other policy objectives and the profit objective may be secondary;
- the Crown does not usually have a particular purchase interest in SOEs, but often does in CrOCs (although it may be handled indirectly);
- SOEs tend to sell into contestable markets (although at least one is a monopoly) – with CrOCs this may not be the case where the Crown is the dominant purchaser; and
- because of the previous considerations, Ministers may face fewer incentives to involve themselves in the day to day business of SOEs.

This means that SOEs have a clearer commercial focus than CrOCs, and, all other things being equal, are likely to perform better as commercial organisations. All parties concerned in an SOE - shareholding Ministers, the board, management, staff, customers, creditors and Parliament -- should have a clear understanding of its objectives, as set out in the State-Owned Enterprises Act. This will not be the same for CrOCs, or at least not true to the same extent. These considerations clearly indicate that, in general, an SOE is the preferable form for Government owned commercial enterprises. If an organisation is to have clear commercial objectives, operate in a contestable market and the government does not have a particular purchase interest in it, it should be an SOE.

When might a CrOC be used instead of an SOE?

If the SOE is the preferred form for commercial activities, in what circumstances might a CrOC be used? A CrOC might be considered where:

- the organisation is to have non-commercial objectives rather than commercial ones; or
- some technical considerations apply.

Mixed objectives

The most common reason for establishing a CrOC is that the organisation is to have a mix of commercial and non-commercial objectives (or even entirely non-commercial objectives as in the case of hospitals). Another way of putting this is to say that the Government will have a range of interests in the organisation in addition to the ownership interest that it has in a commercial organisation. Usually it will have a major purchase and policy interest in a CrOC, although the purchase interest may be managed indirectly. Indirect purchase has been used in some cases to establish an institutional separation between the Government's purchase and ownership interests.

This is quite different from the situation with an SOE which has clear commercial objectives - if the Government wants an SOE to supply a service that it would not supply otherwise, it must commercialise it by buying the service at an agreed price. In some cases the commercial objectives in a CrOC will be secondary to purchase and policy interests. Examples of CrOCs, which have mixed objectives, include hospitals, CRIs, HNZ, and NZSO. Care must be taken with this, however. Mixed objectives may not be satisfactory unless conflict between them can be avoided, or there is a clearly understood order of priority.

Technical issues

There are two technical reasons which may favour use of a CrOC:

- *Joint ownership* - The SOE Act does not contemplate an SOE having any full shareholders other than Ministers (s11 - redeemable preference shares with no voting rights can be issued to others). In some circumstances the Crown may hold only a proportion of the shares in a company, and this may be another reason for favouring a CrOC over an SOE even where the organisation has unambiguous commercial objectives. Where the Crown owns 50% or more of the shares, the company should be a Crown entity. Auckland and Wellington international airports were examples of this; in these cases, the balance of the shares was owned by local authorities. The Crown owns shares in other international airports, but these companies are not Crown entities because the Crown owns less than 50% of the shares.[9]

[9] One possible complication with a company jointly owned by the Crown and local authorities is that the company might conceivably come within the FEC's definition of a Crown entity (by virtue of the Crown owning 50% or more of the shares), but also fall within the definition of a LATE in the Local Government Act 1974. In particular s594B 1[iii & iv] - "[LATE means]…[a]ny organisation through which a local authority or local authorities operate a trading undertaking with the intention or purpose of making a profit (being an organisation over which the local authority or local authorities have significant control, or…[a]ny other company or organisation (being an organisation through which a trading undertaking is operated) which a local authority or local authorities, directly or indirectly, have control of by any means whatsoever…[some bodies such as airport companies are explicitly excluded]" The Audit Office have defined significant control as 30% or more of the voting power and *control* in s594B 1[iv] as a lower threshold - Second Report for 1997, p80. A similar question might arise for a company that was jointly owned by a Crown entity and local authorities, since the subsidiary might be both a Crown entity and a LATE. This poses conceptual and practical problems, since the governance and accountability regimes of LATES and Crown entities operate on somewhat different premises.

