

Financialisation: constructing shareholder value... for some

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ABSTRACT

Drawing from the theorising of Froud *et al* (2004) and Krippner (2005) on financialisation, we explore the activities of New Zealand's largest listed company Telecom (NZ) Ltd. The success narrative produced by Telecom since its privatisation and listing in 1991 is centred on shareholder value. However, its financial reporting practices seem increasingly complicated and difficult to comprehend. Telecom's original off-shore investors reaped considerable returns on their investment and, until recently most investors in Telecom were domiciled outside New Zealand. Its production activities have remained concentrated in New Zealand where it holds a monopoly over an essential part of the country's communication infrastructure. This examination of Telecom's activities and financial reporting adds to the debate about financialisation by questioning the effects of the separation of production and accumulation on those where production is located. It also demonstrates the use of accounting and financial reporting practices to support a success narrative which results in resource transfers to those engaged in accumulation activities to the potential detriment of those involved in, or affected by, the company's production activities. .

Key words: distributive conflict; financialisation; intellectual property; normalisation; privatisation; shareholder value; special purpose entities; success narrative; telecommunications

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The aftermath of Enron's collapse has prompted various interpretations of the collapse, events prior to it, and lessons to be learned. Some regard Enron as an isolated incident reflecting the worst excesses of corporate greed (eg, as noted by Moriceau, 2005). Those supporting this view might see improved governance arrangements as sufficient to overcome the problem, and the response to Enron in the United States has involved governance changes mainly imposed through the Sarbanes-Oxley Act which focuses on individual wrong-doing (Froud et al, 2004). The Sarbanes-Oxley Act does not address institutional arrangements which some have argued help to shape behaviour, and which are part of a larger dysfunctional financial system (Baker, 2003; Baker and Hayes, 2004; Briloff, 2004; Froud et al, 2004; Reinstein and McMillan, 2004; Zeff, 2003a and b). That larger system continues and, with the increasing economic integration of countries through financial markets, its effects go well beyond the United States.

Froud *et al* (2000, p. 109), described one effect of this system some time before the Enron collapse and the scandals that followed.

Even in blue chip companies, whose managements once built factories and market share, operating management becomes an endless series of cheap financial dodges: this year's target is met by ending the defined benefit pension scheme, which saves labour costs, and next year's dodge is leasing the trucks so that the capital appears on somebody else's balance sheet. This work is punctuated and interrupted by major restructurings and changes of ownership where it is the financial engineering which is crucial...

The parts played in this larger financial system by the accounting profession (Briloff, 2004; Zeff, 2003a and b) and accounting standards (Clarke, Dean and Oliver, 2003) have been criticised, both before and after Enron. Froud et al (2004) noted that Enron's success narrative prior to its collapse involved the use of legitimate accounting devices for "the illegitimate purpose of hiding debt and fabricating earnings" (p. 895). These devices also required the collusion of others, including accounting professionals and financiers, for whom Enron's predicament represented a business opportunity.

Our focus is on the flexibility of financial reporting standards and financial reporting practices for use in the presentation of success narratives. Increasing economic integration and free capital mobility means that major shareholders may be domiciled anywhere in the world. Lazonik and O'Sullivan (2003) suggest that the pressure on companies to report desirable financial measures and distribute cash has the potential to run down both a company and an economy, while Krippner's (2005) analysis suggests the need for closer scrutiny of the economy affected. We extend their analysis to observe that in a small country such as New Zealand, when the company is comparatively large, the dysfunctional effects of this system potentially endanger a major part of the country's infrastructure as well as its economy. Our article focuses on New Zealand's largest listed company, Telecom New Zealand Ltd.

Froud et al (2004) refer to this larger system as one of financialisation because financial markets have become increasingly powerful. Massive increases in institutionalised savings flows have meant that the role of financial markets has changed from that of intermediaries to being a major influence on the behaviour of firms and individuals. Krippner (2005, p. 174-177) analyses this further, noting the increasing separation of production and accumulation, and defines financialisation as “a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production”. Krippner proposes that “financialization of the US economy is better understood as resulting from the globalization of production.” In other words, the increasingly marked pattern of accumulation occurring in the US is at least partly brought about because production occurs outside the US.

The increased power of financial markets prompts companies to pursue goals set by the financial markets, rather than operational goals related to their production function (Froud *et al*, 2000) In the process, companies “disgorge an ever-growing share of their shrinking cash flow to financial agents” (Crotty, 2005, p.15) but, in the longer term become less likely to meet their objectives of, for example, improved operating profits (Froud et al, 2000).

Integral to financialisation is the notion of shareholder value. Exactly what is shareholder value is not often explained, but consultants have earned sizeable fees from promoting and selling their own variants of measures purported to monitor shareholder value. Just some of these measures include economic value added (EVATM), shareholder value added (SVATM)ⁱ, market value added (MVATM), and various return on investment (ROI) measures (Froud et al, 2000), all of which are derived from or draw on accounting numbers. For example, EVATM is a variant of the idea that share price should equate to the present value of expected future dividends and is derived from earnings capitalised in perpetuity. There is some circularity in measures such as these because achievement of the measure (and therefore shareholder value) tends to become narrowed to reporting a particular figure or financial ratio. This can prompt management into adopting strategies to improve the ratio by affecting either the numerator or the denominator, or both (Froud et al, 2000, p. 85). Despite this, the consultants promise much may be achieved by companies adopting such measures, but “a persistent gap [emerges] between expectations and outcomes [which] can nevertheless drive management behaviours” (Froud et al, 2000, p. 80).

The crude nature of these shareholder value measures and the failure to recognise the unreality of expecting a single measure to fit all companies, or of expecting companies to achieve a single measure continually, may also prompt change in the particular version of the shareholder value measure adopted. For example, EVATM requires a company consistently to earn a surplus over its cost of capital, and this may induce companies to capitalise expenses in order to boost reported earnings which, in turn, is likely to boost expectations of future dividends. MVATM is simply the difference between the current value of a company (as measured by the share price) and the total invested capital it reports.

This measure, by contrast, may induce companies to engage in off-balance sheet activities in order that invested capital is minimised, or to borrow then repurchase shares as a means of maximising the gap between reported capital and share market capitalisation. Further, a company reporting a poor or negative EVATM could, especially in a rising market, show a positive MVATM, not through performance attributable to company management but simply because of the rising market (Froud et al, 2000).

