Corporate Governance Practices and Disclosures in Singapore: An Update[a]

Mak, Yuen Teen, PhD, CA
Associate Professor and Deputy Head
Department of Finance and Accounting
fbamakyt@nus.edu.sg

and

Chng, Chee Kiong, PhD, CPA
Assistant Professor
Department of Finance and Accounting
fbacck@nus.edu.sg

The NUS Business School
National University of Singapore
FBA2, 17 Law Link,
Singapore 117591

April 2000

Draft only

Please do not quote without permission.

This paper was written for The OECD/World Bank 2nd Asian Roundtable on Corporate Governance on *The Role of Disclosure in Strengthening Corporate Governance and Accountability*. It reflects the views of the authors and not of National University of Singapore. We thank Kusnadi Yuanto for helping us collect data on corporate governance practices and disclosures from annual reports.

Corporate Governance Practices and Disclosures in Singapore: An Update

Mak, Yuen Teen
and
Chng, Chee Kiong

National University of Singapore

ABSTRACT

This paper discusses recent developments and future trends in corporate governance in Singapore. The first part of the paper briefly describes the Singapore economy, the impact of the financial crisis, the Singapore equity markets over the last few years, the disclosure philosophy and practices in Singapore prior to the crisis, and major reforms subsequent to the crisis. The second part of the paper describes recent trends and changes in specific corporate governance practices and disclosures in Singapore. Part 3 summarises the major practices in corporate governance in Singapore and discusses further changes that are necessary for corporate governance standards in Singapore to meet the standards in more developed markets, such as Australia, U.K. and U.S.

1. INTRODUCTION[1]

Singapore is a small country (582 square metres) with no natural resources. It achieved independence in 1965, at which time it had a population of 1.9 million and growing at a rate of 2.5% per annum, and an unemployment rate estimated at 10%. The economy was highly dependent on entrepot trade and the provision of services to British military bases in Singapore. There was a small manufacturing base, limited industrial know-how and local entrepreneurial capital. In order to develop Singapore, the government adopted the following strategies:

(a) Industrialisation to solve the unemployment problem and diversification away from regional entrepot trade.

(b) Internationalisation by attracting foreign investors to develop the manufacturing and financial sectors.

(c) Improving the investment environment by introducing employment and industrial relations legislation and investing in key infrastructure, such as the development of the Jurong Industrial Estate and Port of Singapore.

(d) Establishing new companies such Singapore Airlines, Neptune Orient Lines, Development Bank of Singapore and Sembawang Shipyard in areas where the private sector lacked capital or expertise.

Singapore's economic growth averaged 10% per year during the period 1965-1980, the unemployment rate fell to 3% in 1980, and the manufacturing sector accounted for 28% of GDP in 1980 compared to 15% in 1965.

During the 1980s, the government adopted strategies to restructure the economy towards higher value-added activities in light of the tight labour market. These strategies included ensuring wage increases reflect the tight labour market, increasing emphasis on education and training, encouraging the increased use of technology, adopting a more selective investment promotion policy, increasing emphasis on research and development, and developing higher value-added services.

By 1990, Singapore was classified a Newly Industrialised Economy (NIE) by the United Nations. The economy had become more matured, and was enjoying rapid growth as

[1] In this paper, we focus on recent changes in the corporate governance environment in Singapore. For a more detailed discussion of the economic environment of Singapore before and after the crisis, and the pre-crisis corporate governance environment, see Mak, Y.T. and Phan, P., "Corporate Governance in Singapore: Current Practice and Future Developments", Invited Paper, *Corporate Governance in Asia: A Comparative Perspective*, Seoul, OECD Conference, March 3-5, 1999. [http://www.oecd.org/daf/corporate-affairs/governance/in-Asia/teen-phan.pdf]

were many other economies in the region. The Strategic Economic Plan was then formulated to transform Singapore into a developed country. In the 1990s, the aims of Singapore are to become a globally-oriented city, a centre for high-tech manufacturing industries and an international business hub. She hoped to achieve this by being the hub of an Asia Pacific economic community through active participation in regional economic initiatives, and investing in other rapidly growing economies in the Asia Pacific.

1.1. The Impact of the Crisis

Although Singapore was less affected by the economic crisis than most other Asian economies, the effect was still severe relative to its previous growth patterns. The strategy of increasing regionalisation adopted in the early 1990s meant that the health of the Singapore economy was closely linked to that of other regional economies. For example, many Singapore banks have reported significant non-performing loans made to other Associate of South East Asian Nations (ASEAN) countries although there were no bank failures resulting from the crisis. Contagion was also widely seen as contributing significantly to the effects of the crisis on Singapore.

The effects of the crisis included significant declines in stock and property prices, a large fall in demand in the local property market, a significant decline in the value of the Singapore dollar relative the U.S. dollar, increasing unemployment and bankruptcies, and a significant decline in GDP growth. In 1998, real GDP growth fell to 1.5%. All sectors of the economy experienced deterioration in growth, with the manufacturing, distribution, and financial services sectors particularly badly hit. Total employment fell in the second and third quarters of 1998. The seasonally adjusted unemployment rate rose from 2.3% in the second quarter of 1998, to 4.5% in the third quarter. In summary, the impact of the crisis on the Singapore economy, while not crippling has been severe.

1.2. Equity Markets

Table 1 provides information on selected indicators for the Singapore equity markets over the four years from 1996 to 1999.

Table 1: Indicators for Singapore Equity Markets: 1996-1999

Indicator	**1999**	**1998**	**1997**	**1996**
Straits Times Index	2479.58	1392.73	1507.65	2216.79
UOB-Sesdaq Index	153.65	56.24	62.95	92.35
No. of mainboard companies	327	307	294	274
Mainboard market capitalisation (S$billion)	447.43	263.17	329.27	255.86
No. of Sesdaq companies	81	64	62	51
Sesdaq market capitalisation (S$billion)	8.42	2.45	3.17	4.29
Number of new listings	53	20	35	21
Highest subscription rate for IPO (no. of times)	216.43	55.92	156	30.40
No. of full/over-subscriptions	53	19	35	20
No. of undersubscriptions	0	1	0	1
Funds raised through IPOs (S$billion)	2.70	0.41	1.18	0.81

As at the end of 1999, there were 327 companies listed on the mainboard of the SGX, with a total market capitalisation of S$447.43 billion. In addition, there were a total of 81 companies listed on the second board (SESDAQ), with a market capitalisation of S$8.42 billion. As Table 1 shows, the number of companies listed in both the Mainboard and SESDAQ have increased over each year between 1996-1999. Clearly, the crisis has had a significant impact on the Singapore equity markets, with both the Mainboard and SESDAQ indices experiencing significant declines in 1997 and 1998. However, by 1999, both indices have more than recovered their 1996 values, with the SESDAQ index showing the greater gain. Table 1 also shows that IPOs in Singapore tend to be well subscribed, and very high over-subscription rates are common. Under-subscriptions are rare. Retail investors participate actively in IPOs. The interest of retail investors can be attributed to the high savings rate, low interest rates, and the liberalisation of rules concerning the use of Central Provident Fund (a national pension fund) monies for equity investments. However, companies making IPOs often make only enough shares available to the public in order to satisfy minimum shareholding spread requirements. It appears that the status and improved liquidity associated with a listing, rather than the need to obtain funds from the public, is the major motivation for IPOs.

1.3. Disclosure in Singapore Prior to the Crisis

Regulation in the public sector is effected primarily by the Registry of Companies and Businesses (RCB), which administers the Companies Act of 1990. The Companies Act requires financial statements to comply with the detailed disclosure requirements in the Ninth Schedule and to present a true and fair view. There are some differences in accounting and auditing requirements for private companies, public companies and listed companies. For example, the Act includes provisions for maintaining adequate internal accounting controls for public companies, and for listed companies to have an audit committee made up of at least 3 directors, a majority of which must be independent directors.

The regulation of accounting in Singapore involves a combination of private sector and public sector regulation. The Statements of Accounting Standards (SAS) together with the rules contained in the Stock Exchange Listing Manual and the Companies Act determine how accounting is practised in Singapore. The two major institutions involved in private sector regulation are the professional accounting body, The Institute of Certified Public Accountants of Singapore (ICPAS), and the Singapore Exchange (SGX). The ICPAS has the sole responsibility for developing and maintaining SAS and issuing Statements of Recommended Accounting Practice (RAP) which specify how to account for certain business transactions. Standards setting is done through the Accounting Standards Committee appointed by the Council of the ICPAS. Each new Standard becomes part of GAAP, the "accounting law of the land."[2] There is also the Financial Statements Review Committee of the ICPAS which reviews published financial statements for compliance with statutory requirements.

Since the SAS issued by the ICPAS do not have legal backing and the ICPAS only has the authority to require members to follow its standards and guidelines, compliance with these standards depends largely on general acceptance by the business community. The SAS is based on the International Accounting Standards (IAS) issued by the International Accounting Standards Committee (IASC). In most cases, SAS are identical to IAS, although

[2] The ICPAS has regular interactions with numerous government agents, especially MAS, the Economic Development Board (EDB), and Inland Revenue Authority (IRA). The Institute discusses with these agents frequently on accounting and auditing issues related to banking and finance (with MAS), industry and commerce (with EDB) and taxation (with IRA). The ICPAS also sends draft copy of the standards, guidelines and key reports to these agents for their comments and review before formal publication.

there are occasional deviations and omissions. Examples of the major differences include treatment of goodwill, and classification of extraordinary and exceptional items. [3]

The regulation of disclosure standards in financial institutions is spread over a number of institutions, namely the SES, MAS, Securities Industry Council, Registrar of Companies and Commercial Affairs Department of the Ministry of Finance. Thus, there is no single point of reference both for companies and stockholders, which contributes to a lack of transparency to the governance process.

Banks have traditionally being subject to lower disclosure standards than other corporations through modifications by the MAS. Lower disclosure was mandated because of the high regulatory and supervisory standards practised by the MAS, and concern that fuller disclosure may have an adverse impact on the stability of the banking system.

Prior to the crisis, the philosophy of regulation in Singapore was predominantly merit-based. Under the merit-based philosophy of regulation, the securities regulator decides on whether transactions should be allowed to proceed based on their perceived merits and whether adequate disclosure has been made before the release of the disclosure is allowed. Under this philosophy, regulators rather than shareholders primarily determine whether certain transactions are allowed, and strict rules are set to restrict the transactions that companies may undertake.

Many commentators, regulators and government officials have lamented the fact that Singapore companies generally disclose the minimum information that is required by required by law, regulations and accounting standards. Companies often comply with the letter rather than the spirit of these requirements, and are rather liberal in taking advantage of the discretion that is often permitted under accounting standards.

