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UNDERSTANDING THE RELATIONSHIP BETWEEN THE GOVERNMENT AND SOVEREIGN WEALTH FUNDS: THE CASE OF SINGAPORE

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Introduction

Government-in-business is a pervasive phenomenon. Large institutional investors like the Sovereign Wealth Funds (SWFs) have been set up by the government to invest in foreign financial assets.[1] Examples include China Investment Group (China), Khazanah Nasional (Malaysia), Government Investment Corporation of Singapore and Temasek Holdings Limited of Singapore. Being government owned implies that the SWFs are expected to maximize the interest of the shareholders who are effectively the citizens of the country. This gives rise to the free rider problem because the cost of exercising control is personally concentrated while the benefits are diffused.[2]

It is therefore important to ask how the investment arms of the government should be managed and controlled. What should be the appropriate relationship between the government and the entities? While much has been written about the pros and cons of the government being involved in the business sector, the discussion on the appropriate relationship between the government and its investment arms has received much less attention. This paper attempts to fill this gap in the literature by generating a conceptually coherent description of the relationship between the government and SWFs, particularly as the latter are increasingly interpreted as expression of state power thereby sharpening suspicion of the SWFs from the host countries (El-Erian, 2010; Greene, 2012; Kimmit, 2008).

Eric Weiner (2010), for example, describes SWFs as institutions that are primarily run by independent governments "many of them rivals of American and other western nations and all willing to use their capital to advance political, rather than financial, aims"

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1 There are cases of the ruling political parties investing in businesses (such as United Malays National Organization in Malaysia, Kuomintang in Taiwan and People's Liberation Army in China). This paper shall confine its discussion to corporations owned by the government and not political parties.

2 This paper applies the specific definition of SWF as adopted by the International Working Group of Sovereign Wealth Funds (IWF 2008). IWF (2008: 27) defines SWFS as "special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets".

(Weiner, 2010: 10). Hence, "it's not just corporate greed that we have to watch out for anymore, it's geopolitical power plays as well" (*ibid:* 11). The fear of the SWFs utilizing their economic power to achieve political agendas is real. As President Barack Obama of the United States commented during his first Presidential election, "I am obviously concerned if these SWFs are motivated by more than just market considerations, and that's obviously a possibility".[3] Former U.S. Treasury Secretary Lawrence Summers cautioned that it would be "imaginable" that government-related entities investing in the United States would be "motivated to strengthen their national economies, make political points, reward or punish competitors or suppliers, or extract know how".[4]

By means of a case study, this paper argues that it is necessary for the government to separate its role as the shareholder and a regulator of the corporate sector. The separation is essential so as to avoid the government being caught in the awkward state-first condition where political-economic interest overrides the commercial interest as its exercises both the shareholder and regulatory roles. As a shareholder representative of the home citizenry, the government has to prove that it is a worthy custodian of national wealth by ensuring that the state-invested companies maximize shareholders value and be held accountable under the laws of the state. As a regulator, the government has to build the institutions capable to bringing dividends in terms of economic growth and development.

In this regard, Singapore provides an interesting case study. It is well known that Singapore embraced a pragmatic approach to economic development with the state playing a dominant role in the development process (Vasil, 2000). A unique feature of the Singapore model is its emphasis on attracting multinational corporations and growing the local government-linked companies (GLCs). In recent era, there has been a shift from state driven to more market oriented initiatives like divestment and privatization, and by allowing the private sector to engage in sectors that were traditionally managed almost exclusively by the state (Kong, 2000). To manage state-invested companies, the Singapore government, through a representative who is the Minister for Finance, serves as the shareholder representative of the citizens of the country to monitor the performance of Temasek and its executives. The day to day operations of the fund is left to the fund managers who in turn report to the board of directors. As reported by Temasek, "Under Singapore's Constitution and laws, neither the President of Singapore nor the government is involved in our investment, divestment or other business decisions, except in relation to the protection of Temasek's past reserves" (Temasek Holdings Limited, 2012: 44).

In short, the relationship between Temasek and the Singapore government is one of delegation of responsibility from the government to Temasek to manage state-invested companies, including partially privatized firms, on a commercial basis. The

3 'Obama says concerned about sovereign wealth funds', Reuters, 7 February 2008.

4 'Lobbyists smoothed the way for a spate of foreign deals', *The Wall Street Journal,* 25 January 2008.

demarcation aims to convey the message to the investment community that Temasek is an independent investment entity that happened to be owned by the Singapore government. From Singapore's standpoint, the initiative is therefore necessary to offer a higher chance for state-invested companies to venture into the regional and global markets. This paper illustrates the strategies adopted by the Singapore government and Temasek that serve to depoliticize the SWF.

