

PPRO 4/039/0003
Trust Port Advice

Final Report

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Modernising Trust Ports: A Guide to Good Governance

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Executive Summary

Context

The Department for Transport (DfT) wishes to ensure that trust ports are accountable to their stakeholders and that they are making efficient use of their assets. DfT commissioned PricewaterhouseCoopers LLP (PwC) to undertake a short study concerning the trust port sector. The study focussed on:

- The financial and operational efficiency of trust ports, including their contribution to the wider economy, and whether quantitative benchmarking could help assess and incentivise efficiency;
- Trust ports' accountability to stakeholders, including a comparison of their governance against the recommendations set out in Modernising Trust Ports (MTP)¹ and the Combined Code²; and,
- Whether different corporate or commercial structures could enhance accountability and / or improve incentives to be efficient.

The study included desktop reviews of financial, operational, economic and governance information for the larger trust ports. In addition, we met the chairman and chief executive of Dover, Tyne, Milford Haven, Shoreham, Poole and Blyth ports (the "selected ports"), the chief executive of Harwich, the harbour master of Langstone and the director of the British Ports Association (BPA). We discussed our provisional findings with representatives of DfT and the Shareholder Executive and port sector representatives from the BPA Council, which included representatives of the majority of the ports interviewed.

In 2001, the Office for National Statistics (ONS) reclassified the seven largest trust ports as Public Corporations. The effect was that these ports' new borrowings have had to be accounted for within the DfT's budget. These seven ports have since applied for Harbour Revision Orders (HROs) that would disapply certain controls that DfT has over them with the result that they would cease to be classified as Public Corporations. Port of London Authority's HRO has been granted but the remaining six are outstanding. This has been one factor in the selection of specific ports for consultation and review of data.

The comments and findings in this report relate in the main to the six selected ports but we believe many of them will be applicable to all or the majority of trust ports.

¹ Modernising Trust Ports: A Guide to Good Governance, Department for Transport, 2000 (updated in 2005).

² The Combined Code on Corporate Governance, Financial Services Authority, 2003.

Why are Trust Ports different from “plc Ports”?

Trust ports are independent statutory corporations, governed by their own unique local legislation and controlled by an independent board. Most other major UK ports are private sector ports owned by listed companies or private equity (“plc ports”). While all ports have statutory duties and responsibilities, trust ports are run for the benefit of their stakeholders including their users. As such they are accountable in principle to their stakeholders but those stakeholders have neither control nor power of sanction over the trust port boards. Trust ports have neither shareholders nor a requirement to distribute any dividend. In the absence of the pressure provided by shareholders of plc ports, there is a potential deficit in accountability and / or efficiency.

Trust ports have different priorities from plc ports. Therefore, while they operate in a commercial way, they do not necessarily seek to maximise profits in the way that a plc port would normally do. We noted a significant number of cases where non-financial objectives of the port and its stakeholders were prioritised over profit generation, for example by investment in infrastructure with limited return potential or by setting charges below the level which would maximise profits. In this report, we are adopting the term ‘stakeholder dividend’ (a term not so far used by trust ports) to describe *the use of resources by trust ports in a non-profit-maximising way for the benefit of stakeholders*, i.e. actions that would not normally be taken by a plc port. This concept seems consistent with trust ports’ objectives but there has to date been no acknowledgement of its existence or disclosure of its value, in sharp contrast to the visibility of plc port dividends to shareholders.

Findings of the Study – Efficiency

A plc port’s shareholders would regard profit as a primary measure of efficiency. The absence of the shareholder dividend makes it difficult to define and measure trust ports’ efficiency. Each port is different and each measures its own performance differently. It is difficult to benchmark efficiency in a comprehensive way from publicly available data.

Each of the selected ports appears to be able to win business whilst being exposed to reasonable levels of competition, at least around the margins and in the medium / long term. Where competition exists and volumes are growing, this indicates a degree of operational efficiency (although not necessarily financial efficiency), without which trust ports would be less successful than they appear to be in winning and retaining business.

All of the selected ports have adopted a commercial ethos - in several cases through the relatively recent appointment of more commercially minded management - and most appear to be growing. All the selected ports are profitable or very close to profitability - although several have suffered set-backs to the trend towards greater profitability. In general, the financial performance of all the selected ports is below the benchmarks of ABP and Forth

Ports, two of the larger plc ports. It is probable that there are further financial (and possibly operational) efficiency gains that could be achieved, which implies that from a financial and macro-economic viewpoint, asset utilisation is not being optimised.

All the ports reviewed have reasonable internal arrangements for setting internal efficiency or performance targets and monitoring their achievement, although these are not necessarily transparent to stakeholders. We believe that it is possible to define a set of high-level efficiency indicators that would allow any stakeholder to understand broadly whether a particular trust port is efficient compared to its peers and whether efficiency is improving or declining over time. Such transparency with stakeholders would help to incentivise efficiency in the absence of pressure from private shareholders. Trust ports should also set a target level of return / profitability for both existing activity and new investment, which should be determined by each trust port board taking account of plc ports' weighted average cost of capital and reflecting the risks of their business or a particular project. This might drive trust ports to achieve further efficiency gains.

Findings of the Study - Accountability

We have analysed the factors that might indicate whether trust ports are in practice accountable to their stakeholders, including governance arrangements, reporting on compliance with governance best practice and their general attitude to stakeholders.

Governance arrangements are the aspect of accountability which is most easily reviewed independently. Overall the standard of governance in trust ports appears good, with reasonable levels of verifiable compliance with the most significant requirements of MTP and the Combined Code in relation to financial reporting. After MTP was first published in 2000, trust ports appear to have focussed on the key principles and initially taken steps to implement them. Nonetheless gaps exist, though in many cases the gaps relate to the reporting of compliance, i.e. the port may be implementing best practice but not reporting that it is doing so. Best practice in accountability is continually developing and has moved on since MTP was published. DfT may therefore wish to consider issuing some form of update. So far, best practice guidance appears to have been effective as a means of encouraging accountability, efficiency and good governance and we therefore believe it remains a sensible way to implement further modest reforms to the trust port sector.

The trust port structure relies heavily on the ability of the chairman to make the Board - and therefore the port - work effectively. There should be a power to remove the chairman if he / she does not perform satisfactorily. DfT should ensure that it has this power in relation to the ports where it appoints the chairman. It could also warn a chairman that they would not be reappointed. Clearly, this depends on having relevant information and the internal capability to judge performance objectively. In some ports, the chairman can only be removed by the board. There will remain a higher risk of these trust ports failing to be accountable or efficient

because of the greater difficulty of holding the chairman to account. This arrangement is clearly sub-optimal, but we do not believe that there is sufficient evidence of under-performance or failure in practice for us to recommend the wholesale changes required to remedy it. DfT may however wish to consider whether the safeguard of removal of the Chairman by the board is adequate to protect against potential future failure or underperformance.

Given the differing structure of trust ports, we suggest that each port should review whether its own governance arrangements would be adequate to deal with such a failure. Consideration might be given to involving private investors or other stakeholders, whose role in reviewing performance is considered in Section V.

Other aspects of accountability include the key officers' attitudes to stakeholders and the degree of openness with information which might be relevant to them. In our interviews, it was apparent that chairmen and chief executives see themselves as existing to serve the interests of their port and its stakeholders, and accountability is taken seriously. We noted that a significant level of consultation takes place. Management were generally willing to be open with information and there is a significant amount of information published though practice is not consistent between ports and types of information. Trust ports' efficiency and accountability should be fully transparent to all stakeholders: information relating to governance and efficiency should be comprehensively reported in a single document to make it easier for all stakeholders to review.

Our review also identified a number of features of the selected ports that we regard as consistent with best practice and which should be considered for adoption by all trust ports. These are detailed in the main report.

Structural Changes

We have considered whether significant structural changes are required to ensure that trust ports meet DfT's objectives of efficiency and accountability. Notwithstanding the lack of shareholder-driven pressure for efficiency, we consider that implementation of the recommendations in this report would deliver (on their own) significant improvements. We noted a high degree of willingness to comply with best practice as set out in documents such as MTP and we therefore believe that the selected ports would be inclined to implement any such requirements without need for statutory force. In our view, structural change should not therefore be mandated at this stage. However, if trust ports fail to make further progress, a clearer case for structural change might emerge.

Structural change may, however, be of assistance to trust port boards as a means of embedding efficiency incentives and improving transparency and accountability. Up to now, privatisation may not have been considered because it implies a loss of control and the

proceeds would be lost to local stakeholders. There are, however, other options which seek to strike a balance between the trust ports' stakeholder obligations and a potential need to improve incentives for efficiency. We have not sought a legal view on the vires for these options, but we assume they would be deliverable through an HRO if necessary.

The options we have reviewed in detail are:

<p>1. Changes to governance / management arrangements to improve accountability:</p> <p>a. Restructuring of the trust port entity to give it two-tiers of management: the higher tier ("the Trustees") focussing on accountability to stakeholders and observance of statutory duties and the lower tier ("the management") responsible for the efficient and profitable operation of the business; or,</p> <p>b. Setting up an operating subsidiary to carry out commercial port activities with a remit to maximise profits.</p>	<p>2. Introduction of private investors:</p> <p>a. The sale of a minority or majority stake in an operating subsidiary carrying out the commercial port activities; or,</p> <p>b. The award of a long term concession.</p> <p>c. Full privatisation</p>
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Our evaluation indicated that option 1a has some conceptual advantages but also some challenges to be overcome to make it work effectively. Option 1b might have some benefit but in practice might make little difference. Option 2a offers the greatest potential benefit whilst retaining the benefits of the trust port concept. Options 2b and 2c might raise more cash but would compromise or risk compromising this concept. All these arrangements would bring a much clearer distinction between trust ports' commercial incentives and their obligations to stakeholders. The introduction of private sector investors would have the benefit of involving an independent party with a direct interest in improving efficiency and the ability to make this a reality. It would also generate capital for expansion or distribution to stakeholders whilst still preserving trust ports' ability to serve their stakeholders' interests. A number of trust ports are considering increasing their borrowings and the introduction of a shareholder would give additional comfort to lending banks.

Recommendations

Our recommendations are listed below and also appear throughout the main report. We believe that adoption of these recommendations will help to deliver improvements in trust ports' efficiency together with greater accountability. At the larger ports, they can generally be implemented without disproportionate cost, i.e. the cost can be justified by the benefit. Recommendations are generally for the attention of trust port boards unless marked "(DfT)" or "(Both)"

Stakeholder Dividend (Main Report Section II)

Recommendation 1: The level and intended use of any stakeholder dividend should be determined in advance by each trust port board in the light of consultation with stakeholders. The actual level of stakeholder dividend should then be reported transparently in the annual report.

