

# PRIVATE SECTOR CORPORATE GOVERNANCE AND THE SINGAPOREAN GOVERNMENT-LINKED CORPORATIONS

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## ABSTRACT

*This article examines aspects of corporate governance in Singaporean public sector. Most government linked corporation in Singapore have performed well. In addition these corporations have been largely successful in combating corruption. Corruption has in recent years resulted in the collapse of some large private sector corporations such as Enron Energy and HIH Insurance. This paper suggests that large multinationals can benefit from governance strategies employed by the Singaporean public sector corporations. Although the principal-agent problem is often stated in the context of private sector corporate governance, this paper discusses the problem within the public sector.*

## INTRODUCTION

The primary objective of private sector corporations is net profit maximization whereas the public sector corporations tend to focus on net benefits to the society. Despite differences in objectives, at least some of the problems faced by the public and private corporations are very similar. This paper focuses on the similarities with particular reference to Singapore. Singapore is a city-state with real GDP per-capita of S\$44,666 in 2005, up from S\$1,567 in 1965. Singaporean economic system has been described as state directed capitalism where the state directly participates in business sector growth through the government-linked corporations (GLCs).<sup>1</sup>

It is widely believed that the private sector corporations are more efficient as compared to the public sector corporations, which explains large scale privatisation in many developing countries. The interesting thing about the Singaporean economy is that most state controlled corporations are very efficient and therefore it can be argued that the private sector corporations can in fact learn from their public sector counterparts. Corruption is an example of problems that are faced by both public and private corporations. During the past few years several scandals involving manipulation of financial statements in private corporations have been reported by the media.<sup>2</sup> Corruption can also involve executive managers seeking opportunities to expropriate company's funds to furnish their offices with unnecessary electronic gadgets and excessive business trips. In addition, the managers may employ more workers than required thus raising the operating expenses unnecessarily. In other words, corruption can take place in a typical private sector organization. Corruption is a type of Principal-Agent problem where agent's actions are inconsistent with the objectives of the principal. Given the rising level of private sector corporate scandals, it is imperative that the private corporations look elsewhere for direction and guidance to further improve their management practices (Frey, 2003; Osterloh and Frey, 2003). Principal-

Agent problem is normally stated within the context of the private sector. However, because the public corporations are bureaucratic and hierarchical, the principal-agent problem can also arise within the public corporations.<sup>3</sup>

The choice of Singapore for this study is based on at least four reasons. First, Singapore is considered to be as one of the least corrupt countries in the world.<sup>4</sup> It is useful thus to study how Singapore has successfully curbed the level of corruption. In addition, Singapore has also fared well in some of the indicators relating to the quality of governance. Second, Singapore's GLCs have performed well as compared to a number of corporations within the Asia-Pacific region.<sup>5</sup> In terms of annual sales turnover, the GLCs have performed well relative to most multinational corporations. Third, while many lessons from the Singaporean model may not be relevant to large countries, large private sector corporations or multinationals can benefit from the lessons that Singapore has to offer. It is useful to recognize that Singapore's public corporations have adopted a pay for performance principle which better aligns the interest of the agents with those of the principals. The resulting set-up resembles the practices adopted by most private corporations. Hence, it may not be wrong to conclude that Singaporean public sector corporations are being managed like large private sector corporations. Finally, it is worth pointing out that as far as Singapore is concerned, the existing literature considers the principal-agent problem almost exclusively in the context of the private sector (see for example Eng and Mak, 1999; Phan and Mak, 1999; Heracleous, 1999; Goodwin and Seow, 1998; Pang and Leung, 2002 and Yeo and Koh, 2001). This article discusses the principal agent problem in Singaporean public sector.

The rest of the article is organised as follows. The next section examines the nature of the principal-agent problem in the public sector. This section also outlines some difficulties faced by GLCs in Singapore. Section 3 considers the problem of corruption and measures taken to curb corruption in Singapore. The last section contains some concluding remarks.