Characteristics of the Sovereign Wealth Funds

Sovereign Wealth Funds (SWFs) serve as the investment vehicles of the government to manage public funds and invest them in financial assets both locally and abroad.[5] Unlike central banks that usually invest their reserves in highly liquid fixed-income securities, SWFs have the intention to seek higher returns by investing in more risky assets/equities.[6] It has been reported that a third of the emergency fund that entered the western financial institutions during the 2008 global financial crisis has come from Asian and Arab SWFs.[7] According to the International Monetary Fund, foreign assets under management of the SWFs valued at between US$2-3 trillion by end February 2008,[8] which was equivalent to more than 50% of global foreign exchange reserves, 13% of global pension fund assets, 6% of the global asset management industry and 6% of the world's stock market capitalization (Butt, Shivdasani, Stendevad and Wyman, 2007: 76). Morgan Stanley expects this figure to grow to US$12 trillion by 2015.[9]

SWFs share a number of characteristics. First and foremost, acquiring a firm from a sensitive sector is hardly easy for SWFs and state invested companies. Even in supposedly liberal economies like the United States, a complex structure with respect to approval of cross border investments is often put in place. It is true that most countries control or restrict cross border investment whether the investing company is privately or publicly owned. However, the fact that it is a SWF, it is likely to subject to a higher degree of scrutiny (Greene, 2012). Indeed, Singapore has a fair share of failed or difficult acquisitions. In May 2002, Temasek-Linked Company, Singapore Telecommunication's (SingTel), lost acquisition battle in its purchase of Malaysian-Renong controlled Time Engineering because the Malaysian government reconsidered

5 For discussions of SWF activities, see Bahgat (2008), Kimmit (2008), O' Brien (2008), Saw and Low (2009), El-Erian (2010), Park and Rozanov (2010) and Truman (2011).

6 This is not applicable to all SWFs. For example, Kuwait Investment Board (established in February 1953) received specific instructions from the Kuwaiti government to use its proceeds exclusively for the Kuwaiti people. For five decades, the Board invested significantly in safe securities rather than in the risky financial products to secure higher returns.

7 'GCC needs the dollar and the US needs the funding', *Financial Times*, 29 May 2008.

8 IMF's report on 'Sovereign Wealth Funds: a work agenda'. Available at http://www.imf.org (accessed on 1 July 2011)

9 Currencies: how big should sovereign wealth funds be by 2015? http://www.morganstanley.com (accessed on 20 June 2011)

its flagship telecommunication company's desire to join hands with a company which the Singapore government had 78% stake in it. By the time Temasek came to acquire Optus (Australia) in 2001, the government through Temasek had to reduce its stake from 78% to 65% and give up its golden share to create the arm's length distance. The Australian Defence Department was uneasy that 78% government-owned SingTel and the Singapore government would have access to satellites that would carry military information alongside telephone traffic. The agreement came through only after SingTel and Optus signed an agreement to safeguard Australian military communications and co-invest in satellite infrastructure a year later.[10]

Unlike stock traders, SWFs do not typically go in and out of shares in the short term. They tend to display more patience with corporate executives, rather than pressuring them to focus on short term goals. As Robert Kimmitt (2008: 122) wrote in the *Foreign Affairs*; "SWFs are in principle long-term investors, which typically do not deviate from their strategic asset allocations in the face of short-term volatility. They are not highly leveraged and it is difficult to see how they could be forced by regulatory capital requirements to liquidate their positions quickly. In this context SWFs may be considered a force of financial stability". The sentiment is shared by the International Working Group of Sovereign Wealth Funds. According to the Working Group, SWFs "ability in many circumstances to take a long-term view in their investments and ride out business cycle brings important diversity to the global financial markets, which can be extremely beneficial, particularly during periods of financial turmoil or macroeconomic stress" (International Working Group of Sovereign Wealth Funds, 2008: 3). During the 2008-2009 global financial crises, for instance, Temasek injected US$900 million in Merrill Lynch, raising Temasek's stake from 8.85% to over 10%.[11] Merrill Lynch was subsequently acquired by the Bank of America (BOA), translating to Temasek's 3% stake in BOA (holding of 18.8 million shares).

Edwin Truman (2011: 6) warned that the SWFs might sell investments in financial institutions that were weak, contributing potentially to financial volatility. It should be added that selling at a loss could provoke strong criticism from citizens of the source countries (as evidenced in Singapore, Norway, China and Kuwait) because of the large losses that the SWFs had incurred from investing in the financial institutions.

