Journal of the Asia Pacific Economy ›

Volume 13, 2007 - Issue 1

ARTICLES

Partial privatization, corporate governance, and the role of state-owned holding companies

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Pages 63-88 | Published online: 10 Jan 2008

Cite this article https://doi.org/10.1080/13547860701731895

Abstract

The success of privatized firms has been of interest to researchers in economics. In this study, we examine the role of a state-owned holding company (SOH), serving as a monitoring arm of the government to track the performance of the government-linked companies (GLCs). In the case where state assets are partially privatized, the holding company serves as a useful institution to mitigate the agency problem involving the government as the principal and the GLCs as agents. To play this role effectively, the holding company itself must be respected and well governed. In the first part of this paper, a simple framework is presented to put in context the specific role of the SOH and its relationship with the various stakeholders. Next, we turn to a case study, the Temasek Holdings Limited of Singapore, to gain a better understanding of the style of corporate governance of a holding company.

Keywords:

corporate governance

privatization

Singapore

state-owned holding company

JEL-Classifications:

G38

L33

Acknowledgments

The author would like to thank two anonymous referees for their helpful advice and comments. The interpretations and conclusions expressed in this paper are entirely those of the author.

Notes

1. In this paper, GLCs refer to local firms wholly or partially owned by the government. Hence, they can be subject to further privatisation. The term does not include government investments in oversees firms, which may be liable to regulations and requirements that are less easy to control by the SOH. Our definition of the GLCs, in this sense, is narrower. This distinction, however, should not be a matter of concern in the context of the present paper, which focuses on corporate governance of the SOH.

2. By corporate governance, we mean the effectiveness of mechanisms to mitigate the agency problem, involving the privatized firms as agents and the SOH as a shareholder representative of the government.

3. ‘Temasek to Strike Balance in Information Disclosure’, it The Straits Times, Singapore, 30 March 2004. In the case of disclosure of executive compensation, one of the concerns is that others may use the disclosure as a benchmark to negotiate for even higher pay.

4. Although THL is a registered company under the Companies Act, it is exempted from disclosing its audited consolidated financial statements to the public except its owner, the Minister for Finance (in the Review, THL releases the Group Financial Highlights and

‘consolidated financial information’ summarized by the THL from the underlying audited consolidated financial statements). But THL still requires the approval of the Elected President of Singapore on its annual budget (to ensure that past reserves are not drawn without explicit approval from the president) and appointments, reappointments and/or removal of the board members or CEO.

5. Chan, Fiona, 2005, Set up single governance body: SIAS, The Straits Times, October 13, 2005.

6. Singh and Siah (1998) and Ang and Ding (2006) have argued along a similar line. Ang and Ding (2006, p. 72) review that the THL has a team that looks after stewardship matters of companies in which it has at least a 20% share ownership. The THL ‘does not seek waivers from disclosures, is open to GLCs being acquired, and limits the tenure of board members to a maximum of 6 years’. Following the success of the THL, other SOHs like Mainland China's SASAC have expressed interest to learn a thing or two from the THL.

7. See Ho (2004). Since inception, the THL has provided its shareholder (the Minister for Finance) with an average annual cash dividend yield of more than 7% (over the last three years, cash dividends amounted to an average of S$1.3 billion a year).

8. The debate on divesting the GLCs intensified after several failed acquisitions from the GLCs. Singapore Telecommunication's unsuccessful acquisition of Cable and Wireless (Hong Kong) in March 2002 and Malaysia's Time Engineering in May 2002 and the Singapore Airlines' failure to take a controlling share of New Zealand's Air New Zealand were some examples. These incidents subsequently led to greater calls for divestments. The government conceded and reduced its stake from 78% to 65% and gave up its golden share to create the arm's-length distance by the time Singapore Telecommunication acquired Optus (Australia) and Telekommuninasi Selular (Indonesia) in 2001 (as at end March 2005, THL stakes in Singapore Telecommunication fell marginally to 63%). THL has the intention to reduce the share of investments in Singaporean GLCs from the current 49% to one-third. This, however, does not necessarily mean a reduction in absolute terms should total investments correspondingly increase.

9. MacAvoy and Millstein (2003, p. 5) even go to the extent of suggesting that separating the Chairman and CEO should be made a compulsory requirement among listed companies.

10. EVA represents returns over the cost of capital of the firm.

11. ‘Singapore's Mr Buffett’, Australian Financial Review, May 24, 2002 (extracted from http://www.singapore-window.org). The Temasek Review 2005 contains the EVA performance of the major Temasek-Linked Companies.

12. Using the case of Singapore Technologies Engineering (which is partially owned by the THL), Conyon (2006) estimated that stock option compensation accounted for only about 10% of the total compensation, which was smaller than that of the UK (12%) (Conyon and Murphy 2000) and the US (where a typical CEO at the S&P 500 list received about 50% of his/her pay in terms of stock options) (Murphy 1999).

13. Singh and Siah (1998) also show considerable interlocking directorship among GLCs (see Singh and Siah 1998, p. 43, Table 9). Judging from the performance of the GLCs, the authors conclude that the Singapore experience has been positive. However, Phan and Mak (1998) warn that a high percentage of interlocks between competitors in the same industry may lead to ‘moderation of competitive intensity’.

14. Refer to Temasek Review 2005.

15. The model has worked generally well, at least in the Singapore case. But it is not free from criticisms. United States, State Department (2001) expresses concerns that (1) government influence over the management of GLCs may constitute an unfair advantage over non-GLCs in contract bidding and access to loans, and (2) former civil servants holding senior positions at the THL and GLCs may be less inclined to take significant risks. In addition, critics have raised questions on a number of appointments at the THL and GLCs. THL CEO Ho Ching, for example, is the wife of Prime Minister Lee Hsien Loong and daughter-in-law of Lee Kuan Yew. Lee Hsien Yang, brother of PM Lee is currently heading Singapore Telecommunications, a GLC. When asked about the perception that the only way to shake up the GLCs is to bring in a member of the Lee family, former PM Goh Chok Tong agreed but said, ‘But what do you do? Because of the perception, you don't appoint Lee Hsien Yang, you don't appoint Ho Ching, and any number of their relatives to high position?’ Goh sees the perception as a ‘big problem politically for us’ (Q&A: Singapore's Premier on the Power of the Lee Family, Business Week, 24 June 2002). These are some issues that have been around for quite some time. The Temasek Charter, released in July 2002, attempts to address some of them (see Low 2004 for more details).

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