

TEMASEK HOLDINGS

Sustainable State-Owned Enterprises – Why Governance Matters

[Salutation]

Introduction

- 1 First, I would like to thank Khazanah Nasional for inviting me to speak at its annual Megatrends Forum. It is good to be back in Kuala Lumpur to have another chance to catch up with many friends I have made over the decades.
- 2 Today, allow me to share with you some thoughts and perspectives on the role of the state in the economy and in particular governance of State Owned Enterprises (SOE)

State-owned Enterprises in Context

- 3 In practically any economy, the state has, and continues, to play an important role. In the 19th and 20th centuries, two major models emerged to influence the global economy. In the capitalist model, the private sector was the generator of wealth and prosperity and the role of the state was to be a catalyst and enabler. In the communist model, the state controlled all factors of production to create a utopian class-less society. In between we had the mixed economies which tried to combine both approaches with varying degrees of success.
- 4 Of course we all know what happened to the communist model, and hence my remaining remarks will focus on the capitalist model and its variants which are now the undisputed models of economic development.

- 5 As the private sector became the dominant force in how an economy is organised, did the state completely withdraw from it? Not really. In Scandinavia, the state continues to be an owner of assets and sees its role beyond that of a mere enabler.
- 6 In the post-colonial world, many newly-independent countries felt a strong political need to regain control over their economies from former colonial masters, and to rapidly industrialise. Post-independence India followed a socialist model, stifling its vibrant private sector, and only in the late 1980s did it begin to change. In Singapore, the government in promoting fast growth of the economy and rapid industrialisation shared the risk with investors in start-ups and became a shareholder in key enterprises which formed the initial portfolio of Temasek, as I will explain later. Here in Malaysia, where the British dominated the pre-independence commodity-driven economy, the government launched many initiatives including establishing Bank Bumiputra in 1965 and the Heavy Industries Corporation of Malaysia (HICOM) in 1980.
- 7 Even in Britain – and I cite this as an example because Malaysia and Singapore were both under British colonial rule and our economic and legal systems are a legacy of that period – the government remained a key influence. In 1938, the British Parliament passed the Coal Act and nationalised access to a key resource. In the 1950's, Britain's Conservative government attempted to nationalise the steel industry and eventually succeeded when British Steel Corporation was created in 1967 under a Labour government. In the United States, arguably the most powerful private-sector led economy, the state remains involved: Congress created Fannie Mae in 1938 during the Great Depression and in 1970 Freddie Mac was added as a “government-sponsored enterprise.”

- 8 I cite these examples not to pass any political judgement but to emphasise that behind each of these political acts, there were clearly defined objectives– at least initially – that were subservient to profit-maximisation. In Britain it was access to key resources and job creation; in the U.S. it was to expand home ownership and the home mortgage market. In Singapore and Malaysia, the objectives were to promote economic growth and redistribute wealth.
- 9 What lessons can we draw from these experiences? One is clearly that state ownership is neither unusual, nor detrimental per se. Problems emerge when non-commercial objectives or motivations are not clearly defined and made transparent. Problems also emerge when these institutions with non-commercial objectives are structured as commercial institutions with governance structures which attempt to be commercial. The blurring of commercial and non-commercial objectives often erodes whatever public-good reason that the state had for its involvement in enterprises in the first place. The public and other stake holders in these enterprises get confused over the nature of the animal, with the result that they are seen to be always wrong in their actions. An example is the British coal mines. When Margaret Thatcher moved to deal with the perennial loss-making coal mining companies, there was outrage. The mining labour leader, Arthur Scargill stated it well when he said that the mines existed to provide employment and not to produce coal at an economic price. He was not being facetious but stating the conventional view among the miners.
- 10 After years of making losses, British Steel was eventually privatised by Margaret Thatcher's government in 1988 amid massive protests and strikes by labour unions which stood to lose the most from a change in ownership. In India, state-owned

enterprises became a conduit for political patronage and most neither provide public service efficiently, nor can they survive without the state's financial patronage. In the U.S., Fannie and Freddie had their credit standards set aside for political reasons and had to be taken over by the government in 2008 and a review of their operations is underway.