## **PRINCIPAL-AGENT PROBLEM IN THE PUBLIC SECTOR**

As far as the public listed companies are concerned, there is a separation of ownership and control. Board of directors or other groups of professionals manage public companies on behalf of the shareholders. Principal-Agent problem, also known as the agency problem, arises when the actions of the agent are inconsistent with the objectives of the principal. This problem is normally described in the context of private sector management. However Principal-Agent problem can also arise within the context of public sector management. At an aggregate level, the voters (i.e., the public) can be considered as the principal and the cabinet ministers and/or members of parliament can be viewed as the agent. It is possible that the two parties (voters and the members of parliament) have conflicting interests whereby the actions of the agents are inconsistent with the notion of maximizing the principals' interest.

This section considers two sets of relationship that exist between the principals and agents within the public sector. The first involves the general public as the principals and the state as the agents where the state consists of the members of parliament (MPs) and cabinet members. The public elects the MPs to run the country on their behalf.

Among other things, the role of the MPs is to elect the cabinet members. The cabinet must enforce the statutes which the parliament enacts. The cabinet is also responsible for implementing the agreed policies. The state must ensure that, among other things, the nation's resources are efficiently allocated and no one suffers from extreme poverty.

The problem arises when the public and the state have conflicting interests. What constitutes the public's interest however is difficult to ascertain. The term 'public' comprises a vast majority of people. In real life personal interests of the members of public are unlikely to be identical which makes it very difficult to accurately identify and define public's interest. The state has the discretionary power to determine how the country's resources are to be allocated. Hence, the state has the ultimate responsibility in defining the public's interest. The extent of the principal-agent problem therefore depends on (a) state's ideology, (b) the interest of the majority in the country and (c) how close the two are matched.

The second set of relationship involves the state as the principal and the civil servants as the agents. The ministers are expected to ensure that their subordinates implement the relevant policies and carry out their tasks diligently and ethically. The public bureaucracy makes a contractual agreement with the civil servants which specify their responsibilities, salaries and other benefits. Unfortunately, the contracts are often incomplete. It is technically infeasible to spell out specifically in the contracts how the workers are to allocate their working hours and how and when the assigned tasks are to be completed. It is not practical to monitor every action of the workers. The cost of such monitoring is simply too high. The presence of asymmetric information worsens the situation. Because of the presence of asymmetric information, principals may find it hard to fully understand the rationale of decisions made by their agents. In real life, some civil servants make decisions that maximize their own interest at the expense of the public's interest.

Singapore's public sector utilises the pay for performance principle in an attempt to align the interest of civil servants with the state. The objective is to encourage the civil servants to perform their tasks with the community's interest in mind. The remuneration package of the civil servants is linked to their performance, not so much with seniority. The performance-linked remuneration is tied to the variable component of the total wage received. The system tends to reward high achievers and penalize under performers. It may be useful to note here that the Singapore public sector has been actively pursuing the flexible wage system since the National Wage Council (NWC) recommended the system in 1986 following the recession in 1985. While the private sector does not appear to have fully embraced the recommendations of NWC, the adjusted salary structure of the civil service in Singapore now includes a variable component that is larger than the recommended size as shown in Table 1. It was recently reported that as much as 40 percent of the civil service pay package consists of the variable component (The Straits Times, 20 June 2003).

TABLE 1: The Civil Service and the Wage Targets

	NWC Guidelines	Civil service
1986	Flexible pay with an annual variable component of 20 percent	Stated in 1998, and met 20 percent AVC target in 1991
1999	Another 10 percent of total wage set aside as monthly variable component	Today, MVC is more than 20 percent of total wages
2002	<p>Total variable components recommended:</p> <ul style="list-style-type: none"> <li>• Not less than 40 percent for top management</li> <li>• 30-40 percent for middle managers</li> <li>• 30 percent for workers</li> </ul> <p>Minimum-maximum salary ratio should be 1.5 within four to six years</p>	<p>More than 40 percent of wages of top management is variable, and at least 40 percent for other civil servants</p> <p>Average salary ratio is already 1.5</p>

Source: The Straits Times (20 June 2003)

Note: AVC: average variable component, MVC: monthly variable component. Source: The Straits Times, 20 June 2003.

Public enterprises like the statutory boards and GLCs in Singapore are not required to follow the human resource policies and remuneration systems that are the norm within the civil service. This allows GLCs to take steps that (a) enhance staff morale and (b) attract and retain talented staff.<sup>6</sup> Like the civil servants in public institutions, staff employed by statutory boards and GLCs are paid competitive salaries as compared to their counterparts in the private sector.