During the 1990s, shareholder value rhetoric drove “old economy” companies to deliver high returns on capital employed to achieve the ultimate measure of a rising share price, and this is consistent with the use of EVATM. Constraints on firm activity, however, prevent many companies from achieving such high returns through their operations. In contrast, the “new economy” technology companies were able to achieve the rising share price measure without high returns on capital – or, indeed, without making any profits - by building and maintaining a narrative about the transformations to come from digital technologies (Froud et al, 2004, p. 888). In other words, these companies could simply talk up their share price, and this is more consistent with MVATM. Both types of companies could improve their ratios through such means as divestment, downsizing and distribution of funds either by dividend payments or through share buybacks (Froud et al, 2000, p. 98). The shareholder value rhetoric had brought with it a change in corporate strategy from earnings retention and reinvestment to earnings distribution and corporate downsizing (Lazonik and O’Sullivan, 2000, p. 33). While it may seem ultimately self-defeating in the longer term, in the short term this divestment and distribution strategy helps to increase the price of a company’s shares. As noted by Lazonik and O’Sullivan (2000, p. 33) the shareholder value rhetoric is deceptive because the pursuit of shareholder value may function as “an appropriate strategy for running down a company” rather than for building one up.ⁱⁱ

The gap between expectations of what may be achieved from the pursuit of shareholder value and actual outcomes may also prompt other perverse management strategies. For example, Enron maintained a narrative of success, thus helping to keep the share price improving, and used accounting practices regarded as aggressive and fraudulent in an effort to depict financial success as determined by common measures such as reported profits and debt to equity ratios. In Enron’s case, the “sheer complexity” of the accounting shenanigans made the financial reports “nearly incomprehensible” (McLean, 2001). Even so, with media and analysts acting as cheerleaders for Enron’s success narrative, and accounting and other professionals focussed on revenue earning opportunities for themselves, investor protection responsibilities seemed to be overlooked. Investors apparently accepted without question Enron’s success narrative, never suspecting the manner in which it had been constructed (Froud et al, 2004, p. 887). In the process, some within Enron took personal profits from their fraudulent activities, but far more was taken legally through such means as bonus schemes based on the manipulated performance measures adopted (Froud et al, 2004). Investors and creditors lost out.

It is important to recognise that the systemic conditions within which Enron occurred remain, and through trade liberalisation efforts are being extended world-wide. If Enron could occur in a country like the United States with its large population and a long history of active financial markets, professional analysts, and hard-bitten investors, what might occur in a country without such attributes? This article argues that, as the financialisation model is rolled out internationally, smaller countries, such as New Zealand, may be especially vulnerable to financial predation. One potential means of predation may be compared with Enron because it involves success narratives loudly trumpeted while the counterpoint is barely noticed through the use of deceptive accounting and financial reporting techniques. It begins by outlining some of the regulatory changes made from the mid-1980s when New Zealand embarked on a series of radical economic reforms. It then moves to focus on the under-researched micro level of this financialisation system (Froud et al, 2004) providing a background to Telecom New Zealand Ltd, New Zealand's largest listed company, and examining aspects of its success narrative. Froud et al (2004) advocated the need to understand the mechanisms through which Enron disconnected its success narrative from operations, and this paper identifies and explains mechanisms through which a similar disconnection may be achieved before outlining Telecom's distribution policies and their effect. The final section discusses accounting's involvement in the spread of financialisation and the potential impact in small countries when the possibly more sophisticated offshore investors in major companies in that country with access to different and possibly better information have the opportunity to extract considerable financial benefits before selling down their shares to others. Accordingly, the contribution of this paper is to call attention to the other side of financialisation: if financialisation in the US represents an increasing pattern of accumulation brought about by the globalisation of production and the power of financial markets, what is the effect in those countries where production is located but heavily influenced by financial markets and overseas shareholders? This paper draws on Krippner (2005) to extend Lazonik and O'Sullivan's argument that shareholder value added may occur to the considerable detriment of both the company and the economy. The separation of production and accumulation implies that more than one economy will be affected. In this case, the dysfunctional effects arising from the measures used in the financialised model seem likely to damage the economy of the country where production occurs while benefiting the economies of more sophisticated investors and damaging those of the less sophisticated investors

New Zealand and its economic reforms

New Zealand is a small country of four million people which, until the mid-1980s, maintained a protected social welfare state. Although changes had been occurring gradually, it was following the election of a Labour government in mid-1984 that dramatic and extreme changes occurred (Kelsey, 1995; Pallot, 1998). New Zealand is especially well known internationally for its radical public sector reforms, but those reforms were just one component of an extreme and rapid process of restructuring the whole economy (James, 1992). According to drivers of this process from within the Treasury, the restructuring was intended to bring

about “sustainable medium-term growth with a more market-oriented economy” (McCulloch and Ball, 1992, p. 7). Important aspects of the restructuring received little or no debate, and critics complain that the reforms took the Washington consensus to its neo-liberal extreme (James, 1992; Kelsey, 1995, p. 19).

New Zealand adopted a “light-handed” regulatory regime. The Commerce Act 1986, helped to establish the competitive aspects of this regime, and the removal of statutory monopolies soon followed (Pallot, 1998). This development dovetailed with one of the earliest reforms to the public sector which required the corporatisation of those government departments that were trading enterprises. The State-Owned Enterprises Act 1986 required these corporatised departments to be incorporated under the Companies Act, and each was required to “operate as a successful business” (State Owned Enterprises Act 1986, s. 14). This development was followed by a programme of privatisation (Pallot, 1998), and the focus of this article is on the activities of one of those privatised government operations.

New Zealand’s small population means that such regulation and supervision as does occur tends to involve closely-linked elite networks. The same people who advise government on the form of regulation to adopt, tend subsequently to serve on boards created to develop and/or supervise secondary regulation. This gives rise to numerous potential conflicts of interest: for example, accounting standard-setters, unlike their counterparts in the United States, function on a part time basis and continue their other professional and business activities. The audit partner from one of the Big Four accounting firms is also a member of both the accounting profession’s Financial Reporting Standards Board (FRSB) and the Securities Commission, while the chairman of one of the Big Four who had advised on company and accounting regulation was, until recently, also chairman of the Accounting Standards Review Board (ASRB), the government body which gives legal enforceability to financial reporting standards, and to which the FRSB submits its standards. Further cross memberships exist between the FRSB and the ASRB, and they merely exemplify the small number of people involved and their links which typify New Zealand’s regulatory environment.

Today, New Zealand is classified as one of the least costly countries in which companies can do business. That this is good for company shareholders and the country’s citizens seems to be assumed but it has undergone little serious scrutiny. The lack of regulation and scrutiny has, perversely, led to New Zealand being promoted as a tax haven for international investors. For example:

New Zealand is a tax haven in terms of the lack of death duties, capital gains taxes and for certain types of offshore trusts which can be structured through New Zealand. (www.propertytalk.co.nz/content-29.html, accessed 25 January, 2005) (See also, www.taxcounsel.co.nz/abstracts.asp, accessed 25 January, 2005; and www.fmlaw.co.nz/publications/trust_articles/foreigntrusts.htm, accessed 29 November, 2005).

Even today, further liberalising changes seem to proceed with little debate (see Rosenberg, 2004, for an example of one of the few attempting to stimulate debate). However, with a small sharemarket, a thin share trading environment in

which relatively few shareholders control the shares in major companies, a light-handed regulatory regime, and very little critical assessment of companies' financial and other activities, New Zealand's resident shareholders and citizens seem reliant on company management and boards voluntarily refraining from taking advantage of opportunities to profit at their expense.

