Unpacking Singapore's Corporate Governance

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Singapore maintains a robust and transparent corporate governance framework, which benchmarks well with regional peers. The Code of Corporate Governance operates on a comply-or-explain basis, an approach pioneered by and working well in the UK. But has corporate governance based on similar principles in a comply-or-explain regime achieved its fundamental objective of creating value for investors in the local context?

Singapore prides itself on generally strong corporate governance, with the country placed relatively well against regional competitors. Reports such as the *CG Watch* series by the Asian Corporate Governance Association and the ASEAN Corporate Governance Scorecard by SID and NUS' Centre for Governance and Sustainability offer validation in this respect.

Staying ahead of the region – which has been closing the gap fast – has required constant change and improvement. The Code of Corporate Governance (CG Code), first issued in 2001, has been updated in 2005, 2012 and most recently in 2018.

These revisions have introduced new requirements that sought to move the debate forward and have, in part, reflected contemporaneous concerns. Requirements continue to be tweaked, even outside the Code refresh cycle. For example, earlier this year, Singapore Regulation (SGX RegCo announced a hard limit of nine years on independent directors' tenures and new requirements around CEO remuneration disclosure.

Whilst these are steps towards greater accountability, there is also an opportunity to take stock of the status quo and to ask whether more can be done. This involves asking bigger – and perhaps uncomfortable – questions. The answers to these questions will be diverse. Nevertheless, such considerations can contribute to the discussion on corporate governance and how to continue to move forward.

Does corporate governance currently work?

The first basic question is whether corporate governance works at all.

This begs the question of the purpose of corporate governance. Is it to minimise risk, avoid failures and ensure the long-term survival of a firm? Or is it to help the company maximise its potential? If this sounds like a deliberately provocative construct with an artificial "either/or" outcome, that's because it is.

The 2018 CG Code includes in the introduction that "Corporate governance refers to having the appropriate people, processes and structures to direct and manage the business and affairs of the company *to enhance long-term shareholder value*, whilst taking into account the interests of other stakeholders" (italics are my emphasis).

Paragraph 1 of the CG Code then highlights the importance of corporate governance to shareholder value creation. In short, one reading is that corporate governance exists to help support and drive value creation.

It follows, therefore, that to assess the success of our corporate governance regime, we should consider not only the incidences of failures in our market (i.e. has corporate governance helped to avoid the sort of catastrophic corporate failures that destroy shareholder value) but also the track record of shareholder value creation in Singapore.

Put simply: are companies creating value for the investors who invest their savings and retirement in a company?

Whilst this sounds quaint, it is actually closer to reality than many perceive. There is a chain of intermediaries (including asset managers, consultants, etc), but at the end of the chain, the ultimate provider of capital is typically a group of individuals saving for their retirement, college fees, or some other life event, and who need to earn a return on their investments to help them achieve their goals.

The box, "Do Companies Drive Value Creation?" shows ways of calculating a return on the cost of equity.

From box analysis, we can see that only a quarter of companies in Singapore compensate investors for taking equity risks, and only a quarter trade above book value.

Can we then conclude whether corporate governance is helping "to enhance long-term shareholder value"? If it seems corporate governance is not helping to enhance long-term shareholder value, then the question should be, why not? And, by extension, what more can

Do Companies Drive Value Creation?

There are two relatively simple methods for determining whether companies create value. (Neither is, in fact, simple given the assumptions contained within, but for our purposes, we can dispense with any of the tweaks that might otherwise be made.)

1. Does the company return value above and beyond its cost of equity?
2. Does the company trade above or below its "break-up" value, defined as book value per share, i.e. is the "price to book" multiple greater than 1?

Providing a return above the cost of equity is important. The cost of equity is the minimum return that equity investors expect to receive to compensate them for the risk of investing in the equity of a business. If a company earns above its cost of equity, then investors are adequately compensated. If a company earns below the cost of equity, they are not.

A look at Bloomberg can help us answer these questions. Note that Bloomberg data are for illustration only. No assumptions regarding future performance should be made.

- There were 640 companies listed on SGX at the end of July 2023, including 433 mainboard listings (406 primary and 27 secondary listed companies) and 207 Catalist listings.

- Let's assume a simplistic 8 per cent cost of equity (a broad assumption but a necessary one). This means that companies need to earn a return on equity above this 8 per cent hurdle.

- Of the companies listed, Bloomberg suggests that only around a quarter (172) have a return on equity of greater than 8 per cent (data as of 17 August 2023).

- The remainder (three quarters) are not returning above their cost of equity, and hence, investors are not being adequately compensated. Now, this is a snapshot and does not take into account changes over time, but it is still a relatively low number.

- If we turn to valuations, we can see that around the same number (181) are trading above "book value", i.e. are worth more than the sum of the parts (data as of 17 August 2023).

As with the return on equity calculations, there are a lot of assumptions included here, and, of course, book values do not always reflect current market valuations, and there are differing accounting treatments of assets. However, the conclusion is directionally important rather than specifically so.

subsequent CG Codes and regulations do to help this?

The answer may not touch on risk and controls. However, some of the answers may be around the structure of market discipline, which the CG Code assumes. That brings us to the next question.

Does "comply or explain" work?

Whilst the CG Code has been regularly updated since the first one in 2001, the basic premise has not, which is: That companies are expected to either comply with the Code or explain deviations from the Code (i.e. "comply or explain").

This comply-or-explain regime was pioneered by the UK's Cadbury Code in 1992. It sought to emphasise flexibility and allowed companies to either comply with code provisions or explain why they do not. Institutional investors would then analyse a company's arrangements, consider the argument(s) made by the company, and act accordingly.

Given the high levels of institutional ownership in the UK, and the associated higher levels of influence these investors have historically enjoyed, this has worked relatively well. There have been periods of soul-searching, some of which in more recent times have resulted in the publication of "stewardship codes", which sought to codify not only the rights but the responsibilities of investors to act as stewards. But on the whole, the market has worked well in maintaining standards.

However, the Singapore context is different. Large ownership stakes by families or other groups mean that the market discipline mechanism for governance is largely absent, save for certain transactions reserved for minority approval. Corporates can provide fairly general comments on why they deviate from the provisions of the Code, knowing that there is little to no risk of a director failing to be successfully re-elected at the next Annual General Meeting.

The ecosystem of ownership here does not seem conducive to a comply-or-explain approach. This should not be taken as an extremist or alarmist position. But we should reflect on our own specific ownership context here in Singapore when contemplating corporate governance mechanisms, given ownership and control (i.e. principals and agents) are more blurred than in the UK.

Moving forward

As mentioned, there is much to take pride in and comfort from. Corporate governance in Singapore remains generally strong. Nonetheless, considering the two provocative questions above might contribute to the ongoing debate about corporate governance here in Singapore.

In part, these questions stem from the hypothesis that there is insufficient "optimisation" of companies listed in Singapore. Three-quarters of companies are not earning above their cost of equity, and three-quarters trade below book. Yet there remains little to no market discipline mechanism, no way to change boards, and no way to optimise capital allocation.

As an ecosystem, we should reflect on how we can ensure that capital is better allocated, returns are optimised, and savers are better compensated for the risks they are taking. Addressing this could unleash a wave of capital maximisation that could help drive reinvestment in the market, unlocking capital to be invested in more efficient and more productive undertakings, helping savers and retirees meet their financial goals, and reinvigorating global interest in Singapore as an attractive financial hub. ■