CHAPTER 1: INTRODUCTION

1.0 Background of study

Ownership structure and its impact on company performance have been widely debated since Berle and Means (1932). According to Jensen (2000), ownership structure is significant in determining a company's objectives, shareholders wealth, and the discipline of managers. Besides aiming to achieve company objectives, managers and shareholders also try to maximize company performance. However, managers have other interests that may conflict with those of shareholders.

Government ownership is one type of ownership structure that has become more important today, especially in Malaysia (as a developing country) and also Singapore (as a developed country). Government owned companies or corporations (or state-owned enterprises, SOE) exist just for the sake of national welfare or being non-profit organisations, since profit maximisation is not their major target. When more companies under government control became privatised, many were still owned and controlled by the government, and, thus, the privatisation is only partial privatisation.

Different countries use different terms for their government-owned companies. For example, Malaysian and Singaporean companies under government control are called Government Linked Companies (GLCs) while their investment companies are called Government Linked Investment Companies (GLICs). However, in China, they are called State-Owned

Enterprises (SOEs) and in Australia and New Zealand, Government-Owned-Corporations (GOCs).

According to La Porta (1999), state or government ownership in Asian countries has become more vital, especially in market capitalisation after the Asian economic crisis. In Malaysia, GLCs and GLICs that are led by government agencies, namely, Khazanah and six other agencies control more than 30% of market capitalisation. Furthermore, more than a 50% stake in the companies is held by Temasek Holdings, Singapore Technologies, and MND Holdings. Without a doubt, GLCs in both countries have been a major element in the socio-economic development of these countries, however, their performance has been questionable even with government involvement (Hamid, A.A, 2008). Their performance has also lagged behind that of the more established non-GLCs. This study will identify, or determine the performance of GLCs as compared to those of non-GLCs in the periods prior to the economic crisis through post crisis (1999-2005).

Modern corporate finance literature focuses on two important issues that govern the management activities and their behaviour. These are ownership, and the control mechanisms placed to ensure a positive impact on the value of the company. Therefore, the relationship between ownership structure and company performance has been an issue of interest among academics, investors and policymakers alike because of the importance of an alternative governance system in which government ownership serves as a control mechanism.

As defined, government ownership (or common, full-community non-state ownership; also called public ownership, state ownership, or state property) refers to the ownership by a government of any asset, industry, or corporation at any level –national, regional or local (municipal). The process of bringing an asset into public ownership is called nationalisation or municipalisation.

A government-owned corporation may resemble a non-profit corporation, as it may not be required to generate profits. Governments may also use profitable entities they own to support the general budget. A synonym for a government-owned corporation is that of state-owned enterprise (SOE). However, it is less expected to operate in a broadly commercial manner and not all the SOEs are monopolies in their respective industries.

The creation of a government-owned corporation (corporatisation) from other forms of government ownership may be a precursor to privatisation. Government-owned and run enterprises, in principle, represent the interest of a broad base of individuals, not just the controlling shareholders. If the ownership/control rights of the government evolve into a strong monitoring role without operational or managerial responsibilities, then it may fill the role of an external monitor when strong external institutional investors are not yet available in the transition period.

Government involvement in corporate decisions is still important even though their ownership and control pattern already differ over the last four decades, especially after privatisation. This situation is called partial privatisation. Before privatisation, all managerial decisions of government companies (including SOEs) are guided by the objectives laid down by government bureaucrats. However, after privatisation, managers are guided by the principle of value maximization and face the consequences of any risk taking projects. For example, in China, partial privatisation, whereby the government still controls companies, is still the major contributing factor in developing its economy, providing employment, and reducing poverty. These reform processes began in the late 1970s and many SOEs in China have attained significant progress in some important areas. However, most of the SOEs in China underperform, as reported by Wei (1997), Yu and Wang (1997), and Wang (2003).

However, in Singapore most studies indicate that GLCs with government involvement lead to better performance than non-GLCs (Ang and Ding (2005) and Ramirez and Tan (2004). GLCs have higher valuations than the non-GLCs even after controlling for company specific factors such as profitability, leverage, company size, industry effect, and others.

In Western Europe, there is an ongoing debate among government officials in deciding how much the government involvement should be in regulating the national economy and which industrial sectors should be reserved for state ownership. For example in the UK, when the Thatcher government came into power in 1979, it was decided that the government should control or own major economic contributions for the country such as telecommunications and postal services, utilities, and non-road transportation (such as airline and railroads). Meanwhile in other European countries, especially Western Europe, most of their governments or states monopolised and protected their own banks even though through partial privatisation (La Porta et al., 1999).