Recommendation 2: Each trust port should ensure that the use of the stakeholder dividend is efficient, i.e. that it meets stakeholders' legitimate needs. One method for assessing this would be a stakeholder survey.

Recommendation 3 (DfT): DfT should consider whether it wishes to have a role (as stakeholder) in approving or directing the level and use of the stakeholder dividend.

Efficiency (Section III)

Recommendation 4: Each trust port should include a small number of high-level, comparable efficiency indicators in its annual report and trust ports should work together to achieve comparability in these between ports.

Recommendation 5: The target level of return / profitability for both existing activity and new investment should be determined by each trust port board taking account of the benchmark of plc ports' weighted average cost of capital. The target should reflect the risks of the business or project.

Recommendation 6 (DfT): DfT may wish to consider taking a more pro-active stakeholder role, challenging under-performance on behalf of the national economic interest.

Recommendation 7 (Both): DfT or trust ports as a group should consider whether there is a case for facilitating mergers in the sector to enable ports to benefit from economies of scale. DfT may want to consider how to enable and incentivise trust ports to look beyond their core business for opportunities to invest.

Recommendation 8: Each trust port should demonstrate that its board has a balance of key competencies at board level, including financial and commercial skills.

Recommendation 9: An appraisal of the performance of all board members without exception, including the chairman, should be undertaken annually, in line with the Combined Code.

Recommendation 10: Each trust port should have a policy on performance measurement across the whole business, aligned with the organisation's objectives. Remuneration of management and staff should be aligned with this policy.

Recommendation 11: Each trust port should publish an annual efficiency statement. To support this it should regularly review whether services provided by or in the port should be market tested.

Accountability (Section IV)

Recommendation 12 (DfT): DfT could usefully update MTP to assist in the implementation of these recommendations.

Recommendation 13: Trust port boards need to have a full appreciation of the range of perspectives of their stakeholders, whilst not compromising the need to have the right skills and experience. In recruiting board members, trust port boards should take positive action to ensure that their selection criteria and pool of potential recruits allow for sufficient diversity of talent and perspectives to be recruited and that they do not simply recruit people with similar backgrounds to existing directors.

Recommendation 14: Any 'reserved' board positions for specific groups should be replaced by open competition for all posts, according to Nolan principles. All posts, including that of chairman, should be for a three year term, to provide stability and continuity subject to a maximum of two terms with one more in exceptional circumstances.

Recommendation 15 (DfT): DfT should ensure that it can provide regular industry training/seminars such that all new board members can be trained within 6 months. DfT should ensure that it processes HROs promptly. DfT should also clarify MTP on the issue of directors' and officers' liabilities and insurance.

Recommendation 16: Each trust port should review and update its governance arrangements to match current best practice, including the Combined Code. Proportionate application or derogations may be appropriate for smaller trust ports. Best practice we noted during our review includes, for example:

- Compliance with MTP, especially in respect of (re-)appointment processes, performance appraisal and reporting;

- Regular consultation with stakeholder groups, annual open meetings and a focus by the board on user needs; and,
- Reporting of the degree of compliance in the annual report.

Recommendation 17: Each trust port should publish an annual 'comply or explain' commentary in its annual report addressing governance best practice, in which it should either describe how it has complied or explain why it has not.

Recommendation 18: (DfT) For trust ports where the chairman is appointed by the board rather than DfT (such as Shoreham and Poole), DfT may wish to give consideration to the arrangements for removing a non-performing chairman. Any changes could be incorporated in the draft HROs currently under consideration.

Recommendation 19: (Both) Each trust port board should review objectively whether its own governance arrangements would be adequate to deal with a failure in the performance of the board and make any appropriate changes. DfT should also consider whether relying on a board to hold the chairman to account gives adequate protection against failure or underperformance.

Recommendation 20: Each trust port should ensure that information regarding its efficiency and accountability is made easily accessible to all stakeholders, including by publishing a comprehensive annual report and accounts on its internet site. All necessary reporting in relation to governance should be grouped together in a single document.

Recommendation 21 (DfT): DfT may wish to consider adopting powers to carry out investigations into any complaint made to it, including the right of access to relevant data and information from the trust port in question and, potentially, the power to issue a binding determination (subject to obtaining legal advice on this point).

Structural changes (Section V)

Recommendation 22 (DfT): DfT should consider revising the current arrangements for the use of proceeds of any structural changes (e.g. privatisation) to give trust ports an incentive to consider such changes. In particular, the part-hypothecation of proceeds to local uses may make such structural changes more attractive to trust port boards.

Recommendation 23: (Both) Each trust port board should consider whether some form of structural change might facilitate its development. DfT should consider whether to recommend any of these models to trust ports. Examples of structural models which could be of benefit to trust ports, in terms of embedding efficiency incentives and improving transparency and accountability, include:

- (1a) Restructuring of the trust port's governance structure so that it has a higher tier supervisory board ("the Trustees") focusing on accountability to stakeholders and observance of statutory duties and a lower tier (management) board responsible for the efficient and profitable operation of the business; or,
- (2b) Introduction of private investors, through the sale of a minority or majority stake in an operating subsidiary of the trust port responsible for commercial port activities.

I Introduction

Our Study Focus

The Department for Transport (DfT) wishes to ensure that trust ports are accountable to their stakeholders and that they are making efficient use of their assets. DfT commissioned PricewaterhouseCoopers LLP (PwC) to undertake a short study concerning the trust port sector, focussing on:

- The financial and operational efficiency of trust ports, including their contribution to the wider economy, and whether the use of quantitative benchmarking would be useful to assess and incentivise efficiency;
- Trust ports' accountability to stakeholders, including a comparison of their governance against the recommendations set out in Modernising Trust Ports (MTP)³ and the Combined Code⁴; and,
- Whether different corporate or commercial structures could enhance accountability and / or improve incentives to be efficient.

Our Terms of Reference included desktop reviews of financial, operational, economic and governance information for the larger trust ports. In addition, we met the chairmen and chief executives of Dover, Tyne, Milford Haven, Shoreham, Poole and Blyth ports ("the selected ports"), the chief executive of Harwich, the harbour master of Langstone Harbour Commissioners and the director of the British Ports Association (BPA). We discussed our provisional findings (but not all of our detailed recommendations) with representatives of DfT, the Shareholder Executive and the BPA Council, (including representatives of the majority of the ports interviewed).

In undertaking this work we have been struck by the level of enthusiasm the trust ports have displayed in their willingness to engage in discussions and provide information and their recognition of the importance of demonstrating efficiency and accountability to their stakeholders. Our principal conclusions were generally not disputed, although some reservations were noted on commercial confidentiality, the burden of reporting and the comparability of ports. We have taken account of these reservations in finalising this report.

³ Modernising Trust Ports: A Guide to Good Governance, Department for Transport, 2000 (updated in 2005).

⁴ The Combined Code on Corporate Governance, Financial Services Authority, 2003.

Our Findings

Our findings are presented in the following sections:

➤ **Section II: Why are trust ports different from plc ports?**

This is a short section on the context for this study, the unique features of trust ports, the remit of trust ports and the concept of the “Stakeholder Dividend”;

➤ **Section III: Findings - efficiency**

This section considers the definition of efficiency for a trust port, the factors that incentivise efficiency, whether efficiency might be meaningfully measured and how to report efficiency;

➤ **Section IV: Findings - accountability**

This section explores the meaning of accountability for a trust port, examines (through interviews and analysis) the level of compliance with MTP and the Combined Code and recommends changes that would lead to greater accountability;

➤ **Section V: Findings - structural changes**

This section explores the potential options for structural change in the trust ports sector, presents a short-list of generic preferred options and considers their advantages and disadvantages, as well as deliverability.

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II Why Are Trust Ports Different from plc Ports?

What is a Trust Port?

'Trust port' is a plain English term, without precise legal definition, for an independent corporation, with an independent board, created by or under statute for the purposes of managing a harbour. Trust ports do not have share capital or members. Their constitutions vary depending on the detail of the individual legislation. A key feature of trust ports is that they do not distribute profits to investors: instead they are recycled for the benefit of the port.

There are currently around 100 trust ports in the UK, out of around 600 ports in total. Most are small / medium sized and only 20 have an annual turnover exceeding £20 million. Trust ports in aggregate account for over a quarter of the total UK port traffic by tonnage (including that handled by private terminals within trust port boundaries) and even the smaller trust ports are often significant to regional or local economies.

Context and Classification Issues

The review of trust ports, carried out in 1998 by the Department of the Environment, Transport and the Regions (DETR), noted that the concept of a trust port had stood the test of time and continued to play a valuable role. At that time, therefore, no structural change was felt to be needed. However, the review recognised the need to update governance arrangements and MTP was intended to produce greater transparency for trust ports, including adopting the 'Nolan' principles of governance, which were developed by the Committee for Standards in Public Life.

An Office for National Statistics (ONS) decision in 2001 resulted in the new borrowings of the seven largest trust ports⁵ being accounted for within DfT's budget. The classification decision was based on two key elements, of which either element was deemed by ONS to give DfT "control": the appointment of the majority of the board by the Secretary of State and the ability of the Secretary of State to compulsorily privatise the port (through the Ports Act 1991). DfT has noted that it does not have any control over trust ports' borrowings; neither do any of DfT's appointees owe any duty to DfT.

These seven ports have each applied for a Harbour Revision Order (HRO) to disapply whichever of the provisions noted above is relevant. London's HRO has been approved but the other six are suspended awaiting the outcome of the Ports Policy Review (PPR⁶), the consultation for which closed in September 2006.

⁵ Dover, Harwich, Milford Haven, Poole, Shoreham, London and Tyne

⁶ To be published in 2007. Information on consultation at: www.dft.gov.uk/consultations/closed/ppr/portspolicyreview.

A key rationale for this study was to consider whether or not the trust ports would be sufficiently accountable and efficient in a situation where these two provisions did not apply. This led to a focus on the larger English and Welsh trust ports, rather than the mid-sized and smaller trust ports.

Why are Trust Ports Different from “plc Ports”?

Trust ports have statutory duties and responsibilities and are run for the benefit of and are accountable to stakeholders, but have no shareholders or requirement to pay a dividend. Most other major UK ports are private sector ports owned by listed companies or private equity (“plc ports”) or owned by local authorities (“municipal ports”). Trust port stakeholders generally have much weaker rights, if any, than shareholders of a plc or municipal port. Trust ports have some similar characteristics to other infrastructure operators such as utility distribution companies, Network Rail and BAA. In particular, trust ports’ non-dividend distributing status is similar in some respects to Network Rail and Glas Cymru (Welsh Water). However, in contrast to other UK infrastructure companies, trust ports have relatively low gearing levels and are not subject to a specific economic regulator.

