Corporate Governance And Financial Crises: Lessons From Singapore's Public Sector

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INTRODUCTION

In the aftermath of the 1997 Asian crisis, international institutions (most notably the International Monetary Fund, IMF) encouraged East Asian corporations to subscribe to the Anglo-American system of corporate governance and privatize the state-owned enterprises (SOEs). This begs the question: Are The Private Sector Corporate Governance Practices Really Effective? The high profile corporate scandals in the 2000s affecting the western private sector corporations raised serious questions about the effectiveness of private sector style of corporate governance. In many cases, corporate managers failed in their fiduciary duties to shareholders. The global financial crisis that began in the United States in December 2007 and *"reached gale-force intensity in 2008"* **(Roubini and Mihm, 2010: 238)** demonstrated the rampant weakness of the incentive schemes where banks' executives could get rich very quickly at the expense of the shareholders.

Although a great deal of the literature examines corporate governance in the private sector, only rarely do studies mention the role of governance in the public sector. There have been recent attempts to call for private sector organizations to emulate good practices from the public sector **(Osterloh and Frey, 2000; Benz and Frey, 2007; Frey and Benz, 2005)**. Noting the weaknesses and failures of private sector corporate governance practices as illuminated in Enron, WorldCom and others, **Frey and Benz (2005: F378)** argue that, *"Corporate Governance (in the private sector) can learn from public governance, in the sense that institutions devised to control and regulate the behavior of actors in the public sphere can give new insights into how corporate governance practice can be improved"*. Consequently, the present study examines the basis of which public sector style of corporate governance in Singapore can be transferred to the private sector. Singapore is selected on the premise that it is often regarded by international rating agencies as one of the most well governed countries in the world. Understanding its public sector governance practices is crucial, particularly the large state-owned organizations such as Temasek Holdings Limited[1].

It should be mentioned at the outset that this paper is not advocating a blind acceptance of public sector practices per se. Public sector organizations, in the first place, rarely participate in the market for corporate control, and hence, they are less subjected to unwelcome bid for control. In addition, public administration exists because there are services in which the market simply could not and should not provide. Public goods-related industries offer a good illustration. The purpose of maximizing the social values and public interest is ,therefore, a distinguishing feature of the public sector organizations. Nevertheless, a case can be made to emulate at least some of the good practices of the public sector. While some of the lessons, such as paying competitive salaries, are not exclusively practiced nor originated in the public sector, it is useful to observe progress and innovations that the public sector has made over the years, and assess their implications for the private sector.

AN OVERVIEW OF THE FINANCIAL CRISES AND CORPORATE SCANDALS

When the Asian crisis hit in 2007, there was a great deal of attention placed on microeconomic reforms, particularly in the area of corporate governance. The Eurocentric view of the IMF prescribed the Western model to the affected economies, including privatization of the SOEs, on the basis that the Asian crisis was caused by crony capitalism and dominant state interference in industrial policy. Reporting on 29 April 2000, The Economist noted how, *"Asia's tycoons are coming under pressure to adopt a more 'western' style of business. The change is gradual, but Asia's companies have started to shift away from their old patriarchal cultures and towards those prevailing in America or Britain"* **(quoted in Yeung, 2007: 92)**. The structural reforms in Asian countries such as Indonesia, South Korea and Thailand focused on the transfer of the *'corrupted'* version and bank-based system to a market-based, with a greater

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reliance on the capital markets to finance corporate development. The consultants engaged by foreign donors (the IMF inclusive) promoted the *'international best practices'* modelled after the Anglo-American governance style as the measures for the governments. For **Hamilton-Hart (2006: 266)**, this option appears to be the safest for the consultants to *"seek reemployment"*.