Most of the earlier literature on the involvement of government on company ownership studies argues that private ownership may provide better incentives for managers, as such ownership provides them with property and ownership rights, therefore, privately owned companies perform better than companies with government or state ownership and central planning (Alchian and Demsetz, 1972, Laffont and Tirole, 1993, Shielfer, 1998). In the 1980s, most of Central and Eastern European Countries initiated large-scale privatisation programmes to reform the poorly performing state-owned enterprises (SOEs). However, these mass privatisation programmes failed in the absence of a well-functioning financial infrastructure (Estrin, 1998, and La Porta, Lopez de-Salinas, Shleifer and Vishny, 2002).

Government ownership allows the government agency to advance its own political interests by intervening in the business operations of the company (Shielfer and Vishny 1994, and Boycko, Shielfer and Vishny 1996b). This distortional effect and the commitment effect constitute the trade-off between government ownership and private ownership. The extent of market failure affects the manager's outside options, which, in turn, determine the nature of this trade-off. In particular, government ownership dominates private ownership when the product market is heavily underdeveloped; however, as the market growth matures, such dominance disappears and private ownership becomes more efficient. They also highlight the benefits of private ownership under government failure. According to them, private ownership helps prevent the government from interfering with the operations of the company.

In the last two decades, particularly after the fall of the communist bloc in Eastern Europe, there has been an increasing dynamism in the public sector. Perhaps the single most significant feature of this change is the action taken by the governments to "corporatise" many aspects of governmental activities in their countries (Nellis, J and Kikeri, S 1989). Nonetheless, government control on the new structure of companies remains visible. In broad terms, corporatisation means the adoption of private sector organisational structures and governance techniques in the registered company for the conduct of governmental activity (Shirley, 1991). The main and important objective of corporatisation is to promote greater efficiency and more accountability of the organisations' operations.

At the government level, the issue of corporatisation strategy is deeply controversial and intimately connected with political and economic ideology. The emergence of government owned corporations undertaking activities previously conducted by government departments has been widely seen as a necessary step in the rolling back of the 'nanny-state', as an abdication by the state of its social welfare function, and as a mechanism to insulate the government from public accountability (La Porta et al.,2000b).