Trust ports are essentially self-regulating. In the absence of external pressures, such as shareholders, rating agencies or independent regulators, which could bring hard-hitting sanctions to bear in the event of inappropriate trust port behaviour or underperformance, there is a clear potential for a deficit to occur in accountability and/or efficiency. Trust ports generally have specific legislation that defines how the port should be managed – though it does not necessarily specify the extent of accountability and efficiency that is required so does not provide clear scope for enforcement action by stakeholders. Using general legislation to hold a trust port to account would be considered an expensive last resort: its coverage applies to specific areas only such as competition (e.g. referral to the Office of Fair Trading), safety and environment. Complaints can be made to the Secretary of State but this option is burdensome for DfT’s limited resources and places a burden of proof on the complainant. Only low reliance can be placed on directors’ concern about their reputation but the effect of this can be greater if there is transparent reporting of trust ports’ performance.

MTP describes a trust port as follows: *‘A trust port can be compared to an heirloom. It is a valuable asset presently safeguarded by the existing board. They have a duty to hand it on in the same or better condition to succeeding generations. Boards have an obligation to transact port business in the interest of the whole community of stakeholders openly, accountably and with commercial prudence’.*

Most of the trust ports see themselves as profit-making commercial entities, and they told us that they aim to operate no differently from similar sized plc ports. However, rather than returning profit / cash to shareholders the trust ports instead retain cash for investment in the port or its activities, which can take a variety of forms. This means they have less incentive

than a plc port to maximise profitability. Furthermore, there are a variety of obligations and commitments to stakeholders which trust port boards interpret as requiring them to act differently from plc ports.

In summary, trust ports:

- operate in a commercial way, but also would give a high priority to non-financial objectives, which may be prioritised over short term profit generation. However there is a lack of transparency in the funding and delivery of these non-financial objectives; and,
- aim to be accountable to a range of stakeholders: the composition of which varies between ports, but typically includes port users, employees, local businesses dependent on port business, local residents affected by port activities and Government bodies, such as local authorities, development/regeneration agencies, and central government.

The Stakeholder Dividend Concept

We have adopted the term 'stakeholder dividend' (a term not so far used by trust ports) to describe *the use of resources by trust ports in a non-profit maximising way for the benefit of stakeholders*. It represents the cost of actions that would not be taken by a plc port. This concept potentially takes a variety of forms, including:

- discounting of port charges below market rates,
- investment in new or maintenance of existing infrastructure for the long term future of the port rather than for short to medium term profit e.g. the highest standard of maintenance of critical infrastructure such as lock gates, where a plc port might opt for a cheaper solution,
- undertaking port activities with less than commercial returns e.g. provision of cruise terminal facilities which support the local tourist industry,
- employee packages above market rate,
- support for community projects,
- charitable payments or donation of time,

In its purest form, a stakeholder dividend might take the form of the payment of a significant proportion of profits to stakeholders. We are not aware of any examples of this in practice.

This stakeholder dividend may take the form of cash revenue foregone as well as capital or

revenue expenditure and is spread across a range of commitments, benefiting different stakeholders to varying degrees.

Although trust ports do not currently use the term stakeholder dividend, the concept is consistent with the philosophy, objectives and practice of trust ports. Fundamentally, not all statutory objectives of a trust port are intended to be profit-maximising, so it is appropriate that trust ports undertake activities or investments that may not maximise profit but benefit the stakeholders in the longer term. This is one of the fundamental features that distinguish trust ports from plc ports.

How Should Stakeholder Dividends Be Reported?

In most cases, we do not believe that trust ports are currently quantifying the 'cost' of the stakeholder dividend, nor do they have a clear policy, approved by the board, regarding how much it should be and how it should be allocated between stakeholders. For example, boards do not discuss whether they should increase charges in order to direct resources to community projects. We believe that some of the ports may be charging users below the level that a plc port would charge, partly from a fear of losing custom, and partly from a user expectation that trust ports should not make high profits, which is related to the fact that the ports may not have an apparent use for additional cash. In Section III below, we recommend that trust ports target returns commensurate with the risk that they face and the resources they employ. In an efficient port which is operating in an efficient market, charges should be set at a level that reflects an appropriate target return on assets. Of course some users' may not be willing to pay this level of charges but any loss of revenue if users switch to another port should be compensated by greater profitability from the business that remains. Should trust ports wish to discount those market rates to a lower level for example if the retention of non-profit-maximising business was deemed to be in the interests of stakeholders, this amounts to a use of the stakeholder dividend pool and should be accounted for as such. Another use of the stakeholder dividend might be investments in new or existing assets that would not have been undertaken by an operator more incentivised to 'sweat' those assets.

In all such cases, accountability would be improved if the trust port's policy on the level of notional profits (before stakeholder dividends) that is allocated to stakeholder dividend was set by the board periodically looking several years ahead, in order to provide part of a transparent set of targets against which to measure the port's performance. The board should also agree in advance the uses of expected future stakeholder dividends, in order to explicitly balance and prioritise the demands of different stakeholder types (*Recommendation 1*).

Glas Cymru (see below) has taken a similar approach except that they have one homogenous stakeholder group, their customers, who are all treated equally.

Glas Cymru – Paying a Stakeholder Dividend

Glas Cymru is a single purpose company limited by guarantee (CLG) formed to own, finance and manage Dŵr Cymru (Welsh Water). Any financial surpluses are used for the benefit of Welsh Water's customers through the payment of a dividend and investment of additional sums for further customer benefits. In 2005 / 2006 each customer was paid an £18 'dividend' as a rebate on their bill, worth a total of £23 million (4% of turnover). Glas Cymru has set this as the minimum level for the next four years and achieving the target dividend is a factor in determining directors' bonuses.

For more information, see <http://www.dwrcymru.com/English/Company/Glascymru/index.asp>

We recognise that the additional transparency may then lead to disagreement between stakeholder groups, but only as a result of them being better informed about their own interests. We believe that the additional transparency should also lead to better decision making and therefore enhance overall efficiency, which in turn further benefits all stakeholders.

The example below illustrates the financial impacts of a stakeholder dividend. In this case we have shown the summary profit and loss account of a port which is setting its charges £5m below the profit maximising level and funding a net £10m cost of non-profit-maximising activities, giving a total stakeholder dividend of £15m.

P&L – normal		P&L – restated to show stakeholder 'dividend'		Difference
100	revenue	105	revenue	5
(60)	opex	(50)	opex	10
40	EBITDA	55	EBITDA	15
(25)	depreciation	(25)	depreciation	-
15	profit before interest and tax	30	profit before interest and tax	15
(5)	interest	(5)	interest	-
(5)	tax	(5)	tax	-
5	profit (5%)	20	profit before st/holder div. (19%)	15
	(net of stakeholder dividend)	(15)	stakeholder dividend	(15)
		5	profit after stakeholder dividend	-

In this example, the accounts would show a profit margin of 5%, however after stripping out the stakeholder dividend, the margin on core commercial activities is actually 19%. Similarly, one would expect return on capital employed (ROCE) on core activity to be increased.

The above example treats the stakeholder dividend as a notional or presentational concept, which we have assumed to be tax neutral. Nonetheless, its adoption by trust ports will greatly

improve transparency. However, the board could, if it wished, choose to formally pay the stakeholder dividend to a separate fund as if it was paying a dividend to shareholders.

In considering the way in which this information is presented, trust ports will need to consider any tax implications. This report does not seek to suggest that the stakeholder dividend should be an addition to taxable profits, since this is not a question of accounting treatment under UK GAAP but rather disclosure of the benefits of the trust ports' business activities. However if additional tax was incurred, this might be regarded as a legitimate part of the stakeholder dividend since the national economy is one stakeholder. No tax advice has been sought on these recommendations.

The issue of discounted charges is the most controversial aspect of the stakeholder dividend. Some of the trust ports are concerned about disclosure of any theoretical discount since it might open them up to challenge by a competitor. However, it can be argued that trust ports should not use public assets to undercut commercial rivals. In a market economy, price signals such as port charges, play a key role in enabling the market to utilise resources efficiently. If these are distorted by institutional arrangements, inefficient resource allocation results. The disclosure of any discount therefore provides an incentive to operate effectively and in accordance with trust ports' obligations.

Trust ports should also review whether the usage or allocation of the stakeholder dividend is efficient, i.e. that it meets stakeholders' legitimate needs. This is particularly important where it is not benefiting port users, as there are not always clearly established channels for feedback on this issue. One way of assessing the "efficiency" of the stakeholder dividend would be through a stakeholder survey, which could also be used for consultation on future uses of the stakeholder dividend. (*Recommendation 2*)

Although the stakeholder dividend would be controlled by the trust port, DfT may wish to consider whether it wishes to have a role in approving or directing the level and uses of the stakeholder dividend. As an example, it could direct trust ports to invest a fixed proportion of stakeholder dividends into community projects that are not related to port activities, as was recommended for the Co-op (see below). This may be especially important should a trust port grow and/or become more efficient and produce more profit than it can invest in the port. Alternatively, the sale of shares to an investor (see Section V) may produce a large windfall, which trust ports would not be used to having to deal with. (*Recommendation 3*)

Co-op – Paying a Stakeholder Dividend

The Co-op is a well known brand, encompassing convenience stores and banking, as well as insurance, travel pharmacies and funerals. Its stated top priority is “to provide the best possible services for our members and to invest in the communities where they live”.

The Co-op is owned by its 10 million members. Anyone can become a member by investing £1, which entitles them to a share in the Co-op’s profits. The profit share is based on amount spent, rather than on capital invested as with traditional shareholdings. Members can also donate all or part of their profit shares to a Community Dividend Scheme, which helps local communities throughout the UK. Co-op is noted for its ethical focus, supporting fairtrade products and ethical banking.

In 2001, the Co-operative Commission made recommendations as to how the commercial and social performance of the Co-op could be improved. Regarding the distribution of profits, the Commission recommended that reinvestment in the business should take first priority but that the business should earn a return greater than the costs of Members’ funds. Any further surplus should be split between members and the community on a 70:30 ratio.

For more information see: <https://www.co-operative.co.uk/en/> and <http://www.co-opcommission.org.uk/COOP.PDF>

III Findings - Efficiency

Introduction

As part of our review we considered whether the six selected ports are undertaking their operations in an efficient manner and whether quantitative benchmarking would be useful to assess and incentivise efficiency going forward.

Why Should Trust Ports be Efficient?

Like plc ports, trust ports need to act as commercial entities. MTP states that:

“All trusts have a duty of care to their current and future stakeholders to ensure that assets are managed prudently in order to generate a commercially acceptable return⁷”

By achieving and maintaining profitability, a trust port contributes to fulfilling its obligations to be sustainable and meet its users' needs over the long term. It is not in users' interests that trust ports are insufficiently robust to withstand any financial shocks or to finance investments that will meet users' future needs. Given this clear aim it is reasonable to examine whether trust ports are achieving financial efficiency by comparing them with each other and with plc ports.