However, the corporate scandals in the 2000s, involving some large private organizations like Enron, WorldCom in the United States and Parmalat and Royal Ahold in Europe, shook confidence in the Western style of corporate governance. In many cases, corporate managers failed in their fiduciary duties to shareholders **(Jensen, 2003; Clarke, 2005)**. The scandals showed that while putting in place the external monitoring mechanisms was necessary, they were not sufficient to prevent improper practices by the agents. The Enron debacle, for instance, took place despite Enron being monitored by no less than eight gatekeepers and monitors. Yet, few, if any were able to identify any wrongdoings **(Branson, 2003)**. Remuneration committee members succumbed to peer group comparisons and ended up paying their executives the going rate or brought them into the top quartile **(see Bender, 2003)**. Enron relentlessly pursued profits and got away with overstating profit and revenue figures - a result of a complex web of special-purpose mechanisms that managed to keep losses out of the company's net profit calculation and to keep debt off its balance sheet.

The scandals were largely associated with unethical practices of top level managers (such as Kenneth Lay and Jeffrey Skilling in Enron and Bernie Ebbers in WorldCom). Because they wielded substantial power, such leaders enticed others, including external parties such as the auditors, to collaborate with them. Their political contributions to the United States political system further enhanced their position with the political elites. It is unfortunate that the narrative prescription of raising the corporate governance standards in the West has paid little attention to the question about *'who runs the show'* but instead focuses on the functions, tasks and responsibilities of corporate executives. There seems to be a blind acceptance of CEOs as heroes at least in the 1990s. In the name of value creation, many had profited personally although the creation of value was really *"a result of general share price movements driven by rhetoric and middle class savings pattern"* **(Erturk et al, 2004: 691)**. In theory, the firms' shareholders and board of directors could put a stop to improper practices. In reality, the financial system that started to emerge in the late 20th century was opaque and complex for shareholders to react decisively and there were conflicts of interest among the board of directors to come out with decisions that could effectively align the interest of the shareholders and those of other stakeholders.

The recent global financial crisis that resulted from the bursting of the housing market bubble in the United States has been regarded as the most severe crisis since the Great Depression. **Clarke (2010)** cited four corporate governance causes of the 2007/2008 crisis:

(1) Deregulation : The dismantling of the 1932 Glass-Steagall Act (in 1999), which separated commercial banking from investment banking and insurance services and created big institutions capable of taking excessive risks;

(2) Failure Of Rating Agencies As Gatekeepers : Many failed to monitor rigorously the growth of financial markets but instead *"became junior partners in enterprises"* **(Clarke, 2010: 24)**;

(3) The Traditional Risk Metrics As Value At Risk (VaR) Failed To Alert Business Leaders Of The Credit Crisis: *"The reality is that innovation in financial products has far exceeded the capacity of risk management measurement and monitoring tools to gauge risk"* (*ibid*);

(4) Incentivization : Where compensation for staff at financial institutions commensurates gross revenue without proper account taken of the quality and sustainability of the earnings. The executives were driven by the necessity to maximize shareholders value, and focus on short-term gains measured by quarterly profits and stock market valuation rather than long-term development. This resulted in the executives taking excessive risks such as borrowing many times over the capital base to take over companies (leveraged buy-outs) to boost profits. Moreover, the executives have the incentive and the tools to design compensation packages that benefited themselves at the expense of the shareholders. Private corporations deceived the shareholders by moving risk off the balance sheet, making it difficult for people to assess it.

To **Kirkpatrick (2009: 1)**, the 2007/2008 financial crisis was attributed to the failures and weaknesses in corporate governance arrangements which *"did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies"*. **Kirkpatrick (2009)** cited several companies, including Citigroup, Bear Stearns and

Lehman Brothers, that hired past executives as board members, turning boards essentially into retirement homes. Strict compliance in the private sector corporations to recruit independent directors in their boards (as imposed on listed companies in Sarbanes-Oxley Act) further led to the appointment of less-than-qualified persons in the financial and accounting fields, prompting **Kirkpatrick (2009: 23)** to conclude that "*the issue is not just about independence and objectivity, but also capabilities*".