As managers of foreign exchange assets, SWFs seek for higher rate of return by investing in a range of assets. This helps to prevent the Dutch disease – a term that is used to refer to the strengthening of the local currency that would make it harder for the local organizations to compete in the exports markets. In Russia, the Stabilization Fund (established in January 2004) was explicitly used to sterilize the large inflow of foreign currency from the sale of oil by absorbing the excess liquidity and therefore controlling inflation. In addition, SWFs are capable of channelling financial capital to domestic strategic firms. There is ample evidence to support the view. Qatar SWF

10 See Low (2002) for a detailed analysis of Temasek's efforts to globalize.

11 'Temasek pumps US$900 million more into investment bank', *The Straits Times*, 30 July 2008.

– Qatar Investment Authority – has invested in local strategic sectors outside of the energy fund. Temasek has actively invested in companies that manage critical resources that are critical to the Singaporean economy as a whole. Under the leadership of Bader Al Sa'ad, Kuwait Investment Authority (KIA) provided seed money to boost Kuwait's financial services industry, by matching any amount of capital raised by an investment house for an investment fund. By 2009, the number of investment houses in Kuwait grew to around fifty from five in 2004. The French SWF, Strategic Investment Fund, was primarily set up to promote the development of French businesses that the government deemed significant to the country's economic security.

In summary, it is quite clear that SWFs perform a number of functions. They are large institutional investors who have experienced some failures in globalizing state-invested companies. The challenge is to see how SWFs can improve the standard of corporate governance, and counter nationalism. In the following section, I propose to explore the question by examining the relationship between the government and SWFs. As the concern about SWFs' activities is centred largely on their political association, an examination of the role of the government in SWFs is necessary as a means to enhance their change of acquiring more financial assets abroad.

The relationship between the SWFs and the government

The agency framework offers a useful theoretical tool to dissect the relationship between the government, the SWFs and state-invested companies whether the state-invested companies are fully or partially owned by the government. The agency problem views Modern Corporation as a nexus of contracts between the principals (shareholders) and agents (managers). Concerns arise when the agents make decisions that maximize their personal interest with the shareholders facing problems in monitoring the agents. In the context of this paper, the agency framework allows the government to play the role of a shareholder in state-invested companies with limited liability and revitalise the firms by granting more decision rights to SWFs. As a shareholder representative of the government, the SWFs have the responsibility to raise the firms' standards of corporate governance, and allow for a more credible long-term commitment between the SWFs (as the principal) and the state-invested companies (as agents).

In the case where the SWFs have the autonomy to strategize its investment plans despite being wholly owned by the government, they assume the role of an agent with the government representing the principal (Table 1). The agency problem tells us that the executives in the investment arms may make decisions that benefit their own interest rather than those of the shareholders. In this context, a key concern is to align the interest of the SWFs with that of the government (or its representatives). Since the former is wholly owned by the government, ultimately it is the responsibility of the SWFs to maximize the long-term interest of the citizens of the country. The government may assign a minister or appoint a committee to monitor the management and performance of the SWFs. Other interested parties capable of filling the role of external monitoring agents include the anti-corruption agency (to investigate suspected persons for acting improperly), tax department (to scrutinize the accounts), auditing

Table 1 Principal-Agent Framework

	Agent	Principal
1	Sovereign Wealth Funds (SWFs)	Government
2	State-invested companies, including partially privatized state-owned enterprises	Sovereign Wealth Funds (SWFs)

Source: Author

firms and credit/bond rating agencies (to provide independent assessments and ratings), judicial system (to provide effective legal protection to investors/shareholders) and media (to provide information on private misdeeds by agents). Internal controls in the SWFs such as appointing independent board members and non-executive Chairman for the SWFs, separating the Chairman and CEO and establishing incentive mechanisms can similarly mitigate the agency problem.

In privatizing state assets, the government may choose to sell the assets either fully or partially. Most privatization programs begin with a period of partial rather than full privatization (Boardman, Eckel and Vining, 1986; Perotti, 1995).[12] For example, the Singapore government remains the major shareholder of SingTel when the national telecommunication authority was converted from a statutory board to a private company in 1993. As at end March 2012, 54% of SingTel's shares are held by Temasek. In the event that state assets are partially rather than fully privatized, the government plays a dual role, as a shareholder representative of the partially privatized firms and the regulatory body of the corporate sector. Ideally, privatized entities are to be transferred to state-owned holding companies or SWFs to manage the companies on a commercial basis. Unlike an enterprise that is wholly owned by the government, in which case, it is reasonable for the enterprise to focus on non-commercial objectives, a partially privatized firm has to be accountable to non-state shareholders. This effectively implies that the partially privatized firms have to be controlled by strategic investors that are commercially orientated. SWFs can play an effective role in this regard to monitor the partially privatized companies and promote organizational effectiveness. Privatized and listed state-owned enterprises are expected to be run strictly on profit maximizing basis and be permitted to go bankrupt.