At formation, trust ports have been entrusted by the state with a monopoly on the operation of certain assets, in addition to the requirement to carry out certain duties. If these assets are being operated in a sub-optimal manner, this is an inefficient use of public resources which is not in the national economic interest. There could also be a detrimental effect on the performance of the local economy. There is also a wider macro economic argument, mentioned in Section II, that sub-optimal pricing by trust ports could lead to inefficient resource allocation in the national economy. It is therefore important that trust ports demonstrate that they are an efficient part of the local and wider economy. Return on capital employed may be seen as a proxy for the efficiency with which the assets are being used.

Trust ports also have a wider remit to serve stakeholders. The principle benefits they provide to stakeholders are the inherent by-products of their core profit-maximising activities, e.g. the economic benefit of employees spending their income in the local economy. In addition, there is a stakeholder dividend (as explained in Section II) involving the distribution of additional benefit to stakeholders. Any definition of 'efficiency' must encompass this obligation to stakeholders.

⁷ Page 47, Modernising Trust Ports: A Guide to Good Governance, 2005.

Therefore, a combined qualitative and quantitative approach to considering the extent of a trust port's wider role is appropriate, including a comparison across a number of ports. There is however some difficulty in establishing the efficiency of a port's commitments or interventions aimed at benefiting stakeholders. It is unlikely that a quantitative only assessment would be adequate, as it could for a financial performance indicator, but in gathering a range of data and comparing across port activity it may be possible to identify interventions considered particularly beneficial to stakeholders, or to measure the level of shareholder satisfaction. These could then influence future stakeholder dividend policy.

How Should We Measure Performance?

To assist in the consideration of whether trust ports are undertaking their operations in an efficient manner it would be useful to establish a basket of Key Performance Indicators (KPIs) against which the ports could report. It is important to recognise that whilst suitable reporting will increase transparency in the performance of trust ports, the increased administration burden needs to be minimised and KPIs therefore need to be relatively easy to report upon. It is important to remember that no single indicator gives 'an answer' or should be seen in isolation, but a set of indicators allows a picture to be built and informed questions to be asked.

We have undertaken work to assess what measures might be developed to measure the performance of trust ports, covering three headings:

- **Financially:** are trust ports well-managed as profit-generating businesses, providing an economic return on capital employed?
- **Operationally:** are trust ports operating efficiently?
- **Wider impacts:** how beneficial or effective are the 'knock-on' impacts of port activity (economic social, environmental and safety)?:

Some of these measures overlap – for example, safety might well be considered a useful indicator of operational efficiency since a poor safety record might be an indicator of poor management.

Efficiency might typically seem to be a measure of the conversion of inputs to outputs (e.g. profit per tonne). However, given the inherent difficulty in meaningfully relating inputs to outputs at a port business level we have focused primarily on output related performance measures as a proxy for efficiency. For some of the indicators (in particular those relating to financial efficiency) it will also be possible to benchmark trust ports against plc ports. There is no reason why trust ports should not be as financially efficient in their core commercial activities as their plc peers. Stripping out non-commercial activities via the stakeholder dividend concept would show the returns on fully-commercial activities for proper comparison

with plc ports and other trust ports.

Defining a Basket of Key Performance Indicators

Each port is different and each measures its own performance differently. All the ports reviewed do have reasonable arrangements for internally setting efficiency or performance targets and monitoring their achievement on their own terms, however these are typically not comparable with other ports and do not generally measure the wider impacts. It is difficult to benchmark efficiency in a comprehensive way from publicly available data. One means of benchmarking efficiency might be to compare the charges levied by trust ports. However these charges are not all published and we accept there may be legitimate commercial reasons for this. We believe however that it is possible to define a set of high-level efficiency indicators that would allow any stakeholder to understand broadly whether a particular trust port is efficient. Such transparency with stakeholders would help to incentivise efficiency, given the absence of pressure from private shareholders.

We have defined a basket of Key Performance Indicators (KPIs), which can be considered as a form of 'balanced score card' against which individual trust ports could be measured. In aggregate these provide information about the relative efficiency of the port – measured against other ports (trust and private), its own targets and over time. The main benefit of this clearer reporting is improved accountability which can act as an incentive for efficiency. We believe the incremental cost of this reporting should be relatively low. These KPIs are summarised below and defined in detail in Appendix A.

If the recommended KPIs are to be introduced, further work will be required before they can be collated, particularly addressing the issue as to how trust ports could report against the same set of KPIs with a standard definition and method of calculation (*Recommendation 4*). This could be taken forward by the trust ports together, or be led by BPA or DfT.

- Financial Indicators

- Profit
- Return on Capital Employed
- Weighted Average Cost of Capital
- Gearing
- Wage Comparator

- Operational Indicators

- Labour Productivity
- Profitability of Land Holdings
- Channel Depth Management
- Berth Utilisation
- Port Charges (subject to commercial sensitivity)

- Wider Impact Indicators

- GVA / NVA
- Economic Impact Assessments
- Social Impact
- Environmental Reporting
- Safety Reporting

We expect that ports will wish to set their own targets in relation to each indicator. This is reasonable if the board of the port is acting effectively to hold management to account. However, DfT may wish to challenge any undemanding targets. MTP⁸ recommends trust ports to produce a similar rate of return to that specified in the Green Book⁹ – between 6% and 8% (since amended to 3.5% in real terms). However, the Green Book primarily relates to public sector investment and government-owned businesses - and this figure reflects a concept of social time preference¹⁰, not an actual cost of capital. We therefore believe that it is not good guidance for returns in a private sector commercial business. The target level of return / profitability (before deduction of stakeholder dividend) should be determined by each trust port board taking account of the benchmark of plc ports' weighted average cost of capital. The target should reflect the risks and resources employed in their business or project. (*Recommendation 5*)

We expect that trust ports would need to take the lead in measuring and reporting on the basket of indicators, as they are the only organisations with access to this information and the knowledge of the business to interpret it. When published, the data would enable any stakeholder to form a view on whether it believed that the trust port was acting efficiently. While this greater transparency should be of benefit to the trust port and its stakeholders, there is a risk that stakeholders will not view the information in an unpartisan way. However that might be regarded as a legitimate price to pay for openness. DfT may wish to challenge underperforming trust ports to improve performance where stakeholders do not take on this role effectively. Such a role could be exercised alongside DfT's consideration of the performance of the five chairmen that it appoints. To cover all trust ports, DfT would need additional resource to take on this role. However it is important to remember that the primary responsibility of holding a trust port accountable for its performance rests with the board. (*Recommendation 6*)

Are Trust Ports Efficient?

All of the selected ports have adopted a commercial ethos; in several cases through the appointment of more commercially-minded management than were previously in post. This was triggered by the adoption of the MTP appointment principles, although it may also have been necessary in some cases to address previous unpredictability of financial results. Most of the selected ports have reported increasing volumes, which implies they may be taking steps to operate efficiently, although this could just be reflection of economic trends.

⁸ MTP point 115

⁹ <http://greenbook.treasury.gov.uk/>

¹⁰ Social Time Preference is defined as the value society attaches to present, as opposed to future, consumption.

All the selected ports are profitable or very close to profitability. It was not possible to determine whether they are returning their cost of capital, which would be the clearest measure of financial health. The trend is also towards improvements in financial performance, although several have suffered set-backs to the trend towards greater profitability. For example, in 2005 Milford Haven recorded a significant one-off charge for FRS 17 (pension liability). Milford Haven and Tyne also noted increased maintenance costs in 2005, which reduced profits against previous years. The selected ports seem to accept such setbacks more readily than plc ports would, reflecting the lack of a commercial incentive to report continuous growth in profits and potentially a lack of transparency regarding the reinvestment of profits in the port. Were the trust ports setting a commercial rate of return and declaring their stakeholder dividend transparently, it is likely that underlying profitability on the core commercial activities would be higher and more consistent from year to year.

In general, the financial performance of all the selected ports is below the benchmark of ABP¹¹ and Forth Ports, two of the largest UK plc ports. While the trust ports may not be directly comparable to the larger scale of operations and more diverse activities of Forth and ABP, the gap is greater than would be expected between different plc ports and we believe it is probable that there are further financial (and possibly operational) efficiency gains that could be achieved. There might be a greater incentive to achieve these gains if trust ports set themselves a target level of profit which reflected the risks and public resources employed in their businesses.

A common feature of all the selected ports is the existence of significant levels of competition. Even where users have invested in long term immovable assets, there is still competition around the margins for large parts of trust ports' business. For example, Dover competes with the Channel Tunnel, Milford Haven competes with other UK and continental European locations for oil and gas terminals, Poole with neighbouring ports for ferry business and Blyth competes generally with Tyne, as well as other ports in the NE of England. Where adequate competition exists, it should be a strong driver of operational efficiency and of accountability of the port to users' needs. There is therefore anecdotal evidence of a reasonable level of operating efficiency otherwise trust ports would be less successful than they appear to be in winning and retaining business. However this driver could be weakened if trust ports are able to under-charge in order to offset any operational inefficiency perceived by users.

Our discussions with the selected ports have highlighted a number of important wider impacts of the ports, including the contribution to the local (or in a few cases, national) economy, as well as some (but limited) direct social contributions. However, it is not within our scope to

¹¹ In August 2006, ABP plc was acquired by a private consortium of investors. However we have used the 2005 accounts for ABP to derive a comparator.

ascertain the size of these contributions, nor have we evaluated whether these are being undertaken efficiently or to the satisfaction of the beneficiaries (stakeholders).

Restructuring of the Industry and Economics of Scale

Most other transport-related industries in the UK have been privatised, often in a fragmented form. In almost all cases, this has been followed by consolidation through mergers and acquisitions. Examples include airports, bus operators, rail operators, road hauliers and plc ports. Utilities have often followed a similar pattern. This tends to indicate that there are efficiencies and economies of scale to be obtained from such consolidation, though there might also be economic inefficiencies generated from the creation of oligopoly.

Any such efficiencies are unlikely to be achieved in the trust port sector because the governing legislation for each port generally does not provide for the creation of, or transfer of ownership to, a merged entity. The market is therefore unable to operate freely.