1.4. Financial Sector Reforms

In late 1997, the Monetary Authority of Singapore (MAS), Singapore's Central Bank, embarked on a fundamental review of its policies in regulating and developing Singapore's financial sector. This review was undertaken by the Financial Sector Review Group, chaired by the Chairman of the MAS and Deputy Prime Minister Brigadier-General Lee Hsien Loong. In February 1998, the MAS unveiled a series of sector reforms aimed at making Singapore the dominant financial centre in South East Asia. The MAS new strategy involved

[3] Some commentators have criticized the decision of the ICPAS not to adopt the new IAS standard on extraordinary items, after issuing the exposure draft for comment. The new IAS standard would have tightened considerably the reporting of extraordinary items.

the creation of an investor friendly regulatory environment that had, as its primary objectives, transparent supervision, product innovation, and aggressive advocacy for the industry.

The Financial Sector Review Group also formed various committees to make recommendations on various aspects relating to the financial sector. The major committees are the Committee on Banking Disclosure (CBD), the Corporate Finance Committee (CFC), and the SES Review Committee (SRC).[4] Many of these recommendations have already been implemented. Perhaps the two most significant overall developments in the context of corporate governance are the major improvements in banking disclosures recommended by the CBD, and the move from a merit-based philosophy to regulation to a disclosure-based philosophy to regulation recommended by the CFC.

Disclosure and corporate governance in Singapore have been widely recognised as being among the best in Asia, and many commentators have attributed the robustness of the Singapore economy during the financial crisis to the relatively good disclosure and corporate governance in Singapore. In the PriceWaterhouseCoopers (PWC, 1997) survey of companies, respondents rated corporate governance in Singapore as being better than Taiwan, Malaysia, Hong Kong, and Japan, but to lag behind Australia, U.K. and U.S. Similarly, a more recent PWC (2000) survey of institutional investors ranked Singapore as second only to Australia among principal markets in the region, in the areas of auditing and compliance, accountability to shareholders, disclosure and transparency and board processes.

Nevertheless, the Singapore Government has identified meeting international standards of disclosure and corporate governance as being extremely important, given the globalisation of business and Singapore's aim of becoming an international financial centre. Therefore, following on from the work of the above committees, especially the CFC, the Government in December 1999 announced the establishment of the Corporate Regulation and Governance Policy Committee (hereafter "Policy Committee"), jointly chaired by the Permanent Secretary of the Ministry of Finance and the Managing Director of the MAS. The Policy Committee has in turn established three private sector-led Review Committees in three areas: (a) Company Legislation and Regulatory Framework, (b) Disclosure and Accounting Standards, and (c) Corporate Governance. These committees are due to submit their recommendations to the Policy Committee in December 2000.

---

[4] See Report on Banking Disclosure, May 1998; Report of the Corporate Finance Committee, 29 October 1998; Report of the SGX Review Committee, 29 July 1998.

In the following section, we discuss actual corporate governance disclosures and practices in Singapore based on recent questionnaire and annual report surveys. We also discuss in more detail the major recommendations of the various committees reviewing disclosure and corporate governance in Singapore, the extent to which these have been implemented, and how they may affect corporate governance in Singapore. We also discuss further the reviews of accounting standards, company regulation and regulatory framework, corporate governance, and takeover legislation currently being undertaken in Singapore and how they may affect corporate governance in the future.

2. CORPORATE GOVERNANCE DISCLOSURES AND PRACTICES IN SINGAPORE: RECENT TRENDS AND CHANGES[5]

One of the key recommendations of the CFC, which has been adopted by the Government, is that Singapore should move from a predominantly merit-based philosophy to regulation towards a predominantly disclosure-based philosophy of regulation. Under the merit-based philosophy, the merit of transactions is largely determined by regulatory or quasi-regulatory bodies such as the MAS and SGX. Under this philosophy, strict rules governed what companies can or cannot do, and in this setting, the role of disclosure is limited. Under the disclosure-based philosophy to regulation, the merit of transactions will be largely determined by shareholders. This requires a high level of disclosure and monitoring by shareholders rather than regulators. Moving from a merit-based to a disclosure-based philosophy to regulation not only changes the role of regulators, but also requires fundamental changes in the areas such as the legal and regulatory framework, accounting and auditing standards, codes of best practices, and the role of third-party watchdogs such as the news media and investors' associations.

In general, corporate governance disclosures in Singapore annual reports lag behind those in more developed markets, such as Australia, U.K. and U.S. As we discuss further below, Singapore companies generally disclose only the minimum required information. Therefore, most corporate governance disclosures do not go beyond those specified by the Companies Act, the SGX Listing Rules and Best Practices Guide (BPG), and other requirements. Unfortunately, at the present point in time, the corporate governance

[5] This section draws heavily from a recent survey of annual reports by the authors, and from the following reports: "Survey of Corporate Governance in Singapore," PricewaterhouseCoopers, 1998 and "Corporate Governance: 1999 Survey of Institutional Investors," PricewaterhouseCoopers, March 2000.

disclosures that are required to be disclosed are sparse. In particular, although the SGX has introduced a BPG (which is non-mandatory), it deals only with two aspects of corporate governance - audit committees and dealing in securities by directors. Disclosure of compliance with the BPG is only required for audit committees. Further, although the BPG specifies that companies should provide sufficient disclosure of their corporate governance processes and activities, specific guidelines on what should be disclosed are lacking. At the present time, there is no equivalent of the U.K. Combined Code used by the London Stock Exchange or the Toronto Stock Exchange Corporate Governance Guidelines in Singapore, although the Singapore Institute of Directors has produced a draft code modelled after the Combined Code.

In our survey of corporate governance disclosures in 150 SGX-listed companies, we found that only 6 companies did not make corporate governance disclosures. Thirty-three companies (22%) incorporated their corporate governance disclosures within the directors' report, while the remaining companies (74%) included a separate statement of corporate governance. However, as the following subsections indicate, most companies do not go beyond the minimum requirements in the BPG in their corporate governance disclosures. The PWC (2000) survey identified more guidance on corporate governance and activities in the BPG as an area requiring improvement. In the same survey, 38% of institutional investors felt that considerable improvement in the corporate governance regime in Singapore was required, while another 54% felt that some improvement was needed. Interestingly, in the PWC (1997) survey of companies, 17% felt considerable improvement was needed while 63% felt some improvement was needed. Therefore, institutional investors seem to be somewhat less satisfied than companies with the state of corporate governance in Singapore. Following one of the recommendations of the CFC, the Committee on Corporate Governance is in the process of developing a Code of Best Practices. In the following subsections, we discuss disclosures in specific aspects of corporate governance.

2.1. Companies Legislation and Regulatory Framework

One of the recommendations of the CFC is consolidating securities legislation into a unified code and moving to a single securities regulator responsible for enforcing all aspects of securities law and regulation (including disclosure obligations) and prescribing accounting rules. Currently, enforcement of companies and securities laws and regulations reside across

a number of regulatory bodies, such as MAS, Ministry of Finance, and Registry of Companies and Businesses. This issue is currently being considered by the Committee on Companies Legislation and Regulatory Framework, a private sector-led committee formed by the Ministry of Finance and MAS. This committee is scheduled to deliver its recommendations to the Minister of Finance by December 2000.

One recommendation of the CFC that has already been implemented is making it easier for shareholders to institute civil right of action for insider trading and to obtain compensation for losses from insider trading. Following changes to the Securities Industry Act, aggrieved shareholders can now file civil actions for damages and penalties for insider trading without first securing a criminal conviction, which was the case in the past.[6] In addition, the time bar has been raised from 2 to 6 years. Given that civil actions require a lesser burden of proof than criminal actions, this change is expected to improve the rights of minority shareholders. Nevertheless, problems of proof and costs are likely to remain significant impediments to effective civil actions for insider trading violations.

The PWC (2000) survey indicated that improved education about existing rules, clarification and simplification of existing rules, and improved enforcement of existing rules, as areas requiring improvement.

2.2. Competition in Product and Factor Markets

Singapore's small size and lack of natural resources have necessitated an open trade policy. It is a very strong supporter of free trade, as evidenced by its stance in WTO meetings and signing of bilateral free trade agreements. Singapore has virtually no exchange controls on inflows and outflows of foreign currency funds by residents and foreigners, whether in amount or destination. Singapore also has a very liberal policy towards foreign direct investment. Before the crisis, there were few regulatory restrictions on competition apart from certain sectors such as banking, insurance, media, telecommunications and utilities, although certain sectors were dominated by government-linked companies and MNCs. The onset of the financial crisis has brought about accelerated liberalisation of the banking, insurance and telecommunications industries by the government. For example, the MAS recently awarded four foreign banks Qualifying Full Bank (QFB) privileges and eight banks Qualifying Offshore Bank (QOB) privileges, and also announced eight new Restricted Banks

[6] In fact, since the enactment of the Securities Industry Act 1973, there has been no reported case of compensation being awarded on a civil action for insider trading violation (Woon, 1997)
.

(RB). The QFB privileges allow the foreign banks to have additional branches and/or off-premise automated teller machines (ATMs), as well as to share ATMs amongst themselves. The result is that local banks will be subject to significant product market competition from foreign banks in Singapore. As a result of the government, regulatory and market pressure for change in how local banks are managed, we are starting to see some positive signs of improvements in corporate governance among local banks. For example, in recent months, the local banks have reported the appointment of highly-qualified foreign executives to board and senior level positions.

It is well accepted that competition in product and factor markets is an important external corporate governance mechanism (Shleifer and Vishyny, 1997). Therefore, the accelerated liberalisation programs in various industries taking place in Singapore, coupled with the open trade policy practised by Singapore, can be expected to positively affect corporate governance in Singapore.

2.3. Market for Corporate Control

Although friendly mergers occur from time to time in Singapore, the takeover market is inactive in Singapore. Hostile takeovers are almost unheard of and when they do happen, auctions seldom take place because of the secrecy rules just described. This is due in large part to the high ownership concentration among families and government, and traditionally tight controls by the SGX and other regulatory agencies. Thus, an important corporate governance mechanism in developed markets such as the U.S. and U.K. is virtually non-existent in Singapore.