Privatisation and Telecom New Zealand Ltd

Telecom New Zealand Ltd is New Zealand's largest listed company and comprises 26% of the weighting of the sharemarket index for the top 50 companies. It is listed on the NYSE, PNK, XETRA and in Australia, Berlin, Frankfurt and Munich. Within New Zealand, Telecom shares comprise a significant portion of any share portfolio constructed with reference to the local share market index.

Telecom New Zealand Limited was created in the first wave of New Zealand's radical post-1984 public sector reforms. Until 1986, all telecommunications functions were conducted through the Post Office, a government department which was also responsible for mail and provided a banking service for individuals, but not companies. A Telecom Establishment Board was created in 1986 to corporatise those telecommunications functions, and was required to have the new Telecom Corporation established by 1 April 1987. At the same time, the State Owned Enterprises Act 1986 was passed requiring state owned enterprises to be structured as companies and to comply with company laws and practices.

In December 1987, a massive programme of privatisation of several newly established state owned enterprises was announced. The sale of shares in the Telecom Corporation Ltd in 1990 was the largest of these privatisations (Pallot, 1998). Telecom's shares were sold for NZ\$4.25 billion to a consortium comprising two major US companies, Ameritech and Bell Atlantic and, as part of the arrangement Ameritech and Bell Atlantic undertook to sell down their holdings to no more than 49.4% within three years (Beavis, 1991). Also as part of this privatisation agreement, two New Zealand companies, Fay Richwhite and Freightways of New Zealand agreed to buy a stake of less than 1% of Telecom's shares, and to increase that stake to up to 10% over the subsequent three years.ⁱⁱⁱ

In 1991, the consortium floated Telecom's shares publicly both in New Zealand and overseas (Pallot, 1998). That flotation was intensively marketed and included chartering a specially painted train and taking it throughout New Zealand. Each stop involved two days of special promotions, one for the general public, and the other for "entertaining local financial advisers" (Beavis, 1991, p. 9). 31% of the shares were offered and sold (Anon, 1998). The remaining sales required under the initial privatisation agreement were completed in 1993. Both Ameritech and Bell Atlantic earned significant profits on the sale of these shares and most of which went to overseas investors.

Both companies decided to exit from Telecom shares in 1998, planning a disposal of Telecom shares amounting to US\$5 billion, from their remaining stakes. This prompted an immediate 10% drop in Telecom's share price. In the event, Ameritech sold its shares, while Bell Atlantic issued notes convertible at its option into Telecom shares or redeemable in cash. Both companies had already recouped their original investments in Telecom through two share sales in the company, in 1991 and 1993, and through dividends they had received (Hall and Waters, 1997).

Bell Atlantic, by then known as Verizon, eventually sold its shares in September 2002 and since then an increasing proportion of shares has come to be held by New Zealand and Australian investors. In 2002, prior to Verizon's sell-down, Telecom's shares were held mainly in the United States, Europe and Asia while just 13% were held by New Zealanders and Australians. By 31 July 2004, 26.2% of Telecom's shares were held in New Zealand and 20.2% in Australia, while North American investors held 25.7%, British investors 19%, Asians 4.5% and Europeans. It seems ironic, given New Zealand's radical privatisation programme, that the government of New Zealand has become a significant investor in Telecom's shares as a result of its efforts to fund future liabilities through investment such as the government superannuation fund.

Questions about Telecom's activities and accounting practices arose in February 2002 (Birss, 2002). The telecom industry around the world had come under scrutiny with questions raised about World Com's and Global Crossing's accounting when they collapsed shortly after Enron. In that year, The Economist claimed the telecom bust was "ten times bigger than the better-known dotcom crash" (Economist, 2002, p. 9)

Telecom's involvement as counter-party to some of Global Crossing's purchase and sale of cable capacity transactions was drawn to public attention in New Zealand and Australia. In New Zealand, the Securities Commission announced an inquiry into Telecom's treatment in its half year financial reports to 31 December 2001 of the purchase and sale of cable capacity and the pre-payment of cross border finance leases. These transactions contributed \$28 million and \$34 million respectively to Telecom's reported result, adding a total of 20% to the reported financial result. They also had a positive effect on Telecom's reported gearing.

The Commission's inquiry into Telecom's half year reports was brief and quickly settled with the announcement that the results were accounted for in accordance with New Zealand financial reporting standards. Telecom's chief executive, Theresa Gattung (Press, 2002), greeted that ruling with the comment that a collapse like Enron's could not happen in New Zealand "because our accounting standards make sense — they reflect the economic substance of the transaction." Around the world, in the aftermath of Enron, US accounting standards were criticised because they were rules-based and the purportedly principles-based international standards were presented as superior.

The Commission's decision and Gattung's statement were questioned (Robb and Newberry, 2002a). The claim that New Zealand's principles-based standards, like the international standards, reflect economic substance was challenged (Robb and Newberry, 2002b). Telecom's financial reports contained other dubious items, one of which involved an off balance sheet associate company, Southern Cross Cables Holdings Ltd. Telecom's accounting for this had contributed \$221 million, or 52%, to Telecom's reported financial result for the year ended 30 June 2001 (Robb and Newberry, 2002a; and 2002b). That transaction is explained in more detail below, and was explained at the time. The Securities Commission remained silent and has never explained its rationale for the decision, while others defended New Zealand's accounting standards and Telecom's accounting practices (Bogoievsky, 2002; Hagen, 2002).

Lending further credibility to Telecom's success narrative was its receipt of awards from the Institute of Chartered Accountants' (ICANZ) annual report awards for the years 2000, 2001, 2003, and 2004. The only year Telecom did not receive an award was for the 2002 year which was the year of the Securities Commission inquiry into its financial reporting practices. It made up for this, however, with its 2003 annual report for which it won the award for large companies and ICANZ's supreme award.

Closer scrutiny of Telecom's success narrative

Telecom's portrayal of itself as a successful company relies heavily on selective reporting of results, and the use of increasingly complex accounting devices. These, in turn, feed into such shareholder value measures as EVATM and MVATM because those measures draw on the accounting numbers produced.

Selective reporting

Telecom commenced reporting 'normalised' profits from 1997. This was the year that its reported profits fell to \$581 million from the \$717 million reported in 1996. Telecom reported that its 'normalised' profits for 1997 were \$771 million, calculated by excluding losses from its discontinued venture into the Australian Pacific Star Group (\$87 million) and abnormal costs (restructuring \$65 million, Y2K computer costs \$87 million). Telecom also restated its comparative figures to show normalised profits in 1996 of \$746 million, the change relating to the 1996 losses of its subsidiary, the Pacific Star Group. These losses are discussed in more detail below. The normalisation meant that, for 1997, Telecom reported an increase in normalised profits of \$24 million or 3.2% over the previous year even though its after tax profits fell \$136 million or 19%.

Table 1, summarises the reported and normalised earnings for the years 1996 to 2004. Although the normalisation reduces the volatility of reported results the cumulative total of normalised profits (\$6,970 million) is 19% higher than the cumulative total of reported results. In addition to the normalisation, the change in year end (1999) and insertion of results for a single quarter provides a disconnection between earlier results and obviously declining profits. Further, the

normalised results in 2001 were reported in the unaudited management discussion and analysis as \$835 million, the main difference being a dividend taken from an off balance sheet loss-making associate company (discussed further below).