There would be merit in the DfT or trust ports as a group considering whether such efficiencies could be achieved through merger to create a trust ports group or groups at a national or regional level. The same could also be achieved by introducing a common private sector investor to several trust ports together with common management arrangements, without changing the ownership of the trust port entity. The same consideration would apply to a trust port investment in opportunities that are not directly or closely linked to the port. We understand that trust ports generally do not seek these opportunities, believing them to be outside of their statutory scope. DfT may want to consider how to enable and incentivise trust ports to look beyond their core business for opportunities to invest. This may only require guidance, as trust ports are capable of promoting HROs to extend their powers (as Milford Haven has done¹²). (*Recommendation 7*)

Best Practice Efficiency Measures

Our analysis and interviews highlighted a number of examples of best practice at the selected ports, (some of which are inspired by MTP), which we recommend are adopted across the whole sector, subject to selective proportionate application to smaller ports:

- Achieving a balance of key competencies at board level, including financial and commercial skills (*Recommendation 8*);
- Annual appraisal of the performance of all board members without exception, including the chairman, as required by the Combined Code (*Recommendation 9*);

¹² Milford Haven Port Authority Act 2002, Part 4, Section 22, Powers of Investment. "the Authority may ... acquire by agreement any business, undertaking or assets [... etc ...if ...] the exercise of the powers is likely to provide economic, social, cultural or environmental benefits to all or some of the population of Pembrokeshire or any part of Pembrokeshire"

- Performance measurement across the whole business, aligned with the organisation's objectives. The remuneration of management and staff is in many cases linked in part to performance including in respect of qualitative factors (e.g. safety) (*Recommendation 10*); and,
- Use of market testing of both operational and back-office services. This has been carried out by several ports resulting in cost reduction and innovation in service delivery. Even if a port wishes to retain control of certain services (e.g. pilotage) to safeguard service quality, it should ensure that it has an understanding of the relative costs of different options. This can be done through informal market testing of costs or full tendering of services or rights to operate. Furthermore, we recommend that each port produces an annual 'efficiency statement' as part of its annual report which would be a statement of the steps it has taken to enhance procurement and service provision in an efficient manner. (*Recommendation 11*).

Conclusions - Efficiency

Trust ports have different priorities from plc ports, being accountable to a wide range of stakeholders. While they operate in a commercial way, they do not necessarily seek to maximise profits in the way that a plc port does. We noted a number of cases where non-financial objectives were understandably prioritised over profit generation, for example by investment in certain infrastructure that was not justified on profit maximising grounds or by setting some charges below the level which would maximise profits. As noted in Section II, we have adopted and defined the term 'stakeholder dividend' as the allocation of resources in this way. The stakeholder dividend concept seems consistent with trust port objectives but we noted that the value of such allocation of resources is rarely apparent to readers of trust ports' accounts. Arguably, a greater degree of disclosure would be in the stakeholders' interest.

Each trust port should also adopt and report against, a basket of efficiency indicators, as noted above, we therefore recommend that trust ports each set a target level of return/profitability before and after deduction of stakeholder dividend taking account of plc ports' weighted average cost of capital and reflecting the risks and resources employed in their business or a particular project.

IV Findings - Accountability

Introduction

Our review has considered the factors that might indicate whether trust ports are accountable. We have focussed on their governance arrangements, the way they report on compliance with governance best practice and their attitude to stakeholders.

In order to evaluate trust ports' accountability, we have reviewed documents produced by the six selected ports and comments made in our meetings with them and compared these with the requirements of MTP. We have compared trust ports' practice and MTP with best practice in other areas. We also discussed the individual ports' approaches to accountability with them when we met them.

Definition of Accountability

For the purposes of our review we have adopted the following definition of accountability:

An organisation is deemed to be accountable when it:

- *Acts responsibly towards others;*
- *Explains and justifies its actions;*
- *Is open to challenge; and,*
- *Can be judged and sanctioned.*

We have addressed these points by reviewing the selected ports' compliance with MTP and the Combined Code and through discussing the ports approach to accountability with their management. The nature of the constitution of trust ports without shareholders or members increases the need for their boards to be transparent about their activities and performance so that stakeholders can challenge them and for board members to be independent with the experience to challenge, and if necessary sanction other board members and the port management.

The Requirements of MTP

MTP reflects the public interest ethic required of trust port boards and the lack of shareholders. In some areas its requirements are justifiably more onerous than those for companies with shareholders such as plc ports.

Our review has identified the following areas where MTP could be improved or updated: (*Recommendation 12*):

- Compliance with the requirements for managing conflicts of interest (MTP point 57-59) is hard to monitor as most stakeholders do not have access to board minutes; it

would be more transparent if trust ports had to report compliance with these arrangements;

- Some areas of MTP are out of date, such as the age limitations to membership, which now potentially fall foul of new age discrimination legislation;
- Some good practice, not required by MTP, is identified in the Combined Code and followed in varying degrees by the selected ports, particularly areas relating to internal control and risk management, the role of the audit committee, reporting of directors' responsibilities, performance evaluation and recording of directors' concerns in board minutes. These areas could be considered for inclusion in MTP either in full or by cross reference.

DfT might also consider reflecting some of the other recommendations of this report in a revised MTP.

Compliance with MTP

Almost all aspects of MTP are complied with by at least some ports. Full compliance with MTP is not currently the case for all trust ports, thus leaving ports open to challenge by stakeholders. Several ports told us that they were aware of this but had limited resource to implement and report full compliance. Nevertheless, it is clear that improvements in governance have resulted from adoption of MTP.

After MTP was first published in 2000, trust ports appear to have initially focused on considering the following key principles and have taken steps to implement them:

- Principles and behaviours around appointments which reflect Nolan principles (MTP point 23) and the public interest ethic;
- Ability of a majority of the board to dismiss a member through a resolution (MTP point 48); and,
- The ability of a trust port to appoint deputy or vice chairs in lieu of senior independent directors in order to provide sufficient challenge to the chair.

We have carried out a detailed analysis of the selected ports' compliance with the reporting requirements of MTP and the Combined Code and these are set out below.

MTP Requirements	Compliance *
<p>KEY ELEMENTS OF REPORTING REQUIRED BY MTP</p> <ul style="list-style-type: none"> All trust ports to publish their annual report and accounts (Ref 101); How the board steers a course fulfilling their commercial operational and strategic requirements against the MTP framework (Ref 20); In respect of board member appointments the annual report to confirm adoption of the MTP, explain the member appointment process, indicate the avenue of appointment (Ref 27); A full list of committees sitting during the year, their membership and responsibilities should be included in the annual report or strategy document (Ref 81); The number of board meetings, the attendance record of board members, the membership and function of all board committees should be set out in the annual report or strategy document (Ref 83); and, Key elements of the register of interests should be published (Ref 56). 	87%
<p>REPORTING OF BOARD'S KEY COMPETENCIES REQUIRED BY MTP</p> <ul style="list-style-type: none"> Level of board remuneration and expenses should be detailed (Ref 52); Confirm all board members have received training in accordance with MTP standards (Ref 69); Strategy – plans for achieving balance and fitness for purpose in the board should be published (Ref 45); and, Strategy – efforts to maintain open channels of communication with stakeholders should be reported (Ref 84). 	55%
<p>OVERALL COMPLIANCE WITH MTP GOVERNANCE REPORTING REQUIREMENTS</p>	74%

* compliance as % of each requirement at the selected ports

Combined Code Requirements ¹³	Compliance
<p>C1 FINANCIAL REPORTING</p> <p><i>Main Principle: The board should present a balanced and understandable assessment of the company's position and prospects</i></p> <ul style="list-style-type: none"> Directors should explain in the annual report their responsibility for preparing accounts Annual report should include a statement by the auditors about their reporting responsibilities Directors should report that the business is a going concern, or provide qualifications as necessary 	100%

¹³ Assessment of compliance with Section C.1 (Accountability and Audit - Financial reporting) of the Combined Code

Where compliance is weakest is in the areas concerned with the reporting of board appointment processes, and director performance and competencies, specifically (*Recommendation 13*):

- Reporting on plans to maintain a representative balance of members is not generally done (MTP point 45). We noted in particular a great imbalance in the gender of board members. This is an indicator that, whilst appointment processes may be properly conducted, trust ports may not be paying sufficient attention to the pool of talent from which they are recruiting and the selection criteria they are using. We do not suggest that gender should be a criterion for selection but it may be desirable to ensure that a wide range of candidates are selected for interview. There is a tendency for interview panels to recruit people who share their own characteristics whereas it is important for businesses to recruit people who not only have the right skills but also have a range of perspectives and experience, particularly when they are acting for a range of stakeholders;
- The role of the board in appointment of senior officers is not generally being fully explained (MTP point 28);
- There appears still to be some legacy representation on boards from specific stakeholder interests whereas MTP requires that these be phased out in favour of open appointment (MTP point 23);
- It is not always clear if all new board members sign up to their duties as trustees while being inducted, as required in MTP (MTP point 30);
- The appraisal process for individual board members against specific performance targets is not always clear, so ports are vulnerable to complaints regarding their re-appointment process (MTP points 62-66); and,
- Reporting on completion of training is not always done (MTP points 67-71). (In respect of this point, some ports commented that the DfT had not provided the training envisaged in MTP)

In addition, much is reported on community activities and engagement with stakeholders but no formal strategy or policy for community and stakeholder relations and access to information is generally disclosed beyond a general policy of being open subject to commercial confidentiality (MTP point 109).

Whilst trust ports generally appear to comply with best practice with respect to appointment processes, there appear to be a small number of exceptions. We recommend that any 'reserved' board positions for specific groups be replaced by open competition for all posts, according to Nolan principles. We also recommend that all posts, including that of chairman,

be for a three year term, to provide stability and continuity. There should be a maximum of two terms for directors, with one more in exceptional circumstances, as mandated by MTP point 39. (*Recommendation 14*)

MTP implicitly requires compliance with aspects of the Combined Code relating to financial statements. There is a high level of compliance in respect of financial reporting (C1), which is mandated by MTP. Compliance with C2 and C3 (regarding internal control and audit committee) is not mandatory in MTP and while some ports have taken steps towards this, none are compliant with the Combined Code.

Two issues were highlighted by ports in relation to DfT responsibilities:

- DfT is not providing regular industry training/seminars such that all new board members can be trained within 6 months as required by MTP;
- The HRO process is too protracted, leading to slow processing of HROs by DfT and making the MTP requirement for good housekeeping by the ports difficult.

We have also found variance between ports as to how to interpret the MTP guidance on directors' liability. MTP implies some form of indemnification of trust port board members but does not state whether this indemnity comes from the government or from the port. It is also not clear how such indemnity is enforceable in the Courts¹⁴. MTP also goes on to require ports to take out separate commercial cover (which may be the means by which this indemnity is implemented), DfT should clarify and then advise ports and amend MTP on the matter of whether there is an indemnity from government or whether trust ports also need to take out separate directors and officers insurance. (*Recommendation 15*)

Our review identified a number of governance and management features of some of the selected trust ports, which we regard as consistent with 'best practice'. In light of this we believe it is practical for all ports to continue to work towards full compliance with MTP and clear reporting of how this is achieved, subject to proportionate application or derogations for smaller ports. Some of the best practice we noted in some ports related to compliance with MTP regarding (*Recommendation 16*):

- Appointment and reappointment processes (job description, open competition and independent membership of the appointment panel) for board members
- Performance evaluation of the board and individual members, including the Chair; and,
- Regular consultation with stakeholder groups, annual open meetings and a focus by the board on user needs.