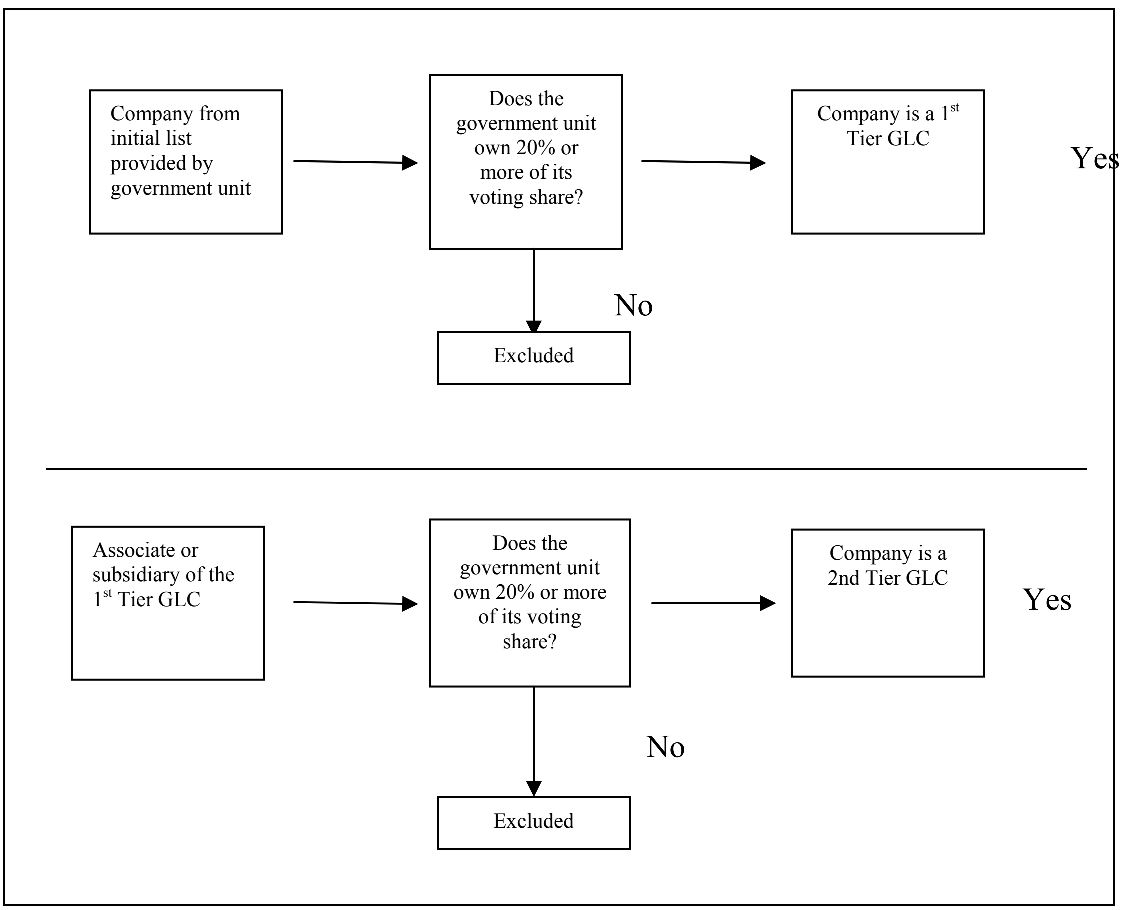
In Malaysia, government linked companies (GLCs) are defined as companies that have a primary commercial objective and in which the Malaysian Government has a direct controlling stake. Controlling stake refers to the Government's ability (not just percentage ownership) to appoint board members, senior management, and/or make major decisions (e.g. contract awards, strategy, restructuring and financing, acquisition and divestments, etc.) for GLCs, either directly or through their investment companies. Meanwhile, government linked investment companies (GLICs) are defined as Federal Government linked investment companies that allocate some or all of their funds to GLC investments. These include GLCs, which the Government of Malaysia controls directly through Khazanah Holdings, the Employees' Provision Fund (EPF), Pensioner Trust Fund (KWAP), Pilgrim Fund (TH), Armed Forces Fund (LTAT), National Capital (PNB), and Ministry of Finance Incorporate.

GLCs and their controlling shareholders constitute a significant part of the economic structure of the nation. GLCs account for approximately RM260 billion or approximately 36% and 54% of the market capitalisation of Bursa Malaysia and the benchmark Kuala Lumpur Composite Index, respectively. Additionally, GLCs account for an estimated 5% of the national workforce. Even with active divestment and privatisation, GLCs remain the main service providers to the nation in the strategic utilities and services comprising electricity, telecommunications, postal services, airlines, airport, public transport, water and sewerage, banking, and financial services.

Although there is increasing empirical evidence concerning the impact of government ownership on company performance in developed economies, little attention has been given to the modern emerging and developing economies, such as Malaysia to examine what constitutes governance structure and its impact on company performance. This study uses Singaporean company as comparison with Malaysian since Singaporean GLCs controlling more than 50% market capitalization and also is the most successful GLCs among other countries.

Meanwhile, in Singapore, GLCs were established after Singapore's Independence in 1965 and were mainly concentrated in key industries. By definition, GLCs are companies in which some shares are owned by the government. Figure 1.1 illustrates how a Singaporean company is categorised as a GLC.

Figure 1.1: Definition of GLCs



(Source: Ang and Ding, 2006)

For example, all of the direct first-tier subsidiaries of Temasek have their own subsidiaries, or associate companies, some of which may also be publicly listed companies. In turn, these subsidiaries may have third-tier subsidiaries and so on. There are also cross holding among the GLCs. One example is SembCorp, a conglomerate, which is held in part by Singapore Technologies.

GLCs, like all commercial entities also produce and sell goods and services in a competitive market environment. Most of these companies were established in the 1960s and 1970s, primarily to facilitate Singapore's economic development in specific sectors. In the 1980s and 1990s, GLCs were formed mainly from the corporatisation of former government departments and statutory boards.

The GLCs' reach is broad, and includes Singapore's national airline (Singapore Airlines); two leading telecommunications operators (SingTel and ST Telemedia); South-East Asia's biggest banking group (DBS); the main shipyards (Keppel and SembCorp); the port operator (PSA); a shipping company (Neptune Orient Lines) and a number of other businesses. GLCs account for nearly half of the 20 largest listed companies and more than 50% of the local Straits Times index, as at 2007. The government invests in corporations through three vehicles: MND Holdings, Singapore Technology Holdings, and Temasek Holdings. Figure 1.3 shows in detail the list of Singaporean GLCs and their market capitalisation.