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12 It is interesting that partial privatization remains significant since the aim of any privatization program was to sever ties with the state. One reason, as offered by Perotti (1995), is that partial sale of state assets can assist in establishing policy credibility; to signal to investors the government's commitment not to implement policies that would adversely affect the firms. In this respect, partial reduction of state ownership can lead to an increase in the market value of the firms. As reputation of commitment increases, the government fetches a higher price in future sales. For Boardman, Eckel and Vining (1986), mixed enterprises help to facilitate the role of the government as a steward in firms with a lack of market discipline. "Mixed enterprises may be best characterized as a compromise on the part of the government between availability of funding, the desire for efficiency, and the pursuit of equity goals" (*ibid*:235).

Theoretically, Shleifer and Vishny (1986) have argued that larger shareholders like the SWFs have large enough stake to collect information and monitor the management. Effective corporate monitoring by institutional investors results in managers focusing more on corporate performance (Gillian and Starks 2000). McConnell and Servaes (1990) and Del Guercio and Hawkins (1999) find a positive relationship between institutional ownership and various measures of firm performance partly because large shareholders like the SWFs display more patience with corporate executives because they are less pressured to maximize short term interest. This is particularly important in Asia where the real problem is misalignment of interest between the majority shareholders and the minority shareholders, and not between the investors and executives as commonly observed in the Anglo-Saxon countries. The nature of corporate abuse in Asian countries ranges from insider trading involving the majority shareholders selling off their equity shares to uninformed investors during bad times to expropriation of company's funds through commercial transactions.

The principal-agent framework may operate very neatly in theory, but in practice, a conflict of interest arises if the SWFs sacrifices shareholders value for state interest which goes beyond economic efficiency. The SWFs are caught in the awkward state-first condition where political-economic interest overrides the commercial interest.

Indeed, there are indications of commitment to political-economic interest by state-owned holding companies. *State-Owned Assets Supervision and Administration* or SASAC of China, for example, has been criticized for "lacking clear limits of authority" with the Board members who are nominated by government or Party bodies (Chiu and Lewis 2006: 123-24). SASAC claims that it is responsible of safeguarding the commercial interest of the shareholders and preventing the loss of state-owned assets. However, it also serves as an agent for the government to regulate and control the markets on behalf of the government. Furthermore, Li Rongrong, Chairman of SASAC, repeatedly claimed non-involvement of SASAC in the administration of state-owned enterprises (SOEs) but at the same time spoke of a need for SOEs to exercise control in the greater economy. This prompted Green and Ming (2005: 189) to conclude that the SASAC was essentially the "institutional embodiment of the socialist government's ambition to retain both ownership and control of its economy's largest, most important enterprises".

Russia too has established state-owned holding companies such as Gazprom, Rosneft and Rosugol, numbering 100 enterprises by the year 2000 (Radygin and Shmeleva 2003: 491). However, many of these holdings were criticized for being used to meet political interest (e.g. to gain votes during elections) and influence crucial budgetary decisions. With high levels of corruption, Radygin and Shmeleva (2003: 501) labeled the Russian state as an "ineffective" owner, which led to poor maximization of available assets. The Russian SWF – the Stabilization Fund – was a subject of heated debate and political contention in the mid 2000s with various domestic players eyeing for the fund's resources. For example, state-owned corporations proposed using the fund to provide loans to domestic firms whereas President Vladimir Putin urged the fund to finance public expenditure programs such as power stations, roads and waterways.[13] The Russian Ministry of Finance retained full management control of the Stabilization Fund (which split into two separate funds - the Reserves Fund and the National Wealth Fund – in 2008) and the way it used its assets thereby preventing the SWF from operating in an entrepreneur way (Fortescue, 2010). For example, it had been asserted that the funds of the National Wealth Fund were used to help former President Vladimir Putin's oligarch friends such as Igor Vyuzin and Sergei Bogdanchikov to pay off their foreign debts (Shemirani, 2011: 130-131).

It is therefore important to design the SWFs such that it s*eparates the government's function as a regulator and an owner* with the government assuming the role of the 'owner' (not regulator). SWFs should be commercially driven, focusing their attention on long-term capital return, and adhering to the laws and regulations of the countries they invest in. Otherwise, state-invested companies, including the SWFs, may face difficulty pursuing their investments abroad because the host countries fear that the large state owned firms would blackmail them with financial and economic sabotage. Edward Greene puts this across succinctly when he said: "Regulators (in the host countries) reviewing and approving investments are concerned that the SWFs' policies and objectives may not be transparent and may include goals beyond economic return, including political ends or the support of home-country industry" (Greene, 2012: 211).