Trust ports should be required to adopt a “comply or explain” approach, consistent with that required by the Combined Code. In other words, for each governance requirement they should either describe how they have complied or explain why they have not. This approach is particularly relevant to some smaller trust ports for which “complying” might be burdensome but “explaining” should not be. The benefit of this approach is that it draws the attention of stakeholders to any non-compliance, of which they might otherwise be unaware. They can then form their own view of the board’s performance (*Recommendation 17*).

Dealing with Failure to Perform

The trust port structure relies heavily on the effectiveness of a competent and effective chairman to make the board and therefore the port work effectively. However, there needs to be a fallback that the chairman can be removed if he/she does not perform (which may ultimately include responsibility for failure to get the board/port to perform). In many cases, the chairman can be only removed by a majority of the board, rather than an independent body, creating the risk of failure of accountability if the board does not perform its job effectively. Ideally an independent body such as the DfT would have a power to remove the chairman: we understand this does exist in the cases where DfT appoints the chairman. There are also two cases among the selected ports, Shoreham and Poole, where the DfT does not have the right to remove the chairman and where a draft HRO is currently under consideration. In these cases, the DfT may wish to give consideration to whether a right to remove a non-performing chairman ought to be incorporated in the draft HROs (*Recommendation 18*).

Removal of the chairman might be effective in cases where the other board members are performing their duties effectively but might be an inadequate remedy if the chairman had failed to ensure the appointment of robust, competent and well qualified board members. If the board members are generally not being effective, there is a possibility that pressure from stakeholders exerted on the board (including the chairman) might force a change. In an extreme case stakeholders can take legal action under the port’s governing Act, or seek judicial review. However even this could not force a change of board. So there remains an issue at some ports that, while they may be operating efficiently now, their governance arrangements may prove inadequate to deal with underperformance or a serious failure in the future. DfT should also consider whether a board holding the chairman to account is adequate protection against potential future failure or underperformance.

Generally speaking however, given the differing structure of trust ports, we do not consider it practical to recommend a change to the overall structure of the trust port sector simply to rectify this vulnerability, which does not apply to all trust ports and by its nature is unlikely to materialise as a problem for most trust ports. The cost and inconvenience of change will be high in relation to the benefit of guarding against a problem which may not occur and could be dealt with if it does (e.g. through DfT’s statutory powers to reconstitute a harbour authority).

We therefore suggest that each port should review objectively and satisfy itself that its own governance arrangements would be adequate to deal with such a potential serious failure. Trust ports might consider the role which private investors could play in reviewing performance as discussed later in Section V) (*Recommendation 19*).

Attitude to Stakeholders

Other aspects of accountability include the key officers' attitudes to stakeholders and the degree of openness with information which might be relevant to them. In our interviews, it was apparent that chairmen and chief executives see themselves as existing to serve the interests of their port and its stakeholders. Accountability is taken seriously and significant consultation takes place. They were generally open with information but this was not always consistent, for example not all data we reviewed was available on ports' internet sites. Each trust port should ensure that information regarding efficiency and accountability is made easily accessible to all stakeholders, including by publishing a comprehensive annual report and accounts on its internet site. All necessary reporting in relation to governance should be grouped together in one single document (e.g. the annual report and accounts), that addresses all areas of governance rather than the current arrangements under which reporting of governance is dispersed through a variety of channels, some published and some not. (*Recommendation 20*)

Currently, disaffected port users or affected stakeholders have recourse to the normal legal and statutory remedies, as with any plc port. In addition, MTP states that DfT will investigate any complaints made to it. We have reviewed a limited number of complaints on which DfT reached a determination. Based on the complaints we have reviewed, DfT seems to follow a reasonable process for handling these complaints albeit that complainants may not always be satisfied by the results. This process could fail due to the limited resource available to DfT and its lack of power to require information or to bind a port to any verdict. Nonetheless, we have not been provided with any evidence of ports not abiding voluntarily by a DfT decision.

We recommend that DfT considers adopting powers to carry out investigations into the circumstances of any complaint made to it, including the right to relevant data and information from the trust port. DfT may also need to commission external independent investigators in order to have access to sufficient resource and suitable skills (*Recommendation 21*).

We have considered alternative means of resolving disputes, including setting up an independent body within the trust port sector or a voluntary code across the industry with a binding disputes resolution procedure (similar to that which exists in the rail industry¹⁴). We have seen no evidence that such a step that would bring benefits greater than the cost of

¹⁴ The Access Dispute Resolution Rules provide the basis for the resolution of certain disputes arising from track, station or access agreements using standard conditions. For more information, see: <http://www.ridr.co.uk/rules.htm>

operating it. One change which might be considered would be for the DfT to have power to issue a binding determination however this would raise a number of legal issues such as the need for an appeal process, so DfT would need to take legal advice before proceeding in this direction.

Conclusions – Accountability in the Trust Port Sector

Overall the standard of governance in trust ports appears good as far as key areas are concerned, with reasonable levels of verifiable compliance with the requirements of MTP and the Combined Code. Nonetheless many gaps still exist, though in many cases the gaps relate to the reporting of compliance, e.g. the port may be implementing best practice but not reporting that it is doing so.

Our review identified a number of governance and management features of some of the selected ports, which we regard as consistent with 'best practice'. All trust ports should continue to work towards full compliance with MTP and clear reporting of how this is achieved, subject to proportionate application or derogations for smaller ports. Compliance in line with good practice principles on a 'comply or explain' basis could achieve better governance overall.

Furthermore, each trust port should at least review and update their governance arrangements to match current industry best practice, including the Combined Code, with proportionate application or derogations for smaller trust ports. In particular, the trust port structure relies heavily on the effectiveness of a competent and effective chairman to make the board and port work effectively, particularly with regard to dealing with failure to perform adequately. Trust ports need to ensure their governance arrangements can deal with a situation where the chairman underperforms seriously or becomes ineffective. DfT should also consider whether the arrangements whereby only the board can remove a Chairman is adequate considering the Chairman is largely responsible for the appointment of the board members.

V Findings - Structural Changes

Is There a Need for Structural Change?

We have reviewed whether significant structural changes sector are necessary for trust ports to meet DfT's objectives, especially to improve accountability and/or improve incentives to be efficient. We noted a high degree of willingness in the larger trust ports that we interviewed to comply with best practice as set out in MTP and we therefore believe that the larger trust ports would be inclined to implement any further such guidance without the need for structural changes. Our analysis shows that most of the larger trust ports are aware of the need for efficiency and are moving towards (although not yet reaching) benchmark levels. We believe that the adoption of this report's recommendations by trust ports would further enhance ports' efficiency and accountability.

We therefore see no empirical justification for introducing structural change across the board at this stage: we consider that, provided trust ports are continuing to demonstrate that they are working towards optimum accountability and efficiency, there is no need to instigate more fundamental governance, commercial or structural change. However, if there continued to be a deficit in accountability or efficiency that was clearly not being addressed by the trust port boards under a traditional trust port structure, it might be concluded that best practice guidance had insufficient force and a clearer case for structural change might emerge. Nonetheless, we consider that some forms of structural change may offer a useful tool which trust port boards might choose to use to help improve incentives on management to achieve efficiency.

There may be a case for DfT to consider revising the legislation to remove disincentives for structural change. In particular, the entire proceeds from a privatisation of a trust port would at present pass to the Treasury. If all or a proportion of these proceeds were to be retained for reinvestment in the local economy, it might remove a disincentive for trust port boards to consider this option. We understand that part-privatisation options (e.g. 2a and 2b, below) would not result in a cash payment to central government, however the 'locking-up' of proceeds within the trust port may not be efficient, and DfT may wish to consider issuing guidance (or amending legislation) in this area to allow a proportion of proceeds of part-privatisations to be remitted outside of the trust port envelope, e.g. for other local uses. (*Recommendation 22*)

Potential Options for Structural Change

We considered a range of structural options involving either changes to governance or the introduction of third party investors and short-listed the following options:

Type of change	Option
1. Changes to governance / management arrangements:	<ul style="list-style-type: none"> a) Restructuring of the trust port entity with two-tiers of management through the creation of a separate supervisory board; b) Setting up an operating subsidiary for commercial port activities
2. Introduction of third party operators and / or equity:	<ul style="list-style-type: none"> a) Sale of minority / majority stake in operating subsidiary for the commercial port activities; b) The award of a long term concession; c) Full privatisation.

All of these options (with the possible exception of 2c) seek to strike a balance between the trust ports' stakeholder obligations and a potential need to improve incentives for efficiency. A clearer distinction between the commercial activities of a trust port and the way in which it meets its obligations to stakeholders would be achieved by each of the proposed structural changes, through separating the relevant legal obligations and management responsibilities. Each of the suggested changes allows a trust port to explore opportunities to improve efficiency, raise capital and yet continue to serve its stakeholders' interests.

In section IV we mentioned the need for the chairman to be held accountable for his/her management of the trust port board. Involvement of private investors would achieve this by introducing an effective challenge process.

A summary of the pros and cons of each commercial restructuring option is provided below:

Potential Structure	Pros	Cons
1a: two-tier management	<ul style="list-style-type: none"> Improved accountability through separation of responsibilities Gives clearer responsibility to custodians of stakeholder interests Higher tier more independent than non-executive directors so freer to instigate sanctions for under-performance 	<ul style="list-style-type: none"> Potential administration cost Lack of clarity of roles Relies on accountability without shareholder investor incentives May not make any difference in practice (e.g. directors may be common to both levels)
1b: setting up operating subsidiary	<ul style="list-style-type: none"> Improved accountability through separation of responsibilities Gives clearer responsibility to custodians of stakeholder interests 	<ul style="list-style-type: none"> May be tax inefficient Relies on accountability without shareholder investor incentives May not make any difference in practice (e.g. directors may be common to both levels)
2a: sale of operating subsidiary stake	<ul style="list-style-type: none"> Initial competition, then pressure from shareholders to drive efficiency Introduction of skills, disciplines and incentives of private investors Custodians of stakeholder interests (board members) remain influential and can protect those interests Cash proceeds 	<ul style="list-style-type: none"> Controlling parties have conflicting objectives e.g. financial targets. NB: this can be, addressed in a shareholders' agreement.
2b: long term concession	<ul style="list-style-type: none"> Initial competition, then pressure from shareholders to drive efficiency Introduction of skills, disciplines and incentives of private investors Greater access to capital for investment or cash proceeds Greater control for stakeholders than under full privatisation through concession terms (but less than 2a) 	<ul style="list-style-type: none"> Profit maximisation to potential disadvantage of users/ stakeholders Diminishing returns for smaller ports from greater complexity of structure Less flexibility to respond to stakeholder needs Disruption of re-organisation Potential staff opposition
2c: full privatisation	<ul style="list-style-type: none"> Initial competition, then pressure from shareholders to drive efficiency Introduction of skills, disciplines and incentives of private investors Greater access to capital for investment or cash proceeds Higher gearing likely 	<ul style="list-style-type: none"> Profit maximisation to potential disadvantage of users/ stakeholders May lead to stakeholder disbenefit if parts of port change use Benefits paid to Treasury – loss of local benefit Disruption of re-organisation Potential staff opposition

This analysis is expanded in Appendix B for options 2a – 2c (i.e. those which involve private investors). Based on the above analysis, we consider that options 1a and 2a are most likely to be of benefit to trust ports.

