

***Hawke's Bay Regional Council  
Investment Portfolio Mix:  
Strategic Positioning Review***

**Final Report to Steering Group  
By McDermott Miller Limited**

**30 September 2008**

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**PART II**  
**INVESTMENT PORTFOLIO REVIEW**

## 5. CURRENT INVESTMENT PORTFOLIO

### 5.1. CURRENT PORTFOLIO

The Council's investment portfolio as at 30 June 2008 is shown in **Tables 1.1** (above) and **5.1** below.

**Table 5.1 Current Investment Portfolio Mix as at 30 June 2008**

INVESTMENT CLASS	VALUE \$'000	INCOME \$'000	YIELD %
<b>EQUITY</b>			
Port of Napier shareholding	99715		
Other public listed equities	766		
<b>TOTAL EQUITY</b>		<b>100481</b>	<b>39.1%</b>
<b>FORESTRY</b>		<b>964</b>	<b>0.4%</b>
<b>LEASEHOLD PROPERTY</b>			
Napier	93290		
Wellington	11800		
<b>TOTAL LEASEHOLD PROPERTY</b>		<b>105090</b>	<b>40.9%</b>
<b>TERM DEPOSITS</b>			
Proceeds from sale of land	31277		
Derived from other sources	15795		
<b>TOTAL TERM DEPOSITS</b>		<b>47072</b>	<b>18.3%</b>
<b>OTHER</b>			
Government Stock		<b>3119</b>	<b>1.2%</b>
<b>PORTFOLIO TOTAL</b>		<b>256726</b>	<b>100.0%</b>

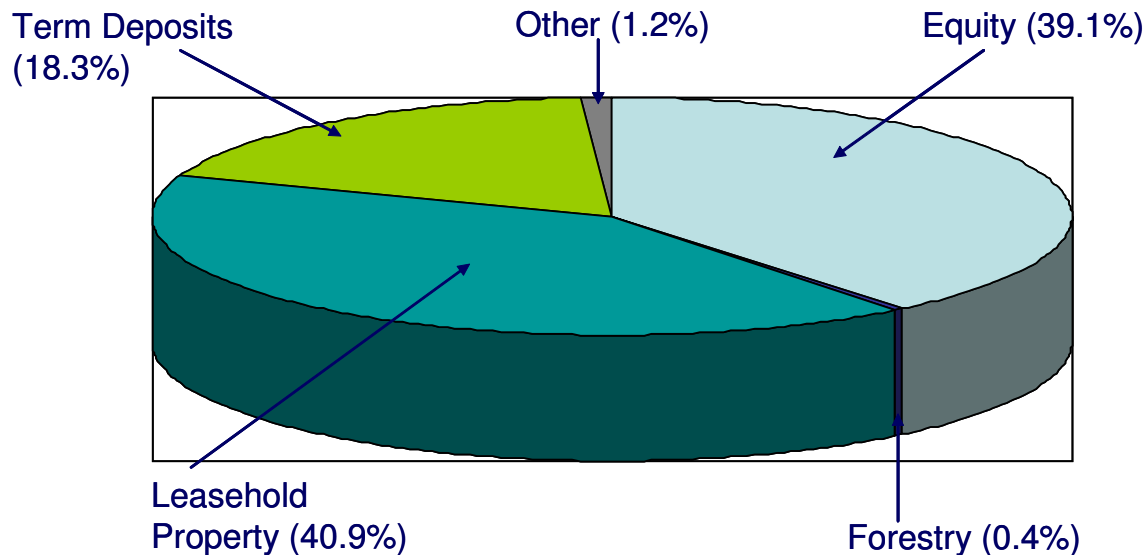
Notes: Investments are shown at market valuation on 30 June 2008, in accordance with accounting policies adopted by Hawke's Bay Regional Council  
 Source: Hawke's Bay Regional Council, August 2008  
 Compiled by: McDermott Miller Limited, August 2008

### 5.2. INVESTMENT MIX

**Figure 5.1** below shows the mix of investment classes within the portfolio. In broad terms the mix is 40% equity, 41% property, 18% bank (or bank equivalent) term deposits, and 1% other classes.

On the face of this analysis the portfolio could be said to be reasonably balanced among investment classes where a "traditional" investment policy has been practiced.

**Figure 5.1: Current Investment Portfolio Mix as at 30 June 2008**



Source: Hawke's Bay Regional Council, August 2008  
 Compiled by: McDermott Miller Limited, August 2008

However, the portfolio is substantially unbalanced within the equity and property investment classes. This is because:

- The equity class (39.5% share of total portfolio, valued at \$100.5million) almost entirely consists of a 91.7% shareholding in Port of Napier Limited.
  - This means the Council's equity investment performance (dividend flow and capital growth) depends solely on the performance of the Port of Napier.
  - The Port's financial performance to date has been relatively good, generating a cash yield from dividends paid of around 6.4% in 2007/2008, and growth in the capital value of its investment
- The property class (40.9% share of total portfolio, valued at \$105.1million) consists of:
  - Leasehold land in Napier (\$93.3million, or 89% of total property assets), which is subject to restrictive sale covenants under the Hawke's Bay Endowment Land Empowering Act 2002; and,
  - Leasehold land in Wellington (\$11.8million or 11% of total property assets), which is able to be dealt without restriction.

- Cash yield from the property class has been relatively poor. Cash yield on the Napier leasehold property was 2.07% for the year ended 30 June 2008, and 3.98% on the Wellington leasehold property.
- These imbalances reflect the origins of the investment portfolio, having been “handed over” from the previous Hawke’s Bay Catchment Board.
- The Council has been successful in selling a portion of the Napier leasehold properties, but that process is slowing, leaving a substantial proportion of its portfolio, performing poorly in producing income, and difficult, and without any strategic advantage in continuing to hold the Napier leasehold assets.
- Although the Napier leasehold assets have shown a continued growth in capital value (about 4% in the 2008 year), the combined capital growth and income generated (6.1%) is still below current cash rates.
- In effect, the Napier leasehold properties are ‘deadweight’ in the portfolio.

5.3.

**INVESTMENT PERFORMANCE**

**Table 5.2** below shows the current income yield by investment class. This is a crucial issue for the Council as it needs to maintain substantial cash flows from the investment portfolio to support its ongoing operations. As noted in **Section 1.1** above the portfolio contributes about 25% of the Council’s annual income, and any significant change in the portfolio yield performance could impact operations.

**Table 5.2: Current Yield Performance – Year ended 30 June 2008**

<b>INVESTMENT CLASS</b>	<b>VALUE \$'000</b>	<b>INCOME \$'000</b>	<b>YIELD %</b>
<b>Equity</b>	<b>100481</b>	<b>6009</b>	<b>6.0%</b>
<b>Forestry</b>	<b>964</b>	<b>0</b>	<b>0.0%</b>
<b>Leasehold Property</b>	<b>105090</b>	<b>2418</b>	<b>2.3%</b>
<b>Term Deposits</b>	<b>47072</b>	<b>3946</b>	<b>8.4%</b>
<b>Government Stock</b>	<b>3119</b>	<b>165</b>	<b>1.3%</b>
<b>PORTFOLIO TOTAL</b>	<b>256726</b>	<b>12538</b>	<b>4.9%</b>

Source: Hawke’s Bay Regional Council, August 2008  
 Compiled by: McDermott Miller Limited, August 2008

Yields on term deposits and equity, (including imputation credits, which are unavailable to the Council), are relatively high, but yields on all other classes are lower than market.