The Securities Industry Council has recently announced a review of the Takeover Code, with a view to making takeover rules clearer and more certain, and less expensive. Under the proposals in the consultation paper, the current UK model for regulating M&A activities, whereby shareholders rather than directors have the right to decide on the offer, will be retained. One of the major specific changes proposed is the raising of the mandatory bid thresholds (for equal price offer to all shareholders) from 25% to a higher level. Clearly, the overall intent of the proposals is to improve the efficiency of the market for corporate control in Singapore, which would be welcome. However, there is of course the need to balance this against the need to ensure that minority shareholders' rights are adequately protected. Further, given the significant concentration of ownership among families and government for Singapore companies, it is unlikely that M&A activities can occur without the support of these large blockholders. Where management and directors of these companies

are related to or nominated by these blockholders, hostile takeovers that may involve the displacement of existing boards and management are unlikely to occur. We do not believe that the proposed changes to the Takeover Code will have a marked impact on the incidence of M&A activities in Singapore, especially those that are disciplinary in nature. Therefore, the role of the market for corporate control as a disciplinary mechanism is likely to remain weak in Singapore for the forseeable future.

2.4. Managerial and Substantial Shareholder Ownership

Under the Companies Act (s.201), the directors' report must report the interests of each director in the shares of the company (or its related companies). These interests include both direct and deemed interests. Under the Companies Act (s. 88), all listed companies must maintain a register of substantial shareholders, defined as shareholders with an interest in 5% or more of the voting shares of the company. The SGX Listing Rules (Appendix 11) also requires the disclosure of substantial shareholders and their direct and deemed interests, and the names and holdings of the top 20 shareholders of the company. However, there are several limitations with the disclosure of interests in voting shares. Since the top 20 shareholders disclosure relate only to direct interests only, this disclosure often include many nominee shareholders, and therefore the identity of the beneficial shareholders is not known. Although the substantial shareholders' disclosures include direct and deemed interests, under the Act, more than one shareholder can have deemed interests in the same shares. Therefore, there are often significant overlapping substantial shareholders' interests reported, leading to cumulative substantial shareholdings of more than 100% of the shares of the company. More importantly, substantial shareholders often include investment holding or other private companies, and the controlling shareholders of these companies are often not easy to determine. In other words, control over voting rights of the company is not very transparent.

Table 2 summarises CEO and executive directors’ ownership for a sample of 158 SGX-listed companies as at 1995/96, as reported by Li and Mak (1999). The median stock ownership by the CEO is 0.3%, and the median ownership by all inside directors is 4.3%. Table 2 also summarises ownership by substantial shareholders (those owning 5% or more of the voting shares) for a sample of 154 SGX-listed companies as at 1995/96, as reported by Tan and Mak (2000). Substantial shareholders are further classified into individuals and families, financial institutions, corporates, and nominees. The median proportion of shares owned by substantial shareholders is more than 60%, which is very high relative to many developed Western economies. However, there are some important differences between

substantial shareholders in Singapore companies compared to other countries. Unlike Japan and Germany, banks do not directly own significant proportions of shares in Singapore companies because they are not permitted to do so under the Banking Act of 1970. At the present time, substantial shareholders in Singapore companies consist mostly of individuals/families, the government (through government controlled investment vehicles), corporations, and especially nominees. The PWC (2000) survey identified clear separation of ownership and management as an area requiring improvement.

In Singapore, the Banking Act of 1970 limits the investments of banks in other commercial enterprises to a specified percentage if its capital funds, the most recent of which is 20%. They are more severely limited in their ability to take large positions in a singular company even though it may be less than the 20% limit. The exception to this rule is when a bank invests in companies set up to promote development in Singapore, which have to be approved by the regulatory authorities (MAS). In order to take high levels of ownership positions, banks have to undergo a judicial review process by the MAS. Therefore, unlike say Germany and Japan, banks are generally not major shareholders in Singapore companies.

Further, unlike the U.S. and U.K., mutual or pension funds are also currently not major shareholders in Singapore. Even though Singapore has a large public pension fund in the form of the Central Provident Fund (CPF), which is a government statutory board, the CPF is not allowed to directly invest CPF savings. Further, the funds management industry remains undeveloped in Singapore and large international mutual funds do not have a significant presence in Singapore, perhaps due to the smallness of the Singapore market. Therefore, institutional investors with no affiliation with management and which have sufficient voting clout to monitor management do not currently play a significant role in corporate governance in Singapore.

As Shleifer and Vishny (1997) note, while large shareholders can potentially improve the monitoring of managers because of the alignment of cash flow and control rights, large shareholders represent their own interests. Where corporate governance is weak, large shareholders may expropriate wealth from minority investors and other stakeholders. Large shareholdings may also result in a loss of diversification and inefficient risk-sharing. Thus, due to the relatively weak takeover market, lower disclosure standards, and weaker protection of minority shareholders' rights, the high concentration of shareholdings in Singapore may actually result in a weak corporate governance environment by Anglo-American standards.

The government has already committed to placing S$25 billion of Government Investment Corporation (GIC) funds and S$10 billion of MAS funds to external

(international) fund managers to manage. Further investments through fund managers are likely. The government has also recently changed the rules on the use of CPF savings for investment, with a reduction of the percentage of savings (above specified minimum sums) for investment in individual equities from 80% to 50%, and an increase in the percentage that can be invested in unit trusts from 80% to 100%. This change is designed to encourage greater diversification and reduced speculative trading in equities by individuals. Although high entry fees are still seen as a barrier to the growth of unit trusts in Singapore, over time, this move is likely to increase ownership by unit trusts in Singapore companies. The use of external fund managers and the development of the local fund management industry may alter the ownership structure of Singapore companies, with a shift towards greater ownership by these institutional investors.

Therefore, the importance of these institutional investors to corporate governance in Singapore is likely to increase in the future. It is hoped that, just like in the U.S., these institutional investors will more actively monitor companies they invest in, and encourage the adoption of best practices in corporate governance that are comparable to international standards.[7]

Table 2: Ownership Structures of SGX-Listed Companies

Percentage of total voting shares[a]	**Min**	**Max**	**Mean**	**Median**
CEO	0	0.875	0.143	0.003
Executive directors	0	0.875	0.229	0.043
Substantial shareholders (5% or more)				
All substantial shareholders	0.134	0.943	0.627	0.639
Individuals and families	0	0.765	0.127	0.027
Financial institutions[b]	0	0.601	0.043	0.013
Corporates[c]	0	0.873	0.262	0.177
Nominees	0.005	0.935	0.312	0.275

[a] CEO and inside directors' ownership include both direct and deemed interests. Blockholder ownership is based only on direct interests.
[b] Financial institutions include trading banks, merchant banks, finance companies and insurance companies.
[c] Corporates do not include government investment vehicles and GLCs

[7] In the U.S., for example, such giant pension funds as the California Public Employees Retirement System (CalPERS) are widely known to be active monitors of investee companies. They develop yearly 'hit' lists of under-performing companies, hold closed door meetings with boards to encourage a shareholder friendly business agenda, organize shareholder revolts through the proxy system, and employ the heavy leverage of public opinion and the popular media to pressure companies to conform to best practices standards for corporate governance.

2.5. Government Ownership

A major feature of the Singapore economic landscape is the dominance of government linked corporations (GLCs). Up to 80% of some GLCs are directly and indirectly controlled by the government while a smaller percentage of major non-GLCs in the banking, shipping, and technology sectors are controlled indirectly through inter-corporate equity shares between the GLCs and non-GLCs. At the end of the 1980s, GLCs comprised 69% of total assets and 75% of profits of all domestically controlled companies in Singapore. In the 1990s, through a program of privatisation, which dispersed the equity of these companies, those numbers have been reduced. However, the government continues to hold majority ownership in these GLCs. Table 3 shows some of the major GLCs that are listed on the SGX.[8]

Since directors of GLCs are often also senior government or ex-government officials, it is an indirect method for controlling and monitoring corporate activities and business policies by the government. However, while the government appears to facilitate governance through GLCs, there are some problems associated with this approach. The appointment of government officers to senior management and board positions within GLCs raises the question as to whether the best managers are running corporations that form an important part of the economy. In addition, even though GLCs are supposed to be run like commercial enterprises, they may have to meet objectives that are associated with the well-being of the country and which may conflict with commercial objectives. As a result, GLCs may also face less pressure in earning acceptable returns.

In addition, the government is expected to play the role of the long-term investor in these GLCs. Therefore, GLCs are even more protected from an already weak market for corporate control. GLCs are also likely to have easier access to different sources of capital when compared to non-GLCs. Often, the government is perceived by the lenders to have a moral and legal responsibility for their liabilities and this tacit backing of the state implies that the enterprise is guaranteed solvency (La Porta et al., 1998). This results in a greater willingness by banks and non-bank financial institutions such as insurance companies to lend

---

[8] The definition of GLCs is not clear-cut. In some cases, the government through its investment vehicles own relatively low ownership stakes (say 5%). For Table 3, only companies in which the Government through its investment vehicles own more than 20% are included. In some cases, such as SIA and SingTel, the percentage ownership are as high as 80%. The source for Table 3 is "Financial Highlights of Companies on the Stock Exchange of Singapore 1994-1998, Centre for Business Research & Development, Faculty of Business Administration, National University of Singapore, 1999.

money liberally to these enterprises. This of course reduces the potential discipline to which a GLC will be exposed in a competitive capital market.[9]

Table 3: Major Government-Linked Companies

Multi-Industry	
1. Intraco Limited	4. SembCorp Industries Limited
2. Keppel Corporation Limited	5. Singapore Technologies Engineering Limited
3. Natsteel Limited	
Manufacturing	
1. Keppel Marine Industries Limited	4. Singapore Petroleum Company Limited
2. Sembawang Resources Limited	5. SNP Corporation Limited
Transport/Storage/Communications	
1. CWT Distribution Limited	4. Singapore Airlines Limited
2. NOL Limited	5. Singapore Telecommunications Limited
3. Sembcorp Logistics Limited	
Finance	
1. Development Bank of Singapore	3. Keppel Tat Lee Bank Limited
2. Insurance Corporation of Singapore	4. Vickers Ballas Holdings Limited
Construction	
1. Jurong Engineering Limited	
Properties	
1. DBS Land Limited	3. TLB Land Limited
2. Keppel Land Limited	
Services	
1. Keppel Telecommunications & Transportation Limited	

Recent problems in attempted overseas acquisitions by major GLCs such as SingTel have highlighted some of the costs of significant government ownership. Some commentators have attributed these failures partly to the significant government ownership, and senior government officials have acknowledged that this may have been a factor. Over the years, GLCs have been accused by certain government officials and other commentators of having unfair advantages over other private sector companies, for stifling private enterprise, and for

[9] Accordingly, "the fact that [GLCs] are part-owned (or managed) by the Singapore government enables them to raise funds much more cheaply – by up to four percentage points lower – than others" (*Business Times*, 4 March, 1997). The Minister of Finance noted that GLCs, being largely cash-rich, usually do not need to resort to raising bonds or bank borrowings (*Business Times*, 23 August, 1997).

over-diversification into non-core businesses.[10] In recent years, these criticisms have become more frequent and vociferous.