Another way to align the interest of the state and civil servants is to link the government agencies' financial budget to their respective specified targets. For example, the Inland Revenue Authority of Singapore (IRAS) is able to promote efficiency and effectiveness in tax collection because the government has linked IRAS's income or budget to the amount of revenue collected. IRAS is allowed to retain a specified percentage of tax collected in excess of the collection target. In addition to the normal agency fee of 1.65 per cent of the targeted revenue, IRAS is entitled to an additional *performance based fee* amounting to as much as two per cent of the difference between the actual and projected tax revenue. It is worth noting that a reduction in the fee awarded is possible if the actual revenue falls short of the initial target (Asher, 2002).

The civil service and IRAS experience shows that the Singaporean public sector has successfully established a strong link between the pay and performance as compared to the private sector. While assessing the performance of GLCs, it is useful to consider the

role of Temasek Holdings Limited (THL). Established in June 1974, THL assumed the role of the state-owned institutional investor ‘to track the performance of the various (government) investments and companies’ (Ho C., 2004). THL Chairman indicated that the character of THL ‘derives from the character of the political leadership in Singapore with the qualities of honesty, meritocracy, focus on the right than the popular decision and transparency being the main features’ Dhanabalan (2002).

Being a shareholder representative of the government, THL exerts pressure on the GLCs to strengthen their standards of corporate governance. With the THL, a team exists that looks after the stewardship matters of its companies, including board appointments (Ang and Ding, 2006). In Singapore, boards of directors govern statutory boards and GLCs. The boards approve proposals tabled by the executive managers, provide inputs on strategic plans and monitor the performance of the managers. Each of the statutory boards and GLCs is mandated to set up board of directors with representatives from statutory boards, ministries, unions, private sector and higher-learning institutions. THL exercises its right to make appointments of the main personnel working for GLCs. THL searches for talented staff domestically as well as internationally to sit on GLCs management boards, recognizing that ‘the character, values and competence of the people who lead the company at board and management level are the most important requirements for the success of a company’ (Dhanabalan, 2002). Hence, in the case of Singapore, it is inevitable that the parliament, the cabinet and the Ministry of Finance play both direct and indirect roles through THL in the governance of GLCs (Ho K.L., 2004). The fact that a majority of the directors were formerly from the civil service further raises the likelihood that some of the public sector practices would transfer to GLCs.

The two sets of principal-agent problem can be summarized in Table 2 below.

*TABLE 2: Governance Structure in the Public Sector*

	<b>Principal(s)</b>	<b>Agent(s)</b>
1.	General Public (Voters)	State (Members of parliament; Members of the cabinet)
2.	State (Members of parliament; Members of the cabinet)	Managers (Civil Servants in the Public Sector)

Source: Sam, 2003

As indicated earlier, Singapore government has been able to promote industrial growth through its influence on GLCs. However, it should be noted that not all GLCs can be described as a role model for the private sector. The rest of this section outlines some negative aspects of GLCs. GLCs are some times accused of acting like ‘big bullies’ in Singapore’s corporate environment. From the local businessmen perspectives, what distinguishes GLCs from the non-GLCs is the strong political connection that GLCs have. The political connection gives GLCs added advantages because of the ‘guidance’

they may either deliberately or unconsciously receive from the bureaucracy (i.e., the ministries and the statutory boards). In this respect, the business community is not very keen with the idea of the government acting as entrepreneurs. GLCs could in fact unwittingly stifle entrepreneurship in Singapore.

There has been pressure on the government to sell its interests in non-strategic GLCs. A subcommittee established by the parliament has recently recommended that the government should establish and maintain only those GLCs that are responsible in managing critical resources (such as the air and seaports), achieving public policy objectives (such as those related to health and education) and developing new growth engines. How far the divestment goes and the speed of its progress are difficult to predict, and depend very much on the top leadership of the country. With the appointment of Ho Ching at the helm of the THL and her connection with Lee Kuan Yew (her father-in-law) and Lee Hsien Loong (her husband), her views regarding the future of GLCs would be very important. Her recent public speeches suggest that she is in favour of divesting some non-strategic GLCs (see <http://www.temasek.com.sg>).<sup>7</sup>