1.1 Research Problem

Most studies show negative results on performance when there is government control on holding companies due to the political intervention and bureaucracy in handling companies' activities. Specifically, GLCs have poor performance results when compared to non-GLCs, possibly due to the GLCs having to forgo profit maximisation, which is the major objective of each company that managers try to achieve. This is because governments consider social and political objectives as their main mission over and above the objective of profit maximization. Hart, Shielfer and Vishny (1996) suggest that governments are likely to pay special attention to social and political goals such as low output prices. These may be the reasons why the performance of GLCs is lower than that of non-GLCs.

Second, Malaysian GLCs are closely associated with government policies such as wealth distribution and restructuring of society under the New Economic Policy (NEP)[1]. As such, GLCs are more often subjected to government intervention, for example, the appointments of Chairman/Chief Executive Officer (CEO) and directors have to be approved by the Ministry of Finance. Furthermore, an empirical study by Suto (2003) suggested that social policy advocating the dispersion of corporate ownership through the NEP weakened the corporate governance mechanism of GLCs in Malaysia.

Previous studies analysing the role of non-duality on a company's performances have been mixed, especially in emerging markets countries. For example, Majmudar (1996) found that

[1] The NEP was part of a series of measures that were intended to redress economic imbalance with the aim of enabling the Bumiputras (son of the soil) to own at least 30% of the nation's corporate share capital within a 20-year time frame (Abdul Aziz,1999). There were two broad objectives of NEP – fostering national unity and nation-building through eradicating poverty and active economics so as to eliminate the identification of ethnicity with economic function" (Malaysia,1991,p.31).

role non-duality will lead to worse performance for mixed, private and also state owned companies in the Indian industry. In New Zealand, Hossain, Prevost and Rao (2001) identified that with separation between the CEO and the chairperson of the company, the company usually performs better due to their transparency in decision-making. As such, Weir, Lang and Phillip (2002) found that non-duality has no effect on company performance in the UK whereas, in the US, Boyd (1994) found that non-duality results in better performance. McKnight and Mira (2003) found that non-duality has a moderately strong and positive impact on quality values. This means that companies that have non-duality roles do perform better than companies in which the CEO occupies both positions.

Meanwhile, according to Fama and Jensen (1983), reducing agency cost occurs by separation of ownership and control. The agency theory proposes that non-duality can be practised by separating the leadership structure. Previous studies indicate that companies that adopt a separate leadership structure significantly increase their financial performance (Che Ahmad, Ishak and Abdul Manaf, 2002; and Harris and Helfat, 1998). As explained earlier, based on empirical and theoretical evidence, there are mixed findings and limited studies on government ownership and performance, in comparing performance between the two categories of GLCs and non-GLCs, and in comparing between companies with different sets of rules and regulations, especially concerning corporate governance.

The conflicts might cause agency problems, which is one of the factors that contribute to a company's performance. Fama and Jensen (1983) explained that separating control from management helps mitigate agency problems and facilitates specialisation of management.

Sheilfer and Vishny (1997) documented that only the US and the UK have a highly diffused corporate ownership. In other parts of the world, concentrated shareholders are controlled by the owners, normally the founders, or regulations. Despite their potential agency problems, government ownership structures are slowly becoming more favourable today compared to other means of enhancing control such as non-voting shares, multiple class shares, and cross holding (La Porta, 1999).

Third, there is no evidence or research comparing between two or more countries concerning the performance of their GLCs or state-owned enterprises (SOE). Previous studies only discussed the comparison between GLCs and non-GLCs in the same country. For example, Ang and Ding (2006), and Ramirez and Tan (2003) looked at the Singapore case and Hamid (2008) compared between Malaysian GLCs and non-GLCs. In the Singaporean case, the results indicate that GLCs outperform non-GLCs on their financial and market performances, however, when applied to the Malaysian case, it is the contrary. Therefore, this study compares the Malaysian GLCs with the Singaporean GLCs, discusses why one performs better than the other, especially in financial and market performance, and identifies the reasons behind the differing results.