- 11 The bad reputation of state owned enterprises is as much from the experience of these enterprises in the capitalist economies of the west as it is from the command economies of the communist countries. In fact, the decades of the 1980s and the 1990s were dominated by the privatisation of loss-making state enterprises in non-Communist economies, a process which still continues today across the developed and developing worlds.

Governance in State-owned Enterprises with commercial objectives.

- 12 I want to focus in the rest of my remarks on enterprises which have been set up by governments with commercial objectives, to make sustainable profits by making the most efficient use of the resources allocated to them. Successful private sector businesses have flourished partly because they have focused on governance and not profit-maximisation alone to ensure success. Without a focus on governance, an enterprise can still be profit-making but it probably won't be sustainable.
- 13 In the case of state-owned enterprises, in a vast majority of cases, both profit-maximisation and appropriate governance are missing – even in the developed world.
- 14 The major challenge in governance of state owned enterprises is to find ways that ownership will not inhibit commercial motivation. Once a state enterprise is set up with a commercial objective, all

the parties involved – i.e. the owner, which is the state and the Board and management must pursue that objective consistently. The bottom-line is that if a state-owned company – and its owner – is not commercially-minded, no matter what the government does to support it, it will remain unsustainable over the long term.

- 15 The government should fundamentally act as an informed and active owner, establishing a clear and consistent ownership policy. It should also ensure that the governance of these enterprises is carried out in a transparent and accountable fashion, employing the necessary degree of professionalism and effectiveness.
- 16 In doing so, the state should avoid interfering in operational matters, and respect the independence of the Board, or a similar authority. Moreover, the state should strive to be consistent in its ownership policy and avoid modifying the overall objectives too often. A clear, consistent and explicit ownership policy will provide a state-owned enterprise, the market and the general public, with predictability and a clear understanding of the state's objectives as an owner as well as of its long-term commitments.
- 17 In some countries, state-owned enterprises have indeed been subject to high levels of governance, just like their private sector counterparts. In the U.K., for example, state-owned enterprises are set up as Companies Act companies and have the same reporting requirements as all registered companies as set out in the Companies Act and in conformity with U.K. accounting standards.
- 18 In Sweden, state-owned enterprises are in fact required to adhere to the same accounting standards as public listed companies. The approach is based on the argument that their ultimate owner

is the general public, so that they are even more 'public' than public companies. They hence follow specific guidelines for external financial reporting.

- 19 Many state-owned enterprises in OECD countries also publish bi-annual reports which could include interim financial statements, information on capital expenditure, reports on operations, as well as discussion on the evolution of strategy and changes in overall operating conditions.
- 20 Let me now touch briefly on Temasek's governance model and how I see it being sustained over the long-term. We don't claim to have in possession a magic formula or that we have an ideal model. We are still a work in progress. . .

The Genesis of Temasek

- 21 Temasek Holdings was incorporated in 1974 as a company wholly owned by the Ministry of Finance of the Singapore government. The seeding of Temasek was set against the backdrop of Singapore's rapid industrialisation starting in the early 1970s. The Government decided in the early 1970s that its role should also evolve. It had to take a more macro view of the economy and of policy formulation, rather than that of a venture capitalist. Thus, Temasek was birthed, allowing the government to separate its role as a policy maker, from one which saw it as an owner of businesses.
- 22 Temasek took over ownership of and responsibility over a mixed bag of new investments and start-up companies, which the investment promotion agency, The Economic Development Board (EDB), had invested in to share the risk with the investors, both local and foreign. When the EDB ceased industrial financing in 1968, these shareholdings were taken over by the Ministry of

Finance. These formed part of the initial shareholdings transferred to Temasek. Other government investments such as Singapore Airlines and shipyards like Keppel Shipyard and Sembawang Shipyard which the government had established were also in the initial portfolio of Temasek. Many became successful and were listed in the 1980s, though Temasek did retain significant shareholdings in a number of these companies. Later, the government also corporatized public sector activities like telecommunications, power generation and transmission and port operations as part of its program to exit the management of businesses. These were also all transferred to Temasek in the 1990s.