Table 1: Telecom Reported and Normalised Earnings

\$ million	1996 restated	1997	1998	1999	1999 3mth	2000	2001	2002	2003	2004	Total
Reported	717	581	820	822	202	783	643	-188	709	754	5,843
Normalised	746	771	815	821	209	768	614	670	709	847	-6.9

Loss-making activities

Commentators have criticised many of Telecom’s operational decisions. For example, Telecom ...

didn’t help itself by picking the wrong mobile technologies. TDMA was not used by any telcos on this side of the globe, and in CMDA it has a service that only roams with the US and Australia. This has allowed Vodafone to eat its lunch in the lucrative mobile sector. (Sainsbury, 2003).

Telecom has incurred significant losses from some of its decisions but is using increasingly sophisticated techniques to de-emphasise the losses incurred or to distance itself from those losses. Clearly, the reporting of normalised earnings helps to conceal the effects of some losses, but other methods include the location of loss-making activities in subsidiaries or associate companies and, more recently, very complicated and barely visible arrangements through a succession of especially created and dissolved subsidiaries.

Loss-making activities in subsidiaries

Telecom’s investment in the Pacific Star Group and the subsequent discontinuation of that group provides a representative example of de-emphasis until the point Telecom was forced to admit to the losses incurred. Telecom’s annual report for the year ended 31 March 1996, issued on 20 June, did not provide figures for the Pacific Star Group operations in Australia but did describe those operations positively:

Pacific Star Group is a provider of facilities management and value-added services to a large number of government and corporate clients....We are confident of Telecom’s strategic direction in the Australian marketplace, with the repositioning of Pacific Star’s business expected to enhance its financial performance. (Telecom, 1996, p. 9)

The Pacific Star Group ... businesses have been largely successful in positioning themselves in a large number of state and federal government agencies and in major Australian corporates, as well as establishing high quality enhanced facsimile platforms. Expansion has continued at favourable rates. (Telecom, 1996, p. 23).

On 5 August 1996, Telecom announced it was quadrupling staff numbers in Sydney and ‘ramping up Australian subsidiary Pacific Star as it moves to combat increased trans-Tasman competition’ (Dominion, 1996, p. 22).

However, when the results for the first quarter ended 30 June 1996 were announced ten days later the Pacific Star group was reported as having made an overall unspecified loss. The results for the nine months to 31 December 1996, released in February 1997, revealed that Pacific Star had recorded a loss of NZ\$39.8 million compared with a NZ\$11.6 million loss in the same period a year earlier.

By the time the annual report for the year ended 31 March 1997 was released on 17 June it reported the approval of a formal plan of disposal or wind down, which allowed Telecom to provide for losses on disposal. The Pacific Star Group was reported as having made losses at an exponential rate for the last three years, as shown in Table 2:

Table 2: Pacific Star Group losses

\$ millions	1995	1996	1997	1998
Loss from operations after tax	4.4	29.6	50.2	
Provision for loss on disposal	0	0	37.4	(30.0)
Total	4.4	29.6	87.6	(30.0)

In 1995 and 1996, these losses had not been disclosed and indications from the MDA discussions were the Pacific Star Group was successful. However, when Telecom began normalising its results in 1997, the \$87.6 million loss from this subsidiary was treated as discontinued activities and thus excluded from normalised profits. The comparative figures for the earlier years were restated to exclude the earlier losses from the normalised earnings, thus improving the normalised results reported in those earlier years, while the over provision was reversed the following year, thus reducing normalised profits in that year but boosting reported profits.

Loss-making activities in associate companies

Although the Pacific Star Group losses were not disclosed in Telecom's reports until shortly before this venture was discontinued, the losses were at least incorporated in Telecom's results. Enron used off-balance sheet special purpose entities (SPEs) to shift its losses and debt off balance sheet, but New Zealand accounting standards do not accommodate SPEs. New Zealand has, however, revised and reissued its accounting standards for associate companies, creating a New Zealand equivalent of SPEs in the process.

New Zealand requires equity accounting for associate companies such that the cost of the initial investment in the associate is adjusted annually by the investor's share of the associate company's profits or losses. This is known colloquially as a one line consolidation, the other side of the entry being recognised in the investor's income statement. SSAP8: *Accounting for Business Combinations* applied until 2002, and this standard stated that if an associate company reports losses such that the investor's share of the losses reduce the cost of the investor's investment to zero:

the investor should discontinue applying the equity method unless the investor has guaranteed the obligations of the associate or is otherwise committed to provide further financial support. If the associate subsequently makes profits, the investor should resume applying the [equity] method ... only after its share of those profits equals its share of net losses not recognised during the period the method was suspended. (SSAP8, para 4.66) (emphasis added).

In other words, provided the investor neither guarantees the associate's obligations nor has other commitments to the associate, once the investor's investment in the associate has been reduced to zero by the investor's share of the associate's losses, that associate functions as an off-balance sheet entity for as long as the investment adjusted by profits or losses is below zero.

In October 2001, a new standard was issued and given legal enforceability by the Accounting Standards Review Board. This is FRS38, *Accounting for Investments in Associates*, and it applied to financial reports covering periods ending on or after 31 December 2002. This standard retains the discontinuation requirement when an associate's losses exceed the investor's share investment but drops the conditions attached to that requirement:

Where the equity method is applied and the investor's share of the post-acquisition reductions in net assets of an associate exceed the cost of the investment less any amounts written off, so that the investment is reduced to zero, the investor must discontinue applying the equity method and must not recognise as a liability any balance below zero. If the net assets of the associate subsequently increase, the investor must resume applying the equity method only after its share of such increase in net assets equals its share of any reduction in net assets not recognised during the period the equity method was suspended. (FRS38, para 5.53) (emphasis added).

In other words, as soon as the investor's investment in the associate has been reduced to zero by the investor's share of the associate's losses, that associate functions as an off-balance sheet entity even if the investor has guaranteed the associate's liabilities or has other commitments to it.

In 1998, Telecom invested \$45 million in the shares of three associated companies, Pacific Carriage Holdings, Southern Cross Cables Holdings, and AOL Australia Online Services. AOL Australia Online Services was incorporated in Australia, and the other two were incorporated in Bermuda. Their financial reports have not been published and the total amount invested in their shares is not certain but information from Telecom's financial report for 1999 gives some indication. Telecom's activities with Southern Cross Cables Holdings is the focus of attention here.

Telecom held 50% of the shares in Southern Cross Cables, with Cable and Wireless Optus, and MCI WorldCom holding the remaining shares between them. Telecom's originally proposed investment in Southern Cross Cables was US\$75 million (NZ\$150 million). However, Telecom was able to make the NZ\$150 million investment by way of either share capital or shareholder advances (Telecom, 1999, p. 67). Telecom made a shareholder's advance of US\$55 million (NZ\$110 million) to Southern Cross Cables, and this suggests that Telecom's share investment in Southern Cross was US\$20 million (NZ\$40 million), leaving

the share investment in the other two associate companies at a total of NZ\$5 million.