The other problem is that previous studies only used simple analysis in comparing samples with control variables. Hamid (2008) adopts one of the studies. In his study, he used simple multiple regression to compare between two samples, which are GLCs and non-GLCs. This study uses three methods of multiple panel pool regression, which are Ordinary Least Square

(OLS), Fixed Effect, and Random Effect. Tests were conducted on these three methods to choose the most suitable one for this research analysis.

1.2 Research Questions

The main purpose of this study is to compare the performance of government linked companies with non-government linked companies in Malaysian and Singaporean listed companies for the periods of 1995 to 2005. Therefore, there are four main research questions in this study are:

(a) Do government linked companies perform better than non-government linked companies in Malaysia and Singapore?

(b) How do company specific factors, namely, size, growth rate and leverage affect the performance of GLCs and non-GLCs in Malaysia and Singapore?

(c) How do company specific factors, namely, non-duality and agency cost affect the performance of GLCs and non-GLCs in Malaysia and Singapore?

(d) Do Malaysian GLCs perform better than Singaporean GLCs?

1.3 Research Objectives

This study investigates whether government involvement in companies leads to better performance in the Malaysian and Singaporean business environments. The motivation to undertake this study –to compare the performance of GLCs and non-GLCs – came from the idea that managers probably perform differently in the presence (or absence) of government involvement because of the different control mechanisms and incentives in place within the companies (Xiang 1997, Dyck 1997).

Earlier literature, which examined the performance of GLCs and non-GLCs, has been in developed markets, but little has been done to ascertain the contention that government involvement in developing markets serves as a control mechanism to enhance the performance of a company. Therefore, this study aims to determine whether government ownership of companies in Malaysia and Singapore leads to better company performance in terms of market and financial performance compared with non-GLCs. Second, this study also aims to ascertain whether other factors beyond government ownership, such as growth opportunities, leverage, size, and profitability have any impact on company performance too. Third, this study aims to compare the performance of the Malaysian GLCs with the Singaporean GLCs. Market performances consist of Tobin's Q, stock return, price earning (P/E) and market to book ratio (M/B), meanwhile financial performance include return on assets (ROA), return on equity (ROE) and profit margin (PM).

It is necessary to compare the two GLC scenarios of Singapore and Malaysia to identify the reasons that make GLCs in Singapore perform better than the non-GLCs, as in Malaysia, the results show that non-GLCs perform better than GLCs. This result may be due to the Singaporean government managing Singaporean companies with more transparency, and good corporate governance, especially concerning the role of their CEO and Chairman. Most of the CEOs are foreigners with great knowledge in running multinational companies.

Meanwhile, in Malaysia the government normally appoints civil servants and, thus, their decisions may be biased or politically motivated. The findings from these comparisons should lead to the development of new incentives and policy measures for Malaysian GLCs to emulate the strategies taken by Temasek Holdings (the government investment arm of Singaporean GLCs).

In addition to the above objectives, this study also examines the performance of selected public listed companies in both Malaysia and Singapore during the pre- and post-Asian crisis periods. The purpose of analysis of these periods is to identify whether there is any difference in the performance of companies in terms of ownership structure, leverage, risk taking, growth, profitability, especially the GLCs, before and after crisis.

1.4 Research Design

A sample of 4,257 observations of 387 companies (210 Malaysian and 177 Singaporean) for 11 years from 1995 to 2005 was used for the analysis in this study (*Refer to Figures 1.2 and 1.3 in Appendices*). However, this study does not include financial and unit trust companies due to differences in regulatory requirements (Haniffa and Hudaib, 2006). As the period of observation was from 1995 to 2005, the performance of these companies before and after the crisis period was also analysed. Hence, the study was also able to determine whether there is any difference in the results among these three periods (including all periods). Data was taken from company annual reports and financial databases such as Perfect Analysis, WorldScope, and DataStream.

This study examines the performance between two different sample sets– government linked companies (GLCs) and non-government linked companies (GLCs) – for both countries. Then it follows by comparing between the two countries GLCs. To determine performance, this study uses two measurements – Tobin's Q for market measurement and ROA (Return on Assets) for accounting measurements. In addition, other variables were also used to determine whether they contribute to the performance of companies such as corporate governance variables (agency cost and role non-duality), leverage, growth and size.