- *Ease of sale* - Legislation is required before an SOE can be sold (although legislation can provide for an SOE to be sold at a time determined by Order in Council). This is also true of some CrOCs established under specific legislation (e.g. hospitals). S3A of the Public Finance Act 1989 allows a CrOC to be established and disestablished by Order in Council. If Ministers intend to sell a company soon after it has been established, but wish to avoid the need for legislation (for whatever reason), this may induce them to use a CrOC rather than an SOE. Care should be taken with this, however:

    - it risks compromising the clear commercial focus and governance arrangements of an SOE, which would suggest a poorer performance over time, and an asset which is worth less when it is sold;

    - arguably Parliament enacted the State Owned Enterprises Act 1986 with the intention that the Crown's commercial enterprises should be arranged under its rubric - the long title to the State-Owned Enterprises Act describes it as an Act "to promote improved performance in respect of Government trading activities and, to this end to - a] Specify principles governing the operation of State enterprises…." Parliament currently provides for the easy establishment and disestablishment of CrOCs by order in council.

Appendix 3: Machinery of Government principles

Key questions

When machinery of government reviews are undertaken, the review team considers four basic questions:

- What are the central government's public policy objectives for a particular area of activity?
- If central government does have public policy objectives, would they best be pursued through ownership or other interventions?
- If a Crown-owned organisation is to be asked to discharge some specified function, what sort of organisation should it be?
- If a Crown-owned organisation is asked to discharge a function, what internal management arrangements would be best?

Machinery of Government principles

Principles could be developed to shape the advice on each of these 'machinery of government' questions. Thus, when the label 'machinery of government principles' is used, reference could be being made to one or more of four categories of principle:

- *Scope of central government principles* – principles which guide advice on the functions which appropriately might be undertaken by central government rather than by local authorities, non-government agencies or individuals.
- *Decision-making principles* – principles which guide the identification of, assessment of, and choice between different approaches to achieving the central government's public policy objectives.
- *Organisational design principles* – principles which guide advice on which of the available organisational design options should be preferred assuming that policy objectives are to be pursued through ownership of one or more organisations.
- *Internal management structure principles* – principles which guide advice on what internal management structure for the Crown-owned organisation would best achieve the government's public policy objectives.

This appendix deals only with 'organisational design principles'. The Commission's organisational design principles are:

- *Effectiveness and efficiency* **-** organisational design choices should be made to best achieve the Government's desired outcomes (i.e. effectiveness), and the low cost production of outputs (i.e. efficiency).
- *Risk management* **-** organisational design choices should be made to best manage the risks posed for the Government by the activities to be undertaken by a Crown-owned organisation.

- *Constitutional conventions* - organisational design choices should be made to best protect established constitutional arrangements and conventions.

Each of these principles can be 'operationalised' by applying the following subsidiary propositions:

Effectiveness and efficiency

- *Match commercial to commercial* - commercial activities should be assigned to organisations with commercial objectives, preferably to SOEs.

- *Transparent funding for non-commercial activity* -- non-commercial activities should be assigned to a commercial organisation only if the full cost of those activities is to be explicitly funded by the Crown.

- *Contestable is better, sometimes* - there is a presumption in favour of making contestable the activities of commercial organisations and non-commercial service delivery activities that do involve the exercise of significant statutory powers.

- *Functional separation: sometimes yes, sometimes maybe* - functions which clearly conflict for constitutional or commercial reasons should be assigned to separate organisations; in other cases, the costs and benefits of functional separation should be considered, and a decision to co-locate or separate the functions made on the specifics of each case.

- *Multiple functions usually means department* - where an agency is to be asked to undertake potentially conflicting functions, there is a presumption in favour of the departmental form.

Managing risk

- *Strategic risk* - if an activity represents a high level of strategic risk the departmental form may be preferred.

- *Contracting risk* - if an activity poses significant contracting risks, there is a presumption in favour of the departmental form.

- *Flexibility* - if the choice between a departmental form and a non-company Crown entity form is not clear-cut, there is a presumption in favour of the departmental form.

Constitutional conventions

- *Ministerial oversight* - where constitutional considerations indicate a need for close ministerial oversight, or for direct ministerial responsibility, there is a presumption in favour of the departmental form.

- *Need for independence* -- if an activity must be, and must be seen to be, undertaken free of political interference, and there are no compelling reasons for close Ministerial oversight, the non-departmental form may be preferred.