Southern Cross Cables was constructing a high capacity fibre optic submarine cable loop at an expected cost of approximately US\$1.1 billion (approximately NZ\$2.2 billion at the time). This cable would link New Zealand, Australia, Hawaii, mainland USA and Fiji. It would have more than 120 times the capacity of the existing cable linking Australasia and North America (Telecom, 1999, p. 14). The financing planned for Southern Cross Cables involved a limited recourse bank financing facility but this did not eventuate, and the sponsors of Southern Cross Cables (Telecom, Cable and Wireless Optus, and MCI WorldCom) took over the financing and commenced efforts to refinance (Telecom, 1999). This gave Telecom a commitment to Southern Cross Cables of US\$460 million (NZ\$920 million) over and above its investment of \$US75 million (NZ\$150 million). Telecom's NZ\$40 million equity investment represented a mere 3.6% of the total amount either invested or guaranteed. Telecom changed its annual balance date from a 31 March financial year end to 30 June and it produced a full financial report for the 3 months ended 30 June 1999. The collapse of the intended limited recourse bank financing facility and the need to refinance was disclosed in that financial report as an after balance date event. Because it was after balance date, no other adjustments were required to reflect the extent of the obligation in that financial report. Arguably, this change in balance date, allowed Telecom additional time to arrange refinancing before issuing half-yearly reports.

All three associate companies incurred losses. The amount of Telecom's equity investment in all three had been reduced from the original NZ\$45 million to NZ\$30 million by the year ended 30 June 2000, followed by further write-downs during 2001 which resulted in the equity investment in all three associate companies falling below zero, with the result that all three associates became off balance sheet entities for as long as Telecom's cost of investment remained at zero or below and their losses almost invisible. In the case of Southern Cross Cables, Telecom received a dividend of NZ\$263 million from Southern Cross Cables in that financial year. Telecom applied \$18 million of that dividend against the cost of its investment in Southern Cross Cables, thus reducing it to zero, and reported the remaining \$245 million of the Southern Cross Cables dividend as income to Telecom. After adjustment for tax this dividend income boosted Telecom's reported after tax profits for 2001 by \$221 million or 52%. Telecom's reported profit after tax for that year was \$643 million. Without the dividend, it would have been only \$422 million.^{iv}

Telecom's disclosures from 1999 suggest that Southern Cross Cables was in trouble, and this was subsequently confirmed (Griffin, 2003). This arose from over-optimism about the revenues to be earned from NZ\$2.2 billion construction project. Over-optimistic expectations for the revenues to be earned from such developments seemed to be a feature of the telecommunications industry at the time. It seems hardly surprising that Southern Cross Cables had incurred losses by 2001. In 1998, Telecom had signed a capacity use agreement, committing Telecom to purchase total capacity on that cable of approximately US\$140

million. The 1999 disclosure of events after balance date reported a change in Southern Cross Cables' marketing strategy. In 1999, Telecom undertook to purchase another US\$69 million of capacity and Telecom's troubled Australian subsidiary, AAPT undertook to purchase US\$40 million.

Questions arose as to how this loss-making associate could afford to pay Telecom a dividend more than six times the size of Telecom's equity investment. The 2001 annual report reveals that during 2001 Telecom seemed to have paid to Southern Cross an amount close to the \$263 million, recording it in Telecom's reports as an asset, either as a shareholder's advance or as an investment in cable capacity. Arguably, such a payment to Southern Cross Cables would have provided it with the money to pay the dividend to Telecom. The Chairman's Report in the glossy front section of Telecom's *Annual Report* for 2001 noted the dividend and described as "splendid" Telecom's investment in Southern Cross Cables. By 2003, however, a footnote disclosure reveals that Southern Cross Cables clearly was not meeting its expected performance levels and restructured its senior debt facility, "to better align debt repayments with anticipated future cash flows, extend maturity, and provide additional flexibility" (Telecom, 2003, p. 89). Telecom provided contingent credit support for this debt restructuring for up to US\$106 million in favour of the senior bank syndicate.

While it was not stated in the 2001 financial reports, or raised in the discussion that ensued, Telecom's accounting policy for reporting on loss-making associates ignored situations where Telecom had ongoing commitments to, or on behalf of, the associates concerned. In other words, the policy ignored the requirement in SSAP8 and had the effect of adopting FRS38 early. Had it followed the SSAP8 requirements, Telecom's other commitments to and on behalf of Southern Cross would suggest that the equity accounting of that company in Telecom's reports should not have been suspended in 2001. This would have required Telecom to recognize in its accounts its full share of Southern Cross Cables' losses, which seemed to be about NZ\$44 million in 2001. Telecom's accounting policy allowed the losses to remain hidden while the use of equity accounting avoided recognition of Southern Cross Cables' debt.

Telecom is listed on the New York Stock Exchange and the listing requirements mean that Telecom must reconcile its profits reported in New Zealand with US GAAP. It is interesting to add to the earlier table presenting reported and normalised profits (Table 1), the effect of Telecom's reconciliations with US GAAP (Table 3). Most of the difference has occurred since 2001 when Southern Cross became one of Telecom's off-balance sheet entities, and is explained by the reconciling items related to Southern Cross. Following the fallout in the United States over Enron, changes were made there to the financial reporting requirements for SPEs which required that, under some circumstances, these previously off-balance sheet entities must be brought back onto the balance sheet. The difference in results reported in 2004 shows the effect of this requirement. Although US GAAP was heavily criticised in the aftermath of Enron, it has the advantage of requiring the inclusion now of special purpose entities. The cumulative difference between US GAAP results and NZ GAAP

results is a little more than \$1 billion (22%), and nearly \$2.2 billion (46%) when compared with the normalised results.

Table 3: Telecom Reported and Normalised Earnings

\$ million	1996 restated	1997	1998	1999	1999 3mth	2000	2001	2002	2003	2004	Total
Reported (US GAAP)	715	675	762	768	163	773	342	-410	839	157	4,784
Reported (NZ GAAP)	717	581	820	822	202	783	643	-188	709	754	5,843
Normalised (NZ)	746	771	815	821	209	768	614	670	709	847	6,970

Creation and dissolution of subsidiaries

Over time, Telecom's involvement with other companies seems to have become increasingly complex, but less and less information is apparent in its financial reports. Telecom's annual report for the year ended 30 June 2003, for example, reports that Telecom's parent company sold to a newly-established subsidiary company, Telecom IP Ltd, its previously unrecognised intellectual property (IP). The parent company's reported gain on sale was the same amount as the sale, viz \$2.141 billion. The sale was reported as being at fair value, the profits arising because the value had not been recognised previously. Given that Telecom continues to use the intellectual property, this appears to be a sale and leaseback transaction. Recent publicity about large tax shelter devices utilising intellectual property and marketed by KPMG to WorldCom and other telecommunications companies, raises the question as to whether this device is similar (Mollenkamp and Simpson, 2003). Certainly, its complicated nature leads one to wonder about the business reason for it.