1.5 Contribution of the Study

This study explores the link between governance structure and company performance for two different countries, which one from developing country, Malaysia and the other from a developed country, Singapore. Findings from this analysis hopefully will significantly contribute to theoretical perspective especially on corporate governance and agency theory. For example, previous literature primarily focused on determinants of corporate performance with little consideration given to government involvement. For policy perspective, there is none of the previous studies made a similar comparative analysis on performance of government linked companies between two countries. Hence, this study contributes to policies for policy makers learnt from a more developed country on how to run and drive

GLCs improve in comparison to nonGLCs. Specifically, contributions from this study are as below:

(i) This study is the first to compare the performance between Malaysian GLCs and Singaporean GLCs. By identifying and classifying the government-controlled companies from the main board, this research has transparently overcome the sensitivities and uniqueness of the Malaysian and Singaporean governments' business culture. Additional, Malaysia is ethnically diverse and a newly emerging economy and has adopted a corporate governance code of conduct to restore investors' confidence. Therefore, it has more similarities with Singapore, which is more transparent. Through the research done on companies from these two countries, this study is expected to reduce any gap between these two countries, especially concerning the concepts on government owned companies, by identifying how GLCs in an emerging market, such as Malaysia, can learn from developed countries, such as Singapore.

(ii) The Malaysian Code of Corporate Governance (MCCG) has been directly enhanced. This study, which explores corporate governance mechanisms such as non-duality, ownership structure, and agency cost focusing on government and non-governmental companies, provides insights on the role of the ownership structure and company performance in Malaysia and Singapore.

(iii)This study is an extensive study comparing GLCs with non-GLCs in Malaysia and Malaysian GLCs with Singaporean GLCs. This research covers various data sets, different economic conditions, and engages in a large number of samples and studies over time to assess the merit of company performance for longer periods, which makes this research different from other studies on corporate governance and company performance, such as those by Ang and Ding (2006) for the Singaporean situation, and by Hamid (2008), which discusses the comparison between GLCs and non-GLCs in the Malaysian situation. In the Singaporean case, Ang and Ding merely analysed the performance of government-owned companies for an 11-year period (1990-2000), comparing GLCs with non-GLCs without taking into consideration matching these samples with control companies. Meanwhile, in Hamid's study, he concentrated on comparing Malaysian GLCs with non-GLCs on corporate governance and company performance for a 3-year period of study (2001-2003) only.

(iv) This study explores the relationship of corporate governance mechanisms and performance of government linked companies in non-GLCs and GLCs in these two countries. This pioneer paper foresees the significant influence of corporate governance mechanisms, such as ownership structure, agency cost, and the role of non-duality on performance, which are beneficial to owner-managers (in this situation refers to government controlled), investors, practitioners and academicians. They may use this result as a reference to improve company performance and corporate governance awareness.

(v) The study will provide some suggestions for the Malaysian government, investors, practitioners, and academicians on how to improve the Malaysian GLCs so that they perform better based on the findings of how our neighbour, Singapore, handles their GLCs. Singaporean GLCs control more than 50% of market capitalisation in the trade market.

1.6 Organisation of Thesis

Chapter 2 discusses the privatisation of public enterprises in a developed country, like Singapore and also a developing country, Malaysia. In this chapter, I explain the experience of the Malaysian and Singaporean privatisation programmes. A review of the literature will then be conducted in Chapter 3. The review will focus on performance of companies in general and specifically on government ownership. The concept, calculation, and philosophy will be studied. In widening the scope, the first part will review the ownership structure (concentration on government ownership) and performance around the world, especially in Malaysia. Chapter 4 will discuss the theoretical framework of this study. The section on theoretical framework will discuss theories related to this study, i.e. the theory of firm and agency theory.

A description of the research methodology is presented in Chapter 5. First, the development and statements of hypotheses will be explained in this study. Then followed by procedures and techniques used in testing the hypothesis will be discussed. The sampling technique, data collection, instrument, and limitations of the studies are discussed. In Chapter 6, the study examines the results of Malaysian listed companies and compares GLCs with non-GLCs based on matched samples. This is then followed by an analysis of the findings of Singaporean companies in Chapter 7 and the final analysis in Chapter 8 is a comparison between Malaysian and Singaporean GLCs. The final chapter, Chapter 9, discusses, summarises, and outlines conclusions drawn from the overall study that has been conducted. The suggestions on improvements and recommendations based on the findings are reported.

This last chapter ties up the study objectives with its significant findings and conclusions on major points and what the study views as major contributions of the study in comparing GLCs with non-GLCs.