

Corporate Governance in Singapore: Recent Developments For the Next Millennium

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ABSTRACT

This paper surveys the regulatory and structural environment as it relates to corporate governance in Singapore, and presents empirical evidence on corporate governance practices in areas such as ownership structures, disclosure, board of directors, the use of share option schemes, and the impact of government corporate ownership. It reviews corporate governance reforms that have been implemented or proposed, and assesses their likely impact on future corporate governance practices in Singapore. Remaining concerns with the future of corporate governance in Singapore are also discussed.

1. INTRODUCTION

Singapore's small size and lack of natural resources have necessitated an open trade policy. Total trade amounts to more than two-and-a-half times GDP. In addition, Singapore has virtually no exchange controls on inflows and outflows of foreign currency funds by residents and foreigners, whether in amount or destination. Singapore also has a very liberal policy towards foreign direct investment (FDI), with no limitation on foreign ownership, except in the onshore banking and news media sectors. On many dimensions, ownership policies in key sectors are more liberal than many developed nations. For example, there are more restrictions on the ownership of financial institutions and media companies in Canada.

In such an environment, it would be expected that corporate governance would evolve along the lines similar to those of the United States (U.S.) and United Kingdom (U.K.) (Jensen and Ruback, 1983). However, this is not what we see in Singapore. Corporate governance in practice and philosophy is still relatively under developed when compared to those of the U.S. and U.K. In addition, the high concentration of ownership combined with a weak takeover market appears to work in favour of owner-managers who can consume at the expense of minority shareholders. Further, without the strong bank-centered monitoring mechanisms com-

mon in Japan and Germany, there appears to be a lack of either market or structural governance mechanism to discipline errant managers.

This paper surveys the regulatory and structural environment in Singapore as it relates to corporate governance, and presents empirical evidence on corporate governance practices in areas such as ownership structures, disclosure, board of directors, the use of share option schemes, and the impact of government corporate ownership. It reviews corporate governance reforms that have been implemented or proposed, and assesses their likely impact on future corporate governance practices in Singapore. Remaining concerns with the future of corporate governance in Singapore are also discussed.

2. THE SINGAPORE ECONOMIC ENVIRONMENT

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

- (a) Industrialisation to solve the unemployment problem and diversification away from regional entrepot trade.
- (b) Internationalisation by attracting foreign investors to develop the manufacturing and financial sectors.
- (c) Improving the investment environment by introducing employment and industrial relations legislation and investing in key infrastructure, such as the development of the Jurong Industrial Estate and Port of Singapore.
- (d) Establishing new companies such Singapore Airlines, Neptune Orient Lines, Development Bank of Singapore and Sembawang Shipyard in areas where the private sector lacked capital or expertise.

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

During the 1980s, the government adopted strategies to restructure the economy towards higher value-added activities in light of the tight labour market. These strategies included ensuring that wage increases reflect the tight labor market, increasing emphasis on education and training, encouraging the increased use of

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

technology, adopting a more selective investment promotion policy, increasing emphasis on research and development, and developing higher value-added services. By 1990, Singapore was classified as Newly Industrialised Economy (NIE) by the United Nations. The economy had become more mature, and was enjoying rapid growth as were many other economies in the region. The Strategic Economic Plan was then formulated to transform Singapore into a developed country. In the 1990s, the aims of Singapore are to become a globally-oriented city, a centre for high-tech manufacturing industries and an international business hub. She hoped to achieve this by being the hub of the Asia Pacific economic community through actively participating in regional economic initiatives, and investing in other rapidly growing economies in the Asia Pacific.

Table 1 provides a summary of key annual indicators for Singapore in 1997.²

Table 1
Key Annual Indicators in 1997

Indicator	Value
Mid-year Population ('000)	3,736.7
Annual Population growth (%)	3.5
GDP(\$m)	143,014.0
Per Capital GDP (\$)	38,272.8
Per Capital GNP (\$)	39,310
Annual Growth at 1990 Market Prices (%)	7.8
Unemployment Rate (% ,seasonally adjusted)	1.7
Annual Growth in Productivity (%)	1.6
Annual Inflation Rate (%)	2.0
Foreign Investments (\$m)	5,908.1 *
Official Foreign Reserves (\$m)	119,616.8
Average Exchange Rate (per U.S. \$)	1.4848
Total Trade (\$m)	382,217.7
Exports (\$m)	185,612.5
Domestic Exports (\$m)	107,535.2
Imports (\$m)	196,605.2

2.1 The Impact of the Economic Crisis

Although Singapore was less affected by the economic crisis than most other

² Source: Statistics Singapore (<http://www.singstat.gov.sg/FACT/KEYIND/keyind.html>)

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

The effects of the crisis included significant declines in stock and property prices, a large fall in demand in the local property market, an average decline of 20% in the value of the Singapore dollar relative the U.S. dollar, increasing unemployment and bankruptcies, and a significant decline in GDP growth. In 1998, real GDP growth fell to 1.5%. All sectors of the economy experienced deterioration in growth, with the manufacturing, distribution, and financial services sectors particularly badly hit. Total employment fell in the second and third quarter of 1998.