The Santiago Principle 16 makes a similar point by emphasizing the importance of disclosing the objectives and governance framework of the SWFs. In particular, the SWF needs to promote "a clear understanding of what the SWF seeks to achieve and of the division of responsibilities to provide assurance that investment decisions are made on an independent basis without political interference" (International Working Group of Sovereign Wealth Funds, 2008: 19). Therefore, it is not surprising that when the western countries expressed concern about the agenda of the SWFs, the SWFs participated actively in the International Working Groups of SWFs to reassure the western nations that the SWFs would not use their investments as a foreign policy tool.

Taken together, the functions of the SWFs should include monitoring the performance of the state-invested companies, and strengthening the standard of corporate governance of state-invested companies. SWFs should not be seen as government-run institutions. Rather, they should be using their capital to advance financial aims. The government can send a credible signal to the market that it is committed to the cause of ownership and regulation demarcation. The extent to which this has been carried out in Singapore will be discussed in the next section.

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13 'Billions pledged for roads, homes', *The Moscow Times,* 27 April 2007; 'Oil fund manager warns on spending', *The Moscow Times,* 19 December 2007.

The case of Temasek Holdings Limited of Singapore

Temasek Holdings Limited was established on 25 June 1974 to assume the role of the state-owned institutional investor. Temasek was set up to hold and manage investments in companies that were previously owned by the Singaporean government. With the dividends collected from the companies, commercial borrowings and occasional injection of capital from the government, Temasek began to expand its investment portfolios. Began with an initial portfolio of S$354 million transferred from the Ministry of Finance, Temasek has grown with a total portfolio worth over S$198 billion as at end March 2012.

Temasek's main measure of performance, the Total Shareholder's Return (TSR) has strong growth at 17% over the last three-and-a-half decades, exceeding the performance of Morgan Stanley Capital International (MSCI) equity index (10%) in the same period (Table 2). However, it is worth noting that the TSR does not separate the performance of Singaporean SOEs and firms outside of Singapore (the latter accounted for 70% of Temasek portfolio as at end March 2012). TSR also does not explain whether Temasek's involvement has led to better corporate governance standard and hence the performance of the SOEs. The SOEs could have achieved a higher TSR because of factors other than corporate governance.

Temasek is not a typical SWF in the sense that it does not receive new funds or directions from its shareholders. It is recognized as one by international institutions such as the International Monetary Fund on the basis that it is wholly owned by the government and that it has substantially invested in the foreign markets.[14] Table 3 shows the geographical distribution of Temasek's portfolio. Temasek's exposure to Asia was 42% as at end March 2012 up from 40% in 2007, excluding Singapore and Japan while its exposure outside of Asia accounted for 28%. The current Singapore's share of the portfolio stood at 30%. Some of the recent major investments involve foreign entities such as the Bank of China, China Construction Bank Corporation, ICICI Bank, Standard Chartered and PT Bank Danamon Indonesia.

As pointed out earlier, countering nationalism is essential for Temasek and other SWFs as a means to globalize their investment portfolios. If the presumption that foreign governments will strategically invest to maximize foreign policy leverage persists, then some form of financial protectionism will arise to hinder the flow of funds. A key strategy of the Singaporean government is to demarcate its role as a shareholder and a regulator of the corporate sector with Temasek serving the role of the government representative. In this regard, the government has repeatedly claimed that despite the presence of public sector individuals in the board and management of Temasek, the government does not

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14 Besides Temasek, the Government Investment Corporation of Singapore (GIC) represents the other Singaporean SWF. GIC and Temasek are different in several ways. In terms of funding, GIC is essentially the manager of Singapore's foreign reserves whereas Temasek obtains initial funding and assets transferred from the government. After which, it relies on dividends and commercial borrowings to finance its investment expenditures. In terms of investment, GIC focuses on foreign investment whereas Temasek invests both in the domestic and foreign markets (Lee, 2010).

Table 2 Shareholders' total return

Morgan Stanley Capital International (MSCI) Equity Index and Total Shareholder Returns of Temasek Holdings				
Year ended in March 2011	Temasek Holdings Limited (%)	MSCI Singapore (%)	MSCI Asia Pacific excluding Japan	MSCI World (%)
1 year	4	11	7	3
5 years	7	8	6	-2
10 years	9	9	11	1
20 years	15	7	8	6
30 years	14	6	n.a.	9
36 years	17	10	n.a.	9

Source: Temasek Holdings Limited (2011); Challenges on many fronts for Temasek, *The Straits Times*, 8 July 2011

Table 3 Temasek's portfolio by geography (%)