Higher income yields could, (at least in theory), be earned on the portfolio. The difference between what is being earned and what

could be earned, given the same security profile, is the portfolio "income opportunity cost".

One measure of the "income opportunity cost" being experienced by the Council is to assume the entire portfolio is "cashed up" and invested in ten year government stock. At current prices the investment of \$256.7million in ten year government stock, yielding 6%per annum would generate an annual income of around \$15.4million per annum, or about 23% more than income generated by the portfolio in the year ended 30 June 2008. The difference in these two income flows, almost \$3million in 2008, is the "income opportunity cost" experienced by the Council each year.

This calculation is based on an average 6% yield on the cashed up portfolio. Every 1% increase in yield (from 6% to 7% say) would add a further \$2.5million per annum to the income generated by the portfolio.

#### 5.4. LIQUIDITY

The portfolio is relatively illiquid.

In **Section 5.2** above we referred to the increasing difficulty experienced by the Council in selling its Napier leasehold land properties. While selling has doubtless become more difficult in the current property market, the Council has been experiencing declining interest amongst purchasers for some years. No more than 6% of properties by value have been sold each year for the last 3 years.

On the other hand the Wellington lease properties, unrestricted by the Hawke's Bay Land Empowering Act 2002, are likely to be much more saleable, especially in light of the forthcoming ground rent reviews (See **Section 7** below).

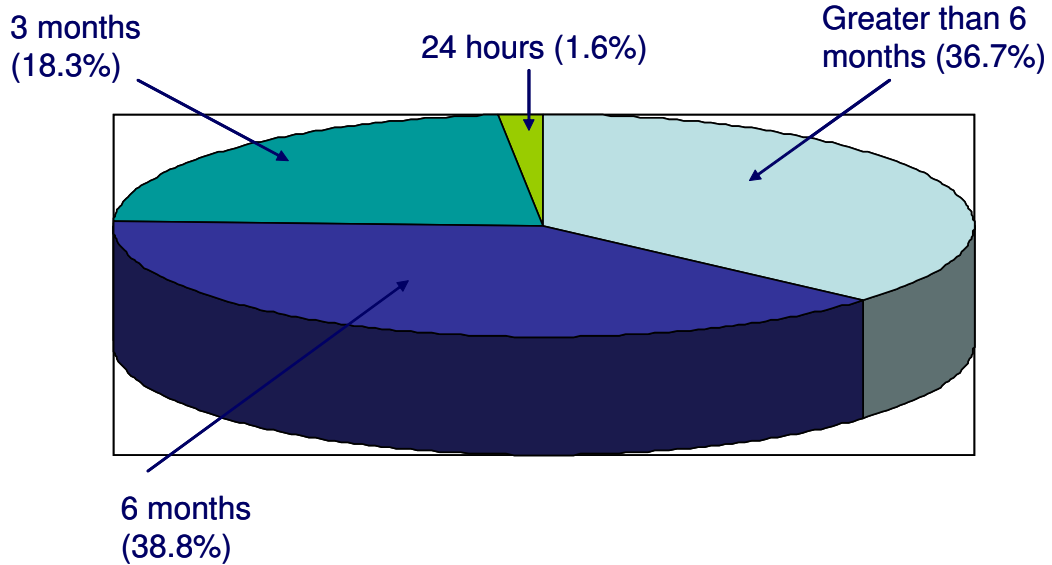
Sales of Port of Napier shares should be achievable much more readily than sale of the Napier leasehold properties. However maximising sales value, including the achievement of a "control premium" if sufficient Port of Napier shares were sold to pass control from Hawke's Bay Regional Council to another party, could well take some time which means they are also a relatively illiquid investment in the short term, (but not as illiquid as the Napier leasehold property).

**Figure 5.2** below illustrates the portfolio liquidity profile. Assets have been classified as realisable:

- Within 24 hours (cash, government stock, public listed securities);
- In up to 3 months (maturing terms deposits and Wellington leasehold property);
- Between 3 and 6 months (Port of Napier shares); and,

- Beyond 6 months (Napier leasehold property).

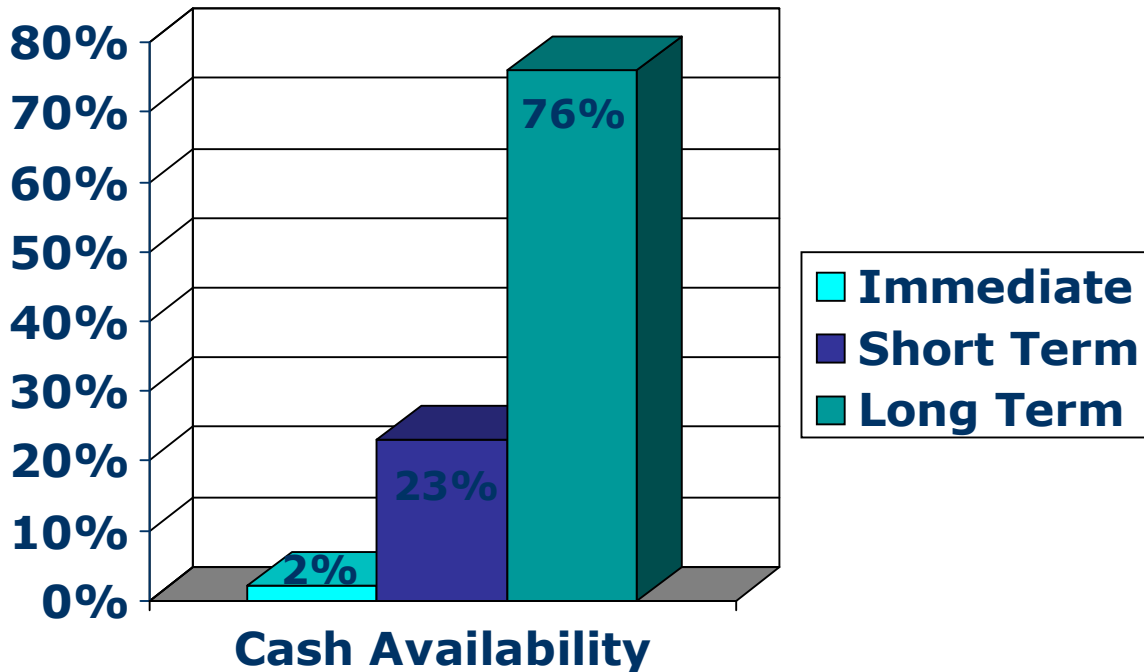
**Figure 5.2: Liquidity Profile as at 30 June 2008**



Source: Hawkes Bay Regional Council and McDermott Miller Limited, August 2008  
Compiled by: McDermott Miller Limited, August 2008

This means, at best, only 25% of the entire portfolio is readily available at short notice for other investment purposes. This position is illustrated in **Figure 5.3** below.