THE CASE FOR EMULATING PUBLIC SECTOR PRACTICES

To promote the Western line of thinking, international institutions often prescribe the *"global standards"* for the developing countries. Privatization, for example, is a popular recommendation to serve as a remedy in the context where private sector corporations are more efficient than the state-owned enterprises (SOEs). It is situated in the belief that the SOEs are ill-suited to lead the development agenda and ,therefore, ought to be replaced and displaced by private sector firms. It is true that SOEs have had a fair share of failures resulting in the extensive call for privatization. But clearly, labeling SOEs as totally ineffective is naïve.

In the first place, SOEs in countries like Taiwan, South Korea and Singapore have bucked the common perception about inefficiencies in the management of public corporations. **Feng Sun and Tong (2004) and Ang and Ding (2006)** concluded that the Singaporean SOEs had performed at least on par with non-SOEs of matching size. Because the SOEs are typically large players in their respective industries, they have the ability to influence (raise) the corporate governance standards of other SOEs as well as non-SOEs. In Mainland China, SOEs such as Chery Automobile, Baosteel, Chinalco and Shanghai Electricare are market leaders in technology, cost control, design and marketing, which are areas of traditional strengths for private sector corporations **(Bardhan, 2010)**.

Empirically, privatized firms had not always performed better than SOEs as in the case of the Czech Republic and Russia **(Black et al, 1999)**, particularly in those services that were generally regarded as core government responsibilities by most governments and liberal theorists **(Funnell, Jupe and Andrew, 2009)**. **Letza et al (2004)** argue that privatization, as a vehicle for efficiency gains is a *"myth"*. Besides ownership, many factors, ranging from political, economic, legal, social and cultural can have a profound effect on firm efficiency and long-term growth. Using a sample of United States corporations, **Kole and Mulherin (1997)** noticed that the performance of SOEs did not differ significantly from that of private sector. "*Merely transferring a public enterprise into a private firm*", according to the authors, *"is not sufficient to improve performance' but requires the 'existence to competitive markets, external valuation, and internal evaluation and incentive devices to monitor the managers of privatized firms"* (*ibid*: 17). **Milward and Parker (1983)** also found no systematic evidence to suggest that public enterprises are less cost effective than private firms. **Grossman and Hart (1980)** show that even with the threat of takeover in the private sector, the agency problem cannot be deterred. A potential takeover of a firm may fail simply because the shareholders decided not to tender their shares and prefer to *'free ride'* if they think that share price would rise after the takeover. It is, therefore, inconclusive as to whether private sector style of governance necessarily leads to an efficient solution for organizational success.

Would it be appropriate for private sector corporations to emulate at least some aspects of governance practices from their counterparts in the public sector? To answer this question, it is prudent to compare the public and private sector style of governance because the notion of transferring practices of one type of firms to another has to be based on the premise that both are confronted with similar problems.

Following **Weber's (1991/1946)** classic work *'Bureaucracy'*, it can be argued that public and private management are fundamentally alike. Weber showed that the characteristic form of modern organization was bureaucratic. *"The principle of hierarchical office authority is found in all bureaucratic structures as well as in large party organizations and private enterprises. It does not matter for the character of bureaucracy whether its authority is called private or public"* (*ibid:* 197). **Nobel Laureate Herbert Simon** further asserted that profit making firms, non-profit organizations, and bureaucratic organizations were equivalent in their critical dimensions in the sense that they all faced *"exactly the same problem of inducing their employees to work toward the organizational goals"* **(Simon, 1991: 28)**. Simon added that there was *"no reason, a priori, why it should be easier (or harder) to produce this motivation in organizations aimed at maximizing profits than in organizations with different goals"* (*ibid*).

It has also been argued that imperfect information exists regardless of the type of sector one refers to. In private sector markets, as **Joseph Stiglitz (1998: 13)** points out, *"The buyer is never sure whether the seller is willing to sell because of inside information which lets the seller know that the buyer is overpaying, or whether there are grounds for a mutually beneficial exchange*[2] *"*. Similarly, *"In politics, there is often a generalized skepticism about proposals offered by an adversary that leads politicians to think that anytime an adversary makes a proposal, it must involve the adversary benefitting at their own expense" (ibid)*. Market imperfections have led to a renewed interest in the study of principal-agents relations, covering areas such as tax evasion, corruption and creative accounting.