	As at end March 2006	As at end March 2007
Singapore	44	38
Rest of Asia (excluding Singapore and Japan)	34	40
OECD Countries (excluding Korea)	20	20
Others	2	2
	As at end March 2011	As at end March 2012
Singapore	32	30
Asia (excluding Singapore)	45	42
Australia & New Zealand, North America and Europe	20	25
Latin America, Africa, Central Asia and the Middle East	3	3

Source: Temasek Holdings Limited (2007); Temasek Holdings Limited (2012)

intervene in the management of state-invested companies, inclusive of Temasek. As former Minister for Finance Goh Keng Swee explains: "there is a clear separation of powers of ownership and authority of management. Neither the supervising ministries nor the Boards of Directors can know more of the Government-Linked Companies' (GLCs) business matters than the managers themselves" (Goh 1995: 46). Companies in Temasek's portfolio are managed by the respective management, and guided by their respective boards. Temasek, as it reports, is not involved in the commercial or operational decisions of its portfolio companies (Temasek Holdings Limited, 2012: 45).

The commercial orientation of Temasek was reiterated by the then Second Minister for Finance Tharman Shanmugaratnam. Queried in the Parliament on why the government had not intervened in the Temasek-Shin Corporation (of Thailand) business deal in January 2006, the Minister told Members of Parliament that the government had not meddled with the Temasek-Shin Corp deal because it was not the government's job to do so.[15] To safeguard the image of the Singaporean government, it can be argued that it is not in the government's interest to do things in contrary to what it has pronounced publicly. Henry Yeung (2002) lent support to the argument of non-government interference in SOE's operations. In an interview he conducted with a Director of Strategic Development from a large Singaporean SOE, the anonymous Director was quoted of saying the following:

> "We are a lot more business-oriented than we were 10 years ago. A lot of decisions are done very independently as against 15 years ago when it was still very much influenced by ministries and government officials. There are corporate guidelines, yes, and so different levels of decision making. If it's a big investment you go to a certain level and if it's small, you just make you own decision. Some of these systems….. sometimes it's not that you don't trust the person. More so because since it's a significant investment, you would like to have a few opinions of it before you finally make the decision. Information sharing or comments given can be very useful. And we actually tap a lot of external parties on the board to help us take a second and sometimes third look" [quoted in Yeung (2002): 235].

Furthermore, using data from 17 Singaporean SOEs and 92 private enterprises, Ramirez and Tan (2004) concluded that the state-invested companies did not have easy access to credit but competed on a level playing field as far as financing is concerned. The results provided some indications of the government willingness to subject the state-invested companies to market forces.

In his testimony before the House of Financial Services Committee in the United States on 5 March 2008, Simon Claude Israel (2008), who was then Executive Director and Member of the Board of Temasek, told the US audience that the professional management team at Temasek consisted of 40% of non-Singaporeans at its senior level.

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15 Temasek ran into problems following its purchase of 49% direct controlling interest of Shin Corp of Thailand in January 2006. While the deal appeared to be of arms length, Temasek seemed to have underestimated or overlooked the discomfort among the Thai about the deal (Shin Corp has received enormous concessions from the government). Some Thai leaders pointed fingers at the Singapore government for spying on them through Thai mobile phone operators. The main operator in question, Advanced Info Service, is Thailand's largest mobile phone operator (45% of the market) and owned by Shin Corp. See Lee (2010: 53-57) for detailed description of the case.

This can be seen as an attempt to profile Temasek as a commercial entity on the basis that it is less likely for non-Singaporeans to serve Singapore's political interest in the hope of moving up the state hierarchy, particularly after the government has publicly pronounced the commercial orientation of Temasek. The creation of Temasek, according to Simon Claude Israel, "served to separate the regulatory and policy making function of the government from its role as a shareholder of commercial entities". As such, "Temasek was and is, expected to manage its portfolio with commercial discipline". Peppering the commercial orientation of Temasek to US audience is important as the United States remains a key investment location not only for Temasek but Temasek Linked Companies as well.

It is also worth noting that besides an internal board, Temasek has appointed a dozen or so individuals with diverse management background and industrial experience from the US, UK, Japan, China and India to sit on the International Panel. That there exist non-Singaporeans to provide advice on how Singapore's resources are to be allocated supports the government's claim that Temasek is commercially and independently run. The international panel also helps to advance Temasek's overseas interests by affecting overseas perception of Temasek. Temasek's purchase of Merrill Lynch's stock worth US$4.4 billion in December 2007 is a case in point. While the talks with Temasek on possible capital injection was led by John Thain, the newly appointed Chairman and Chief Executive Officer of Merrill, it was William J. McDonough who played a key role in dealing with Washington and getting the deal realized.[16] McDonough, who served as a member of the International Board of advisors of Temasek, was a respected former New York Fed Governor and Chairman of the Public Company Accounting Oversight Board. As Vice Chairman and Special Advisor to the Chairman of Merrill Lynch at the point of negotiation, McDonough gained congressional support for the deal by narrowing the information gap concerning the commercial orientation of state-owned Temasek and reinforcing the understanding from both sides that the deal would be strictly commercially orientated.