Figure 5.3: Cash Availability as at 30 June 2008



Source: Hawkes Bay Regional Council and McDermott Miller Limited  
Compiled by: McDermott Miller Limited, August 2008

## 5.5.

### STRATEGIC INVESTMENTS

The Council's investment portfolio contains one investment it considers to be strategic, which is its shareholding in the Port of Napier.

The Council owns 19,257,000 shares in the Port of Napier which is 91.7% of the total shares on issue by the Port of Napier. The only other Port of Napier shareholder is the Manawatu Regional Council (Horizons Manawatu) which owns the remaining 8.3% of the Company's shares on issue.

Hawke's Bay Regional Council valued its shareholding at \$99.715million as at 30 June 2008, or \$5.18 per share

This value compares with the Port's net tangible asset backing as at 30 September 2007 of \$4.52, and Horizons Manawatu's 30 June 2007 valuation of \$3.30 per share.

In December 2007, the Council increased its exposure to Port operations by agreeing to a \$60million capital expenditure programme for reconstruction of number three wharf and purchase of new equipment including another container crane and a new tug. This programme is to be 100% financed by new debt raised by the Port (on a non-recourse to the Council basis) from Westpac Banking Corporation. The Port's Board and management team anticipate a decline in profitability during the construction phase, which will be more than made up when the Port is restored to full operation in 2012/2013 and new wood and other product is channelled over its upgraded facilities.

The Port appears to be well served by a highly professional and motivated management team. In our view, it will be in the Council's interest in the light of this new investment to maintain the management team, at least over the next five years. The Port is the only area of management risk currently faced by the council in its investment portfolio.

**5.6.**

**ECONOMIC IMPACT OF PORT OF NAPIER**

The economic impact of the Council's investment portfolio is principally derived from the activities of its Port of Napier subsidiary. Although the forestry assets make a contribution to the Hawke's Bay regional economy, any contribution is minimal due to the small size of the activity. The other investments within the portfolio are simply financial transfers and make no significant added contribution to the Hawke's Bay regional economy.

The economic impact of the Port of Napier is significant. Based on an economic impact assessment completed by Butcher Partners Limited in February 2005 (*Regional Economic Impacts of Port of Napier*), and updated by McDermott Miller to the 2007/2008 year, we estimate:

- Total economic impact of the Port and businesses directly depending upon the Port are equivalent to:
  - Maintaining an additional 800 jobs annually;
  - Increasing the Hawke's Bay gross regional product by \$70million annually.
- Further, by taking into account indirect and flow on effects the Port:
  - Supports around 20,900 jobs in the region;
  - Helps increase the Hawke's Bay gross regional product by around \$1380million annually.

This means the Port directly and indirectly contributes to around 28% of the Hawke's Bay regional economy. Contribution at this level is very significant and reinforces the position of the Port as the Council's key strategic investment to date.

**5.7.**

**SUMMARY**

In summary, the Council's investment portfolio is relatively unbalanced, low yielding and illiquid, but relatively low risk.

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With the exception of the Port of Napier shareholding, no part of the investment portfolio contributes to the Hawke's Bay regional economy or is a "strategic hold" to assist the implementation of the Council's strategic goals and objectives. However, the Port is a strong contributor to the regional economy and the Council's key strategic investment in the portfolio.

**6. BENCHMARKS**

**6.1. INTRODUCTION**

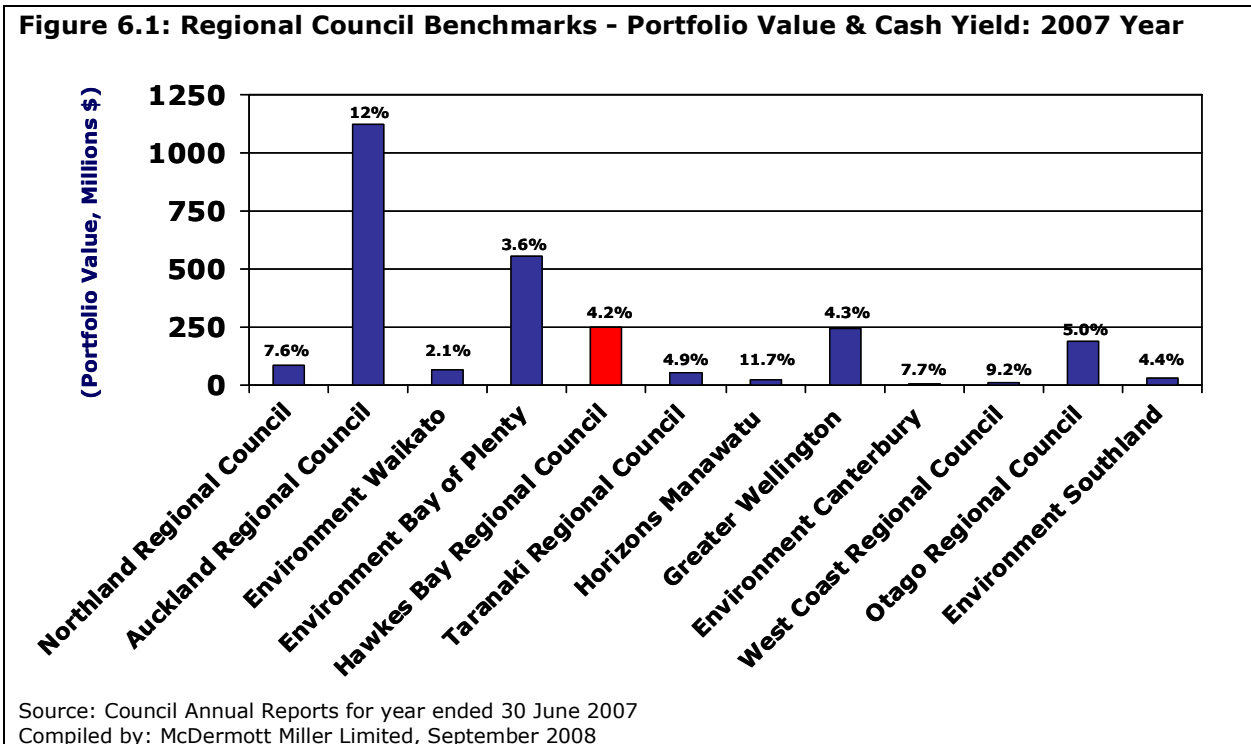
In this section, we review the investment portfolios and structures used by other Regional Councils and a range of selected City Councils.

**6.2. OTHER REGIONAL COUNCILS**

**Figure 6.1** below shows the size of other regional council's portfolios, and the cash yield they obtained from them in the year ended 30 June 2007.

The largest portfolio are held by Auckland Regional Council (\$1.12billion as at 30 June 2007), Environment Bay of Plenty (\$560million), Hawke's Bay Regional Council (\$257million) and Greater Wellington Regional Council (\$240million).