There is little doubt that GLCs were instrumental in the rapid transformation of the Singapore economy from an entrepot-based economy to an industrialised economy. Most commentators would also agree that relative to state-owned enterprises in most other countries, GLCs in Singapore are much better run. One significant advantage that Singapore GLCs have over those in some other countries is that the Government's emphasis on clean government and the severe penalties it imposes on corruption has meant that directors and senior management of GLCs in Singapore (which often include government officials) are generally honest. However, the relative success of the GLCs may have come at the cost of development of private enterprise. Entrepreneurs wanting to start their own businesses in Singapore often have to contend with well-resourced and powerful GLCs. One could conjecture that perhaps the greater entrepreneurship that appears to characterise say the Taiwanese and Hong Kong economies may be attributable to the relatively minor role of the governments in those economies. One can also question whether GLCs can compete in the globalised economy, given that it is difficult, if not impossible, to find a world-class global company that is government-controlled. Recent events also suggest that international investors, management and policy-makers often hold a dim view of significant government ownership. There is also considerable theoretical and empirical evidence that private ownership is superior to government ownership.[11]

The government recognises these problems and has recently indicated that it is willing to divest more of its ownership. Therefore, government ownership in Singapore companies may be further reduced in the near future. The authors believe that further divestment of government ownership will have multiple benefits of stimulating private enterprise, energising the local equity markets (by improving liquidity and increasing the investment by international institutional investors), improving efficiency in the management of GLCs, and

---

[10] In a recent interview, Ho Kwon Ping, Chairman of Singapore Power (the Singapore utility) criticised GLCs for excessive diversification (*Straits Times*, May 15, 1998, p.52). In a competitive market, one would expect any wealth-decreasing diversification to be penalised by investors. However, the reduced exposure to market disciplines caused by a reduced exposure to takeovers and access to cheap capital because of implicit government guarantee may allow GLCs to be less efficient than other private companies. This criticism is supported by a recent empirical study by Lim and Mak (1999), which found that that listed companies in which the government is a significant shareholder were more likely to be highly diversified.

[11] See Megginson, W.L. and Netter, J.M., "From State to Market: A Survey of Empirical Studies on Privatization" (2000) for an excellent summary of theory and empirical evidence on privatisation.

contributing significantly to the development of the fund management industry in Singapore (if funds released from privatisation are re-invested through fund managers).

2.6. Share Ownership Limits

As at June 30, 1998, there were a total of 31 companies on the Singapore Stock Exchange (SGX) that had imposed restrictions on foreign ownership. Foreign ownership limits range from 20% to 49%. As noted earlier, foreign ownership limits were imposed by statute in the banking and news media industries. In other cases, these restrictions are adopted voluntarily by the firms themselves through amendments to their Memorandum and Articles of Association (M&A). The justification given for imposing foreign ownership limits include strategic (i.e., defence) and national interests. Where foreign shareholdings have reached the statutory or self-imposed limit, shares are traded in separate local and foreign tranches. In general, foreign tranche shares trade at a significant premium over local shares provoking a debate over whether firms should remove foreign shareholding limits. According to Lam (1997), overseas evidence suggests that the use of foreign shareholding limits to prevent companies from falling into foreign control imposes capital costs on the company.

The adoption of foreign ownership limits, whether statutory or self-imposed, can facilitate managerial entrenchment. The imposition of a foreign ownership limit prevents control of the firm from being passed to the hands of foreign investors. It also reduces the ability of foreign investors to acquire large stakes in these firms, thereby reducing the potential monitoring that can be provided by large foreign investors. It can also reduce the vulnerability of the firm to takeovers (Lim, 1997). Where the firm has dual listings of foreign and local stocks, the foreign stocks tend to trade at a substantial premium over the local stocks. The law requires the mandatory takeover (triggered when an investor acquires more than 25% of the voting stocks) to be conducted at the highest price paid by the acquirer for the stocks over the last 12 months. If the acquisition is done solely through the purchase of local stocks, then the highest price paid is unlikely to be higher than the prevailing foreign price. This means that foreign stockholders are unlikely to sell their stocks to the acquirer. To the extent that foreign stockholders have some control over the firm's voting rights, the fact that transfers of restricted stocks have to be approved by the firm essentially precludes a takeover of the firm (Lim, 1997).

However, recently the Government has removed the statutory 40% foreign shareholding limit for banks. As a result of this change, all the five local listed banks have merged their foreign and local shares, and the market has reacted positively to this

development. Nevertheless, the 5% limit on shareholding by a single party in banks remains, and this 5% limit applies to nominee interests.[12] This precludes institutional investors holding nominee interests from acquiring shares above these limits for banks. We believe that these limits should be reviewed as they discourage large institutional investors from investing in these companies, and restrict their ability or incentives to participate in the corporate governance of these companies. There is now considerable empirical evidence internationally on the positive role of unaffiliated institutional shareholders (such as pension and mutual funds) in corporate governance. In this regard, we agree with the following sentiments expressed by a fund manager:

> *We think it is a setback for Singapore in its ambitions of becoming a premier financial centre. It confuses beneficial interest with nominee interest. One wonders why, when there are existing ways of exerting control like nominating committees and golden shares, must they revert to the blunt instrument of equating ownership with control. Most fund managers buy shares with no intention of exerting control. Even when they do try to exercise influence, it is usually to fight for the rights of minority shareholders.*

Therefore, while recent changes in disclosure requirements, board structure and committees for banks are likely to improve the governance of banks in Singapore, we believe that more substantial improvements in corporate governance of banks will result if institutional investors (including foreign institutional investors) are allowed to hold greater stakes in banks.

In addition to banks, several other companies, such as those within the Singapore Technologies (ST) Group and NOL have increased or removed their foreign shareholding limits. In addition, companies such as the ST units and Singapore Press Holdings, have merged their foreign and local shares. This is a positive development as large foreign institutional investors can become more actively involved in corporate governance of Singapore companies.

2.7. Share Buybacks

[12] This limit is 3% for media companies. In the media release by the MAS dated 17 May 1999, it was stated that "The concern that local banks should give priority to the national interest remains valid.... The requirement to create Nominating Committees, and to have a majority of citizens and permanent residents on the board, will effectively ensure that control of the banks rests with individuals or groups who will act in a manner consistent with the national interest. In addition, MAS will tighten existing safeguards on the accumulation of significant ownership in a local bank". Therefore, the need to prevent local banks from falling into foreign control remains a concern for the Singapore government.

Another development in corporate governance in Singapore is the legalising of share buybacks. Where a company has excess cash and insufficient investment opportunities, share buybacks can be an effective mechanism for company management to return excess cash to shareholders and can therefore reduce the free cash flow problem described by Jensen (1990).[13] Since the legalisation of share buybacks more than a year ago, 11 companies have initiated share buyback programmes. According to a recent report,[14] seven of these companies have experienced increases in stock prices (above the average price at which the shares were bought back).

2.8. Board Responsibilities and Structure

Section 157 of the Companies Act requires directors to act honestly at all times and use reasonable diligence in discharging their duties. In addition, directors are also subject to common law and equitable rules established by cases. Directors have three major categories of duties – fiduciary duties, duties of skill, care and diligence and statutory duties (Woon, 1997). However, apart from these broad duties and responsibilities of directors established by statute and case law, the responsibilities of boards of directors are relatively vague. The SGX BPG is silent on board responsibilities. Indeed, the PWC (1997) survey of companies listed the clearer definition of responsibilities of directors as the most important area requiring improvement.

Clearly, one of the major responsibilities of the board of directors is to monitor management on behalf of shareholders. To perform this role effectively, the board must have some measure of independence from management. Two characteristics of the board that are generally believed to be related to board independence are the separation of the CEO and Chairman roles, and the inclusion of non-executive, especially independent, directors. In both the PWC (1997) and PWC (2000) surveys, both these areas were identified as requiring improvement.

The PWC (1997) survey reported that 17% of companies had 2, 23% had 3, and 60% had more than 3 non-executive directors. However, non-executive directors were seen to be

[13] In Singapore, only profits otherwise available for payment of dividends can be used to pay for shares bought back. The number of shares that can be bought back is limited to 10% of the company's ordinary shares for each relevant period of time, which is essentially the period of time between two successive annual general meetings. Unlike the purchase of treasury stock in the U.S., shares bought back in Singapore must be cancelled and cannot be reissued.

[14] "More firms buying back their shares," The Sunday Times, April 2, 2000, p. 47.

valuable for their contacts, rather than for their independence per se. This raises questions as to the criteria by which these directors are selected. In the case of the separation of the CEO and Chairman roles, 37% of the companies indicated that they already split these roles.

Appendix 1a of the SGX Listing Rules requires companies applying for listing to have at least two non-executive directors who are independent and free of any material business or financial connection with the issuer.[15] Since the Companies Act (s. 210B) requires listed companies to have an audit committee of at least 3 members, with a majority being independent, listed companies are also required to have at least 2 independent directors on the board under the Act.[16] Specifically, the Act, through its audit committee requirements, considers the following directors to be non-independent: executive directors of the company or any related corporation; a spouse, parent, brother, sister, son or adopted son or daughter or adopted daughter of an executive director or of any related corporation; or any person having a relationship which would, in the opinion of the board of directors, interfere with the exercise of independent judgement in carrying out the functions of the audit committee (s.201B(2)). Section 201B(10) further defines a non-executive director as "a director who is not an employee of and does not hold any other office of profit in, the company or in any subsidiary or associated company of the company in conjunction with his office of director and his membership of an audit committee". Although the listing rules and the Act together require two directors who are non-executives of the company or its related companies, not immediate family members, and who do not have "material" financial or business interests with the company, it remains possible for more distant relatives and "grey" directors who have business relationships (such as consultant or lawyer) with the company to qualify as independent directors.

Table 4 shows the board structures of a random sample of 150 SGX-listed Mainboard and Second Board companies, based on their 1998 and 1999 annual reports. We tried to further classify non-executive directors into grey or independent directors, following conventions used in the literature. However, note that our ability to accurately classify non-executive directors as independent or grey is limited by the quality of disclosure of directors'

[15] Chapter 9 of the Listing Manual requires the appointment of directors, CEO, general manager or other executive officers of equivalent rank to be announced to the Exchange, together with demographic information, other past and present directorships, shareholding in company and its subsidiaries, family relationship with any director and/or substantial shareholder of the company or its subsidiaries, any conflict of interests, and serious criminal convictions or civil actions. However, there are no specific provisions for these information to be disclosed in the annual report.