- 23 The objective of this exercise to form Temasek to take over all these government investments was established very clearly from the start. The government wanted to prioritise and focus on policies which would promote businesses and economic development and did not want its ownership of businesses to distract it from this primary task. It wanted the companies in which it had shares to be professionally managed and adopt a commercially disciplined approach to investments and managing businesses. It did not want to get involved in the management of companies operating in the market.
- 24 Though initially the Chairmen and most Board members and even part of management in most of these companies were civil servants it was clearly established from the start that they were to be managed without interference from the political leaders or the policy makers. Many of the board members were serving Permanent Secretaries and other top civil servants. But they were given the sole responsibility to run these companies. The Minister

for Finance as a shareholder did not interfere. He confined himself through a government committee to deciding who should be on the boards of these companies, and clearly the financial performance of the companies was a key consideration in making these appointment decisions. But as I will explain, even this role has been relinquished by the Minister for Finance since the late 1990s

25 With this mandate, the Boards in turn recruited the necessary management and ran the businesses, by expanding and diversifying the business according to what was best for the company. So they bought and sold businesses all based on the decision of the management. Market forces and market opportunities shaped the activities of these companies and not the agenda of policy makers or politicians. This principle of running the businesses according to market imperatives and market opportunities has become even more pronounced as the Board and management of Temasek and the Temasek Linked Companies now comprise individuals who hail overwhelmingly from the private sector. This does not mean that the government has given up its right as a shareholder. On the contrary, as with any shareholder, it seeks periodic reports from the Board of Temasek on the financial performance of the company and information on the strategy to grow and improve Temasek's performance. It however stops short at getting involved in the investment, divestment and other business decisions of the company. These are the responsibilities of the Board and management of Temasek. Nor does it require reports from the Temasek Linked Companies.

26 This same philosophy of not interfering in day-to-day operations is echoed in Temasek's interaction and relationship with its companies. Singapore Airlines has its own board, which decides

what aircraft to buy and which routes to fly. They do not go to the cabinet, government or parliament for these decisions. They do not go to Temasek either for these business decisions.

Fostering a Culture of Discipline

- 27 The Temasek model of governance could perhaps be viewed as a hybrid of sorts – rules and process driven on one hand, and built on stakeholder relationships on the other. Above all, Temasek’s governance model is built on high levels of discipline and professionalism. I have highlighted earlier that Temasek does not get involved in the day-to-day commercial and operational decisions of our companies, in the same way that the Singapore government does not direct ours. The onus of delivering long-term sustainable value rests on our Board and the Boards of our companies respectively.
- 28 Further, we have institutionalised discipline within the company. Temasek is a long-term investor. The compounded annual 17% return we have earned and the S\$186 billion diversified portfolio we have built over the last 36 years is a result of keeping a long-term focus and a disciplined approach to investing. We remain single-minded about building our institution for the long term. A critical element is an owner mindset or culture in the Board and management.
- 29 How do we nurture an ownership mindset? I believe the starting point is our Board. The model which we have today is the result of continuous improvement over the years. Initially, as I have mentioned, the appointment of the board of Temasek and the Temasek Linked Companies was determined by a government committee led by the chairman of the Public Service Commission. This started to change from the late 1990s. This Committee no

longer exists. The appointment of board members of Temasek has to be approved by the Finance Minister. But the persons to be appointed are recommended by a sub-committee of the Temasek Board and submitted to him for consideration and approval. As far as the Temasek Linked Companies are concerned, there was a time when they looked to Temasek to appoint members to their boards and even make the decision as to who should be the CEO of the company. Now all the Temasek companies have Nomination Committees who make these decisions and have regular reviews for succession of directors and CEOs. Sometimes they do consult us or seek our opinion as most private sector companies do when they touch base with their main shareholders on key personnel decisions but the Temasek linked companies make their own decisions.