As far as GLCs are concerned, not every thing has gone according to the plan. For example, Singapore Telecommunications failed to acquire Cable and Wireless Hong Kong Telecommunications (C&W HKT) in Hong Kong and Time Engineering in Malaysia (in March and May 2002 respectively). Singtel lost the acquisition battle in its 2<sup>nd</sup> attempt to purchase the Malaysia Renong-controlled, Time Engineering in 2000. It is believed that the deal fell through when the Malaysian government changed its mind concerning its flagship telecommunications company's desire to join hands with Singtel (Chee, 2001, p. 58). The Development Bank of Singapore (DBS) also acquired big stakes in Dao Heng (in April 2000) and Thai Danu (in January 1998). DBS bought over 50.3 percent of Thai Danu (a bank in Thailand) for US\$104 million without sufficient scrutiny of its loan portfolio and other issues which led to a significant decline in DBS's profits in 1998 (Ang et al, 2000). Some observers believe that a premium has to be paid for acquisitions by GLCs because of their close link with the government (Low, 2002). Besides Thai Danu, it is widely believed that Singtel paid too much for Optus. It can therefore be argued that some GLCs might be better off without government backing, particularly those with strong business profile.

In a recent Standard & Poor's (S&P) survey of GLCs, it was noted that Keppel Corp, Keppel Fels Energy and Infrastructure, Chartered Semiconductor Manufacturing (CMI), and Neptune Orient Lines (NOL) had below average business profile (Low, 2002). These companies were suffering from financial vulnerability. For example, CMI has suffered losses for the last three years amounting to US\$1.1 billion as it failed to weather the downturn in the electronics sector and compete with its Taiwanese counterparts (The Straits Times, 24 April 2004).

In February 1994, the Suzhou Industrial Park (SIP) project was launched as a Singapore-China government cooperation project. The China-Singapore Suzhou Industrial Park Development (CSSD) was 65% owned by a Singapore led consortium. This consortium was made up of Singaporean private companies, GLCs, statutory boards, and non-Singapore multinationals. It has been suggested that the arrogance of some government officials towards the Chinese led to the failure of this project (see Pereira, 2003). Low (2002) argues that the project would have been more successful if it was led by smaller Singaporean private firms.

In July 2003, Sembcorp Logistics, part of the Sembcorp Industries group and one of the leading GLCs in Singapore, uncovered an accounting fraud in its subsidiary in India. It was found that certain individuals in the finance department had created fictitious documents and inflated revenues and profits by about S\$18.5 million between 2000 and 2002. This is the second time the company had to amend its financial statements. In March 2003, the company amended its financial statement when its Swiss associate, Kuehne & Nagel International announced a write-off that Sembcorp Logistics had failed to take into account (ACGA News Brief, 2003).

In December 2003, ST Telemedia, a GLC, bought 61.5% of Global Crossing for US\$250 million thus assisting the latter to emerge from bankruptcy in 1991. ST Telemedia claimed that a stringent and thorough due diligence process was followed before the purchase. However, on 27 April 2004, Global Crossing stunned the market by announcing that it had understated by up to US\$80 million the money it owed to other companies in 2003 for services rendered. The accounting error could pose difficulty to Global Crossing in arranging for the required funds to finance its expenditure programs. Some analysts had warned that ST Telemedia, as the majority shareholder, might have to bear the full brunt of Global Crossing's funding needs which could amount to as much as US\$252 million or more. More bad news followed when Global Crossing's investors filed a lawsuit against the company and two of its executives for causing them to suffer share price losses. If the company is ordered to pay for damages but does not have the money to do so, it may eventually turn to the controlling shareholders, ST Telemedia, for further funds (The Straits Times, 29 April 2004; 4 May 2004).

The above suggests that not all GLCs in Singapore are a role model for the private sector firms. The following section deals with problem of corruption which is usually discussed in the context of public sector corporations. The collapse of big names such as Enron and HIH suggests that corruption is also a serious problem within the private sector.