[16] The requirements relating to audit committees are discussed in greater detail in the next section.

background in the annual reports, which is often poor. To classify directors, we relied on any explicit classification used by the company either in the audit committee disclosures or elsewhere in the annual report, related party disclosures in the notes, disclosures of directors' interests in the directors' report, amongst others. A grey director is either one who was not specifically identified as independent in the annual report, who has a relationship with the company that may contravene the concept of director independence in the Singapore context, or who has a relationship with the company that certain overseas jurisdictions (such as U.S.) may consider to be prejudicial to independence. Therefore, our distinction between grey and independent directors should be interpreted with caution. This limitation applies to our classification of independent and grey directors relating to board composition, board leadership and audit committee membership.

The average board size is about 7, with a range of 4 to 15 board members. Subject to the above caveat regarding the classification of independent and grey directors, on average, boards in Singapore have 42% executive directors, 27% grey directors, and 30% independent directors. Therefore, the typical board tends to have a majority of non-executive (grey or independent) directors.

In terms of board leadership, 23% have a CEO who is also the Chairman, 46% have an executive director other than the CEO as the Chairman, 24% have a grey director as Chairman, while 6% have an independent director as Chairman. Therefore, using the traditional definition of unitary leadership (where CEO is also the Chairman), only 23% of companies have this board leadership structure. However, a majority of Singapore companies have a Chairman who is an executive director (either the CEO or another executive director), and very few appear to have a Chairman who is clearly independent.

On the surface, boards of Singapore companies do not seem to exhibit the three features that are considered to be indicative of ineffective boards, i.e., being too large, dominated by executive directors or having unitary leadership (Jensen, 1993). However, the more liberal definition of independence in Singapore compared to countries such as U.S. may mitigate the effectiveness of the board in monitoring management. Further, because the disclosure of directors' background in annual reports, including director independence, is inconsistent across companies and often vague, it is difficult for investors to properly gauge the quality of the board or its independence. The effectiveness of Singapore boards in monitoring management is likely to be further limited by the fact that new directors are

typically nominated or proposed by existing directors, who are often themselves either controlling shareholders or who are affiliated to controlling shareholders. Other problems include the difficulty of removing ineffective directors and appointing new ones due to the large stakes held by directors, family members and passive shareholders, the lack of cumulative voting which may help minority shareholders appoint their own directors, and the weak market for corporate control which results in few board upheavals even when corporate performance is poor. Until recently, boards of local companies almost never have a foreigner. This suggests a failure to tap into the global market for talent at the very senior levels.[17] Because of the heavy concentration of stock ownership, the practice of using nominee (or representative) directors is common. This often contributes to the problem of conflicts of interests, as directors are required by the law to represent all shareholders. In addition, nominee directors can potentially obscure the decision-making process in the boardroom because of their own agendas.[18]

Mak and Phan (1999) also reported on board interlocks in Singapore.[19] The median number of interlocks is 6. Firm interlocks of more than 10 are rare. Hence, from what can be seen, it can be concluded that although interlocking directorates is an extensive phenomenon in Singapore, most companies with interlocks usually maintain only a few. Furthermore, companies that form many interlocks are usually interlocked through only one or two directors on the board, and often involve prominent businessmen and politicians.

Table 4: Board Structures of SGX-Listed Companies (1998/99, n=150)

Board Characteristic	Min	Max	Mean	Median
Board size	4	15	7.3	7
Proportion of executive directors	0.00	1.00	0.42	0.41
Proportion of grey directors	0.00	1.00	0.27	0.25
Proportion of independent directors	0.00	0.80	0.30	0.30
Board leadership - single CEO/chairman[a]	0.23	-	-	-
Board leadership - CEO/executive chairman	0.46	-	-	-
Board leadership - CEO/grey chairman	0.24	-	-	-
Board leadership - CEO/independent chairman	0.06	-	-	-

[17] Recently, several GLCs and banks, such as NOL, SIA, DBS and Keppel-Tat Lee, have announced the appointment of foreigners to board and senior management positions.

[18] Interestingly, the large institutional investors in the U.S. are almost unanimously against the use of representative directors for this very reason.

[19] A board interlock is defined as a dyad of companies in which a director serves. Therefore, there can be more interlocks than directors because each director may serve on several companies, each of which will be counted as one interlock.

[a] Since board leadership is a binary variable, the mean represents the proportion of companies coded as 1 (i.e., having a separate Chair).

Recently, the Government introduced new requirements regarding the composition of the board of directors for banks.[20] Under these requirements, the board of directors of local banks must comprise a majority of Singapore citizens or permanent residents, and must have a majority of independent non-executive directors. In addition, where the bank is not a subsidiary of another bank incorporated in Singapore, the board of directors must have a majority of directors who are not substantial shareholders of the bank and are independent of the substantial shareholders of the bank. Where the bank is a subsidiary of another bank incorporated in Singapore, the board of directors must have a majority of directors who are not substantial shareholders of the parent bank and are independent of the substantial shareholders of the parent bank. In addition, the candidate must be fit and proper for the position and be the best and most qualified candidate nominated for the office, taking into account the candidate's track record, age, experience, capabilities and other relevant factors.

In a recent development, the three family-controlled banks in Singapore (UOB, PUB, and OCBC) announced that they were retiring a total of 10 long-serving directors who are in their 70s.[21] One of these banks, OCBC, is making it a policy that no director over 75 years old will be allowed to sit on its board. Again, this is a positive sign of the changes that are taking place at the board level of local banks.

2.9. Board Committees

Under the Companies Act, all listed companies in Singapore are required to have an Audit Committee with at least 3 members. The majority of the members must be independent directors, and the Chairman must be a non-executive director. The SGX Listing Manual also requires listed companies to have an audit committee. The Best Practices Guide states that a majority of audit committee members, including the Chairman, should be independent of management. A director can be considered as independent if any relationship he may have would not, in the individual case, be likely to affect his exercise of independent judgement.[22]

[20] MAS Notice No. 622, 17 July 1999.

[21] "Younger stalwarts at helm of 3 banks," The Sunday Times, April 16, 2000, p. 2. According to the report, this is taking place two years after the MAS called for local banks to undertake self-renewal at the board level. The age and long tenure of local bank directors have been criticised by investors as making banks slow to react to changes. The report noted that one director had been with the bank for 44 years, another for 27 years, and a third for 17 years.

[22] See previous section for a further discussion of definition of independence under the Act and listing rules.

In the PWC (1997) survey, 44% of the companies indicated that the Audit Committee was primarily responsible for ensuring an effective system of internal control. Further, 23% indicated that the Audit Committee was primarily responsible for detecting fraud.

Table 5 reports the audit committee structure for the sample of 150 SGX-listed companies. Most companies have the minimum of 3 members on the audit committee as required by the Companies Act and SGX Rules. However, 25 of the 150 companies (16.7%) had more than 3 members.[23]

Table 5: Audit Committee Structure (n=150)

Audit Committee Characteristic	Min	Max	Mean	Median
Number of Members[a]	2	7	3.18	3
Proportion of Executive Directors[a]	0	0.5	0.22	0.33
Proportion of Grey Directors	0	1	0.17	0
Proportion of Independent Directors	0	1	0.61	0.67

[a] Based on the 1998 annual reports, 2 companies had an audit committee with only 2 members, after the resignation of one of the members. In one case, the independent chair resigned, resulting in an audit committee size of 2 members, with 1 being independent.

Apart from the Audit Committee, neither statute nor listing rules contain requirements for other board committees. The exception is the recently introduced requirement for local banks to form a Nomination Committee and a Compensation Committee.[24] The Nominating Committee must comprise of five board members to be approved by the MAS. This Committee is responsible for identifying individuals and reviewing nominations by the board or shareholders for the following positions: Board membership, the Executive Committee of the Board, the Compensation Committee, the Audit Committee, the Chief Executive Officer / Deputy Chief Executive Officer / President / Deputy President, and Chief Financial Officer. Since three of the five local banks are family-controlled (the other two being government-controlled), there was a prevailing view that board members and senior executives of the family-controlled banks were traditionally chosen from families and relatives of the

[23] Based on the 1998 annual reports, 2 companies had an audit committee with only 2 members, after the resignation of one of the members. These companies were therefore temporarily not complying with the requirement of the Companies Act and the SES Listing Rules which require an audit committee with at least 3 members, a majority of whom must be non-executive and independent.

[24] MAS Notice No. 622 specifies the requirement for local banks to have a Nomination Committee and a Compensation Committee. It also specifies the size, composition, functions and duties of the Nomination Committee, and the size and composition of the Compensation Committee.

controlling shareholders. The Compensation Committee must have at least 3 members of the Board, a majority of whom are not employees of the bank.

Apart from the Audit Committee for listed companies, and the Nomination and Compensation Committees for banks, companies are not required to form other board committees. An exception is the committee responsible for administering the Employee Share Option Scheme (ESOS). Under the SGX Practice Note No. 9h, companies having an ESOS have to form a board-level committee, and to disclose the members of this committee in the annual report. Not surprisingly, therefore, by far the next most common committee disclosed by companies in the annual report is the Compensation Committee, including the committee responsible for the ESOS (or its equivalent). Forty-two companies (28%) reported the use of this committee. However, the functions of the Compensation Committee in Singapore may be more limited than in other countries, because they are often formed to administer the ESOS as required by SGX rules. The next most common committee reported is the Executive or Management Committee. Examples of other committees reported were Nomination Committee, Finance Committee, Investment Committee, Policy Committee, Strategy Committee, Risk Management Committee, Credit Committee, Management Development Committee, and Y2K Committee, but these were relatively uncommon.

In the PWC (1997) and PWC (2000) surveys, the introduction of remuneration (compensation) and nomination committees were both identified as areas requiring improvement in Singapore.

2.10. Board and Senior Management Compensation

Under the SGX Listing Rules, companies are only required to disclose, for the current year and the previous year, the number of directors whose remuneration falls within the following bands: Below $250,000, $250,000-$499,000, and $500,000 and above.[25] Our survey of 150 1998/99 annual reports found that all 150 companies reported remuneration using these three bands. Table 6 shows the distribution of directors whose remuneration falls within each band.

Table 6: Proportion of Directors Within Each Remuneration Band (n=150)

Remuneration Band	Min	Max	Mean	Median
Below $250,000	0	1.00	0.76	0.80
$250,000-$499,000	0	1.00	0.16	0.13

[25] The SGX had briefly introduced the requirements for detailed disclosures of individual directors' remuneration, which were subsequently withdrawn.