In the second quarter, the decline was mainly in the manufacturing sector, while the third quarter was more broad-based and also affected the service sector. A net loss of 18,000 jobs was recorded in the third quarter of 1998, which is the highest quarterly number of jobs lost since the recession in the mid-80s. The seasonally adjusted unemployment rate rose from 2.3% in the second quarter of 1998, to 4.5% in the third quarter. However, by 1999, real GDP growth had recovered to an estimate of 4 to 5% and is projected to be 1 to 2% higher for 2000.

In summary, the impact of the crisis on the Singapore economy, while not crippling has been severe. More importantly, what started out to be a localised impact on manufacturing has spread to the services, real property, and financial sectors engendering a sharp decline in consumer and investor confidence. In order to deal quickly with the situation, the government initiated a series of budgetary and off-budgetary measures to lower the cost of business, encourage greater mobility in the labour market to growth, high-valued added sectors, and minimise the social costs associated with declining asset values and job displacements.

2.2 The Government's Response

2.2.1. Economic Initiatives

In June 1998, the government announced a S\$2b package of off-budget measures to cut business costs and enhance the economic infrastructure as well as to help stabilise specific sectors of the Singapore economy. Major cost containment measures included additional property tax rebates on commercial and industrial properties, and rebates on electricity tariffs. Infrastructure spending is to be accelerated through the year 2002. Measures to support the property and financial sectors were also introduced.

In November 1998, the parliamentary designated Committee on Singapore's

Competitiveness proposed a series of short-term recommendations to help alleviate the effects of the crisis and long-term strategies to enhance Singapore's competitiveness over the next decade. These recommendations included reducing total wage cost by up to 20%, which included trimming employer pension fund contributions from 20% to 10%, and reducing foreign worker levies in the manufacturing and services sectors. It also recommended reducing land and factory rental rates, government charges for a wide range of services, vehicle use-related costs, and extending income tax rebates for fiscal year 1999. The total package was estimated to reduce business costs by S\$10b a year, which is equivalent to about 7% of GDP.

2.2.2 Financial Sector Reform

In late 1997, the Monetary Authority of Singapore (MAS), Singapore's Central Bank, embarked on a fundamental review of its policies in regulating and developing Singapore's financial sector. This review was undertaken by the Financial Sector Review Group, chaired by the Chairman of the MAS and Deputy Prime Minister Brigadier-General Lee Hsien Loong. In February 1998, the MAS unveiled a series of sector reforms aimed at making Singapore the dominant financial center in South East Asia. The MAS' new strategy involved the creation of an investor friendly regulatory environment that had, as its primary objectives, transparent supervision, product innovation, and aggressive advocacy for the industry.

The Financial Sector Review Group also formed various committees to make recommendations on various aspects relating to the financial sector. The major committees are Committee on Banking Disclosure, the Corporate Finance Committee, and the SES Review Committee.³ In part 4 of the paper, we summarise these recommendations and discuss their implications for corporate governance in Singapore.

3. CORPORATE GOVERNANCE IN SINGAPORE: PRE-CRISIS

3.1 Regulatory Environment

The Singapore corporate governance system is loosely based on the Anglo-American model (Li, 1994; Prowse, 1998). However, because the capital market in Singapore is thin (there are less than 4300 listed companies on the Singapore Stock Exchange), and equity is tightly held among the investors (including government, corporations, individuals and families), takeovers tend to be friendly rather than hostile. Furthermore, the lack of strict accounting standards, and the lack of legal backing and enforcement of these standards, means that the quality of publicly available corporate information is generally lower than in the U.S. More impor-

³ See Report on Banking Disclosure, May 1998; Report of the Corporate Finance Committee, 29 October 1998; Report of the SES Review Committee, 29 July 1998.

tantly, the high concentration of ownership among company management and large shareholders potentially violates the principle of the decision management and decision ratification (Fama and Jensen, 1983), and may result in the expropriation of wealth from minority shareholders to large shareholders (La Porta et al., 1996).

3.1.1. Companies Legislation and Shareholders Rights

In Singapore, the Companies Act of 1990 governs the registration of companies and is the primary source of law protecting the rights of shareholders. Most of the rights of shareholders are specified in the Articles of Association that companies are required to adopt. A model set of Articles of Association is contained in the Fourth Schedule of the Act. The model articles apply to companies that have not adopted their own Articles, or where the companies' Articles are silent on particular matters. Under the model Articles of Association, companies are allowed to issue shares with different rights pertaining to dividends, voting or return of capital. However, Section 64 of the Act requires all ordinary shares to carry one vote per share (the exception being a management share issued by a newspaper company under the Newspaper and Printing Presses Act). Other major features of company legislation relating to shareholders' rights include voting by proxies must be in person and not by mail, and cumulative voting for directors is not permitted.