To counter nationalism, Temasek has recently advocated three strategies; to avoid buying over or taking a controlling stake in companies with 'iconic' value, to look for good partners to invest with and to opt for a minority stake if investing in a company from a sensitive industry.[17] There is a clear recognition that investments in sensitive sectors that involve critical infrastructure or critical energy resources can arouse nationalistic sentiment and antagonize larger states that do not like foreign takeovers

16 By the third quarter of 2007, Merrill had written down the value of its mortgage-related holdings by US$7.9 billion, prompting the departure of Stan O' Neal as Chairman. See 'Lobbyists smoothed the way for a spate of foreign deals', *The Wall Street Journal,* 25 January 2008; 'Merrill's escape route from turmoil', *Financial Times,* 22 December 2007.

17 Temasek's strategy to counter nationalism, *The Straits Times,* 23 November 2007.

of sensitive firms. [18] The strategies adopted by Temasek were aimed at allying fears and suspicions of recipient countries towards Temasek so that regulators reviewing and approving investments would view Temasek more favourably. They supplement the continuous efforts by Temasek to inculcate the trust within the investment community that investment arm of Singapore runs strictly on a commercial basis. They are deemed essential not only assist in globalizing Temasek's business, but companies it invested in as well since a commercially disciplined Temasek, which is 100% owned by the government, could increase the level of trust that such companies are also commercially orientated. In this regard, Temasek has been associating the investee companies more closely with Temasek rather than the government so as to counter the impression that they invest in the interest of the government. This can be seen, for example, in Temasek's rebranding exercise where its companies were labelled as Temasek Linked Companies in public pronouncements and not Government Linked Companies as they were previously known.

From the government's standpoint, two other measures are essential. First, to portray Temasek as a commercial entity requires Temasek to be accountable to the shareholders. The government of Singapore has relied on two main monitoring agents; the Minister for Finance - to monitor the management and performance of Temasek and the Elected President of Singapore - to ensure that Temasek's past reserves are not drawn without his explicit approval from the president (Section 22C of the Singapore Constitution). The statutory consolidated financial statements of Temasek audited by PricewaterhouseCoopers are submitted to the Minister on the activities of Temasek during the financial year. Like a typical private company, Temasek pays dividends and taxes to the Singapore government annually. Approval from the Elected President, on the other hand, is required for appointments, reappointments and/or removal of the board members or CEO (Section 22D). The Elected President serves as a check on the government and government related companies in the interest of preventing corruption and safeguarding Singapore's hard-earned assets. It is well known that an important reason for the agency problem to arise is the information asymmetry between the principals and agents where the latter have better knowledge about their ability and actions than the principals. By appointing the Minister and President as the key monitoring agents, the agency problem may be moderated since they stand a better chance of uncovering improper practices.

Second, Temasek has taken the initiative to strengthen its own standard of corporate governance. While putting in place the external monitoring mechanisms is necessary, they are not sufficient to prevent improper practices by the agents. The

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18 Temasek and the privatized Singaporean SOEs are not alone in facing resistant when investing abroad. In 2005, for instance, the US Congress blocked China's based China National Offshore Oil Corporation's (CNOOC) US$18.5 billion bid to acquire US Unocal. Dubai Ports World attempt to take over Peninsular and Oriental and Steam Navigation Company in 2006 had also generated a powerful nationalist backlash in the US. In this regard, it may be useful to examine how the Singaporean government has attempted to mitigate the problem. See Petrusic (2006) and Yao and Sutherland (2009).

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). Although Temasek has so far been free from any serious scandals, its role as an external monitor has its limits. For example, in March 2003, Sembcorp Logistics, which is part of the Sembcorp Industries group and one of the leading SOEs in Singapore, had to make amendments to its financial statement when its Swiss associate Kuehne & Nagel International announced a write-off that Sembcorp Logistics had failed into consider. In July 2003, the company uncovered an accounting fraud in its subsidiary in India. Certain individuals in the finance department had created fictitious documents and inflated profits by about S$18.5 million between 2000 and 2002.