## CORRUPTION

In its simplest form corruption involves bribery.<sup>8</sup> Corruption is a serious problem that exists everywhere but its severity varies from country to country. International agencies have ranked Singapore as one of the least corrupt countries in the world.<sup>9</sup> Up until recently, corruption was considered to be mainly a public sector problem. However recent scandals involving large multinationals appear to have reinforced the view that significant corruption exists in the private sector. Several causes of corruption have been noted in the literature. Low salary is considered to be one of the main reasons for corruption (Mauro, 1997 and Van Rijkeghem and Weder, 1997).<sup>10</sup> Corruption is likely to be more severe if the probability of catching the offenders is low and the punishments imposed on offenders are not significantly high. In other words, the level of corruption is linked to its opportunity cost.

Healthy budgetary situation has allowed Singapore government to pay competitive salaries to all civil servants. The public sector salary revisions are carried out regularly (a recent revision was concluded in 2000) to ensure that the gap between the public and

private sector salaries is not significant. Top public sector executives receive very high salaries. For example, the government ministers in Singapore are currently paid as much as S\$50,000 per month each while the prime minister receives around S\$85,000 per month, making them possibly the highest paid government officers in the world. The efforts of the Singaporean government have been acknowledged by many including Tanzi (1998).<sup>11</sup>

Besides paying high salaries, the government of Singapore has enacted relevant anti-corruption laws and strengthened the anti-corruption agency to minimize opportunity for corruption. The Prevention of Corruption Act (POCA) for example was enacted in 1960 to provide the necessary legislation to curb corruption, replacing the less efficient legislation, the Prevention of Corruption Ordinance (POCO) which was enacted in 1937. Some of the improvements made in POCA include higher penalties for corruption related offences and introduction of new laws to give more power to the anti-corruption agency (CPIB) in Singapore. CPIB is an independent institution housed in the prime minister's office where its director is answerable only to the Prime Minister, and its officers appointed by the President. Because it is possible for the Prime Minister to be investigated himself, a provision exists in Singapore's constitution which allows the Director to proceed with investigations 'despite any direction to the contrary from the Prime Minister' (Ho, 2003, p. 269). The new laws give power to CPIB officers to scrutinize the accounts of individuals working in the public and private sectors. CPIB also has the authority to summon witnesses to assist in its investigations (see Quah, 2003 for further details).

Besides CPIB, other parties capable of filling the role of formal monitoring agents include tax department (to scrutinize the accounts), auditing firms and credit/bond rating agencies (to provide independent assessments and ratings), judicial system (to provide effective legal protection), media (to provide information on private misdeeds by agents) and the Head of State (like the President in the parliamentary system of government).

The methods used to curb corruption in public corporations can in fact also be applied in private corporations. Unfortunately, it is often difficult for the principals to monitor closely the activities of the agents. In public listed companies the shareholders (principals) delegate the task of controlling the firm to managers (agents). The agents have discretionary power over the use of the companies' resources. The recent corporate scandals suggest that some executive managers are involved in corrupt practices. Corrupt activities can be discouraged by the management board by introducing measures that lower the incentive and opportunity for corruption. Paying the executive managers higher salaries, increasing the probability of getting caught (like setting the audit committee headed by an independent member of the board) and protecting the whistleblowers are the common recommendations. However it turns out that paying a higher wage does not always curb corruption. Indeed some corporate executives have been involved in falsifying the financial records to show huge profits because only huge profits can justify their salaries and benefits. In fact, the Enron case demonstrates how formal mechanisms can fail to prevent corrupt practices that could result in the collapse of a well established corporation. It is interesting to note that Enron was monitored by no less than eight agencies/departments - few, if any, were able to catch or knew anything about what Enron was up to (Branson, 2003). Hence, in a typical organization, it is generally useful to attempt to inculcate good group norms. The



reason is that, with imperfect information, individuals are more likely to adopt the 'follow-the-norm' mentality. Ferrell, Fraedrich and Ferrell (2002) noted that as many as 80 percent of the workforce adopted the follow-the-norm mentality rather than following their own instincts or go against the norms. Accordingly, it is imperative that good business norms are established and are complied.

As far as Singapore is concerned, there appears to be a strong political will among the politicians to contain and eradicate corruption. The political leaders frequently appeal to the moral consciousness of public servants. The constant and continuous effort put in by the political leaders appears to have contributed towards a strong public support against corruption. There is a perception that all complaints lodged with CPIB would be seriously investigated. It is also interesting to note that the public sector in Singapore provides information on the potential cost of corrupt activities. Corruption cases involving the public sector are readily reported by the media. The government does not appear to have hesitated to prosecute people involved in corruption regardless of their status which may have discouraged corruption.<sup>12</sup> Private corporations through their intranet systems can also report corruption related cases which took place within and outside their respective organizations.