In each case, the largest single asset in these portfolios is the regional port. The Ports of Auckland and Port of Tauranga are both valued at \$500million or more and comprised 52% and 90% of the Auckland and Environment Bay of Plenty portfolios respectively.



Cash yield is a measure of the net cash flow to the respective regional councils from their investment portfolios. It excludes unrealised revaluation gains from changes in market values. The highest performer is Auckland Regional Council which earned 12% of its portfolio in the 2007 financial year. The next highest performer was Horizons Manawatu, which earned 11.7% from its mix of port investments (CentrePort and Port of Wellington) and term deposits.

Care needs to be taken when reviewing cash yields. This because different councils may value their assets differently, (e.g. market value for Environment Bay of Plenty's Port of Tauranga shareholding, and discounted net asset value for Horizon Manawatu's Port of Napier shareholding), so that the revenue flows to councils from interest and dividends may show a higher or lower percentage yield to different asset valuations. For example, Horizon's Manawatu values its Port of Napier shareholding at a lower per share value than Hawke's Bay Regional council does. This means the same dividend payment rate from Port of Napier will show a higher cash yield to Horizons Manawatu than it does for Hawke's Bay Regional Council.

### **6.3.**

#### **SELECTED CITY COUNCILS**

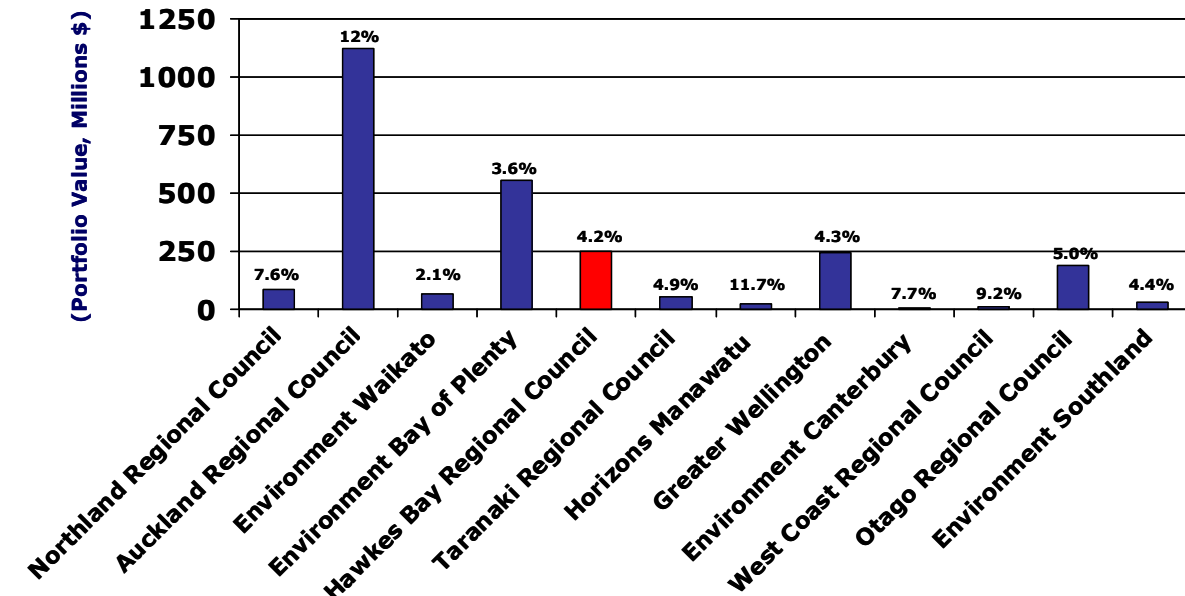
The following **Figure 6.2** expands the benchmarks comparison by showing Hawke's Bay Regional Council alongside the investment portfolios of major metropolitans, and its regional neighbours.

Here the largest investment portfolios are Auckland City (\$1.97billion), Christchurch City (\$1.60billion), Manukau City (\$750million), Wellington City (\$340million), and Waitakere City (\$250million), compared with Hawke's Bay Regional Council (\$257million).

Over all councils, Hawke's Bay Regional Council directly controls the 7<sup>th</sup> largest Council owned investment portfolio in New Zealand.

Again the largest assets in the City holdings are infrastructure (e.g. Auckland International Airport shares held by Auckland and Manukau Cities).

**Figure 6.2: City & Other Council Benchmarks – Portfolio Value & Cash Yield: 2007 Year**



Source: Council Annual Reports for the year ended 30 June 2007  
 Compiled by: McDermott Miller Limited, September 2008

Investments held by other councils in the Hawkes Bay region, Hastings District Council and Napier City Council, (\$12.5million and \$70.9million respectively), were small compared to Hawke’s Bay Regional Council’s portfolio. Since June 2007, Hastings District Council sold its landholding in Nelson Park for \$18.6million and reinvested a substantial part of this money in new community facilities. Gisborne District Council held \$20.8million of investment assets, but significant parts of that District’s infrastructure assets had been moved into the Eastland Community Trust (including Port Gisborne, the airport and the lines network).

**6.4. INVESTMENT STRUCTURES COMPARED**

The majority of Councils continue to own their investment assets directly. Council’s can directly manage their own investments and receive income from their investments directly, without deductions for taxes (other than imputation credits generated by investments in limited liability companies, which are not useful to non-tax paying councils).

On the other hand a number of Councils, especially those controlling larger investment portfolios, have placed part or all of their investment portfolios in a corporate structure. This includes Auckland Regional Council, Environment Bay of Plenty, Greater Wellington Regional Council, and Otago Regional Council. In addition a number of the major cities have also placed their investments in corporate structures. These include Christchurch City, Dunedin City, Manukau City, but not Auckland City or Wellington City.

The pattern of current investment holding structures is shown in the following **Table 6.1**.

COUNCIL	STRUCTURE	
	DIRECTLY HELD ASSETS	HOLDING COMPANY
<b>Northland Regional Council</b>	Northland Port Corp (52.4%) Investment properties Financial Assets	
<b>Auckland Regional Council</b>		<b>Auckland Regional Holdings Ltd</b>
<b>Auckland City</b>	Auckland International airport	
<b>Environment Waikato</b>	Financial Assets	Proposed
<b>Hamilton City</b>	Waikato Regional Airport (50%)	
<b>Environment Bay of Plenty</b>		<b>Quayside Holdings Ltd</b>
<b>Gisborne District Council</b>		<b>Gisborne Holdings Ltd</b>
<b>Hawkes Bay Regional Council</b>	Financial Assets Property Port of Napier (91.7%)	
<b>Napier City Council</b>	Hawkes Bay Airport Authority (26.12%)	
<b>Hastings District Council</b>	Hawkes Bay Airport Authority (24%) Nelson Park	
<b>Taranaki Regional Council</b>	Port of Taranaki Ltd Properties & financial assets	
<b>Horizons Manawatu</b>	CentrePort Ltd (23.08%) Port of Napier Ltd (8.3%)	Proposed
<b>Greater Wellington</b>		<b>WRC Holdings Ltd</b>
<b>Wellington City</b>	Financial Assets Wellington International Airport (34%)	
<b>Environment Canterbury</b>	Financial Assets	None
<b>Christchurch City</b>	Financial Assets	<b>Christchurch City Holdings Ltd</b>
<b>West Coast Regional Council</b>	Financial Assets	None
<b>Otago Regional Council</b>	Financial Assets	<b>Port Otago Ltd</b>
<b>Dunedin City</b>		<b>Dunedin City Holdings Ltd</b>
<b>Environment Southland</b>	South Port NZ Ltd (66.48%) Financial Assets	None