While there are some bases for comparison, it is important to note that in terms of organizational goals, unlike the private corporations, public organizations are not motivated by profit. There is much debate about profit maximization being the primary objective for private corporations. Some of the concerns that have been raised include the tendency for executives to focus on short-term profits and the lack of considerations of the risk profile of investment initiatives. Finance scholars have emphasized the need to think about maximizing shareholders value, which essentially raises the importance of thinking long term and sustainable development, which are more closely associated with the objectives of a typical public organization. With this in mind, the following section shall examine the governance style of the Singaporean public sector, and ascertain to what extent it can offer some lessons to raise the standard of corporate governance in private corporations.

THE CASE OF SINGAPORE

Singapore has been labeled as quintessential development state **(Low, 2001)** where the state's legitimacy is derived from its ability to develop the country economically[3]. Political support for the ruling party, the People's Action Party (PAP), has been overwhelming to the extent that the party is generally seen as synonymous with the state **(Hill and Lian, 1995: 34-35)**. The downside to this was the creation of the *'government-knows-best'* society, where the state is deemed capable to resolve problems and safeguard the assets to the extent that information pertaining to assets of some state enterprises is largely hidden from the public[4].

Much has been said and written about governance in the city state, and they shall not be repeated here other than to point out that the principles of governance, namely incorruptibility, meritocracy, rationality, use of economic incentives and markets, pragmatic and result orientated have been recognized as the governance fundamentals **(Neo and Chen, 2007; Quah, 2010)**. Shaped by the founding leaders of the PAP, the principles have created the culture and ethos of the Singaporean public sector where the various government entities work in a coherent manner with predictable behavioural patterns. With recruitment in the public sector selected on merit, not race or ethnicity, the persons' economic and moral values are going to be judged globally, and not by citizenship, rendering it even more important to be seen as incorrupt.

Comparatively speaking, the city state's public sector has an impressive record. According to the World Bank's *'Governance Matters'* report, Singapore obtained a score of close to 100 for five of the six categories of the quality of governance[5]. In 2009, Transparency International (TI) ranked Singapore as the 3rd least corrupt economy. Hong Kong based Political & Economic Risk Consultancy (PERC) Limited has ranked Singapore as the least corrupt country since its inception in 1976. However, the fact remains that Singapore is *not the least corrupt* country in the world. The TI, for example, has considered Singapore to be relatively more corrupt than Finland. **Tiihonen (2003)** explained that in the case of Finland, appointment of someone from outside the public administration to high positions is unusual. This is not the case for Singapore. Courting talented individuals from the private sector and retaining them is a common practice in Singapore's public sector. This situation can lead to a conflict of interests.

Nevertheless, it remains clear that the governance standard in the Singaporean public sector has out shined many other economies in the Asia Pacific region. Two features of public sector governance in Singapore are namely

(1) Identification and recruitment of clean and capable agents and

(2) Adoption of pay for performance principle are worth studying in greater detail.

❁CLEAN AND CAPABLE AGENTS

The selection of people in the Singaporean public sector follows the principle of meritocracy. The methodology of selection is not confined to educational and professional qualifications - as potential candidates have to go through high-powered interviews and written tests as part of the selection process to assess their character and attitude[6]. In this regard, the selection process of Public Service Commission (PSC) scholars is a relevant illustration to show how public servants are recruited (the scholars are often groomed to take up leadership positions in the Singaporean public sector).

In a speech delivered to junior college students, PSC Chairman Eddie Teo listed integrity as the most *"vital"* quality of a public servant, pointing out that, *'while pragmatism may be a key concept for governance in Singapore, it is dangerous to have Singapore governed by public servants who are unprincipled pragmatists'.*[7] A person with integrity, according to Teo, is someone who challenges the rule if they go against his values and principles although he stresses that, *"how he challenges the rules is also important, for it reveals how shrewd and street-savvy he is"*. To sift out persons with integrity, the PSC relies on the schools and psychologists, the latter in particular, as they are trained, *"To determine whether the candidate has strong values which he is not afraid to express or uphold even against peer pressure"*. Trait theorists have similarly identified integrity as one of the most important traits associated with leadership. However, traits alone are not sufficient to identify effective leaders since traits ignore the interaction between the leaders and the group members as well the leaders' ability to make good decisions under various circumstances and situations **(Kirkpatrick and Locke, 1991; Judge et al, 2002)**.