$500,000 and above	0	0.75	0.08	0

The Companies Act (s. 164A) states that 10% of shareholders of the company or shareholders in aggregate holding at least 5% of the company's shares can require the company to provide an audited statement of individual directors' remuneration. However, to our knowledge, this requirement has never been invoked by shareholders. As reported above, 28% of companies report the existence of a Compensation Committee. However, there is little disclosure as to how the level and mix of director remuneration is determined. Therefore, disclosure relating to directors' remuneration (including the process by which the level and mix of compensation is determined) is poor.

One other issue relating to compensation is the remuneration of employees or management (who are not directors of the company) but who may be related to directors or controlling shareholders. This is an important issue especially for family-controlled companies where family members may be employees or managers, but not directors of these companies. The current rules on disclosure of directors' remuneration will not cover the remuneration of these employees or managers.

2.11. Incentive Compensation

In recent years, many Singapore companies have adopted employee share option schemes (ESOS) as a means of compensating directors, managers and employees. However, most companies only issue options to senior management and directors, although there have been several recent instances of the adoption of broad-based ESOS that include stock options for lower-level employees. Stock options can be an effective tool for aligning the interests of managers/employees and shareholders and provide a stronger link between pay and performance, and therefore perform an important corporate governance function. However, as many writers have noted, providing proper incentives through stock options requires a well-designed ESOS. Further, as the recent U.S. experience indicates, stock options can be controversial as they are often seen to lead to an inflation of executive compensation. Further, questionable practices such as repricing options can mitigate the incentive effects associated with options.

Since the cost of options are not required to be reported as compensation expense in the income statement, companies often see stock options as being costless and as a means for shifting compensation expense off the income statement, by substituting it for cash

compensation. Clearly, stock options are not costless because they lead to a dilution of earnings per share and shareholders' interests.

Preventing abuse in the use of options requires transparency in the determination of option award and disclosure of the cost of options. In Singapore, ESOS are subject to rules in the SGX Listing Requirements (Practice Note No. 9h) and the Companies Act 1990. The Companies Act (s. 201) requires the number and class of shares for which options are issued, date of expiration of the options, and basis upon which the options may be exercised to be disclosed in the directors' report. The maximum expiration term of options is 10 years.

The SGX Rules relate to matters such as exercise price, expiration terms, vesting periods, total size of the scheme, number of options issued to particular individuals, participation in ESOS, and administration of the ESOS. In general, options are to be issued at the market price. However, options may be issued at a discount of up to 20% provided they have a minimum vesting period of 2 years and are approved by shareholders. Controlling shareholders and their associates who are directors or employees may participate in the ESOS provided it is approved by independent shareholders for each person. Award of options to controlling shareholders, awards to employees receiving in aggregate 5% or more of the options, and aggregate number of options to be made available for grant have to be approved by independent shareholders. For Main Board companies, the number of shares available under the ESOS must not exceed 15% of the issued share capital. There are also limits on proportion of options that may be issued to controlling shareholders and to each individual participant. The ESOS has to be administered by a board-level committee (see earlier discussion).

In the annual report, the name of each participant who is a director, controlling shareholder or who receive 5% or more of the total number of options available must be disclosed, together with the number and terms of options, aggregate number of options issued since commencement of the ESOS, aggregate number of options exercised since commencement, and aggregate outstanding options.

In a survey of 158 companies listed on the SGX in 1995, 51% had share option schemes in place (Ching and Mak, 1999). However, shares issued to directors and executives under these schemes constitute only a small fraction of the total share capital of companies, the maximum percentage being 2.7%, and the mean (median) percentage being 0.2% (0.1%). Of the 80 companies that have option schemes, 68.4% (55) only required the options to be held for a minimum period of one year. For these companies, options can be viewed as a mechanism primarily for rewarding short-term performance. Based on a study of 94 SGX-

listed companies that had adopted share option schemes between 1986 and 1997, Tan, Mak and Ng (1999) reported that, although the adoption of these schemes was associated with positive stock price reaction, they did not lead to higher long-run stock price or operating performance.

In Singapore, the use of vesting schedules, whereby only a portion of the options issued can be exercised each year, and other features such as indexing of the exercise price, are very rare. There appears to be a need for directors to pay more attention to the design of ESOS, how option awards are determined, and to ensure adequate disclosure of the determination and cost of options.

2.12. Disclosure and Accounting

The disclosure of information is covered by several chapters and appendices in the SGX Listing Rules. Chapter 9 requires immediate announcements to the SGX for any information necessary to avoid the establishment of a false market or which would be likely to materially affect the price of the company's securities, including appointment or resignation of directors and senior management, appointment of special auditors, appointment of auditors, general meetings, acquisitions and disposals, winding up, and earnings and dividends. It also requires half-yearly and annual reports. Chapter 9A requires shareholder approval and immediate announcement of interested party transactions. Chapter 12 requires companies to disclose to the SGX, shareholders and other security holders, as soon as reasonably practicable, any material information that is necessary for them to appraise the position of the group, is necessary to avoid the establishment of a false market in the securities, and which might reasonably be expected to materially affect the market activity or price of the securities. Examples of events that may require disclosure include joint ventures, mergers and acquisitions; declaration of dividends; earnings announcements; stock splits; litigation; and tender offers.[26] Appendix 11 covers the contents of annual reports.

In the PWC (1997) survey, 20 out of 75 respondents (27%) did not have a formal policy for the release of price sensitive information, although 6 have some formal controls in place. Only 18 companies (24%) had publicised their policy to all staff. However, formal announcements were found to be well controlled.

[26] Section 103 of the Securities Industry Act deals with insider trading, and applies where an insider has access to information that is not generally available but if available, would be likely to materially affect the price of the securities. Sections 104 and 105 impose criminal penalties and civil remedies for insider trading.

In the case of financial reporting, as mentioned earlier, SAS are identical to IAS in most cases, although there are occasional deviations and omissions. A notable departure from IAS is the Singapore accounting standard dealing with extraordinary items, which still follows the previous IAS.[27] As a result, companies commonly treat items such as profits from the sale of investments or assets as extraordinary, and banks usually treat loan provisions as extraordinary rather than operating items. In addition, it is not uncommon for companies to change their accounting policy for such items in order to manage their reported operating profits. These practices introduce a lack of comparability of financial statements over time and across companies.

One of the recurring criticisms of East Asian economies during the crisis has been the low quality of accounting standards and their enforcement. While Singapore is always ranked among the best in terms of corporate disclosure in this region, disclosure and enforcement of accounting standards in Singapore still lag significantly behind more developed economies, such as U.S. and U.K. A study by Goodwin and Seow (1998), in which they examined the annual reports of 94 Singaporean companies from 1994 to 1996, concluded that compared to U.S. firms, disclosure practices of Singapore corporations were poor, although they were better when compared to their South Asian counterparts. In the PWC (1997) survey, 27% of companies admitted that disclosures in their annual reports only meet minimum requirements, and a further 51% stated that their disclosures exceed the minimum by a little. Only 11% of the respondents stated that they strive for full disclosure and transparency. The PWC (2000) survey reported that greater disclosure and transparency in the annual report and financial statements were ranked as the most important area where improvements should be made. Greater disclosure of directors' dealings with related parties and greater frequency of company reporting were ranked as the second and fourth most important areas.

The relatively poorer disclosure levels in Singapore can, in our view, be partly attributed to the merit-based philosophy to regulation that was practised in Singapore. Under this philosophy, regulators rather than shareholders largely determine the merit of transactions, and the role of public disclosure is limited. Further, standard-setting and enforcement in Singapore is largely left to a professional accounting body that does not face close scrutiny from a regulatory agency, as the FASB does from the SEC in the U.S.

[27] The revised IAS on extraordinary items was released as an exposure draft and subsequently withdrawn by the ICPAS.

One improvement in disclosure that has been introduced is the shortening of the publication of the annual report from 6 months to 5 months. There also appears to be considerable support for the CFC recommendation of quarterly reporting by listed companies, compared to the half-yearly reporting currently required.

However, one sector that has seen a considerable improvement in disclosure is the banking sector. Given the extent to which the banking sector has been implicated in the financial crisis, it is not surprising that one of the first tasks undertaken by the FSRG was a review of banking disclosure. The Committee on Banking Disclosure released its report in May 1998 **(**Report on Banking Disclosure).

In terms of banking disclosure, the more significant improvements that have occurred include:

(a) discontinuation of the practice of maintaining hidden reserves,
(b) provision of details on loan loss provisions,
(c) disclosure of off-balance sheet items in notes to accounts, and
(d) disclosure of significant exposures.

With the raising of disclosure standards, disclosure practices of Singapore banks are now comparable with the requirements of international accounting standards. However, commentators have noted that disclosure practices of Singapore banks are still below those of U.K./European and U.S. banks.[28] The government has indicated that a further review of the banking sector is imminent, one of the objectives being to further enhance disclosure by banks.

The ICPAS has also undertaken to review Singapore Accounting Standards to ensure that they are at least comparable to the requirements in International Accounting Standards (IAS). In addition, it has undertaken to adopt IAS on a more timely basis. Further, one of the three private sector-led committees formed by the MOF/MAS is reviewing disclosure and accounting standards. Its terms of reference are to: (a) review the process by which accounting standards, maintained and regulated in Singapore compared to overseas jurisdictions, (b) review SAS with a view to aligning them with IAS, or higher, as a matter of policy except where there are special reasons to deviate, and (c) review the approach, development and promotion of best practices in disclosure requirements amongst publicly-listed companies in Singapore. These initiatives may help raise disclosure standards among Singapore companies in the near future.

[28] See Chua, K.C. and Lian, W.C., "A milestone in bank disclosures", The Business Times, May 27, 1999, p. 15.

2.13. Internal Auditing and Control

In the PWC (1997) survey, 77% of companies reported that they have an internal audit function or share one with a related company. Seventy-one percent of these companies outsource this activity. In two-thirds of the companies that have an internal audit function, this function reports solely to the Audit Committee, while in 13% of these companies, the internal audit function reports to both the Audit Committee and executive management. This is different from the common practice in the U.S. of the internal audit function reporting to both the CEO and the Board of Directors, usually through the Audit Committee. Twenty percent of respondents see the internal audit function as having primary responsibility for ensuring an effective system of internal control, and 23% of respondents see it as having primary responsibility for detecting fraud.

The PWC (1997) survey indicated that, in terms of primary responsibility for ensuring effective internal control, the most important was the Audit Committee, followed by the CFO, Executive Directors and then the Chairman and/or CEO. In terms of detecting fraud, the CFO was the most important, followed by the Executive Directors and then the Audit Committee.