Sociologists such as Granovetter (2005), among others, suggest building a strong social network within the working community. Appointing trusted people who are capable of doing the right things allows for flow of quality information and serves as a source of reward and punishment whose impact is magnified because the information comes from someone personally known. In fact, a key aspect of the Singaporean model is the appointment of trusted individuals from the civil service to GLCs. As an indicator, we refer to Worthington's (2003) study, which finds that the public sector in Singapore dominated GLC directorship, accounting for more than 70 percent of the directorships in 1991. In 1998, the public sector representation increased as it accounted for 74 percent of the representation in GLCs. As such, there is a strong social network among GLCs. The fact that a majority of the Singaporean GLCs have done very well over a significant period of time suggests the workability of this approach.<sup>13</sup>

Interestingly, most studies on corruption in Singapore focus almost exclusively on the positive aspects of its anti-corruption strategy (Quah, 2003; Tan, 2003; Ho, 2003). But the fact remains that Singapore is not the least corrupt country in the world. Both IMD and TI consider Singapore to be more corrupt than Finland. The differences between the corruption strategy employed by Finland and Singapore are as follows. Firstly, Finland is a very strong welfare society whereby the state provides free education at all levels and free health care for everyone. Old age pension is also provided for everyone over 65. Provision of such social services could have lessened the incentive for corruption in Finland (Tiihonen, 2003). The situation in Singapore is quite different in this regard. The welfare system in Singapore is relatively weak. A significant burden of the social welfare is borne by the individuals' themselves. PAP is against the idea of cash or transfer payments. Financial assistance schemes are rare in Singapore. Even if assistance is provided, it is temporary and administered in an ad hoc fashion. In fact in Singapore, financial assistance schemes are deemed undesirable and are considered to be undermining the goal of self-reliance. Instead, PAP has often emphasized that the best form of social security is the pursuance of high economic growth so that more employment opportunities are provided (Asher and Rajan, 2002). The problem with this

system is that public officers might have a greater incentive to receive bribes so as to enable them to attain their desired standards of living.

Secondly, it is unusual in Finland to appoint someone from outside of the public sector to high level positions (Tiihonen, 2003). In the case of Singapore, it is not unusual for PAP to scout for talents from the private sector. For example, the current Prime Minister, Goh Chok Tong, was recruited from Neptune Orient Lines (NOL), a private-listed company partially owned by the government. The reason given was that Singapore had a limited pool of qualified people. Courting the talented individuals from the private sector and retaining them is a common practice in Singapore's public sector. However, this situation can lead to conflict of interest. In addition, it is not uncommon for PAP members of parliament in Singapore to hold directorship in public listed companies. For example Wang Kai Yuen holds 11 directorships while John Chen has 8 directorships and Ong Kian Min has 11 directorships (The Straits Times, 29 April 2004). It is important that the MPs are able to draw the line between their private and public positions although doing so might not appear to be easy in practice. Monitoring such behaviour is also difficult because of asymmetric information. The tendency for corruption to take place in Singapore might be compounded by the fact that the residents are generally strong followers of the Confucianism school. Confucian values, which place paternalism over legalism and a strong emphasis on family loyalty appears to provide a justification for nepotism.

If the notion of corruption is to include poor corporate governance practices, Singapore could not be regarded as a corruption free economy at least in a literal sense. For example, in a joint ACGA/CLSA Emerging Market survey released in May 2003, a large gap was found which separated the best and worst performing firms in Singapore. While Singapore companies were ranked second after South Korea in practising good corporate governance norms, the worst companies in the Republic were considered to be worse than the worst-performing firms in China, Hong Kong, India, South Korea, Taiwan and Thailand. One of the cases involves the late billionaire Khoo Teck Puat who was accused in March 2004 for not disclosing the extent of his control in several listed companies (The Straits Times, 29 April 2004).