To promote principled pragmatists, the Singaporean administration inculcates the mentality that having an efficient and clean administrative government is a must and not an option to build the economy. Public value is strengthened through codes of conduct, detailing, for example, with the way Ministers and Members of Parliament (MPS) deal with gifts and how they should carry out their directorship duties in private corporations. In reality, however, it is not easy to monitor their behaviour because of asymmetric information, such as, whether MPs holding directorship in public listed companies were able to draw the line between their private and public position. It remains important to establish the codes so as to bind the behaviour of the public officers to the stated codes. The public sector could persuasively point to the set of codes when it imposes punishments or warnings on those who do not comply.

Selecting *'clean'* agents is clearly essential and this remains a challenge regardless of whether one considers the public or private sector corporations. Equally important is the issue of recruiting capable persons. Corporate scandals in the 2000s and the recent global financial crisis revealed that strict compliance in the private sector corporations to recruit independent directors in their boards (as imposed on listed companies in Sarbanes-Oxley Act) had actually led to the appointment of less-than-qualified persons in the financial and accounting fields. Misrepresentation of financial statements was not spotted, while risks were often miscalculated.

In Singapore's public sector, the appointment of key officers is largely confined to two categories of people. **Firstly**, there were the *'trusted'* individuals from the civil service. **Worthington's (2003)** study, for example, found that the public sector in Singapore dominated SOEs directorship accounted for more than 70% of the directorships in 1991. In 1998, the public sector representation increased as it accounted for 74% of the representation in the SOEs. Such an arrangement would have violated the United States law where a majority of the board members must be independent of the companies. Secondly, the Singaporean public sector casts its nets wide to identify and recruit capable persons from the private sector. Former Minister for Finance, Richard Hsu was formally an executive at Shell in the early 1960s before he was recruited by the Monetary Authority of Singapore. Former Prime Minister, Goh Chok Tong was with Neptune Orient before taking up positions in various ministries. **Hamilton-Hart (2000)** argued that the clean and efficient Singaporean government was attributed to the *"mixed public-private sphere than makes up the governing elite"*, referring to elite private sector individuals such as S. Dhanabalan, Chandra Das, Ho Kwon Ping, Joseph Pillay and Michael Fam Yue Onn, who had close association and a good understanding with the way the public sector works. These individuals moved back and forth between the public and private sectors, and were often found on the boards of the private and privatized SOEs firms on the Singapore Exchange.

The arrangement has produced some positive results. For example, based on a study of 30 Singaporean SOEs covering the period 1964 to 1998, **Feng, Sun and Tong (2004)** found no evidence that the SOEs under-performed as compared to non- SOEs of matching size. In addition, SOEs were found to perform as well as the market and industry averages even before share issue privatization took place. Using a sample ranges from nine SOEs in 1990 to 25 in 2000 and the corresponding number of non-SOEs from 68 in 1990 to 204 in 2004, Ang and Ding (2006) compared the financial and market performance of Singaporean SOEs with non-SOEs and found that the former had higher valuations and better corporate governance standards than a control group of non-SOEs. The authors argued that the higher standards of corporate governance in SOEs was attributed to effective monitoring role of Temasek, including the appointment of Board members who come largely from the civil service and SOEs, limiting the tenure of Board members to six years and fostering non-duality status.

It can be argued that the appointment of trusted individuals from the public and private sectors helps to facilitate the flow of quality information since many of them have experienced quite similar style of working, and a powerful source of reward and punishment since the information comes from individuals known personally **(Granovetter, 2005)**. As **Jackson (2001: 26)** points out, *"It is precisely the pooling of know-how over a range of actors encompassing public and private societal actors which comprises the advantage of networked systems over traditional, hierarchical decision-making structures"*. Handpicking personalities to lead public sector corporations does not seem to pose the usual problems of government owned enterprises, but in fact may have contributed to Singapore's success in general and the public sector in particular.