- 30 Over the years, through careful selection, Boards comprising respected business leaders from Singapore and abroad have been built in both Temasek and the Temasek Linked companies. Over time, the civil servants have been replaced by private sector veterans. These Directors have been tasked with guiding the evolution of Temasek and its companies, ensuring that the companies remain focused on generating long-term sustainable returns.
- 31 In Temasek, for example, Mr Kwa Chong Seng, our Deputy Chairman, is the Chairman and Managing Director of ExxonMobil in Asia; Mr Goh Yew Lin, is Managing Director of GK Goh Holdings Limited; in 2008, Mr Marcus Wallenberg, the former President and CEO of Investor AB from Sweden and currently Chairman of Skandinaviska Enskilda Banken and many other leading Swedish companies, joined our Board. This is testament to the fact that we are serious about maintaining a highly

professional and independent Board as part of our governance framework.

- 32 We encourage and support our companies to do the same. They have diversified their boards and appointed Independent Directors. We have also made it clear to companies in which we have significant interest that we will not support more than two members of the management on their boards. In addition, we have built up a database of business leaders from all over the world with whom we have established contacts. We submit these names to the boards of our companies for their Nomination Committees to consider and invite to their respective boards. Close to 25% of the directors of our companies are non-Singaporeans. In fact, one of my main jobs is to meet and assess potential candidates to add to our data base which our companies can draw on.
- 33 The Boards of Temasek and the Temasek linked companies make all the business decisions as to where to invest, what to invest in, who to hire as CEO etc. They are accountable for the performance of the company and in our dealings with them we allow no room for excuses that they did something because the shareholder told them to do so.

Sustaining Accountability

- 34 Aside from maintaining critical talent-management and succession plans, Temasek has over the years put in place a set of distinct markers to instil financial discipline.
- 35 The first such marker is our engagement with our stakeholders. In October of 2004, we published our first *Temasek Review*, now known as the *Temasek Report*, which is our annual report. Under Singapore law, we are not required to submit annual reports as

an exempt private company. Our core purpose in publishing an annual report was not transparency per se, but to instil in the Board and management of Temasek the discipline, the professionalism and the open willingness to be tested and measured over various market cycles. Over the years, we have indeed revealed the good, the bad and the ugly through these reports.

- 36 The report also shows our potential partners in our investments outside Singapore who we are and how we operate. It also helps us to recruit talent from all over the world to work in us and with us.
- 37 The second marker was our decision in 2004 to seek a credit rating with both Standard & Poor's and Moody's. Based on full confidential disclosure, we were assigned, and continue to maintain, AAA/Aaa ratings by both agencies. Though the credibility of these agencies has been badly dented by the latest financial crisis in the USA they are still useful markers.
- 38 The third public marker we set was raising funds from the international bond market as well as Singapore bond market. In 2005 we issued an international 10-year US\$ bond. We have continued to tap both the U.S.-dollar and Singapore dollar-denominated bond markets, most recently adding the Sterling into our Global Medium Term Note Program. As at 3rd August this year, we have 11 outstanding Temasek Bonds in USD, SGD and GBP with varying maturities up to 2050, and a weighted average maturity of about 17 years. We have raised almost S\$10 billion and have a good yield curve.

- 39 Our strategic actions and commercial choices are bounded by these clear bright tripwires and any move to shift our credit risk stance requires deep and deliberate debate within our Board and senior management. The bond spreads are a real-time live indicator of our credit risks, much like the role of a singing canary in a coal mine. If a canary drops dead, you would know that there is poisonous gas. This was also a deliberate move to create a new group of sophisticated stakeholders for ourselves.

Conclusion

- 40 As I have shared, there is no one textbook governance model by which we should all abide. What is crucial is putting in place a set of guiding principles, aligned with long-term sustainability goals to build an institution that lasts.
- 41 State-owned companies are here to stay but for them to prosper, governance and clarity of purpose is a must.
- 42 Thank you.