Option 1a: Two tier governance

The potential benefit of a two-tier governance model is to clarify responsibilities and focus the organisation on:

- Engagement of stakeholders in decision making;
- Efficient management of operations; and,
- Articulation of the strategy and vision of the organisation for the medium and longer term.

However, the potential challenges to adopting a two-tier structure are:

- Managing the additional process of supporting two boards, including a higher level of stakeholder engagement;
- Ensuring open and continuous dialogue between the two tiers to avoid breakdown in communications; and,

Furthermore, the different structure does not fundamentally change the accountability of trust ports to themselves with the DfT in reserve in case of last resort.

Four different examples of organisations with two-tier boards are presented below. All of them have commercially orientated business activities, three in the public sector and one in the private sector. These models could be considered by trust ports where they wish to address deficiencies in accountability to stakeholders or improve oversight of efficiency, performance and strategy.

It should be noted that for the public sector organisations considered there is also an independent regulator in addition to the two-tier boards and in the private sector example shareholders take this role through defined rights to intervene in the activities of the business, usually through voting on resolutions at the AGM including strategy, election of board members and distribution of reward. In consideration of a two-tier model for trust ports it is therefore important to recognise that adoption of a two-tier model would continue to require the DfT to take the role of passive regulator for ports with the responsibility for overseeing the overall framework under which they operate, setting guidance (e.g. MTP), outlining performance expectations and the last resort of being prepared to intervene in the affairs of a port.

Network Rail

Network Rail is the organisation responsible for the national rail infrastructure. It is a 'not-for-dividend', 100% debt financed, company limited by guarantee. Its activities are overseen by the Office of Rail Regulation which sets efficiency targets and determines Network Rail's charges. Network Rail is governed by a 100 strong stakeholder membership, with representatives from the industry and the public serving as members. Appointment as a member is based on volunteering and subject to a members' selection panel, drawn from existing members. A requirement for membership is that the individual does not have a financial or economic interest in the company. The members' role is to review and challenge the activities of Network Rail's management board, which itself comprises both non-executive and executive directors. The management board is responsible for governing the strategic direction of the business, supervising its operational management and providing leadership within a governance framework which it oversees. This extends to taking overall responsibility for financial performance, internal controls and risk management of the company.

Foundation Trust

Foundation Trusts are an independent Public Benefit Corporations owned by 'members'. They are required in law to use their assets to promote their primary purpose of providing NHS services. Foundation Trusts are regulated by Monitor, an independent body with the authority to ensure that Trusts act within the terms of their authorisation. Members are selected from local stakeholders, to include staff, patients and local residents. Members then appoint and oversee a governing body, representing key stakeholder groups. They are also entitled to stand for non-executive positions on the board of directors. Members' voting rights on the governing body are shared with other defined stakeholders such as the local Primary Care Trust, which is responsible for commissioning local services. The governing body is responsible for representing the interests of the local community in the management and stewardship of the Foundation Trust, and for the appointment of the chair and non-executive directors of the board of directors which is responsible for managing the affairs of the Trust.

BBC

The BBC Trust, established by Act of Parliament, replaces the former role of the BBC Governors. The BBC Trust, with Chair, Vice Chair and 10 members, is appointed by HM the Queen on advice of ministers through an open appointment process. The role of the Trust is to work on behalf of the licence fee payers and protect the independence of the BBC. It is responsible for setting the BBC's overall strategy direction, its high level budgets and for holding to account and assessing the Executive Board. The Trust and the Executive Boards act separately. The Executive Board has responsibility for delivering the BBC's services in accordance with the priorities set by the Trust and for all aspects of operational management, except that of the Trust's resources. The Trust is supported by a Trust unit to provide Trustees with independent and objective advice and oversees Audience Councils to capture stakeholder views locally.

Germany – listed company

All German listed companies are required to adopt a two-tier board structure with a Supervisory Board and a Management Board. The Management Board is responsible and accountable for managing the business. Members of the Supervisory Board are elected by shareholders at the AGM. The supervisory

board then in turn appoints, advises and supervises the management board and determines their performance objectives and remuneration. For companies with more than 500 employees the Supervisory Board will have $\frac{1}{3}$ employee representatives, or with over 2,000 employees, $\frac{1}{2}$ are employee representatives.

Unlike Germany, two tier boards are not seen as best practice in UK corporate governance for shareholder owned companies but this should not rule out their consideration for trust ports where the requirements are different.

Option 2A: Introducing Private Investors

An example of a deal involving a minority sale similar to option 2a is presented below:

Newcastle Airport

In May 2001 the local authorities that own Newcastle Airport signed a Public Private Partnership (PPP) agreement with Copenhagen Airport in order to further the expansion and development of Newcastle Airport. The objectives of the deal include:

- Optimisation of the Airport's commercial business activities;
- Development of property opportunities;
- Increased profitability and passenger volumes; and,
- Best utilisation of existing infrastructure capacity and creation of new capacity.

As part of the transaction, the seven local authorities (LA7) sold a 49% equity stake to Copenhagen Airport (CPH), which in turn is now majority owned by Macquarie. CPH also provides management services to the airport through a Technical Services Agreement. Control is shared between the LA7 and CPH and the PPP agreement sets out shared objectives and development plans. The transaction structure was chosen by the vendors in order to meet their key objectives, including:

- Leverage private sector experience by introducing additional efficiency e.g. operational;
- Maximise economic benefit to the region;
- Maintain airport viability;
- Minimise future investment;
- Deliver efficient funding by CPH of capital projects;
- Improve airport access / infrastructure;
- Maximise value achieved / realise capital receipts;
- Access private capital (debt and equity);
- Ensure ongoing financial robustness; and,
- Share in the future equity upside.

Recommendations – Structural Change

Each trust port board should consider whether some form of structural change might facilitate its development. Examples of structural models which would be of most benefit to trust ports, in terms of embedding efficiency incentives and improving transparency and accountability, include: (*Recommendation 23*):

- (1a) Restructuring of the trust port's governance structure so that it has: a higher tier (supervisory) board focusing on accountability to stakeholders and observance of statutory duties; and a lower tier (management) board responsible for the efficient and profitable operation of the business; or,
- (2a) Introduction of the incentives, skills and disciplines which private investors can bring to bear, through the sale of a minority or majority stake in an operating subsidiary of the trust port responsible for the commercial port activities.

It is up to trust port boards to decide whether either of these models offers significant benefits. DfT may wish to consider whether to recommend any of these structures to trust ports. The above recommendation has not taken into account the specific circumstances of each port so trust ports should take their own independent advice before making any such a decision.

Appendix A - Key Performance Indicators

The following tables explain further the recommended KPIs in the proposed basket of indicators as well as selected others – see Section III. All measures should be reported after adjusting for stakeholder dividend.

FINANCIAL INDICATORS	
Profitability	<p>Profit (EBITDA*) / Turnover</p> <p>While not a measure of efficiency and rather a blunt measure of performance that does not take into account port size or asset base, profitability is important in assessing a company's health. Year-on-year data also allows us to effectively identify changes in performance.</p> <p>* ie Earnings before interest tax depreciation and amortisation</p>
Return on Capital Employed (RoCE)	<p>Profit (EBITDA) / (Total Assets – Current Liabilities)</p> <p>RoCE is a widely used measure of a company's success in generating return against an asset base and it therefore indicates how effectively the ports assets are being utilised. One way of looking at RoCE is the number of pence each pound of useable asset generates. For an individual port in isolation RoCE is not a particularly useful indicator, but it can be a very useful comparator. Year-on-year data can assist in examining longer term changes in performance.</p>
Weighted Average Cost of Capital (WACC)	<p>It is possible to benchmark RoCE against WACC, which is the blended cost of financing a company's operations and represents the average cost of debt and equity funding weighted by the proportion of the company's capital structure that those two components constitute.</p>
Gearing	<p>Total Debt / Total Assets</p> <p>This can assist a company in assessing its financing position, and it is also a useful comparator across sectors, potentially indicating whether there may be in/efficient financing and investment levels i.e. if gearing is very different between similar companies. For trust ports low gearing may not indicate inefficiency but may simply be a function of not having to pay a dividend since in the absence of further investment cash would instead be retained within the company.</p>
Wage Comparator	<p>Wages and Salary Costs / Average Number of Employees</p> <p>In the absence of a direct economic owner, one indirect economic beneficiary could be the employees with this reflected through higher wage levels. This comparator can be used to examine whether differences between trust port and private port wage levels exist.</p>

OPERATIONAL INDICATORS	
Labour Productivity	<p>EBITDA / Man hours per annum</p> <p>A measure of operational performance can be gained from labour productivity. Undertaking this broad calculation allows a comparison across all ports. Man hours per annum can be obtained by the ports (from Health and Safety Reports or other records).</p>
Profitability by Land Holdings	<p>EBITDA / Number of Hectares</p> <p>Number of hectares relates to the land the port owns and uses, owns and rents to others, and rents off-site for its own use. This is another indicator of asset utilisation.</p>
Channel Depth Management	<p>With the increasing move of the industry towards larger ships, it would be useful to highlight how trust ports are adapting to this trend. The channel depths could be reported alongside strategic justification for planned dredging, deepening and widening activities. In one sense channel depths alone are not a particularly useful indication, but the strategic justification will give a transparent explanation as to why a particular approach has been taken. Channel depths are easily available as should be the justification and therefore how well the port is responding to its market.</p>
Berth Utilisation	<p>Time Berth in Use / Time Available</p> <p>Information on berth utilisation is recorded by ports that manage berths as this is an important tool in their management. An indicator on berth utilisation would provide a measurement that could reflect various operational performance issues such as under-utilisation, capacity issues etc, that a port may be experiencing. It would also raise further issues in terms of, for example, a port which is not open 24/7, but could increase opening times to accommodate capacity requirements rather than invest in a new berth. This information is unlikely to be easily available for private ports, but across trust ports this could be a useful comparator. However, not all are likely to manage berths and so this may be one indicator used to compare larger trust ports only.</p>
Port Charges	<p>The level of port charges may indicate whether profit is being maximised by the port and helps to explain its overall financial performance. The changes may be commercially sensitive and not easily comparable between ports but may be useful for year or year comparison.</p>