To recapitulate, the presence of capable leaders with strong moral values is undoubtedly a determining factor of organizational success. Asia, through Chinese classics such as Confucius and Lao Zi, has long focused on the person, the values and the character of the leader. The West, on the other hand, focuses on the functions, tasks and responsibilities of the leader by putting in place good corporate governance, controls and transparency **(Wee, 2010)**. The corporate scandals in the 2000s and the financial tsunami that hit Wall Street showed that transparency and corporate governance could not stop massive cheating, frauds and scandals from taking place. The episode, as **Wee (2010: 45)** succinctly pointed out, told us that, *"It is not the sound structures, systems, processes and controls that caused the catastrophe"* but, *"the lack of the integrity, moral values and character among corporate leaders that caused the disaster"*. In this regard, an understanding of Singapore's approach in selecting leaders may be a useful exercise since Singapore integrates the best of the East and the West. This section shows that the public sector assures itself of the integrity of key executives by appointing trusted individuals. The relevance to private sector organizations is that the process of incorporation into senior positions could be selective based on informal recognitions of the individuals' capability, supplementing the conventional indicators like performance in education or prior success in business.

REMUNERATION

The Obama administration blamed the compensation practices as one of the significant causes of the 2007/2008 stock market meltdown. The incentives for short term gains overwhelmed the checks and balances meant to lower the risk of excess leverage[8]. For example, AIG sold insurance on events that investment companies such as Lehman Brothers collapsed yielding large revenues and profits in the short run. In the long run, when the inevitable occurred, companies like AIG nearly went bankrupt. Following a large nationalization program of private sector organizations in response to the 2007/2008 global financial crisis, public sector representation in the boards of directors is likely to become more significant. The way civil servants were remunerated in successful public sector organizations might serve as useful point of reference in rewarding private sector executives.

Frey and Benz (2005), Benz and Frey (2007) and Osterloh and Frey (2002) suggested awarding employees based on seniority and with fixed compensation as commonly practiced in the public sector so as to allow agents to concentrate on work content. With the arrangement in place, individuals who were intrinsically motivated would be attracted to the organization while minimizing rent seeking activities like manipulating the performance standards to reap short-term gains. On the contrary, tying the wage to a performance measure created an incentive for the agents to take action even if the action was irrelevant or adversely affected their total contribution to the organization.

Intrinsic motivation certainly has its merits particularly in situations of incomplete contracts and when financial goals were not assignable to operational goals for employees **(Osterloh and Frey, 2002)**. However, extrinsic motivational measures should not be dismissed too easily. A wage premium, for example, is necessary to entice the agents to exert more effort and provide some form of insurance to the risk averse agents. There is no overarching evidence to suggest that the underlying motive of the pay for performance principle is flawed. A system that pays the executives who have created value for the organization is a good thing - to raise productivity, motivate and reward agents, curb corruption and create value for the corporations. The motivational effects are often cited as the main agency-based justification for spending more of the firm's resources on executive pay[9]. Otherwise, managers manage their firms with a risk averse attitude, retaining free cash flow to the maximum level possible. The real challenge is to design a pay system that avoids penalizing agents unnecessarily for being distracted with ethical dilemmas, yet assures that they do not that avoids penalizing agents unnecessarily for being distracted with ethical dilemmas, yet assures that they do not succumb to short term temptations.