3.1.2. Regulations of Takeovers

The major source of guidance on the conduct and procedures to be followed in takeover and merger transactions in the Singapore Code on Takeovers and Mergers (hereafter, "The Code"). The Code is non-statutory and supplements and expands on the statutory provisions on takeovers found in sections 213 and 214, and the Tenth Schedules of the Companies Act. The Code is modelled after the U.K. model, whereby shareholders, rather than directors (as is the case in the U.S.), decide whether to accept or reject an offer. Companies listed on the SES that are parties to a takeover or merger also have to comply with the provisions in the Listing Manual of the SES.

The Securities Industry Council administers the Code, which is divided into General Principles, Rules and Practice Notes. It was developed to aid directors and officers in the discharge of their duties in the event of a merger or takeover of a listed company. In general, the Code was set up as a way to protect the minority shareholder from possible adverse impact. As the concentration of stockholdings is very high in Singapore, the likelihood of minority oppression is very real because many takeover resolutions require only majority, rather than super-majority assent by the shareholders. For example, a principle in the Code states that at no time after a bonafide offer has been made can the board of a target firm take action to prevent the shareholders of the target firm from assessing the merit of the offer. In effect, such a principle prevents the ex-post adoption of poison pills as a method of entrenching management by frustrating the takeover. The Code reinforces the prin-

ciple that directors have a duty to all shareholders with preference given to none, including and especially to those with personal relationships to the board. In this regard, the Code imposes a rule that there can be no termination of director's service contracts within a 12-month period if the contract has more than 12 months to go prior to an impending takeover. This is to prevent directors from taking their own interests into consideration during a tender offer, such interests being to prevent the loss of a position or to capitalise on a golden parachute.

Unlike generally accepted practices in North America, the Takeover Code makes no mention or encouragement for boards to hold auctions. In North America, the initiation of an auction by the board is seen as a way to maximise the shareholder value. In Singapore, the Code promulgates a principle that all parties to a transaction must take special care to prevent the creation of a "false market", which, while left undefined, implies a proscription on auctions. While the Code states that information on the takeover must be made available to all shareholders, it holds the target company responsible for unusual movements in the price of its stock. Rule 7 emphasises the 'vital importance of absolute secrecy before an announcement'. Thus, it appears that the Code is primarily concerned with friendly mergers and not hostile takeovers, in which the very real possibility of an auction may exist⁴ In large part, this is due to the fact that hostile takeovers are rare in Singapore because the concentration of stockholdings in family trusts, related institutions, and government-linked corporations renders hostile takeovers very difficult if not impossible.

3.1.3. Disclosure Regulation

Regulation in the public sector is effected primarily by the Registry of Companies and Businesses (RCB), which administers the Companies Act of 1990, and the MAS, which administers the Securities Industry Act of 1986. The Companies Act requires financial statements to comply with the detailed disclosure requirements in the Ninth Schedule and to present a true and fair view. There are some differences in accounting and auditing requirements for private companies, public companies and listed companies. For example, the Act includes provisions for maintaining adequate internal accounting controls for public companies, and for listed companies to have an audit committee made up of at least 3 directors, a majority of which must be independent directors.

The regulation of accounting in Singapore involves a combination of private sector and public sector regulation. The Statements of Accounting Standards (SAS) together with the rules contained in the Stock Exchange Listing Manual (administered by the SES) and the Companies Act determine how accounting is practised in Singapore. The two major institutions involved in private sector regulation are the

⁴ Accounting to some commentators hostile takeovers should be encouraged because it engenders the creation of shareholder value by freeing up cash that has been inefficiently employed (Jensen and Ruback, 1983).

professional accounting body, The Institute of Certified Public Accountants of Singapore (ICPAS), and the Singapore Stock Exchange (SES).⁵ The ICPAS has the sole responsibility for developing and maintaining SAS and issuing Statements of Recommended Accounting Practice (RAP) which specify how to account for certain business transactions. Standards setting is done through the Accounting Standards Committee appointed by the Council of the ICPAS. Each new Standard becomes part of GAAP, the "accounting law of the land." There is also the Financial Statements Review Committee of the ICPAS which reviews published financial statements for compliance with statutory requirements.

Since the SAS issued by the ICPAS does not have legal backing and the ICPAS only has the authority to require members to follow its standards and guidelines, compliance with these standards depends largely on general acceptance by the business community. The SAS is based on the International Accounting Standards (IAS) issued by the International Accounting Standards Committee (IASC). In most cases, SAS are identical to IAS, although there are occasional deviations and omissions.⁶

3.1.4. Financial Sector Regulation

Understanding the institutional environment in which corporate governance is played out in Singapore would be incomplete without understanding the role and importance of the financial services sector. The Singapore government, as part of its industrial policy, targeted the financial services sector 15 years ago for development into one of the three lynchpins of the local economy (information technology and distribution being the other two). To help the financial services sector to develop, local banks and insurance companies were protected from competition, through restrictions on the entry or types of services offered by foreign financial institutions.