Source: Council Annual Reports and Media statements  
Compiled by: McDermott Miller Limited, August 2008

The advantages perceived by some regional council's in using corporate structures are to:

- Bring all commercial activities under one umbrella, utilising professional commercial management to operate these activities.
- Provide a cost-efficient source of funding for the Council. For example, a holding company could borrow, say, \$10million at an interest rate of say 9%. After allowing for tax deductibility of the interest against income earned from commercial operations the holding company's net cost of funds would be around 6.3%. The \$10million could be passed back to its owning council as a dividend (excluding imputation credits). This allows the Council to reduce its effective interest cost from, say, 7.5%-10% experienced by some councils in the 2007 year to around 6.3%.
- Provide a commercial return to the shareholding council.
- Help sustain the economy of the region.

**6.5. PORT PERFORMANCES COMPARED**

In this section we compare the financial performances of the regional council's investments in ports. **Table 6.2** below summarises the Port's performances for the year ended 30 June 2007.

**Table 6.2: Comparative Port Performances as at 30 June 2007**

REGIONAL COUNCIL	PORT	EBITDA \$'000	NET ASSETS \$'000	EBITDA/ Net Assets %	NET DEBT RATIO %
Auckland	Ports of Auckland (100%)	68281	330450	21%	52%
Environment Bay of Plenty	Port of Tauranga (55%)	79791	643311	12%	22%
Environment Southland	SouthPort (66.48%)	5294	26208	20%	5%
Greater Wellington	CentrePort (76.9%)	29484	191233	15%	31%
Hawkes Bay	Port of Napier (91.7%)	18272	94960	19%	11%
Horizons Manawatu	CentrePort (13.08%) Port of Napier (8.3%)	29484 18272	191233 94960	15% 19%	31% 11%
Northland	Northland Port Corp (52.4%)	9920	153477	6%	4%
Otago	Port Otago (100%)	27100	251923	11%	32%
Taranaki	Port Taranaki (100%)	12999	71563	18%	34%

Note: Regional council ownership is 100% of their port, except where a lower ownership figure is shown in Column 2  
 Source: Ports Annual Reports year ended 30 June 2007  
 Compiled by: McDermott Miller Limited, August 2008

Although **Table 6.2** is a one year snapshot only, it does show:

- Ports of Auckland was the most profitable port business in 2007 in terms of return on net assets (21% EBITDA/Net Assets ratio), followed very closely by SouthPort (20%), Port of Napier (19%) and Port Taranaki (18%).
- The least profitable was Northland Port Corporation, (6% return), but this is probably a function of its "conversion" from a port company to a property investment company.
- Average return on assets over all these ports was 15%. This means Ports of Auckland, SouthPort, Port of Napier and Port Taranaki all performed above the average, while Port of Tauranga, Port Otago and Northland were below average.
- Total net assets exceeded \$2billion. Around 31% of these net assets were employed by the Port of Tauranga alone.
- These ports are relatively lightly geared. That is, their net debt ratios are low, ranging from a mere 6% for Northland Port Corporation to 52% for Ports of Auckland. In most cases, (especially SouthPort, Northland and Napier), port balance sheets could be said to be "lazy", when comparable companies gearing is in the ratio of 30-40%. This gearing leaves room for significant capital expenditure programmes (as Port of Napier has since embarked on), or return of capital to shareholders.
- Some would argue relatively lowly geared balance sheets are acceptable defensive positions for ports to adopt in the light of current economic circumstances and "intense" competition for seafreight along the New Zealand coast and in the exports and import trades.
- We reject this view. In our view forward looking Boards and effective managements will be behaving pro-actively, looking for new business, increasing operating efficiencies and evaluating partnership and consolidation opportunities both horizontally and vertically. They will not be prepared to rest on the "buffer" of an inefficient capital management policy.
- We therefore see opportunity for increased gearing for all ports.
- As noted earlier, Port of Napier has already used its balance sheet to finance a \$60million capital expenditure programme, which is expected to boost its gearing to a projected maximum of 46% over the next 3-4 years, falling back to around 35% by 2016/2017.

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## 6.6.

### REGIONAL ECONOMIC DEVELOPMENT STRATEGIES

Most regional councils have adopted policies that impact on their region's economic development in their respective LTCCP's.

However few link an explicit regional economic development strategy to their portfolio investment policies. Auckland Regional Council and Environment Bay of Plenty do use their investments to assist their region's economic development, and Greater Wellington Regional Council may well do so following the recent adoption of a regional strategy and establishment of investment structures that could be used for this purpose.

Hawke's Bay Regional Council could therefore take a leadership role amongst regions if it was to use an active investment policy to support its regional economic development strategy in future.

**PART III  
COORDINATED REGIONAL ECONOMIC AND  
INVESTMENT PLANNING**

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## 8. REGIONAL ECONOMIC DEVELOPMENT DIRECTION

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### 8.1 REGIONAL ECONOMIC EVALUATION

#### INTRODUCTION

In this section we identify the sectors which, if invested in by Hawke's Bay Regional Council have most potential to generate benefits for the wider economy of the Hawke's Bay region.

We take a two step approach to this. First, we carry out a portfolio analysis to identify those base sectors which the Hawke's Bay region has a competitive advantage in. Second, we estimate the economic output benefits that would be generated through the regional economy with expansion of the exports by industries within the base sectors. Comparing the results of the two analyses allows us to indicate investment priorities.

#### PORTFOLIO ANALYSIS

The purpose of our Portfolio Analysis is to identify those industries that underpin the economy of the Hawke's Bay region and those that have potential to be future drivers of employment growth.

The analysis in **Section 3** indicates that the Hawke's Bay Region is performing well in terms of economic growth. However we are interested in how Hawke's Bay is performing as a "business" – with its industries seen as a regional portfolio of producers who generate GDP and employment.

In a firm undertaking a strategic marketing analysis, the purpose of a portfolio analysis is to identify the products which have most potential to contribute to its future profitability and so most merit further investment.

In our portfolio analysis we view the Hawke's Bay Region as holding a "*portfolio*" of industries, analogous to a portfolio of products produced by a firm. The purpose is to identify those industries which currently contribute most to the prosperity of the area (measured by regional GDP and employment growth) and have most potential for continuing to do so in the future.

In the absence of detailed sales or production data, the portfolio analysis uses the most recent Statistics New Zealand Business Demography data on employment counts in Hawke's Bay Region available.