In Singapore, competitive salaries serve as a useful deterrent against improper practices. Senior civil servants in Singapore are paid salaries of up to 70% to 80% of what their equivalents are earning in the private sector. Salaries are set high to attract people of calibre in joining the public sector, and not the private sector. Although as a monopsonist hirer of jobs that do not have close substitutes in the private sector (such as intelligence officers, soldiers and judges), paying competitive salary is still important in Singapore's context as a means to combat corruption and find enough people to fill the senior positions. A White Paper on *"Competitive Salaries for Competent and Honest Government"* was published in October 1994, stating explicitly the way Senior Civil Servants (and Ministers) would be compensated to peg to the average salaries of top four earners in the private sector professions; accounting, banking, engineering, law, local manufacturing companies and multinational corporations. In a speech delivered in Parliament in June 2000, former Prime Minister of Singapore, Goh Chok Tong, argued, *".....that Ministers' pay is a source of envy for some people is not necessarily bad. We are more likely to recruit good Ministers in this way. I would be extremely worried if it were the reverse. If Ministers envy pay of their counterparts in the private sector, that is the first step towards corruption (sic)"*. Foreign commentators like **Tanzi (1998)** have also applauded the government's decision to pay competitive salaries to public officers. However, paying high salaries cannot guarantee that public officers would replace illegitimate income with legitimate income. Other factors like the opportunity to engage in improper practices and pattern of government appointments during the colonial period matter as well **(Quah, 2010)**.

It is useful to note that stock options plan type of compensation is avoided in the public listed Singaporean SOEs. Temasek's Chairman Dhanabalan (2002) was critical of the plan, noting that:

"As the executives' personal wealth was so closely tied to their companies' share prices, not surprisingly, they had a keen interest in share prices and became very obsessed with maintaining stock market performance even in the short run. ... With management having an increasing part of its fortune tied to the stock price, the obsession with short-term price movements is compounded. The temptation to dress-up results to ensure that the stock continues to perform is almost irresistible".

Temasek's stance is that performance based incentive system is a necessary and Economic Value Added (EVA™) is particularly favored to judge the financial performance of Temasek portfolio of companies. In his rebuts to arguments that Singaporean SOEs had lower *returns to equity* than their private equivalents, Dhanabalan responded that Temasek *preferred* judging the SOEs through the measure of EVA™. In Dhanabalan's words, *"We encourage them (Temasek-Linked Companies) to put in place compensation schemes that are tied to EVA, so that performance and compensation of the management is tied together"*[10].

A distinctive feature of civil servants rewards in Singapore is that they comprise of the basic monthly salary, monthly variable component and year-end bonuses. The adjusted salary structure of the civil service in Singapore includes the variable component that is even larger than the recommended size of 30% where as much as 40% of the civil service pay package consists of the variable component[11]. The variable component is less uncertain and volatile as compared to that received by typical executives in the private sector (for example, through stock options) because the latter requires business executives to make more risky decisions. The year-end variable component, which accounts for about 20% of the yearly wage cost, is tied to the long-term performance of the organization.

A recent speech by Temasek CEO Ho Ching revealed the compensation structure of the 100% state owned investment company. Temasek, as Ho Ching (2009) explained, has a compensation framework that was *"geared towards a strong alignment with long-term shareholder value"* so that the employees would *"think owner, act owner"*, and *"work as one team"*. To support this ideal, Temasek leans heavily towards having, *"a well balanced compensation structure which would reinforce a one-team culture, and an incentive philosophy which puts the institution before self, emphasizes long-term over short-term, and aligns employee interests with that of the shareholder"*. The employees' bonuses are linked to a process called wealth added such that in the event where the wealth added registered a positive value, the employees get a wealth added bonus. Incentives for senior management could be deferred between three and 12 years, some of which are subject to market risks, and the rise and fall of Temasek's total shareholder returns. Some parts of the deferred component could be totally wiped out if the organization delivers below the cost of capital target, a feature known as *'clawback'* that is tied to the long-term sustainable performance of Temasek. It should be noted, however, that being a financial entity, it is generally easier to assess the financial performance of Temasek using financial indicators and associate them accordingly with the executives' remuneration.