WIDER IMPACT INDICATORS	
GVA / NVA	<p>Gross Value Added (GVA) - (Employee Costs + EBITDA) / Number of Employees</p> <p>Net Value Added (NVA) - (Employee Costs + EBITDA – DA) / Number of Employees</p> <p>GVA and NVA can be used as measures of the value added by a company. In effect, both measure the ‘retained wealth’ created by a company and its employees i.e. wages plus the profit made from undertaking its activities. This is also a proxy measure of the local economic impact of the Port, assuming there is a high level of local employment and procurement. NVA subtracts the costs of depreciation and amortisation which takes into account the costs associated with its assets (important for the port sector due to the often large asset base). These two indicators fit well with the wider stakeholder remit that trust ports have, in that they assess the wider impacts of a port’s activity. But they are also quite crude in that they do not take into account some subtleties that affect a port. Both GVA and NVA per employee can be determined from the Financial Accounts, and so can also be compared to private ports as well as other businesses in similar sectors.</p>
Economic Impact Assessments	<p>A common tool now used to assess the wider impacts of a business is Economic Impact Assessments (EIA). These EIAs attempt to quantify the wider economic influence that a business has within an area. While this may not be used in a traditional ‘KPI sense’, EIA allow a greater understanding of a ports economic contribution both locally and regionally. While each EIA is necessarily site specific due to issues of size, activity etc, each would attempt to quantify the economic impact of a hub, and depending on the size and activity of the port such impacts could range from the very local level through to a national level. In relation to ports, important issues to consider would be direct and indirect employment both on and off the port estate, as well as tourism impacts.</p>
Social impacts	<p>The immediate quantitative effects can be captured by listing the amount of social investment a port undertakes. This should include both monetary donations and those undertaken ‘in kind’ e.g. staff members donating time to the local school, which could be monetised.</p> <p>An extension of Customer Satisfaction Surveys could be undertaken to assess the impact of the port’s direct activities on the ‘social customers’ of the port. The current focus of these Surveys is on traditional port “customers” i.e. shipping companies, with little focus given to the wider community. However, ports could extend these to include a wider group.</p>

WIDER IMPACT INDICATORS	
Social impacts (continued)	Exactly how these are undertaken would likely vary by port, but there are already established links with community groups that could be targeted, alongside questioning of the wider community. This type of reporting is likely to be useful to give some assessment of the social impact of their activities, but also to feed back views to the ports which are beyond the often 'issue driven' engagement e.g. formal consultations, they have with communities.
Environmental Reporting	In developing a KPI in this area we need to consider that an 'efficiency' indicator as such is unlikely to be suitable. Trust ports like other companies are required to act in an environmentally responsible manner. To increase the transparency of the trust ports environmental activities, reporting on their environmental performance should be seen as an important first step and many already do this.
Safety Reporting	<p>Number of Incidents / Total Man Hours</p> <p>Again, in developing a KPI for this issue we need to consider that an 'efficiency' indicator may not as such be suitable. Ports could report against the calculation above. This would give a cross-port comparison. However, further explanation behind this calculation would be essential. For example, while minor and major incidents would be recorded as one incident there is obviously a significant difference in severity. These could be split in the calculation, but it is probably more useful for a port to simply list the incidents.</p> <p>In addition, this calculation should be supported by noting the port's activities relating to Health and Safety such as whether they act in compliance with the requirements of the Port Marine Safety Code and their organisational approach to dealing with Health and Safety e.g. establishment and membership of a port H&S Committee.</p>

Appendix B - Pros and Cons of Structural Change Options

Structural Change Options for Trust Ports (involving private investors)				
Structural Option	Notes	Pros	Cons	Conclusions
<p>2a Part-privatisation (sale of minority share in port operating subsidiary to private investor)</p>	<ul style="list-style-type: none"> Shared responsibility for operations / investment / charges setting. 	<ul style="list-style-type: none"> Private involvement would deliver increased efficiency Greater access to capital Trust port gets share of profits TP could maintain non-commercial activities, prevent undesired use of land, avoid short termism Proceeds are captured in TP structure so reinvested in port Higher gearing likely - oversight from lenders should improve efficiency. Can use a 'Public Sector Comparator' to test VfM 	<ul style="list-style-type: none"> May be conflict between profit-oriented aims of private owners and non-profit aims of TP (reconcilable through shareholders agreement) Some profit paid as dividend rather than reinvested Possible short term disruption Possible workforce / political resistance Diminishing returns for smaller ports from greater complexity of structure 	<ul style="list-style-type: none"> Would add value where trust port structure does not deliver an efficiently run port Balances private sector efficiency with Trust's non-commercial stakeholder interests, accountability, etc On balance, best option for larger ports
<p>2b Concession on core port operations (20-30 years)</p>	<ul style="list-style-type: none"> Trust responsible for ensuring concessionaire delivers the statutory duties. Concessionaire responsible for operating port, investing in assets and setting charges. NB: assumption that concessionaire takes revenue risk. Trust may need to cap/regulate charges. 	<ul style="list-style-type: none"> Initial competition, then pressure from shareholders would drive further efficiency Greater access to capital (stronger balance sheet) TP can contractualise certain non-commercial activities if desired and prevent undesired change of use of land Proceeds/premia are captured in the TP structure so reinvested in port Higher gearing likely – oversight from lenders should improve efficiency. Can use a 'Public Sector Comparator' to test VfM 	<ul style="list-style-type: none"> Profit maximisation (i.e. charge optimisation) to potential disadvantage of users May be short termism – can be mitigated in concession contract Accountability more cumbersome as operator remote from trust port board Profits to dividend rather than reinvested Short term disruption from transaction Workforce / political resistance Difficult to unlock value captured in TP model Diminishing returns for smaller ports from greater complexity of structure Social benefits reduced to what is measurable / contractable. Loss of holistic approach. 	<ul style="list-style-type: none"> On balance, sub-optimal to part-privatisation

Structural Change Options for Trust Ports (involving private investors)				
Structural Option	Notes	Pros	Cons	Conclusions
<p>2c Privatisation (trade sale / IPO / MBO)</p>	<ul style="list-style-type: none"> Trust port structure ceases to exist 	<ul style="list-style-type: none"> Initial competition, then pressure from shareholders and increased liquidity in ownership would drive further efficiency Would unlock any value that is captured in the TP model Greater access to capital (stronger balance sheet) Higher gearing likely – oversight from lenders should improve efficiency. Can use a 'PSC' to test VfM May raise greatest amount of proceeds Simple structure Would facilitate industry consolidation and economies of scale Would enable mergers and economies of scale 	<ul style="list-style-type: none"> Profit maximisation (i.e. charge optimisation / asset sweating) to disadvantage of users May be short termism Likely reduction in non-commercial activities to disbenefit of stakeholders Reduced accountability Short term disruption would be significant (eye off ball), esp. political resistance May lead to economic disbenefit if parts of port changed use Profits to dividend rather than reinvested Proceeds are paid to Treasury – loss of local benefit No return to TP structure if 'failure' 	<ul style="list-style-type: none"> Only a good solution for medium / larger ports which are commercially viable Where there is significant value locked up in TP model, may be only solution to unlock this for benefit of taxpayer May need to retain some non-commercial activities in a TP-type structure (e.g. Poole Harbour)
<p>Merger of small trust ports</p>	<ul style="list-style-type: none"> Single company with trust port status. 	<ul style="list-style-type: none"> Efficiencies through shared back-office (HR, IT, etc) services and shared management. May attract higher quality of management / directors Could take more strategic decision regarding an unviable port May reach critical mass to outsource more operations Easier to close a port Easier to raise finance 	<ul style="list-style-type: none"> May lose focus on local issues Unclear extent of legal powers required Disruption of reorganisation Competition issues (mitigated by efficiency = lower charges) May result in ports closure 	<ul style="list-style-type: none"> Worth considering if there is a group of small closely located ports with poor current performance – not included in main report as not relevant to selected ports

Structural Change Options for Trust Ports (involving private investors)				
Structural Option	Notes	Pros	Cons	Conclusions
Local authority ownership of small trust port(s)	<ul style="list-style-type: none"> Transfer of ports to LA ownership / responsibility. 	<ul style="list-style-type: none"> Access to capital (although limited by LA affordability) Access to shared back-office services (HR, IT, etc) More likely to lead to closure of unviable ports than under TP structure May address regeneration / housing issues Any portfolio effect of port ownership should lead to efficiency through shared management 	<ul style="list-style-type: none"> Increase in political interference (e.g. may not close a failing port, may invest according to policy not best return) Unlikely to address commercial viability or operating inefficiencies Contrary to municipal ports review Loss of any commercial leadership from non-execs No test of VfM 	<ul style="list-style-type: none"> Worth considering for small, moribund ports Especially where there is one clear LA influence and port only benefits the catchment of that LA Not included in main report as not appropriate for larger ports

The following structures were considered but not assessed in detail as they were either something that a trust port could do now (e.g. operating contract) or were thought unlikely to achieve the desired outcome:

Option	Comment
<p>Merge all trust ports into single trust port company</p>	<ul style="list-style-type: none"> • Ports are very diverse in operations • Widely dispersed, hard to make economies of scale • Would lose local focus. • Selected mergers considered in Section III
<p>Merge, then privatise Operating contract for core port assets (c. 5-10 years)</p>	<ul style="list-style-type: none"> • As above • Ports can already use out-sourcing where efficient. • Port asset life too long for medium term contracts to be efficient over long-term. • Difficult to incentivise performance effectively • Separation of charging (TP) from costs/service levels (operator) would be inefficient.
<p>Management agreement (c. 10-20 years)</p>	<ul style="list-style-type: none"> • Ports can already use out-sourcing where efficient. • Ports locked into long-term agreement • Separation of charging (TP) from costs/service levels (operator) would be inefficient. • May be useful alongside sale of shares in operating company (part privatisation – option 2a above). Otherwise difficult to incentivise performance
<p>Long lease (>50 years). Outsourcing.</p>	<ul style="list-style-type: none"> • Concession offers better deal than a simple lease • Already considered/done by most ports.
<p>Regulation.</p>	<ul style="list-style-type: none"> • Too bureaucratic. • No significant competition/monopoly issues
<p>Central govt ownership.</p>	<ul style="list-style-type: none"> • Difficult to see any benefit arising