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

For example, the Banking Act of 1970 limits the investments of banks in other commercial enterprises to a specified percentage if its capital funds, the most recent

⁵ The SES, incorporated under the Companies Act and licensed as a stock market under the Securities Industry Act, is regulated by the Securities Industry Act and Regulations and supervised through a set of rules and bye-laws enforced by the 9-member Stock Exchange of Singapore Committee.

⁶ Recently, some commentators have criticized the decision of the ICPAS not to adopt the new IAS standard on extraordinary items, after issuing the exposure draft for comment. The new IAS standard would have tightened considerably the reporting of extraordinary items.

of which is 20%. They are more severely limited in their ability to take large positions in a singular company even though it may be less than the 20% limit. The exception to this rule is when a bank invests in companies set up to promote development in Singapore, which have to be approved by the regulatory authorities (MAS). In order to take high levels of ownership positions, banks have to undergo a judicial review process by the MAS. In addition to enforcing legislation, the MAS also performs regulatory oversight by direct intervention in matters of corporate governance. For example, it maintains the right to approve the appointment of directors on the boards of financial institutions.

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

3.2. Structural Environment

3.2.1. Equity Markets

As of the end of 1997, there were 241 Singapore companies and 53 foreign companies listed on the mainboard of the SES, with a total market capitalisation of S\$329 billion. In addition, there were a total of 62 companies listed on the second board (SESDAQ), with a market capitalisation of S\$3 billion. Prior to the economic crisis, IPOs in Singapore tended to be heavily over-subscribed, with retail investors actively participating in IPOs. The interest of retail investors can be attributed to the high savings rate, low interest rates, and the liberalisation of rules concerning the use of Central Provident Fund (a national pension fund) monies for equity investments. The economic crisis has slowed IPO activity considerably, with some issues being cancelled or deferred, and some companies making IPOs without the support of underwriters.

3.2.2. Ownership Concentration

Table 2 summarises the ownership structures of a sample of SES-listed companies. The median stock ownership by the CEO is 0.3%, and the median ownership by all inside directors is 4.3%. The median proportion of shares owned by blockholders is more than 60%, which is very high relative to many developed Western economies. However, there are some important differences between blockholders in Singapore companies compared to other countries. Unlike Japan and Germany, banks do not directly own significant proportions of shares in Singapore companies because they are not permitted to do so under the Banking Act of 1970. Further, unlike the U.S. and U.K., mutual funds (or unit trusts) are not significant blockholders. This is partly due to the undeveloped funds management industry in Singapore and to the likely lack of interest of large international mutual

Table 2
Ownership Structures of SES-Listed Companies (1995, n=158)

Percentage of total voting shares equity	Min	Max	Mean	Median
CEO ownership	0	0.875	0.143	0.003
Inside directors' ownership	0	0.875	0.229	0.043
Blockholder ownership (5% or more)				
All blockholders	0.200	0.981	0.617	0.627
Individual blockholders	0	0.662	0.053	0
Institutional/corporate blockholders (non-nominees)	0	0.943	0.363	0.383
Nominee blockholders	0	0.875	0.203	0.143

funds in Singapore's small economy companies. Efforts by the government to encourage the further development of the funds management industry, described in the next part of the paper, are likely to increase the ownership of companies by mutual funds and therefore increase the monitoring provided by these large institutional investors⁷

At the present time, blockholders in Singapore companies consist mostly of individuals, the government (through government controlled investment vehicles), corporations and government statutory boards (e.g., the Central Provident Fund). Because of the heavy concentration of stock ownership the practice of using nominee (or representative) directors is common. This often contributes to the problem of conflicts of interests, as directors are required by the law to represent all shareholders. In addition, nominee directors can potentially obscure the decision-making process in the boardroom because of their own agendas.⁸

As Shleifer and Vishny (1997) note, while large shareholders can potentially improve the monitoring of managers because of the alignment of cash flow and control rights, large shareholders represent their own interests. Where corporate governance is weak, large shareholders may expropriate wealth from minority in-

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

⁸ Interestingly, the large institutional investors in the U.S. are almost unanimously against the use of representative directors for this very reason.

vestors and other stakeholders. Large shareholdings may also result in a loss of diversification and inefficient risk-sharing. Thus, due to the presence of a weak takeover market, lack of disclosure, and weak protection of minority shareholders' rights, the high concentration of shareholdings in Singapore may actually result in a weak corporate governance environment by Anglo-American standards. Recent moves to improve transparency in corporate governance in Singapore may disclose shareholdings, and thus the incidence of nominee directors in private companies may become less concentrated in the future.