Incentive scheme that is similar in principle to the one applied at Temasek has been suggested by **Raghuram Rajan (2008) and Richard Posner (2009)**. To them, a substantial portion of executive compensation should be back loaded and tied to the future performance of the firm. Hence, as **Roubini and Mihm (2010: 187-188)** put it succinctly, firms should *"average their performance over the course of several years"*. If a trader's risky bets yield outsize returns one year an equally outsize losses the next, the trader will *"receive a nice bonus in the first year and nothing in second"*. By contrast, the *"under a longer time horizon, the losses would cancel out the profits, and the trader would get nothing at all"*. The United States Federal Reserve is considering imposing rules of that sort, including the requirement for banks to link bonuses to long-term rather than short-term performance to ensure banks' soundness although the industry players are fighting bitterly against these changes. The general belief is that people respond to incentives. The thing to avoid is the creation of strong but misguided incentives, which have played a fundamental role in causing the global economic crisis of 2007/2008.

CONCLUSION

The Asian financial crisis, corporate scandals in the 2000s and the global financial crisis that started in December 2007 have one thing in common - corporate managers in private corporations failed in their fiduciary duties to shareholders. They were motivated by self interest and outright greed than the desire to maximize the long term interest of the corporations and shareholders. This paper suggests the possibility of private corporations emulating some of the good practices of public sector organizations. That the two types of organizations are different in terms of goals is a common knowledge. What is lacking in appreciation is the fact that they are also confronted with very similar problems, rendering comparison between the public and private sectors and emulation of one another's practices possible. By examining closely the incentive mechanisms and leadership appointment in public organizations in Singapore, this article highlights progress and innovations that these organizations have made over the years, and assesses their implications on the private sector. To summarize, Singapore places a premium in selecting clean and capable leaders to lead the public organizations. One of the measures includes appointment of trusted individuals from the civil service. Singapore also establishes incentive-based system to align managers' interest with that of the *'shareholders'*. A worthy lesson is its emphasis on sustainable growth by pegging the executives' remuneration to the organizational long-term performance. From the academic standpoint, scholars have long focused on governance practices in the private sector that are invested with Western ideals. They should cast their views more widely and seek inspiration from practices in the public sector. Future research in corporate governance should evaluate the importance of public sector style of governance in Asia and elsewhere in this new light.

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NOTES

[1]Temasek Holdings Limited, the Singaporean SOH, was established on 25 June 1974 to assume the role of the state-owned institutional investor. It tracks the performance of the various investments and companies and appoints directors and chairmen to the boards of various companies. The objective of Temasek is to maximize the long-term shareholder value, with the shareholders being the citizens of Singapore (Ho, 2004). Hence, Temasek differs from a typical publicly owned firm which may have objectives other than profit maximization. However, Temasek, being a large sovereign wealth fund, has the ability to influence the corporate governance standards of SOEs as well as non-SOEs.

[2]Stiglitz was referring to the 'lemons' problem first studied in a seminal paper by Akerlof (1970). Referring to used cars as 'lemons', Akerlof analyzes the question of why a one-year old with low mileage could cost so much cheaper than new cars. The answer lies in the quality of old cars that are offered for sale and known almost exclusively by the sellers.

[3]Singapore gained independence from British rule on 9 August 1965. The real Gross Domestic Product (GDP) has grown at an average of 8.1% (1965-2008), with the real per capita GDP rising from S$4,668 in 1965 to S$46,255 in 2008.

[4] It remains unclear of the percentage contributions of the SOEs to Singapore's GDP, which can range from 12.9% (government's estimate) to 60% (from the United States, State Department, 2001).

[5] The scores are reported in percentiles. A score of 99 means that the country has beaten 99% of all other countries measured for that category. For details, see Governance matters, The World Bank (http://info.worldbank.org/governance/wgi/index.asp)

[6]Former Prime Minister Goh Chok Tong links entry requirements of a politician to that of professionals such as doctors who have to be trained for a long period of time. Hence, "should we not insist on similar training and certification for those who look after our countries and our lives?" (Goh, 1985: 35).

[7]What the PSC wants in its scholars, *The Straits Times*, 25 July 2009.

[8]See Cheffins (2009: 32).

[9]See, for example, Jensen and Murphy (1990).

(Contd. On Page 54)