The intellectual property transaction had no effect on Telecom's consolidated accounts because transactions between a parent and its subsidiaries are eliminated for consolidation purposes. Close analysis suggests that there was not a single transaction but a series of related transactions of some financial complexity even though they seem to be legally unrelated.

Public files revealed that Telecom had established Telecom IP Ltd in February 2003. In April 2003, it established another two subsidiaries: Telecom IP Investments (No 1); and Telecom IP Investments (No 2). Both of these companies were restricted by their constitutions to fulfilling a series of agreements connected with a "brand financing transaction". This transaction involved the assignment of certain registered and unregistered New Zealand trademarks and domain names to JP Morgan New Zealand Financing LLC and then licencing them back to Telecom IP Ltd. After these transactions, if they proceeded, Telecom IP Ltd would no longer own the IP itself; it would merely own the licences to the IP owned by JP Morgan.^v Several other companies were involved in this planned IP transaction. These were ABN AMRO Bank NV; Westbroeksche Poort BV; Ijsselsteinsche Poort BV; the Telecommunications Brands Unit Trust; and the

Trustee of the Telecommunications Brand Trust. Another company, Norwich Investments Ltd, was listed as a defeasance entity.

If this brand financing transaction proceeded, it seems most likely to have occurred in the first quarter of the financial year ended 30 June 2004. During that period a series of changes occurred. On September 1, 2003, Telecom IP Investments (No 1) and Telecom IP Investments (No 2) each adopted a new constitution, neither of which referred to the "brand financing transaction". At the same time, Telecom IP Investments (No 1) became a limited liability company and changed its name to Telecom IP Investments Ltd.

On September 4, 2003, this new Telecom IP Investments Ltd issued 75,000,100 shares and on the same day the directors of Telecom IP Investments Ltd, Telecom IP Investments (No 1) and Telecom IP Investments (No 2) resolved that the three companies should be amalgamated with Telecom IP Investments Ltd, with Telecom IP Investments Ltd continuing as the amalgamated company. Telecom IP Ltd was struck off by the Registrar of Companies on September 5, 2003, as was Telecom IP Investments (No 2).

On September 11, 2003, Telecom IP Investments Ltd changed its name to Telecom IP Ltd. In other words, it took over the name of the company Telecom had set up in February 2003 and had struck off less than a week previously. Nothing about this series of events was reported in Telecom's annual report for 2004. Neither is it apparent that the Telecom IP Investments Ltd reported as a subsidiary in 2003 is not the same Telecom IP Investments Ltd that is reported as a subsidiary in 2004. Other events that occurred at the same time suggest that some form of financing proceeded. Telecom's annual report for 2004 reveals that Telecom paid down some on-balance sheet liabilities at about the same time. In August and September 2003, a 100% owned subsidiary, Telecom New Zealand Finance Ltd repurchased US\$44 million of 6.5% Restricted Capital Securities. From the figures reported, this seems to have been roughly NZ\$75 million (pp 66-67). Also in September 2003, TCNZ Finance Ltd, another 100% owned subsidiary of Telecom, repurchased Euro 27 million of notes. From the figures reported, this seems to have been approximately NZ\$51 million (*Telecom Annual Report, 2004*, p 66). These two debt reductions lowered Telecom's reported on-balance sheet debt by NZ\$126 million, but this is only a small amount compared with the \$2.141 billion Telecom reported as the value of the initial IP transaction. While little has been disclosed about the nature of the dealings surrounding Telecom's intellectual property, the lack of clear reporting and the complexity of the documentation prompts some scepticism with regard to Telecom's chairman's comments in the 2004 annual report:

What constitutes the sound position that has allowed us to increase dividends? The strong operating performance of the business, the reduction in debt and the excellent prospects for further improvement in the balance sheet. The Board has strong confidence in Telecom's business outlook. We are now in a position where we can see all the key factors moving in the right direction – delivering an increased dividend to shareholders, bringing down debt *and* investing in the future of our business. (*Telecom, 2004*, p. 8).

Telecom's chairman's comments also suggest that Telecom's priorities are more closely aligned to financial market issues (increasing dividends and reducing reported debt) than to Telecom's operational activities.

Distribution policies

Telecom bases its distribution policy on a defined percentage of its reported financial results. Over time, the percentage to be paid has varied, as has the results base. The actual distributions paid have been generous.

In 1996, Telecom's published policy was to distribute as dividends *at least* 70% of net earnings. However, this was subject to cash flow performance and investment opportunities, and to Telecom maintaining a net debt to net debt plus equity ratio of between 40% and 45%. Even so, Telecom sought to "maintain total dividends at not less than the same total cents per share level of the preceding year (on an equivalent number of shares)" (Telecom, 1996, p. 22).

Telecom issued capital notes in 1997 and modified the net debt to net debt plus equity constraint. Instead of maintaining the specified net debt to net debt plus equity ratio, Telecom announced the constraint would relate to "maintaining a net debt to net debt plus capital funds ratio of between 40% and 45%". The capital notes were included in the footnote disclosure of capital funds. (Telecom, 1997, p. 26, emphasis added).

Telecom changed the ratio in 1999, reporting that its dividend policy to distribute at least 70% of net earnings would continue, but increased the level of debt it was prepared to carry. Distributions would proceed, "provided that the net debt to net debt plus capital funds ratio of 45-50% is maintained." (Telecom, March 1999, p.27, emphasis added).

In 2000, Telecom reported a tightening of its dividend policy which would see more of its earnings reinvested in key projects. Accordingly, "from 2000-01 we will target a dividend payout of around 50% of annual net earnings, dependent on the level of earnings, cash flow and other investment opportunities in any given year (Telecom, 2000, p. 3). In 2002, however, Telecom acknowledged market sentiments seeking cash returns, and followed this in 2003 with a relaxation of its dividend policy, announcing it would increase dividends over time (Telecom, 2003, p. 57). The dividend payout ratio was increased twice during 2004. In February 2004, Telecom "targeted a dividend payout ratio of approximately 70% of net earnings (after adding back amortisation and relevant non-cash items)" but by the end of the financial year (June 2004), Telecom had increased this target to 85% of net profit after tax (p. 8). However, elsewhere it was made clear that the net earnings figure for payment of dividends is determined by "adding back amortisation and relevant non-cash items" (Telecom, 2004, p. 41), thus making the payout rate even higher.

The dividend policy was stated as a minimum, and the annual reports for the years from 1995 to 2004 show that the amount of dividends actually paid exceeded the announced policy. These may be seen in Table 4 which, for comparative purposes includes Telecom's reported earnings under US GAAP:

Table 3: Telecom earnings and dividends compared

\$ millions	1995	1996	1997	1998	1999	1999 3mth	2000	2001	2002	2003	2004
Net earnings (NZ GAAP)	620	717	581	820	822	202	783	643	-188	709	754
Dividends paid	597	727	831	859	910	227	906	303	423	428	488
Net earnings (US GAAP)	614	715	675	762	768	163	773	342	-410	839	157

In sum, the earnings reported in New Zealand totalled NZ\$6,464 million and dividends paid out were NZ\$6,698 million, giving a total dividend payout of 103.6% of reported net earnings, as determined by NZ GAAP. But when Telecom's dividend payout is compared with the more believable results reported according to US GAAP, the total net earnings is NZ\$5,398, and the dividend amount of NZ\$6,698 million gives a dividend payout rate of 177%.