3.2.3. *Government Ownership*

A major feature of Singaporean economic landscape is the dominance of government-linked corporations (GLCs). Up to 70% of some GLCs are directly and indirectly controlled by the government- while a smaller percentage of major non-GLCs in the banking, shipping, and technology sectors are controlled indirectly through inter-corporate equity shares between the GLCs and non-GLCs. At the end of the 1980s, GLCs comprised 69% of total assets and 75% of profits of all domestically controlled companies in Singapore. In the 1990s, through a program of privatisation, which dispersed the equity of these companies, those number have been reduced. However, the government continues to hold majority ownership in these GLCs. Thus, a study of corporate governance in Singapore would not be complete without understanding the role and governance structures of the GLCs. In many ways, these companies form the bulwark of the domestic economy and are often seen as opinion leaders in the practice of management.

Since many directors of GLCs are also senior government officials, it is an indirect method of controlling and monitoring corporate activities and business policies by the government. However, while the government appears to facilitate governance through GLCs, there are some problems associated with this approach. The appointment of government officers to senior management and board positions within GLCs raises the question as to whether the best managers are running corporations that form an important part of the economy.⁹ In addition, according to Vernon and Aharoni (1981), GLCs must respond to a "set of signals from the government to which private managers are less alert. These signals are not related to profits but to goals associated with the well-being of the nation. These goals may sometimes be in conflict with the commercial objectives of the enterprise". Because of other superordinate goals, GLCs may also face less pressure in paying dividends.

⁹ This can be contrasted with the approach adopted in New Zealand, which underwent a significant restructuring of its public sector in the 1980s. Under the New Zealand approach, many government departments were converted into state-owned enterprises (some were fully privatised), and a major thrust in this restructuring involves the appointment of private sector managers to senior positions within these enterprises.

In addition, unlike other blockholders, who may play an important third-party role in facilitating the takeovers of poorly-performing firms, the government is expected to play the role of the long-term investor in these GLCs. Therefore, GLCs are even more protected from an already weak market for corporate control. GLCs are also likely to have easier access to different sources of capital when compared to non-GLCs. Often, the government is perceived by the leaders to have a moral and legal responsibility for their liabilities and this tacit backing of the state implies that the enterprise is guaranteed with solvency (La Porta et al., 1998). This results in a greater willingness by banks and non-bank financial institutions such as insurance companies to lend money liberally to these enterprises. Accordingly, "the fact that (GLCs) are part-owned (or managed) by the Singapore government enables them to raise funds much more cheaply - by up to four percentage points lower - than others" (*Business Times*, 4 March, 1997). The Minister of Finance noted that GLCs, being largely cash-rich, usually do not need to resort to raising bonds or bank borrowings (*Business Times*, 23 August, 1997). This of course reduces the potential discipline to which a GLC will be subjected in a competitive capital market.

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

3.2.4. Foreign Share Ownership Limits

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

The adoption of foreign ownership limits, whether statutory or self-imposed,

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

3.2.5 *Market for Corporate Control*

The takeover market, as might be surmised from earlier discussions, is not active in Singapore. This is due, in large part, to the concentration of stockholdings, the pervasive presence of interlocks, the government investment vehicles, and tight controls by the SES (for example, secrecy rules are in place and strictly enforced in order to reduce speculative buying on rumors). Hostile takeovers are almost unheard of and when they do happen, auctions seldom take place because of the secrecy rules just described. Thus, the discipline of a takeover market on director behaviour envisioned by Jensen and Ruback (1983) simply does not exist or is very weak in the Singapore context.

3.2.6 *Board Structure*

Table 3 shows the board structures of a sample of SES-listed companies. The average board size is about 8, with a range of 4 to 14 board members. The average board has a majority of outside directors (57%), with a range of 10% to 100%. Forty-six percent of companies have a dual leadership structure, defined as the situation where there is a separate CEO and executive chairman of the board. Therefore, on average, boards of Singapore companies exhibit the three features of boards that are considered to be indicative of effective boards (Jensen, 1993). In spite of this, a number of actors attenuate the effectiveness of a Singapore board. The reasons for which include the difficulty of removing ineffective directors and appointing new ones due to the large stakes held by directors, family members and passive shareholders, the lack of cumulative voting which may help minority shareholders appoint their own directors, and the weak market for corporate control which results in few board upheavals even when corporate performance is poor.

Table 3
Board Structures Of SES-Listed Companies (1995, n = 158)

Variable	Min	Max	Mean	Median
1. Board size	4	14	8.030	8.000
2. Proportion of outsiders	0.100	1.000	0.571	0.5703.
Leadership structure ^a	0	1	0.462	/
4. Board of interlocks (number of other firms) ^b	0	31	6.893	6.000

^a Leader structure is measured by a dummy variable, with 1 for a company having separate CEO and non-executive chairman, and 0 otherwise. The mean represents the proportion of companies having separate CEO and non-executive chairman.