2.14. External Auditing

The external auditor is another important element in the system of corporate governance. He/she lends credibility to the financial statements prepared by management, so that users of the statements can rely on their fairness and completeness.[29] Moreover, the existence and process of mandatory annual audits can have salutory effects on management actions and accountability.

The effectiveness of the external auditor as a corporate governance mechanism depends on the quality of the auditor (independence and expertise), the quality of the audit (audit planning, procedures and communication), and the enforcement of standards by a regulatory body.[30]

---

[29] The credibility of financial statements will also depend on the quality (or credibility) of the prevailing accounting standards.

[30] The academic and professional literature has collectively referred to these as "(generally accepted) auditing standards". However, a more restrictive usage of "auditing standards" is employed later in the body text above.

In Singapore, a Public Accountants Board was set up under the Accountants Act of 1987 (revised 1998) to register and regulate public accountants who include external auditors. Applicants for registration must satisfy requirements in regard to professional examination, post-examination experience, pre-registration course on ethics and professional practice subjects (no examination), and proficiency in local laws.[31] The Board is also empowered to regulate the professional conduct and ethics of public accountants and to hold disciplinary inquiries and mete out punishments if necessary. In this regard, the Board has issued a Code of Professional Conduct and Ethics (Third Schedule to the PAB Rules), which lays out fundamental principles and more specific principles on pertinent issues such as independence, use of designatory letters, advertising, fees and confidentiality.

Under the Code, a public accountant or his firm cannot be appointed as an external auditor of a company if:

1. he or his immediate family holds a significant beneficial interest, directly or indirectly, in shares of the company (significant = 5% or more for public companies and 20% or more for private companies); or
2. for the year immediately preceding prospective appointment, he was an officer or employee of the subject company, or was a partner of such person(s); or
3. he has a direct or indirect material financial interest in the company.

The above requirements of the Code are specific and fairly stringent in setting minimum benchmarks for the ("appear to be") independence of external auditors. In contrast, section 8 of the Code of Ethics for Professional Accountants put out by the International Federation of Accountants (IFAC) are similar in spirit to the Singapore Code but lacks specification of thresholds. However, the IFAC Code does provide a more comprehensive listing of situations that are increasingly common in practice and which may impair ("actual") auditor independence, such as provision of other services to audit clients, materiality of fees, former partners and long association of senior personnel with audit clients. The IFAC Code has not been adopted by the ICPAS of which all Singapore public accountants are members. Instead the ICPAS has its own Code of Professional Conduct and Ethics, which are almost identical to the statutory Code applicable to public accountants.[32]

---

[31] Approved professional examinations are the final examinations of accountancy degree programmes at local universities or the final examinations of professional qualifications such as ACA and CA. Post-examination experience must be at least two years if it is "structured practical experience" and at least three years if otherwise.

[32] The ICPAS Code is intended to apply to all its members, which include non-public accountants.

The Board also has the authority to prescribe the standards, methods and procedures to be followed by public accountants. To date, the Board has not issued any such standards itself. Instead, both the Board's and ICPAS' Codes require public accountants to observe the professional and technical pronouncements of the ICPAS. With regard to external auditing, ICPAS (more specifically, its predecessor the Singapore Society of Accountants) issued Statements of Auditing Guideline (SAG) and Statements of Auditing Practice (SAP) in the early 80s. SAGs are guidance statements on generally accepted auditing practices and on the form and content of audit reports. SAPs deal with the detailed work or acts which the auditor has to carry out in accordance with the guidelines set out in the SAGs. The SAGs and SAPs are based on the International Guidelines on Auditing and Related Services issued by IFAC. Following IFAC, the SAGs were codified in 1997 and are now referred as the Singapore Standards on Auditing (SSAs) to better describe their authority. However, the SSAs are strictly professional and not legal pronouncements — failure to comply is a disciplinary and not a legal breach.

At this current time, there are 31 SSAs, 27 SAPs and 1 Exposure Draft for a SSA, and they are mostly equivalent to their international counterparts. Given the increasing globalisation of business and investments, this equivalence is a welcome feature, and enhances the international credibility of the external audit as a corporate governance tool in Singapore. In the same vein, foreign investors are likely to be more confident of audit reports on listed Singapore companies because the market for external auditing services is dominated by the Big 5 in Singapore. For our sample of 150 SGX-listed companies, only 12 (8%) did not have a Big 5 auditor.

Nevertheless, in the PWC (1997) survey, 27% of respondents indicated clearer definition of the role of external auditors as requiring improvement. In the PWC (2000) survey, 23% of institutional investors felt that this was an area requiring improvement. We suggest that these responses should be carefully analysed with a view to improving the corporate governance effectiveness of external audits.[33]

[33] The expectation gap is an ongoing concern to the auditing profession all over the world — the public's expectations for audits greatly exceed its perception of auditor's performance. According to the MacDonald Commission Report (1988) in the U.S., this gap can be broken down into the standards gap arising from expectations and the performance gap arising from perceptions of performance. Some of the public's expectations are reasonable and the profession should strive to meet them or be prodded to do so by the relevant authorities. However, some expectations may be unreasonable stemming from the public's lack of understanding of the audit function and its inherent limitations — these expectations can only be addressed by better communication and education. As for the performance gap, some of the public's perceptions of performance shortfalls are real and these shortfalls should without doubt be speedily punished. On the other hand, some perceptions may not be real because the public has the "mistaken assumption that fraudulent

2.15. Investor Relations

In our survey of 1998/99 annual reports and company websites, we found that only 8 out of the 150 companies identified an investor relations, corporate communications or equivalent function. This suggests that Singapore companies generally do not place significant emphasis on communication with investors. It is only very recently that analysts' briefings and conference calls are starting to be used more widely by companies. Another difference between the attitude of corporate management in Singapore and say in the U.S. is the relative lack of emphasis on "managing" market expectations, for example, through correcting analysts' forecasts. It is very common for companies, even fairly large ones, to announce earnings that take analysts completely by surprise. Some commentators have called for better communication with analysts and investors. In contrast, in the U.S., companies often make disclosures prior to mandatory announcements in order to correct market expectations, and often this occur when the news is adverse. This practice probably reflects the highly litigious environment in the U.S. where investors may sue management for not making timely disclosures.

In the PWC (1997) survey, 57% of the respondents restrict dealing with enquiries from media, analysts and shareholders to one person, and the three most important persons for doing this are the Chairman, CEO/MD and the CFO. Although 49% of companies indicated that they have a formal procedure for dealing with investor complaints, again responsibility for this rests largely with operating management. Again, the questionnaire surveys suggest that investor relations and communications are not an important priority for Singapore companies.

3. SUMMARY AND CONCLUSIONS

In summary, significant proposals have been made to improve corporate governance in Singapore. Examples include the improvement of disclosures by banks and other listed issuers, the creation of a single securities regulator with wide powers, the improved ability of investors to take civil action against insider trading, and the greater flexibility in using share option schemes to align the interests of shareholders and management of companies. Many of

---

financial reporting (and, by implication, an audit failure) is involved whenever there is a business failure" (O'Reilly et al, 1990). Such perceptions will also have to be addressed by better communication and education.

these proposals have been implemented. Other financial sector developments such as the development of the funds management industry are likely to further enhance corporate governance in the future. The development of the local fund management industry could increase the role of fund managers in corporate governance in Singapore, and overseas evidence generally suggests that such institutional investors play an important role in enhancing shareholder value. Finally, in recognition of the importance of corporate governance, the SGX, with support from the MAS, instigated the formation of the Singapore Institute of Directors (SID) in May, 1998. The Institute, governed by a Council comprising industry leaders and government representatives, is a voluntary association registered under the Companies Act. It is modelled after the British Institute of Directors and is chartered to improve and professionalise the practice of directing in Singapore companies. With the help of experts from industry and academia, the Institute has developed a director certification program modelled after the British and Australian IODs. Directors of newly listed companies and those wishing to obtain membership in the Institute may participate in this program in order to enhance their directing skills and knowledge. The objective of the SID is to eventually require all directors of mainboard listed companies (as is now the case with London Stock Exchange listed companies) to be certified by coursework. If similar experiences in the U.K. and U.S. can be generalised, the institutionalisation of directorship in Singapore will raise the level of awareness of directors' legal and moral responsibilities, professional conduct in the boardroom, and standardise the implementation of legal remedies for shareholders seeking redress for fraud and other corporate malpractices.

However, based on the review of corporate governance practices and disclosures in the previous section, we believe that further changes are necessary in order for corporate governance in Singapore to meet the standards in more developed economies such as Australia, U.S. and U.K. The following are some of the possible changes that can be considered:

1. Developing a comprehensive Code of Corporate Governance that encompasses both principles and best practices. Currently, in the absence of a comprehensive Code, corporate governance disclosures in annual reports are unsatisfactory because most companies continue to disclose only the minimum information required to comply with laws, regulations and standards. Such a Code may be based on existing Codes developed overseas, but with due recognition of unique characteristics in the Singapore environment, including the dominance of government-controlled and family-controlled

companies, the weak market for corporate control, and the absence of active institutional investors who can develop their own codes and actively participate in corporate governance. Clearly, such a Code should strike a balance between accountability and enterprise. Corporate governance guidelines that are voluntary, but which requires disclosure and explanations of non-compliance, are generally preferable to detailed listing rules, laws and regulations that mandate a "one size fits all" approach to corporate governance. Too many detailed prescriptions on corporate governance also go against the spirit of a disclosure-based philosophy to regulation, and will take us back to the merit-based philosophy.

2. Strengthening the regulatory and institutional framework, including improved enforcement of company and securities laws, listing rules, codes of best practices, and accounting and auditing standards. This would require not only rewriting laws, rules, codes and standards, but also improving the functioning of institutions responsible for enforcing them (e.g., companies and securities regulator, and accounting profession). This is especially important given the shift towards a disclosure-based philosophy to regulation, where shareholders are expected to take a more active role in evaluating the merit of transactions and in enforcing their rights.
3. Encouraging the development and more active participation of private sector institutions and third-party watchdogs, such as institutional investors, investment managers' and shareholders' associations, news media, and institute of directors. Market forces, rather than regulation, are we believe the best method of improving corporate governance in Singapore in the longer term. For example, in the U.S., critical news items on corporate governance matters (such as executive compensation) and scorecards on executive compensation, board of directors, and corporate governance in general provide, in our view, good market pressure on companies to adopt sound corporate governance practices.
4. Even though there have been some concerns about the lack of separation of ownership and management amongst Singapore companies, we do not believe that attempting to control the shareholding structure of companies, for example by restricting ownership by particular shareholders, is an effective mechanism for improving corporate governance. Consistent with this argument, we also believe that restrictions on share ownership in banks and media should be re-examined. Other mechanisms, such as golden share arrangements, can be used to "protect the public interest", where necessary. However, in view of the weight of evidence on the superiority of private ownership over state ownership in terms of corporate governance, and other costs of state ownership that have

recently being highlighted (such as stifling of private enterprise, perception of government interference), we believe that the Government should re-consider the role of government ownership. Although government ownership appears to be have served us well over the last 30 to 40 years, questions have been raised as to whether such a model can enable Singapore companies to compete in the global economy.