Repurchase of shares

With the passage of the Companies Act 1993, companies were allowed to purchase their own shares and, in 1997, Telecom reported "a programme of share repurchases", seeking to repurchase "shares to a market value of NZ\$1 billion." In April 1997, Telecom issued its first tranche of capital notes ("Telenotes") to finance the share repurchase programme (Telecom, 1997, p. 25). Telecom anticipated a favourable effect on its earnings per share as a result of this programme. While the interest on the capital notes would lower the reported earnings, an improved earnings per share (and dividend per share payout) was expected to result from the smaller number of shares.

Subsequent to 31 March 1999, Telecom's financing subsidiary, TCNZ Finance Ltd issued a prospectus for another issue of Telenotes, again with the intention of financing the share repurchase programme or refinancing the funding already obtained to proceed with the NZ\$1 billion share repurchase programme (p. 36). The initial issue ... was for an aggregate principal amount of NZ\$275 million (p. 36). It is important to note the positive effect the share repurchase programme would have had on Telecom's MVATM. As has been noted, reductions in numbers of shares seem to have the effect of increasing share price thus increasing market value at the same time as invested share capital is reduced, even when the capital reduction is financed by borrowing.

Equity-based incentive schemes

Telecom has operated employee incentive schemes since 1994. In 1999, Telecom reported that 40% of its staff were on such schemes. Not all of these were necessarily equity-based, but a portion of the senior management remuneration policy clearly was as reported in 2003:

Typically, a senior executive will have 50% of their remuneration package paid as a fixed component. The remaining 50% is at-risk, with generally 30% in annual cash-based incentive and 20% in longer-term equity-based incentive. (Telecom, 2003, p. 38).

At the time, 768 senior managers participated in these arrangements which included the issue of options and restricted shares. The award of these incentives was based on the achievement of performance hurdles intended to align the interests of Telecom's senior managers with those of its shareholders. It is well-recognised that the operation of equity based incentives in New Zealand is nowhere near the scale and proportion of those in the United States. Telecom's CEO's incentive arrangement appeared to be consistent with the policy, consisting of an amount up to the equivalent of her base salary (www.sec.gov/Archives/edgar/data/875809/000119312504218573/dex46.htm, accessed 25 January 2005). Even so, the incentive payments do appear to be contingent at least partly on reported results and, therefore, the higher the reported results, the higher the wealth transfers to Telecom executives.

Selective reporting of share price changes

Telecom seems, now, to be driven by market perceptions, even changing its announced operating strategy to fit those perceptions. Telecom's success narrative focuses on share price movements and, especially, some sort of positive presentation of those movements, but has referred to both EVA™ for internal purposes and MVA™.

Telecom's Chairman's Review in the 1996 annual report commenced by lauding a 21.5% gross return to ordinary shareholders based on fully imputed dividends paid and share price appreciation over the 12 months. American investors had received an even higher gross return of 28.6% incorporating favourable exchange movements. Prominently displayed on the performance highlights page of the annual report was a graph showing the growth of Telecom's share price over three years. In his review, the chairman noted that:

Companies around the world are adopting Market Value Added, or MVA, as a broad indicator of their value creation. MVA measures the growth in the market value of shareholders' equity invested in an enterprise over and above the equity and debt capital recorded on its balance sheet. For 1995-96 Telecom's MVA was NZ\$1,520 million and over the five years since becoming a listed company, value has increased threefold. (Telecom, 1996, p. 2)

Telecom seemed happy to take full credit for its rising share price prior to 2000 when the world-wide telecommunications bubble burst, and its share price began to fall. Telecom then attempted to distance itself from responsibility for this fall. In August 2000, when its annual report for the year ended 30 June 2000 was released, Telecom's price was about NZ\$6.50 compared with about NZ\$8.90

twelve months earlier. No mention was made of share price performance or MVA™ in the 2000 annual report.

In both 2001 and 2002, Telecom acknowledged its share price had been volatile, ‘consistent with fluctuations in the telecommunications sector in most major markets.’ (Telecom, 2001, p. 5) In 2001, it presented comparisons with nine other telcos over one and two years. Telecom was ranked third with negative returns of 19.0% over one year and 19.1% over two years. In 2002, instead of providing comparative data against the nine telcos of 2001, Telecom provided a comparison with share price indexes for telcos in each of the Australasian, United States and European markets. Returns from Telecom were ‘negative although less unfavourable than from other comparable companies.’

In 2003 Telecom reported a gain of 6.3% in the share price and an overall return of 10.3% to shareholders. The comparison with other telcos again differed making year-on-year comparisons virtually impossible. This time comparisons were drawn with thirteen other telcos of which only six had been in the 2001 table. A further change was in comparing Telecom’s share price performance with six general global indices (NZX 50, Dow Jones, ASX 100, Hang Seng, FTSE and Nikkei).

Telecom reported that its share price rose 12.2% in the year to 30 June 2004 (Telecom, 2004, p. 8). Comparisons were drawn with shareholders’ returns in other telcos but again changes in the information reported made meaningful evaluations difficult. Five new companies were included and three from 2003 were excluded. Also, the comparisons drawn were over the three years ended 30 June 2004 and not the most recent year as shown previously.

Discussion and conclusion

According to Krippner (2005) an important aspect of financialisation is the separation of the production and accumulation functions of economic activity. Further, as Froud et al (2004) note, in these accumulation activities financial markets have become highly influential on companies’ behaviour. Institutional investors have become especially influential, tending to pursue the current conception of shareholder value, thus prompting companies to do the same.

Telecom presents itself as conducting its production activities internationally and, over time has made increasing efforts to expand overseas. The geographical segment information provided in its financial reports is largely based on normalised results, but even this shows Telecom’s international expansion is weak and seems to be carried by exploitation of its monopoly position in New Zealand, where Telecom has been criticised for running down the country’s essential communications infrastructure (Table 4). The one significant percentage return on assets reported outside New Zealand is that categorised as “other” in 2001 and represents the dubious dividend taken from Telecom’s loss-making associate Southern Cross Cables which helped to boost Telecom’s reported profits in that year.