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

The median number of interlocks is 6. Firm interlocks of more than 10 are rare. Hence, from what can be seen, it can be concluded that interlocking directorates is an extensive phenomenon in Singapore but that most companies with interlocks usually maintain only a few. Furthermore, from the raw data obtained, it is interesting to note that companies that form many interlocks are usually interlocked through only one or two directors on the board. United Overseas Bank, for example, has 16 firm interlocks, out of which 13 are formed by Mr. Wee Cho Yaw. Other such examples are Mr. Lim Chee Onn and Mr. Lee Hsien Yang. This seems to suggest that interlocks in Singapore by prominent businessmen and politicians are common, hinting at the class-wide integration theory of interlocks (Useem, 1982).

3.2.7. Accounting and Disclosure

Since IAS requirements tend to be less detailed than U.S. FASB standards, and IAS tend to allow more discretion in adopting accounting policies, the quality of financial disclosure in Singapore is weaker than in more developed Western economies, such as the U.S., U.K., and Australia. A study by Goodwin and Seow (1998), in which they examined the annual reports of 94 Singaporean companies from 1994 to 1996, concluded that the disclosure practices of Singapore corporations fell short of the recommended levels in the Best Practices Guide. They also concluded that, compared to U.S. firms, disclosure practices were poor, although they were better when compared to their South Asian counterparts.

One of the recurring criticisms of East Asian economies during the crisis has been the low quality of accounting standards and their enforcements. While

Singapore is always ranked among the best in terms of corporate disclosure in this region, disclosure and enforcement of accounting standards in Singapore still lag significantly behind more developed economies, such as U.S. and U.K.. We believe that one of the reasons is the standard-setting and enforcement in Singapore is largely left to a professional accounting body that does not face scrutiny from a regulatory agency, as the FASB does from the SEC in the U.S.. In addition, the SES does not appear to be particularly effective in enforcing its disclosure and other listing rules on listed companies.

3.2.8. Share Options

In recent years, many Singapore corporations have adopted employee share option schemes (ESOS) as a means of compensating directors, managers and employees. Until recently, ESOS were subject to strict rules in the SES Listing Requirements and Companies Act 1990. These rules relate to matters such as exercise price, expiration terms, vesting periods, total size of the scheme, number of options issued to particular individuals, and participation in ESOS.

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

Based on a study of 94 SES-listed companies that had adopted share option schemes between 1986 and 1997, Tan, Mak and Ng (1999) reported that, although the adoption of these schemes was associated with positive stock price reaction, they did not lead to higher long-run stock price or operating performance.

4. RECENT DEVELOPMENTS AND THE FUTURE OF CORPORATE GOVERNANCE IN SINGAPORE

In section 2 of the paper, we indicated that the Financial Sector Review Group, formed by the government, has unveiled a number of initiatives in its review of the financial sector. Perhaps the two reports that have the greatest implications for corporate governance in Singapore are the "Report on Banking Disclosure" (May 1998) and the "Report of the Corporate Finance Committee" (October 1998).

4.1. The Banking Sector

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

- (a) discontinuation of the practice of maintaining hidden reserves;

- (b) provision of details on loan loss provisions;
- (c) disclosure of off-balance sheet items in notes to accounts; and
- (d) disclosure of significant exposures.

With the raising of disclosure standards, disclosure practices of Singapore banks are now comparable with the requirements of international accounting standards. However, commentators have noted that disclosure practices of Singapore banks are still below those of U.K./European and U.S. banks.¹⁰

Another major corporate governance improvement is the requirement for local banks to form a board-level nomination committee. Members of the nomination committee have to be approved by the MAS. The major function of the nomination committee is to propose the appointment of board members and senior executives. Since two of the four local banks are family-controlled (the other two being government-controlled), there was a prevailing view that board members and senior executives of the family-controlled banks were traditionally chosen from families and relatives of the controlling shareholders. Consequently, it was felt that these banks were not run by professional managers.

The liberalisation of the banking sector has been accelerated. Recently, the MAS awarded four foreign banks Qualifying Full Bank (QFB) privileges and eight banks Qualifying Offshore Bank (QOB) privileges, and also announced eight new Restricted Banks (RB). The QFB privileges allow the foreign banks to have additional branches and/or off-premise automated teller machines (ATMs), as well as to share ATMs amongst themselves. The result is that local banks will be subject to significant product market competition from foreign banks in Singapore. The insurance sector is also being similarly liberalised.

As a result of the government, regulatory and market pressure for change in how local banks are managed, we are starting to see some positive signs of improvement in corporate governance among local banks. For example, in recent months, the local banks have reported the appointment of highly-qualified foreign executives to board and senior level positions.

Another regulatory change that can have a positive effect on corporate governance of banks is the removal of the 40% foreign shareholding limit. As a result of this change, all the four local banks have merged their foreign and local shares, and the market has reacted positively to this development. Allowing higher foreign shareholding provides the opportunity for large foreign investors (such as mutual and pension funds) to acquire larger stakes in local banks, giving them the incentive and opportunity to play a role in corporate governance of these banks. More active foreign institutional investors can help protect minority shareholders' interests in the face of significant ownership by managers and related parties in banks. They may be particularly important given the relatively undeveloped local fund

¹⁰ See Chua, K.C., and Lian, W.C., "A milestone in bank disclosures", *The Business Times*, May 27, 1999, p. 15.

management industry and the absence of large local fund managers holding significant shareholdings in local banks.