Hence, to complement the external monitoring mechanisms, internal measures are in place to raise the standard of corporate governance. This is necessary particularly in the case of Temasek for three reasons. Firstly, a high standard of corporate governance helps to protect the interest of the shareholders against expropriations. Secondly, any attempt to meddle with the governing affairs of the Temasek invested companies can gain credibility only if the firm itself has in place a respectable corporate governance standard. Thirdly and more importantly, strengthening the internal control lends some support to the government's claim that Temasek is a commercial entity since many of the measures adopted by Temasek (like separating the role of the Chairman and the CEO and limiting the tenure of non-executive Board members) are consistent with the practices of large private corporations. Table 4 summarizes the main features of Temasek's internal process.

Table 4 Corporate Governance of Temasek Holdings Limited

Measures	Description
Separating the role of the Chairman and the CEO	The organization's Chairman, S .Dhanabalan, favors separating the role of the Chairman and the CEO, noting that "if you have a titan sitting as the Chairman and he is also the CEO, when things come up before the board for decision, it's very difficult for the directors to question the management on issues when the Chairman represents management. He is, in fact, representing not just the board, but also the management" (Balan, A. 'Temasek to be more proactive (winds of change), *The Straits Times*, 25 June 1999). Temasek's philosophy is to "create a situation where the board feels at ease in questioning and examining management proposals" (*ibid*). Temasek walks the talk with Dhanabalan serving as full time Chairman and Ho Ching as the CEO. Most of the Temasek Linked Companies have adopted this principle with the notable exception of Keppel Corp.

– Table 4 continued over page

Measures	Description
Adoption of Economic Value Added (EVA^{TM})-linked incentives and stock options plan.	According to Dhanabalan, Temasek encourages the 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". ('Singapore's Mr Buffett', *Australian Financial Review*, 24 May 2002) (extracted from http://www.singapore-window.org). This is to show that, despite being a government-owned enterprise, Temasek readily but selectively adopts the commercial business best practice (the use of EVA in this case) to improve its organizational excellence. Temasek is more skeptical in using stock options. To the Chairman, "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" (Dhanabalan, 2002). This is in line with the general criticism of the stock options scheme as one that encourages managers to manipulate the financial statements to meet the performance standards and reap the rewards associated with them.
Limit the tenure of non-executive Chairman to two terms of three years each, with a further term to be considered only under exceptional circumstances.	Board members of Temasek are rotated at the end of six or nine years. The term of directorship is limited, allowing each director to hold a maximum of six principal appointments at one time. A majority of Temasek board members concurrently hold directorships and advisory roles in both public and private sector institutions, reflecting a dense network and connectivity acquired within the business and political arena in Singapore. To mitigate the problem of conflict of interest, Temasek requires its board members to disclose their associated if they "board or other interests which may conflict with specific Temasek interests" (Temasek Holdings Limited, 2005:45). At least one empirical work finds Singaporean stock prices to react positively to appointment of non-executive directors who sit on multiple boards (Mak, Sequeira and Yeo, 2003). The market, according to the authors, could have seen these individuals as having wide contacts, reputation and experience that could eventually add value to the firm, whether or not the directors may be too busy contributing to the board. Multiple appointments and strong social network also offer to reduce environmental uncertainty arising from a lack of information, unpredictability of change in different sectors, and the inability of the firm to forecast direction of these changes (Schoorman et al, 1999; Granovetter, 2005).
Link remuneration to long-term performance	Temasek CEO, Ho Ching (2009) reviewed the organization's compensation framework on that is "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 wipe out if the organizations 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.

Conclusion

This paper considers the active involvement of SWFs as the nation states' investment vehicle to acquire foreign financial assets. To play the role effectively, the paper argues that it is necessary for the government to separate its role as the shareholder and regulator, and manage SWFs and state-invested companies on a commercial basis. Singapore's experience in commercializing Temasek Holdings Limited is presented.

Early recognition by the Singapore political leaders that civil servants and politicians should be left to focus on what they do best and leave businesses to entrepreneurs and professional managers led to the formation of Temasek. Temasek has taken the role of an investor, focusing exclusively on commercial returns. Although Temasek has encountered a fair share of problems in its efforts to globalize, Temasek can be deemed as a successful SWF with the size of its portfolio hitting close to S$200 billion mark as at end March 2012. The success of Temasek can be attributed to the government's commitment to separate its role as a regulator and a shareholder. The key initiatives taken to depoliticize Temasek are summarized as follows:

- The government demarcates its responsibility as a regulator and a shareholder to give Temasek a freer hand to pursue its strategies.
- The government appoints external persons such as the Minister for Finance, the international panel and the Elected President of Singapore to monitor Temasek.
- Temasek and Temasek Linked Companies are subjected to strong internal control. Their corporate governance standards are benchmarked against the best practices from the private sector.
- Temasek rebrands privatized/globalized Singaporean SOEs as Temasek Linked Companies, and not Government Linked Companies as they were previously known.

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