Table 4: Telecom's geographical segment information (all in NZ\$ millions)

	2001	2002	2003	2004
Earnings before interest and tax (NZ)	1,318	1,465	1,499	1,538
Total Assets (NZ)	5,327	4,886	6,363	6,002
% return on assets	24.7%	30%	23.6%	25.6%
Earnings before interest and tax (Australia)	56	41	24	35
Total Assets (Australia)	1,922	1,553	1,377	1,215
% return on assets	2.9%	2.6%	1.7%	2.9%
Earnings before interest and tax (Other)	307	22	24	6
Total assets (other)	982	1,411	868	1,062
% return on assets	31.3%	1.6%	2.8%	0.6%

Throughout its history since privatisation, the accumulation activities relating to Telecom's shares occurred mostly outside New Zealand (in the United States, Europe and Asia) until late 2002 at which time New Zealand and Australian shareholders combined held only 13% of Telecom's shares. After the 1990 sale of Telecom's shares to Ameritech and Bell Atlantic which did bring investment into New Zealand, much greater amounts have clearly flowed out through high dividends, the share float and share buybacks. In 2002, when Telecom's chairman acknowledged a change in market sentiments from seeking revenue growth to seeking returns and cash generation, he reported that Telecom had, "adjusted quickly to that change in sentiment" (Telecom, 2002, p. 5). Telecom's shares have been promoted in both New Zealand and Australia as a "good buy" with the high level of dividends presented as an indication of excellent shareholder value. By July 2004 the proportion of shares held in New Zealand had risen to 26.2% while Australians held some 20.2%, and the pattern change in shareholding continues as shareholders in the United States, Europe and Asia continue to sell down their shares. Gradually, both economic activities of production and accumulation are becoming concentrated in New Zealand's small economy and, to a lesser extent in Australia's. This pattern shift has occurred during a period of engagement in increasingly complicated financial arrangements, the financial reporting of which, as explained above, prompt concern about the extent to which Telecom's success narrative is disconnected from its operating activities.

Telecom's chairman suggests that Telecom's "sound position" has been brought about through Telecom's strong operating performance, reduction in debt and its excellent prospects for further improvement in the balance sheet, but the counterpoint to this success narrative becomes evident only through very close scrutiny. With increasing efforts internationally to integrate countries' economies through financial market activities, the skills required of analysts in the countries concerned increase, while the attractions of international employment for analysts with such skills can only make their retention difficult. Whether analysts in New Zealand are able and willing to apply the much-needed close scrutiny remains to be seen.

Telecom is so dominant in New Zealand's share market the effects of the almost inevitable need eventually to admit to operating problems could be severe.

When a company is responsible for an essential part of the infrastructure of the economy, its collapse is politically unacceptable and almost inevitably will force a bailout by taxpayers. This has already happened in New Zealand in the case of its national airline, Air New Zealand Ltd, and its railway operator, Tranzrail Ltd, both formerly publicly-owned operations which were corporatised and then privatised during New Zealand's radical economic restructuring. Past shareholders have gained, and the losses to current shareholders as well as other stakeholders seem likely to fall most heavily on New Zealanders and Australians. Lazonik and O'Sullivan (2000, p. 33) observed that the pursuit of shareholder value may function as an "appropriate strategy for running down a company – and an economy". This examination of the financialised system as it affects a small country with its largest listed company listed on other exchanges besides that in New Zealand suggests that it could very well run down both the company and the economy. Accounting's contribution to the potentially damaging effects of financialisation seems facilitative and, in this view, we concur with other critics who call for attention to the institutional arrangements which shape behaviour. Sadly, the accounting profession seems unable, or unwilling, to address the issue. In 2002 in the aftermath of Enron when accounting practices and the accounting profession world-wide came under scrutiny, one major response was to criticise US accounting standards as "rules-based" and therefore inadequate. Part of the criticism related to compliance with generally accepted accounting practices (GAAP). For example, Alan Greenspan, then chairman of the US Federal Reserve, wrote to Paul O'Neill, then secretary of the Treasury, that "a disturbing amount of corporate accounting has come to rest on little more than conforming to...GAAP, without endeavouring to judge whether the companies' accounts in total do, in fact, represent a full and accurate portrayal of the current financial status of the corporation." (Sayles and Smith, 2005, p. 169). One response to this criticism was to promote as superior principles-based standards such as those promoted by the International Accounting Standards Board. In New Zealand, even Telecom's chief executive claimed that an event like Enron could not occur in New Zealand because of its superior principles-based accounting standards (Press, 2002). In this, she was supported by leading members of the accounting profession and standard-setters. What was not mentioned, however, was that compliance with GAAP in the manner Greenspan described has increasingly become the norm, regardless of whether the GAAP is based on standards considered rules-based or principles-based.

The effect of the accounting profession's response to the criticisms was to reduce the growing tension over who would be the world's accounting standard-setter in favour of the International Accounting Standards Board and so the event of Enron's collapse might have been convenient for those promoting a single set of economic and financial rules worldwide. However, it also suggested, misleadingly, that the International Accounting Standards Board's standards were, somehow, superior and events like the Enron implosion could not occur if principles-based standards were in force. But Greenspan's concerns related to behaviour and judgement, matters that are not addressed merely by converting to compliance with international GAAP. Indeed, although compliance with New

Zealand's version of international accounting standards is not required in New Zealand until 2007, Telecom was one of the first to announce itself as an early adopter. Regardless of whether the accounting standards in force are called principles-based or rules-based, compliance with GAAP still supports an "endless series of cheap financial dodges" through which financial reports may be manipulated (Froud et al, 2000, p. 109). Eventually, the accounting profession must address both the behaviour which produces these effects and the institutional arrangements shaping that behaviour.

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ⁱ There are two main variants of SVATM, one initially developed and promoted by Arthur Andersen, the other by LEK/Alcar (Froud *et al*, 2000, p. 82).

ⁱⁱ Krippner (2005) reports surprise (p. 186) at her finding that dividend revenue forms a shrinking proportion of the portfolio income in nonfinancial companies, thus suggesting the disgorging of cash Crotty (2005) and Lazonik and O’Sullivan (2000) report is not significant in financialisation, at least in relation to shares held by those non-financial companies. However, Krippner acknowledges data gathering difficulties which resulted in her use of inconsistent data (see explanation on p. 192). The proportions she identifies (Table 6) which use company data for portfolio income and establishment data for “non-financial profits” seems likely to produce misleading results for any company operating through subsidiaries. This is because dividend revenue from subsidiaries is eliminated on consolidation. If the company financial information available to Krippner is group company information the effects of the consolidation accounting techniques would produce the results on portfolio income that so surprised Krippner. However, it is also worth noting that her study focussed on portfolio income for non-financial companies only and, therefore, should not be regarded as negating Crotty’s (2005) and Lazonik and O’Sullivan’s (2000) comments about disgorgement of cash.

ⁱⁱⁱ Fay Richwhite had also acted as consortium adviser in this arrangement and some of its staff were former Treasury staff members (Witcher, 1990).

^{iv} In the financial reports filed in the United States, Telecom did not report this dividend as income. In the US, Telecom was required to offset the dividend against its advances to Southern Cross Cables.

^v At the time, a deal such as that apparently contemplated would have given Telecom considerable tax benefits in New Zealand, and given its counter-parties further benefits in the United States (Shoeshine, National Business Review, 30/5/03). Shortly afterwards, Telecom's auditor, KPMG, opposed efforts by New Zealand's Minister of Finance, Michael Cullen, to change the tax laws to reduce the tax benefits of such transactions (NBR, *ibid.*).