In addition, improving the efficiency of the market for corporate control and a continuing push toward liberalisation of markets will further enhance the functioning of external corporate governance mechanisms.

3.1. Global Convergence and Corporate Governance in Singapore

There are signs of some global convergence in corporate governance practices. There are a number of factors driving this convergence. First, globalisation and liberalisation give rise to the integration of financial markets, spurred by the recognition by both investors and issuers of the benefits from international diversification. This has in turn led to a greater global push for sound corporate governance practices. For example, CalPERS, the third largest pension fund in the world, has developed its own global governance principles, which it actively encourages its investee companies to adopt. Globalisation of products and services markets, and liberalisation of these markets, will also create pressure to adopt sound management practices to improve efficiency.

Second, there is a certain degree of convergence in companies and securities laws and regulations worldwide. Many Asian countries are moving towards U.S.-style securities regulations and enforcement. There is also increasing impetus for the adoption of international accounting standards, with many influential inter-governmental and regulatory agencies calling for the speeding up of acceptance of these standards. At the present time, the International Accounting Standards Committee (IASC) has largely completed its development of core international accounting standards, which are now being considered by the International Organisation of Securities Commissions (IOSCO).

Third, major inter-governmental bodies such as OECD, World Bank, IMF, and ADB have pushed for corporate governance reforms in Asian economies, and "rescue" packages offered by the World Bank, IMF and ADB often come with the requirement to reform corporate governance. The OECD has developed a set of Principles of Corporate Governance, and together with the World Bank, has initiated a Global Corporate Governance

Forum to push for the adoption of these principles. These principles have support at the Ministerial Level among OECD and many non-OECD countries.

Finally, technology is also likely to accelerate the convergence through the ability to use the internet to trade international securities, disseminate corporate information, disseminate proxy voting advice and decisions, and voting.

We believe that corporate governance in the future in Singapore will be influenced by the global convergence in corporate governance, as Singapore sees itself as being an international financial centre and Singapore companies become increasingly international.

3.2. Barriers to Improvements in Corporate Governance

We believe that there are a number of barriers to improvements in corporate governance in Singapore. First, it remains to be seen whether current and proposed securities and company legislation, and the general legal framework in Singapore, can accord adequate protection to minority shareholders. In the absence of such protection, ownership in Singapore is likely to remain heavily concentrated with significant ownership by executives (and their families), which violates the separation of decision management and decision control and leads to the inefficient sharing of risks. With significant concentration of ownership among individuals who are either managers or relatives of managers (especially for smaller listed companies), matters such as related party transactions and insider trading will remain a concern.

Second, it is likely that the impact of global convergence (discussed in the previous section) will be most keenly felt by larger companies that operate internationally and access international financial markets. Many smaller listed companies have little need to access capital markets, either domestically or internationally. Although poor corporate governance may translate to poor share price performance, these companies may continue to adopt minimal, rather than internationally acceptable, corporate governance practices. This is especially so as the threat of hostile takeovers (usually triggered by a poorly-performing stock price), which is often seen as an effective "last resort" disciplinary mechanism, is not likely to be significant in Singapore.

Third, the continued participation of the government in many private sector firms reduces the exposure of these firms to competitive markets and creates moral hazard problems through implied performance guarantees. Given the perceived need to use these government-owned companies as tools for economic development and regionalisation of the domestic economy, we are doubtful that Singapore will move towards a model of corporate

ownership in which the government does not own significant equity in private sector firms. If the government continues to own significant equity in these firms, there is an urgent need to improve the accountability, management and monitoring of these government-owned companies. Temasek Holdings Limited, the government holding company for GLCs in Singapore, has acknowledged concern with monitoring of GLCs. It has signalled a more active future role in the governance of GLCs, including greater scrutiny of diversification plans, closer vetting of board appointments, and encouraging the separation of the CEO and chairperson roles in GLCs. However, it remains to be seen whether these changes will lead to improvements in the governance of GLCs.

Fourth, the shift towards a disclosure-based regime, which emphasises greater disclosure and shareholder monitoring, implies significant changes in the corporate governance environment. As discussed above, we believe that this will require significant changes in the way accounting standards are set and accounting rules enforced (including the need for a strong independent accounting body), stronger securities regulations and enforcement, greater shareholder activism (especially by institutional investors), and other third-party watchdogs such as analysts and the financial press. We believe there is some way more to go before these can be sufficiently developed and for Singapore to successfully move towards a disclosure-based environment.

Finally, a major problem is that under the merit-based philosophy to regulation that was practised in Singapore, the emphasis was on compliance with rules and regulations set by regulatory and quasi-regulatory agencies. Under this environment, companies were conditioned to disclose the bare minimum as required by rules and regulations, and no more. Since the merit of transactions was frequently determined by regulators rather than by shareholders, there was little benefit from companies disclosing more to shareholders. Moving to a disclosure-based philosophy to regulation requires a significant change in mindset by both companies and shareholders. Companies must be prepared to disclose more, and shareholders must be prepared to exercise their rights and participate more actively in corporate governance. Recent surveys continue to indicate that companies favour minimal disclosure, and we do not as yet have active institutional investors or investors' associations able to effectively participate in corporate governance. There is a danger that inertia will cause companies to comply with the rules (as they did in the merit-based environment) rather than responding to the market demand for disclosure and good corporate governance (as is required in a disclosure-based environment). For example, we have recently seen several

cases of companies changing their ESOS practices in line with the relaxation in the SGX rules, but it is rare to find a Singapore company following what are considered best practices in ESOS overseas (such as using vesting schedules, transparency in how option awards are determined or cost of options awarded, and using indexed or out-of-the-money options). Further, as strict rules are relaxed in the spirit of a disclosure-based environment, one can question whether shareholders in Singapore are willing or able to play a more active role in corporate governance at the present time. There are some disconcerting signs that as the SGX and other regulatory agencies take a more hands-off approach in line with the disclosure-based environment, some Singapore companies continue to practise questionable corporate governance because of the lack of adequate shareholder monitoring to replace the reduced played by regulators. It can be argued that the merit-based approach to regulation that was practised in Singapore for so long reflect the cultural, social and economic environment in Singapore (including the significant concentration of ownership among the Government and families). Although a disclosure-based philosophy to regulation is we believe the right path to take, and is inevitable given the globalisation of markets, much remains to be done if we are to have a corporate governance environment that is comparable to international standards in the next millennium.

REFERENCES

Ching, J. and Y.T. Mak (1999). The Adoption and Structure of Stock Option Plans: An Empirical Study of SGX-Listed Companies, *FBA Working Paper*, National University of Singapore, Singapore.

Eng, L.L. and Y.T. Mak (1999). Ownership Structure, Board Structure and Corporate Disclosure, *Eleventh Asia-Pacific Conference on International Accounting Issues*, Melbourne, November 21-24, 1999.

Fama, E.F. and Jensen, M.C. (1983). Separation of Ownership and Control, *Journal of Law and Economics*, 26, pp. 301-325.

Goodwin, J. and Seow, J.L. (1998). Disclosure Relating to Board Members: Shedding Light to Build Investors' Confidence, *SGX Journal*, August, pp. 6-12.

Jensen, M.C. (1993). The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems, *The Journal of Finance*, 47(3): 831-880.

Jensen, M.C. and Ruback, R.S. (1983). The Market for Corporate Control: The Scientific Evidence, *Journal of Financial Economics*, 11, pp. 5-50.

La Porta, R., Lopez de-Silanes, F., Shleifer, A. and Vishny, R.W. (1996). Law and Finance, *NBER Working Paper #5661*, Washington D.C., USA.

La Porta, R., Lopez de-Silanes, F., Shleifer, A. and Vishny, R.W. (1998). Agency Problems and Dividend Policies Around the World, *NBER Working Paper 6594*, Washington D.C.

Lam, S.S. (1997) Control Can Be Costly: A Lesson to Learn About Imposing Restrictions on Foreign Share Ownership, *FBA Working Paper*, National University of Singapore, Singapore.

Li, J. (1994). Ownership Structure and Board Composition: A Multi-country Test of Agency Theory Predictions, *Managerial and Decision Economics*, 15, pp. 359-368.

Lim, G.H. (1997). Guaranteeing Local Control, Dual Listing, Foreign Share Premiums, and Tranche Merger, *FBA Working Paper*, National University of Singapore, Singapore.

Lim, S.C. and Mak, Y.T. (1999). Ownership Structure, Board Structure and Corporate Diversification, *FBA Research Paper Series #99-83*, National University of Singapore, Singapore.

Macdonald Commission Report (1988). *Report of the Commission to Study the Public's Expectations of Audits*. U.S.

Mak, Y.T. and Y. Li (1998) Ownership Structure, Investment Opportunities and Board Structure. *FBA Working Paper*, National University of Singapore, Singapore.

O'Reilly, V.M., M.B. Hirsch, P.L. Defliese, and H.R. Jaenicke (1990). *Montgomery's Auditing*. 11th edition. John Wiley & Sons, U.S.

PriceWaterhouseCoopers (PWC) (1997). Survey of Corporate Governance in Singapore.

PriceWaterhouseCoopers (PWC) (2000). Corporate Governance: 1999 Survey of Institutional Investors.

Prowse, S. (1998). Corporate Governance in East Asia: A Framework for Analysis, *Working Paper*, Federal Reserve Bank of Dallas, Dallas, Texas.

Shleifer, A. and Vishny, R.W. (1997). A Survey of Corporate Governance, *Journal of Finance*, 52, pp. 737-783.

Tan, S.K. and Mak, Y.T. (2000). The Impact of Large-Block Shareholders on Corporate Performance, *FBA Working Paper*, National University of Singapore, Singapore.

Tan, R.S.K., Mak, Y.T. and Ng, W.C. (1999). The Impact of Employee Stock Option Scheme Adoption, *FBA Working Paper*, National University of Singapore, Singapore.

Vernon, R. and Aharoni, Y. (1981). *State-Owned Enterprise in the Western Economies*, St. Martin Press, New York, USA.

Woon, Walter. (1997). *Company Law*, Pearson Professional Asia Pacific, Singapore.