4.2. Other Corporate Governance Developments

Some notable recommendations in the "Report of the Corporate Finance Committee" that have implications for corporate governance in both the financial and corporate sectors include:

- (a) moving towards a predominantly disclosure-based philosophy of regulation with a high standard of prospectus and continuous disclosure;
- (b) more timely release of annual reports and interim results;
- (c) encouraging listed issuers to report their results on a quarterly basis;
- (d) consolidating securities legislation into a unified code;
- (e) moving to a single securities regulator responsible for enforcing all aspects of securities law and regulation (including disclosure of obligations) and prescribing accounting rules;
- (f) making it easier for shareholders to institute civil right of action for insider trading and obtain compensation for losses from insider trading;
- (g) adopting best practice principles in corporate governance for all listed issuers of stock;
- (h) disclosing corporate governance practices and procedures adopted by listed issuers in their annual reports;
- (i) allowing controlling shareholders who are executives of the company to participate in employee share ownership schemes (ESOS), subject to approval by minority shareholders;
- (j) encouraging a wider participation in ESOS;
- (k) easing, and eventually removing, the current 5% limit on the maximum size of ESOS; and
- (l) allowing greater flexibility in the setting of exercise price for options with specified vesting periods.

The government has expressed support for these recommendations, with several already being adopted, including shortening of reporting period by listed companies from 6 months to 5 months, allowing civil right of action for insider trading without criminal conviction, adopting best practice corporate governance code by SES, and easing of the rules on ESOS. The Ministry of Finance has also formed a committee comprising of representatives from both the government and private sector to make further recommendations on corporate governance reforms. It is expected that in due course, most of the other recommendations of the CFC would be implemented.

The Securities Industry Council has recently announced a review of the Takeover Code, with a view to making takeover rules clearer, more certain and less expensive. Clearly, the intent is to improve the efficiency of the market for corporate

control in Singapore, which would be welcome. However, there is of course the need to balance this against the need to ensure that minority shareholders' rights are adequately protected.

The ICPAS has also undertaken to review Singapore Accounting Standards to ensure that they are at least comparable to the requirements in International Accounting Standards (IAS). In addition, it has undertaken to adopt IAS on a more timely basis. This may help raise disclosure standards among Singapore companies.

Another important development in corporate governance in Singapore is the legalising of share buybacks. Share buybacks provide an additional mechanism for company management to return excess cash to shareholders and can therefore reduce the free cash flow problem described by Jensen (1990). Some companies such as Singapore Press Holdings have announced plans to reduce their share capital by buying back shares.

In addition to banks, several other companies, such as those within the Singapore Technologies (ST) Group and NOL have increased or removed their foreign shareholding limits. In addition, companies such as the ST units and Singapore Press Holdings, have merged their foreign and local shares. This is a positive development as large foreign institutional investors can become more actively involved in corporate governance of Singapore companies. Recently, the regulatory authorities have reaffirmed that the 5% limit on shareholding by a single party in banks and 3% in news media companies applies to nominee interests. This precludes institutional investors holding nominee interests from acquiring shares above these limits from these companies. We believe that these limits should be reviewed as they discourage large institutional investors from investing in these companies, and restrict their ability or incentives to participate in the corporate governance of these companies. In this regard, we agree with the following sentiments expressed by a fund manager:

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

The development of the bond market and the fund management industry can also enhance corporate governance. To help develop the bond market, the government has encouraged GLCs and statutory boards to raise funds through bond issues, and several have either done so or have announced plans to do so. This is

likely to have positive implications for the corporate governance of GLCs and statutory boards, as borrowing through bond issues subject them to the discipline of the capital markets and can reduce moral hazard problems.

The government has committed to place S\$25 billion of Government Investment Corporation (GIC) funds and S\$10 billion of MAS funds for external (international) fund managers to manage. The entry of external fund managers may alter the ownership structure of Singapore companies, with a shift towards greater ownership by fund management companies. Fund managers owning significant blocks of shares in companies have both the incentives and ability to monitor management, and are therefore likely to play a more important role in the corporate governance of Singapore companies in the future.

Finally, in recognition of the importance of corporate governance, the SES, with support from the MAS, instigated the formation of the Singapore Institute of Directors (SID) in May, 1998. The Institute, governed by a Council comprising industry leaders and government representatives, is a voluntary association registered under the Companies Act. It is modelled after the British Institute of Directors and is chartered to improve and professionalise the practice of directing in Singapore companies. With the help of experts from industry and academia, the Institute has developed a director certification program modelled after the British and Australian IODs. Directors of newly listed companies and those wishing to obtain membership in the Institute may participate in this program in order to enhance their directing skills and knowledge. The objective of the SID is to eventually require all directors of mainboard listed companies (as is now the case with London Stock Exchange listed companies) to be certified by coursework. If similar experiences in the U.K. and U.S. can be generalised, the institutionalisation of directing in Singapore will raise the level of awareness of directors' legal and moral responsibilities, professional conduct in the boardroom, and standardise the implementation of legal remedies for shareholders seeking redress for fraud and other corporate malpractices.