Rapid globalization in conjunction with improved information technology presents new challenges for combating corruption. Instant transfer of funds across international boundaries and the popularity of online transactions facilitate concealment of corruption. Anti-corruption strategies may have to be modified and the responsible agencies may have to rely more on tip-offs and whistleblowers.

## **CONCLUDING REMARKS**

This article considers aspects of public sector corporate governance in Singapore. Despite differences in overall objectives, at least some of the problems faced by the public as well as the private corporations are identical. The recent scandals involving Enron Energy and HIH Insurance suggest that corruption can also create serious problems for the private sector corporations. The paper argues that although the principal-agent problem is usually couched in the context of private sector firms, the public sector is confronted with similar problems. The successful governance of government-linked corporations in Singapore provides a good model for large private

corporations. Lower incidence of corruption in Singaporean public sector corporations can be attributed to (a) the lack of opportunities and incentive for corruption and (b) strong anti-corruption culture in Singapore. Private corporations facing similar problems can benefit from the experiences of the Singaporean government linked corporations.

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## NOTES

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<sup>1</sup> The transformation of Singapore from a third-world to a first-world country is a significant achievement given the fact that the country has no natural resources. Strategic location and skilled and disciplined labour force are its major assets. The ruling party, the People's Action Party (PAP) has won every election since independence in 1965. Its popularity appears to be closely linked with the strong economic growth that is attributed by many to PAP's high standards of governance. It is interesting to note that the Singaporean system consists of only one level of government, one level of judiciary and one parliament.

<sup>2</sup> Some well-known examples include WorldCom, Enron, Kellogg, Johnson & Johnson, Parmalat and Xerox.

<sup>3</sup> Recognition of the agency problem within the public sector can be traced back to Max Weber. In *Economic and Society*, Weber (1978[1922], pp. 225, 991-995) recognizes that state officials (agents) are often able to make decisions in contrary to the state (principal) interest. Public Choice School led by James Buchanan, Gordon Tullock and William Niskanen formalizes the agency problem in the public sector. Niskanen (1971) utilized a utility function that includes aggregate budget as an argument - an increase in the size of budget increases the utility of the bureaucrats. This results in the bureau having a myopic view, with a stronger preference for costly capital-intensive production process.

<sup>4</sup> Singaporean private sector is not immune to corruption. For example, the Royal Brothers were charged in 1997 for offering at least S\$1 million to the General Managers of HL Bank in return of lower annual interest rate of company bonds used to re-finance hotels partly owned by the brothers. Although the prosecution withdrew the charge, the brothers were charged in 1999 for giving false information in relation to this case. In a separate case in 1997, the brothers were charged for corruptly receiving S\$2 million for the approval of a lease application involving a food court. Former Amcol Holdings Limited executive director and corporate trader were investigated and charged for conspiring to cheat Amcol Holdings Limited into investing US\$39.6 million in a project in Mauritius. They were sentenced to 18 months' and 20 months' imprisonment respectively.

<sup>5</sup> In a recent ranking of the top companies in Singapore in terms of their market capitalization, the top four companies were GLCs namely, Singtel (S\$39,066.2 million), DBS Group (S\$26,783.7 million), SIA (S\$20,949.7 million) and Chart Semiconductor (S\$20.8 billion). See Low (2001) for further details.

<sup>6</sup> Consider the Inland Revenue Authority of Singapore (IRAS), which has been collecting taxes on behalf of the government since 1992. As the principal, IRAS must ensure that its agents (tax officials) carry out their tasks effectively and efficiently - IRAS board recognizes this. The board attempts to provide fair and equal opportunity for its staff to advance to higher positions not only within IRAS but also in other public

institutions. In addition, IRAS board has approved a policy to peg the earnings of IRAS's tax specialists to those of private sector tax partners or principals (Sia and Neo, 2000, p. 541). This policy allows IRAS to combat corruption.

<sup>7</sup> Bhaskaran (2003) believes that divestment of GLCs would not be attractive to the government during economic downturn. His views are based on the observation that economic downturn is often associated with deflation in asset prices. Accordingly, selling off the government's stake would mean lower revenue for the government. While it is generally agreed that maximizing the selling price is the right thing to do in any business transaction, Bhaskaran suggests that the government should examine the cost and benefit for the whole economy.