**Figure 8.1** below is a portfolio analysis matrix, (after the well known Boston Consulting Group Matrix (BCGM) model.) based on industry employment growth and share of employment in the Hawkes Bay Region

The horizontal axis is the percentage share that each Hawkes Bay regional industry has of total employment in all the provincial regions. The vertical axis shows the average annual percentage growth in employment in each Hawkes Bay regional industry over the 2000-2007 period.

This means the horizontal axis indicates the national importance that Hawke's Bay has in each industry, and the vertical axis indicates its health as evidenced by employment growth.

The portfolio matrix segments industries into four groups:

- "*Stars*" are the Hawke's Bay industries which have a share of total provincial employment greater than the region's overall share of total provincial employment and have average annual growth rate higher than the average for other provincial regions (across all industries in the portfolio).
- "*Cash Cows*" are the Hawke's Bay industries which are growing only slowly, or declining, in terms of employment, but in which Hawke's Bay has a greater than average share of total provincial employment.
- "*Question Marks*" are those industries in which Hawke's Bay has a low share but are growing relatively strongly in terms of employment;
- "*Dogs*" are industries in which Hawke's Bay has a low share of employment and employment is static or falling.

By implication, Hawke's Bay Regional Council should be divesting in the industry "Dogs" and reinvesting in the industry "Stars". It should also be watching closely the performance of the "Question Mark" industries and perhaps investing in overcoming production and distribution constraints on their expansion.

**Figure 8.1** below contains an analysis of the "key driver" vertically integrated sectors.

The figure shows that:

"*Star*" sectors are:

- Meat and Wool Production/Processing
- Wine

"*Question marks*" sectors are:

- Forestry and Forest Products
- Dairy Production

- Chemical & mineral manufacturing
- Metal products & machinery manufacturing
- Tourism

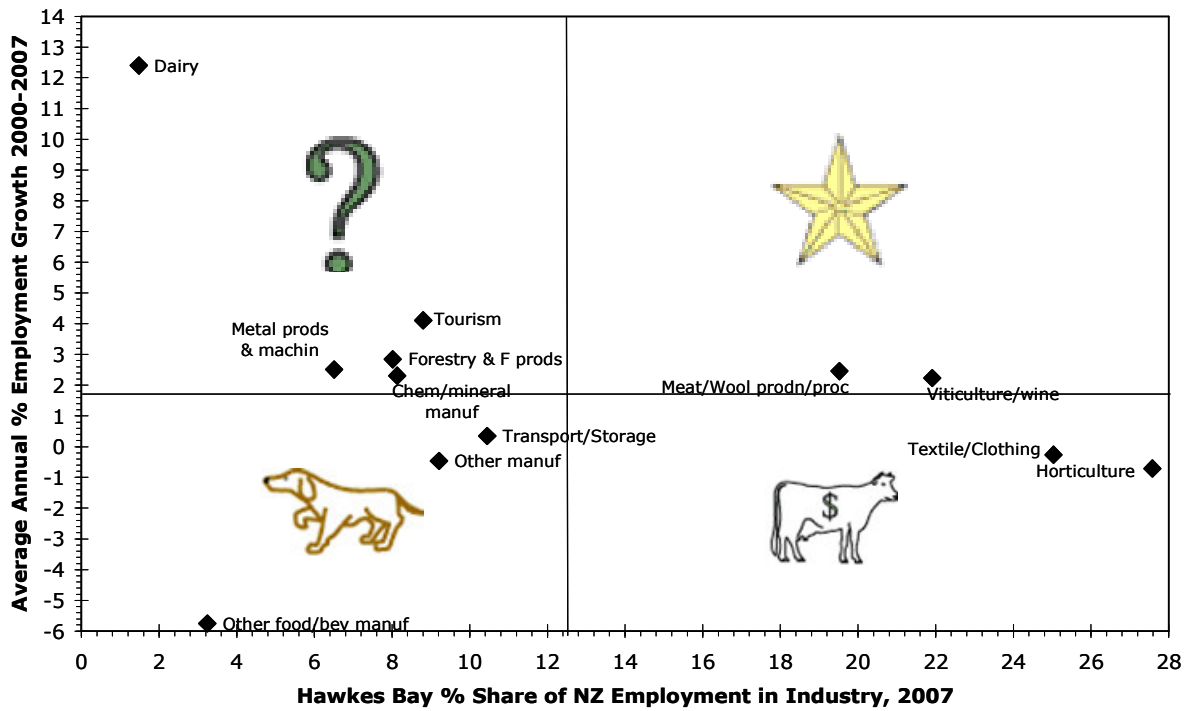
"Cash Cow" sectors are:

- Other Horticulture Production/Processing
- Textile/clothing manufacturing

"Dog" sectors are

- Other food/beverage manufacturing
- Other manufacturing
- Transport and Storage

Figure 8.1: Regional Economic Development Evaluation: Portfolio Analysis



Source: McDermott Miller Estimates,  
Compiled by: McDermott Miller Limited, September 2008

**8.2****RETURNS ON INVESTMENT: MULTIPLIER EFFECTS ON ECONOMIC OUTPUT**

In **Section 2.2** we noted that an increase in the export base (all the exportable goods and services of a region) sets off a multiplier process where the multiplier is the increase in regional output divided by increase in exports. Economic output multipliers are a useful indicator of which sectors, if invested in, stimulate most effectively economic activity throughout regional economy. There are several components to the multiplier effect, as follows:

- Direct impact is the increase in demand (exports) itself, met by an increase in production of the sector producing the exports;
- First round indirect economic impact is the immediate purchase of goods and services from the Hawke's Bay economy by the sectors experiencing the expansion in demand;
- The industrial support economic impact - the second and subsequent indirect rounds of output increases as firms receiving the funds from the first round effects make purchases throughout the regional economy.