4.3. Global Convergence and Corporate Governance in Singapore

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

Second, there is a certain degree of convergence in companies and securities laws and regulations worldwide. Many Asian countries are moving towards U.S.-

style securities regulations and enforcement. There is also increasing impetus for the adoption of international accounting standards, with many influential inter-governmental and regulatory agencies calling for the speeding up of acceptance of these standards. At the present time, the International Accounting Standards Committee (IASC) has largely completed its development of core international accounting standards, which are now being considered by the International Organisation of Securities Commissions (IOSCO).

Third, major inter-governmental bodies such as OECD, World Bank, IMF, and ADB have pushed for corporate governance reforms in Asian economies, and "rescue" packages offered by the World Bank, IMF and ADB often come with the requirement to reform corporate governance. The OECD has developed a set of Principles of Corporate Governance, and together with the World Bank, has initiated a Global Corporate Governance Forum to push for the adoption of these principles. These principles have support at the Ministerial Level among OECD and many non-OECD countries.

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

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

5. CONCLUDING COMMENTS

In summary, the financial crisis has led the Singapore government to implement a number of initiatives to improve Singapore's competitiveness, and to strengthen its financial sector. Significant proposals have been made to improve corporate governance in Singapore. These include the improvement of disclosures by banks and other listed issuers, the creation of a single securities regulator with wide powers, the improved ability of investors to take civil action against insider trading, and the greater flexibility in using share option schemes to align the interests of shareholders and management of companies. Many of these proposals have been implemented. Other financial sector development such as the development of the funds management industry and the bond markets are likely to further enhance corporate governance in the future.

However, a number of concerns remain. First, there remains doubt as to whether current and proposed securities and company legislation, and the general legal framework in Singapore, accord adequate protection to the rights of minority shareholders to encourage them to increase their participation in share ownership. In the absence of such protection, ownership in Singapore is likely to remain heavily concentrated with significant ownership by executives (and their families), which

violates the separation of decision management and decision control and leads to the inefficient sharing of risks. With significant concentration of ownership among individuals who are either managers or relatives of managers (especially for smaller listed companies), matters such as related party transactions and insider trading will remain a concern.

Second, it is likely that the impact of global convergence (discussed in the previous section) will be most keenly felt by larger companies that operate internationally and access international financial markets. Many smaller listed companies have little need to access capital markets, either domestically or internationally, and it seems likely that these companies will continue to adopt minimal, rather than internationally acceptable, corporate governance practices.

Third, the continued participation of the government in many private sector firms reduces the exposure of these firms to competitive markets and creates moral hazard problems through implied performance guarantees. Given the perceived need to use these government-owned companies as tools for economic development and regionalisation of the domestic economy, we are doubtful that Singapore will move towards a model of corporate ownership in which the government does not own significant equity in private sector firms. Thus, we feel there is an urgent need to improve the accountability, management and monitoring of these government-owned companies. Temasek Holdings Limited, the government holding company for GLCs in Singapore, has acknowledged concern with monitoring of GLCs. It has signalled a more active future role in the governance of GLCs, including greater scrutiny of diversification plans, closer vetting of board appointments, and encouraging the separation of the CEO and chairperson roles in GLCs. The government push for GLCs (and statutory boards) to use more bond financing can also help subject GLCs to the discipline of financial markets. However, it remains to be seen whether these changes will lead to improvements in the governance of GLCs.

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

Finally, there is a danger that inertia will cause companies to comply with the rules (as they did in the merit-based environment) rather than responding to the market demand for disclosure and good corporate governance (as is required in a disclosure-based environment). For example, we have recently seen several cases of companies changing their ESOS practices in line with the relaxation in the SES rules, but it is rare to find a Singapore company following what are considered best

practices in ESOS overseas (such as using vesting schedules, transparency in value of options awarded, and using indexed or out-of-the-money options). Further, as strict rules are relaxed in a disclosure-based environment, in order that shareholders can have a larger say in deciding on the merit of transactions, one can question whether shareholders in Singapore are willing or able to play a more active role in corporate governance at the present time. There are disconcerting signs that as the SES and other regulatory agencies take a more hands-off approach in line with the disclosure-based environment, some Singapore companies continue to practise questionable corporate governance because of the lack of adequate shareholder monitoring to replace the role vacated by regulators. It can be argued that the merit-based approach to regulation that was practised in Singapore for so long reflect the cultural, social and economic environment in Singapore (including the significant concentration of ownership among the Government, individuals and families). Although a disclosure-based philosophy to regulation is, we believe, the right path to take, and is inevitable given the globalisation of markets, much remains to be done if we are to have a corporate governance environment that is comparable to international standards in the next millennium.

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