<sup>8</sup> Other forms of corruption include extortion and nepotism. Extortion includes a public servant demanding gifts or favours in the execution of public duties. Nepotism includes the appointment of relatives, friends or political associates to public offices regardless of their merits and consequences on the public weal (see Alatas, 1999).

<sup>9</sup> World Competitiveness Report 2005 ranked Singapore as the fifth least corrupt economy among 30 countries with population less than 20 million. Singapore's Corrupt Practices Investigation Bureau website, <http://www.cpib.gov.sg>, also provides the corruption ranking for Singapore from Transparency International (TI) and the Political and Economic Risk Consultancy Limited (PERC). TI has consistently ranked Singapore as one of the 10 least corrupt countries during 1995-2004. PERC ranked Singapore as the least corrupt country in the world for the last 10 consecutive years.

<sup>10</sup> Empirical evidence appears to support the view of a negative relationship between corruption and civil service pay. For example, Mauro (1997) argues that lower wages in the public sector as compared to those in the private sector increased the tendency of corruption among public servants. Monetary incentives offered by firms or potential offenders encourage public officers to accept bribes, especially if they feel that their wage levels are being unreasonably lower than their counterparts in the private sector. Van Rijkeghem and Weder (1997) empirically tested the hypothesis of a negative relationship and found that higher relative civil service pay led to lower corruption.

<sup>11</sup> Tanzi writes "...countries have increased salary differentials to be able to retain and attract more able, productive, and honest individuals. Over the years, Singapore has pursued a wage policy aimed at reducing the temptation for public officers to engage in acts of corruption. Reportedly, the salaries of ministers and other high-level officers in Singapore are among the highest paid in the world. A common belief is that in situations of low wages but high possibilities of corruption, less honest individuals will be attracted to the civil service..... (Tanzi, 1998, p. 573). However, paying higher salaries could not guarantee that public officers would replace illegitimate income with legitimate income. Some of them may prefer to keep both, particularly those holding sensitive positions. The approach can also lead to a trade off in the sense that the budget size required to finance programs to improve people's life may remain low and inadequate. See Johnston (2000).

<sup>12</sup> Corruption related offences receive extensive coverage in Singapore media. Some prominent corruption cases involves the then Minister of National Development who

was accused of accepting two bribes amounting to S\$1 million in 1981 and 1982. The same minister was accused of accepting bribes from two developers to allow one of them to retain the land which had already been acquired by the government and the other to purchase state land for private development. In 1991, the then Director of the Commercial Affairs Department (the anti-graft and investigative arm of the Ministry of Finance) was charged and convicted of corruption in a business deal. In 2000, a Nominated Member of Parliament was tried by a criminal court on at least three corruption charges. More recently, the chief executive of the National Trade Union Congress (NTUC) Choice Homes was investigated by CPIB for illegally using NTUC Choice Homes' funds for stock market trade. Another recent case involved a senior housing board officer responsible for supervising upgrading projects in the eastern area. He was charged for asking for bribes from two sub-contractors in the form of free renovation work to his house (The Straits Times, 28 August 2003).

<sup>13</sup> Although the model has worked generally well, at least in the Singapore case, it is not free from criticisms. United States, State Department (2001) expressed concerns that (1) government influence over the management of GLCs may constitute an unfair advantage over non-GLCs in contract bidding and access to loans, and (2) former civil servants holding senior positions at THL and GLCs may be less inclined to take significant risks. In addition, critics have raised questions on a number of appointments at THL and GLCs. THL CEO Ho Ching, for example, is the wife of Prime Minister Lee Hsien Loong and daughter-in-law of Lee Kuan Yew. Lee Hsien Yang, brother of PM Lee is currently heading Singapore Telecommunications, a GLC. When asked about the perception that the only way to shake up GLCs is to bring in a member of the Lee family, former PM Goh Chok Tong agreed but said, 'But what do you do? Because of the perception, you don't appoint Lee Hsien Yang, you don't appoint Ho Ching, and any number of their relatives to high position?' Goh sees the perception as a 'big problem politically for us'. [Q&A: Singapore's Premier on the Power of the Lee Family', Business Week, 24 June 2002]. These are some issues that have been around for quite some time. Temasek Charter, released in July 2002, attempts to address some of these concerns (see Low, 2004 for more details).



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