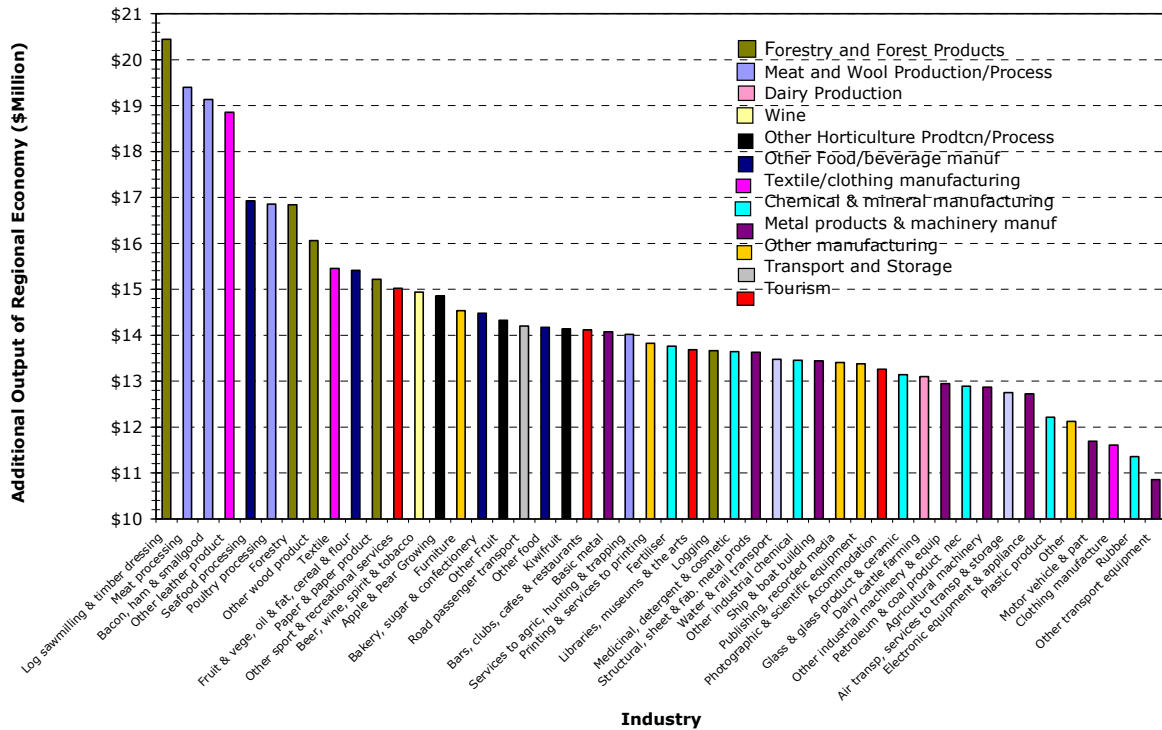
**Figure 8.2** below shows the increase in economic output (direct plus indirect) that will be generated by the economy in response to an increase in exports of \$10 million. This shows, for example:

- An increase of \$10 million in exports of the "Log sawmilling & timber dressing" industry will result in an increase of economic output of \$20.4 million, (direct and indirect effects); and,
- An increase of \$10 million in exports of the "Meat Processing" industry will result in an increase of economic output of \$20.4 million, (direct and indirect effects).

The input-output model which generates these results does not provide a increase in output resulting from a given amount of investment. Instead, the model is consistent with the "regional economic base principle in that it applies a "demand pull" approach answering the question: with a given amount of increase in final demand (exports) what will be the increase in economic output (at current productivity of capital and labour)?

This approach is useful for indicating the industries which, if expanded, (and assuming markets are available for the goods produced), would generate most benefits for the economy of Hawke's Bay region.

**Figure 8.2: Regional Economic Development Evaluation: Gain in Economic Output resulting from \$10 million Increase in Exports**



Source: McDermott Miller estimates,  
Compiled by: McDermott Miller Limited, September 2008

**8.3 IMPLICATIONS**

The combined results of the portfolio analysis and the multiplier effects of export expansion on economic output indicates the sectors where Hawke’s Bay has a competitive advantage and where additional investment would most benefit the economy of the region.

- Forestry and Forest products sector is a “Question Mark” in the portfolio analysis (Figure 8.1). It is growing but Hawke’s Bay only has a modest share of national output of this industry. However, Figure 8.2 shows that increasing exports of the log sawmilling/timber industry have more potential for driving regional economic growth than any other industry. “Forestry” and “Other wood products” also rank highly in Figure 8.2, at 6<sup>th</sup> and 7<sup>th</sup> respectively (out of 48 industries).
- Meat and Wool Production/Processing emerges as a “star” in the portfolio analysis, and meat processing industries are the second and third highest ranking industry in Figure 8.2. This suggests that, providing markets are available, investment in meat processing has potential benefits for the regional economy;

- The viticulture/wine sector also emerges as a star in the portfolio analysis (**Figure 8.1**). The wine production industry also ranks reasonable highly in terms of direct+indirect multiplier effects (**Figure 8.2**) at 13<sup>th</sup>.
- Seafood processing ranks highly in **Figure 8.2**, at 5<sup>th</sup>, however it is now a small industry in Hawke's Bay with 2 enterprises and 18 employment counts in 2007. The high multiplier effect suggests potential for economic benefits to the region, if it can be revived.
- The textile/clothing sector is a "cash cow" in the portfolio analysis, and "leather products" (4<sup>th</sup>) and "textiles" (10<sup>th</sup>) rank high in **Figure 8.2**. This suggests that manufacturing export products based on wool and hides also has potential to benefit the regional economy.

The portfolio analysis identifies the Tourism sector as a "Question Mark". Referring to **Figure 8.2**, the industry which includes tourist attractions/activities, "Sport and Recreational Services", is ranked at 12<sup>th</sup>, and bars, cafes and restaurants ranks in the middle range. While not having such strong benefits from additional export dollar earned as the primary-production based manufacturing industries do, this indicates investment in tourism generates significant economic benefits. Tourism also has an important role in diversifying the regional economic portfolio of Hawke's Bay.

The analysis of **Figure 8.2** understates the economic importance of the transport sector, as the sector does not "export" much in input-output analysis terms. (The wharfage charges earned by Port of Napier for handling export cargos originating in Manawatu region are the port industry's "exports"). The economic significance of the transport sector is much greater than wharfage only, or its 3% contribution to regional GDP (**Figure 2.2**). Transport is the economic activity which integrates the inter-regional and intra-regional economy. Importantly, transport defines the market catchment of a region. As discussed in **Section 5.6** the Port of Napier contributes only some 1.5% of regional GDP directly, but supports around 28% of the region's GDP. The port market catchment, in a sense, extends the economic boundary of Hawke's Bay to cover the whole of the North Island East Coast, together with the Manawatu region.

## 8.4

### TOWARDS A STRATEGY

In this section we present an indicative economic development scenario and estimate the benefits it would have for the Hawke's Bay Region.

#### AN ECONOMIC DEVELOPMENT SCENARIO

We postulate a *Development* Scenario in which the value of exports from the following vertically integrated sectors is higher, compared to the *Continuation* scenario as follows:

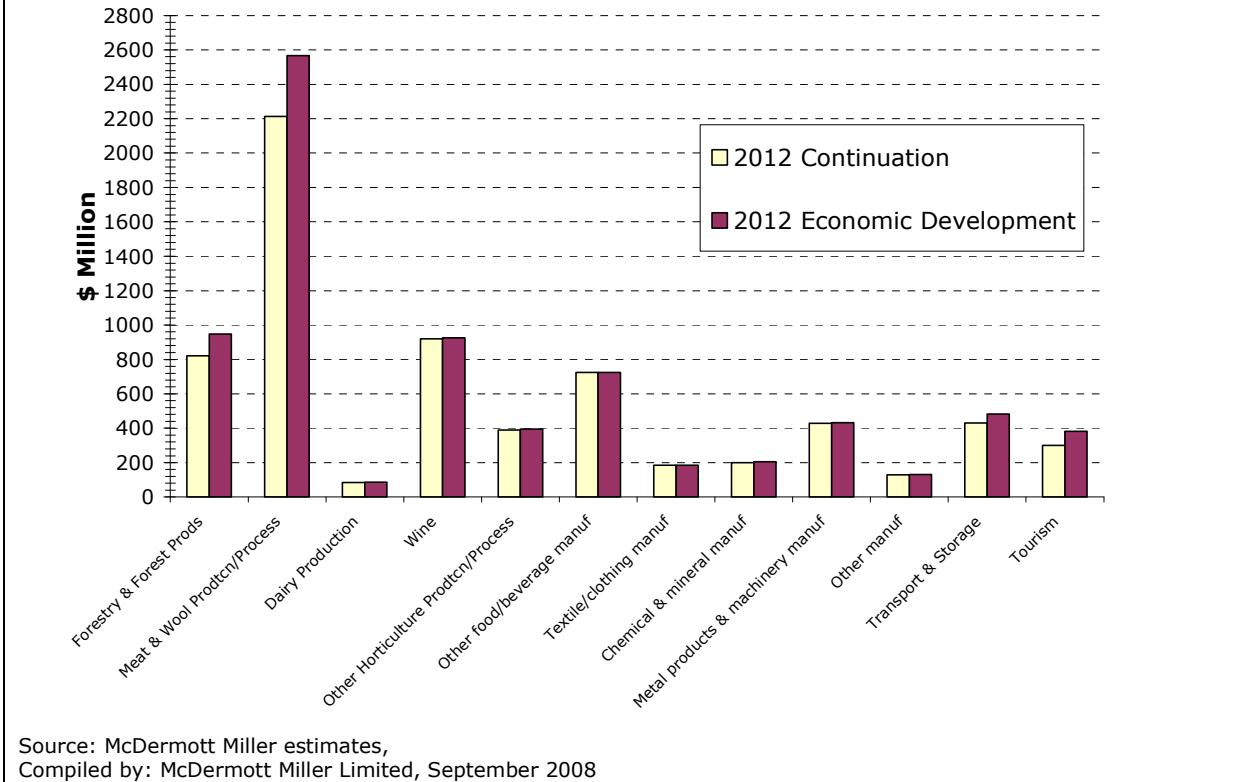
- value of Forestry and forest products exports are 20% higher;
- value of Meat and wool exports also 20% higher;
- value of tourism exports (i.e. spending by tourists) is 67% higher than at present; and,
- value of exports of the transport and storage industry are 20% higher.

#### PERFORMANCE OF THE ECONOMIC DEVELOPMENT SCENARIO

We project the value of these exports from Port of Napier assuming these grow at the national rate (i.e. Port of Napier retains its current share). We then use an input-output model of the Hawke's Bay regional economy to estimate the changes in output by industry that would be required to support the expansion in exports. Under this *Development* scenario we find:

- Total output of the Hawke's Bay economy would be some \$720 million higher by 2012 than under the *Continuation* Scenario;
- Some \$640 million of the increase would be in the vertically integrated sectors shown in **Figure 8.3** below;
- The value of output of the Meat and Wool production/processing sector would be \$353 million higher, accounting for 49% of the difference between the output difference between the *Development* and *Continuation* scenarios; and,
- The value of output of the Forestry/Forest Products sector would be \$126 million higher by 2012 (18% share of the difference).

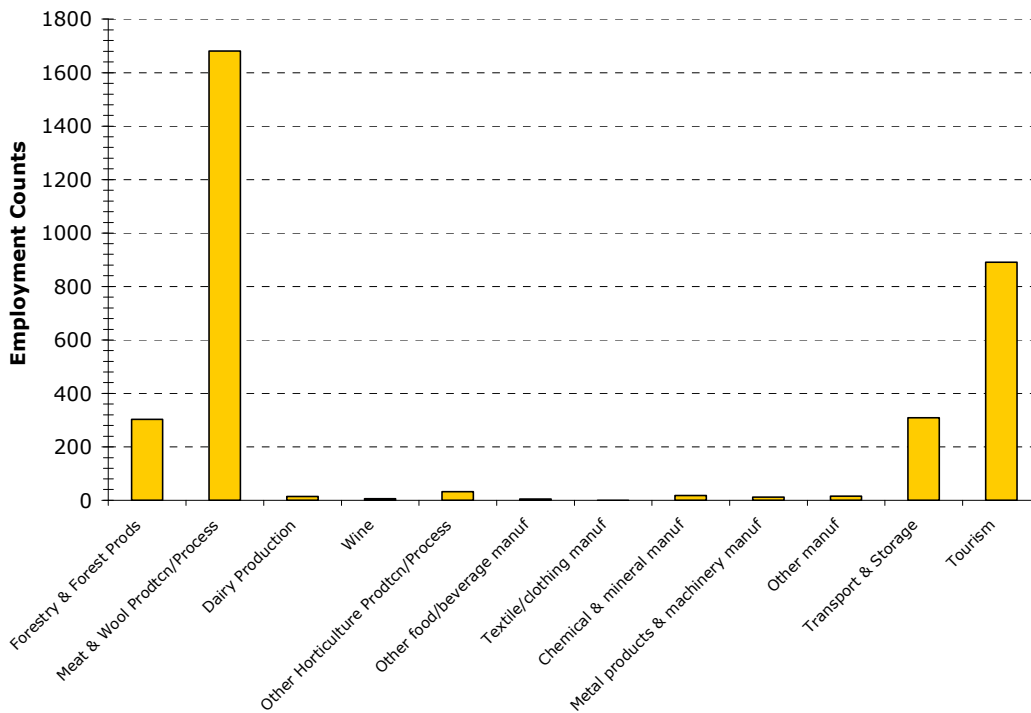
**Figure 8.3: Regional Economic Development Evaluation: Output Projection under Continuation & Economic Development Scenarios**



**Figure 8.4** below illustrates the difference in employment in 2012 under the "Continuation" and "Development" scenarios:

- Employment in the vertically integrated sectors shown in **Figure 8.4** in 2012 would be 3300 higher under the "Development" scenario than would be the case under the "Continuation" scenario;
- There would be 1600-1700 additional jobs in the Meat and Wool production and processing sector (13% more than under the "Continuation" scenario);
- around 300 additional jobs in the Forestry and Forest products sector (16% more than under the "Continuation" scenario);
- some 900 additional jobs in the Tourism sector (21% more than under the "Continuation" scenario);
- and around 300 in the Transport and Storage sector (12% more than under the "Continuation" scenario).

**Figure 8.4: Regional Economic Development Evaluation: Additional employment 2012 under the Economic Development Scenario above Continuation Scenario**



Source: McDermott Miller estimates  
 Compiled by: McDermott Miller Limited, September 2008

The economic *Development* scenario compared to the *Continuation* scenario would add some \$325 million extra to Hawke’s Bay GDP (around 5-6% of regional GDP).

**8.5**

**CONCLUSIONS**

The combination of portfolio and input-output analysis points to the following base sectors having most potential to benefit the Hawke’s Bay region’s economy:

- Forestry and forests products; in particular the sawmilling industry;
- Meat and Wool production and processing;
- Tourism, especially product development; and
- Transport, especially port and coastal shipping services.

[END]

McDermott Miller Limited, Strategic Planning Consultants  
 30 September 2008