

# Holding Company as Corporate Governance Structure for State-Owned Enterprises (SOEs) in Southeast-Asia: Indonesia's Quest to Learn from Singapore and Malaysia

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This paper attempts to highlight the Corporate Governance practice in State-Owned Enterprises (SOEs), focusing on the case of Indonesia and its attempt to learn from its neighbours Malaysia and Singapore managing their Government-Linked Companies (GLCs). The case of corporate governance in GLCs under Singapore's Temasek Holdings (Temasek) and Malaysia's Khazanah Nasional are interesting to be taken as model for Indonesia. In these three countries, following post-independence struggle for self-reliance in economic development, the strong role of the state in ownership of firms is observed as being an embedded development philosophy.

The New Corporate Governance approach (Hilb, 2004) is taken as the model to see how Temasek well fits the corporate governance framework that considers both shareholder and stakeholder value orientation, while Khazanah follows step. Both are government's investment arm owning and managing each country's GLCs.

Agency Theory (Jensen & Meckling, 1976, Eisenhardt, 1989) is the most dominant theory perspective used to analyse corporate governance problems. In the case of SOE, the difficulty to define who the principal is at SOE hinders the development of appropriate mechanism of aligning the agent's interest with the principal's. Other theories related to corporate governance are unfortunately not yet sufficiently developed to explain this situation, except for the new institutional theory (Aoki, 2002) that emphasizes on institutional factors affecting corporate governance practices.

Viewed from agency theory, problems at SOE mainly arise when it comes to the issue of monitoring and controlling of the management board as the agent to execute interest of the principal. It is difficult to have a government body free of interest other than the interest of the people, to be assigned with the tasks of monitoring and controlling the SOEs. The term 'principal of government's agent' became an ironical term to describe the situation happening at SOEs where monitoring bodies are full of vested interests.

The poor performance of many SOEs can be attributed to the three main challenges facing SOEs governance in comparison to private sector enterprises, namely the conflicting objectives, agency issues and lack of transparency (Wong, 2004). A corporate governance reform is the necessary measure to face these challenges. This reform must tackle all the three issues in an integrated manner; otherwise the results would be disappointing.

The approach of New Corporate Governance, where principles of good corporate governance applied in a firm should be kept situational, strategic, integrated and controlled (Hilb, 2004) is a key principle in this paper. A definition of New Corporate Governance (Hilb, 2004) defines it as a system "by which companies are strategically directed, integratively managed and holistically controlled in an entrepreneurial and ethical way in accordance with a particular context". This definition in its emphasis, attempts to cover both the value-orientation of the shareholder and stakeholder perspective. This integrated approach of corporate governance will be paramount in examining the empirical case of Singapore's Temasek Holdings corporate governance practice.

The case of corporate governance for Southeast Asian GLCs in Singapore's Temasek Holdings (Temasek) –as the example of 'best practice' on corporate governance conduct in Asia– and Malaysia's Khazanah Nasional are to be explored in this paper. The New Corporate Governance approach is taken as the model to see how Temasek well fits the corporate governance framework that considers both shareholder and stakeholder value orientation, while Khazanah follows step. Both are government's investment arm owning and managing each country's GLCs. This government's investment holding arm is a structure suggested along the corporate governance reform approach to tackle SOEs governance challenges, especially on dealing with the issue of conflicting objectives.

The problem of corporate governance at SOEs in Indonesia, Thailand and The Philippines viewed from Agency Theory and what implications they can learn from the two neighbours' GLCs investment holding arm in balancing shareholder and stakeholder value orientation are at the heart of the paper. Especially, the fact that Indonesia and Thailand have plans to set-up such investment holding structure for their SOEs.

The most important lesson from this phenomenon in relation to the New Corporate Governance approach is the fact that corporate governance practice –especially at SOEs and GLCs whose ownership structure is quite unique– has to be situational. Contextual differences that countries have –even when located in the same region like Southeast Asia in this case– emphasize even more the importance of applying situational corporate governance.

Important to note in situational corporate governance is that for different type of firms there should be different approaches of corporate governance recommended. Despite the trend that the Anglo-American approach has been gaining most influence and globally spread as Best Practice recommendation, one must take into account that the context in which the firm is embedded differentiates the situation. There are firm-specific factors that define this context. This requires that corporate governance for each firm must be kept situational as well. In principle, the factors defining the context can be divided into company-internal dimensions and company-external dimensions (Hilb, 2004, based on McGrath, 1976).

Realizing that corporate governance at SOEs in Southeast Asia should be situational, it is important to understand how the company-external and internal contexts differ. With regard to company external context, its institutional context, national culture context and norm context must be taken into account. Various countries in Southeast Asia would have differences in these contexts. For the case of SOEs, the company-internal context will also be a very important factor, especially since it will differ based on ownership structure and behaviour of its shareholders, as well as the board power structure and behaviour.

The paper finally argues that the best practice of corporate governance for SOEs in Southeast Asia by using the investment holding arm structure applied by Singapore's Temasek Holdings that have been emulated in some ways by Malaysia's Khazanah Nasional might not apply perfectly to the context of Indonesia –and for the same matter to Thailand and The Phillipines too– if the differences in the contextual differences regarding institutional context, national culture context and normative context are not taken into account. With regard to SOEs reform, the investment holding structure is able to solve the problem of conflicting objectives and agency issues, to some extent the transparency issue.

**Key words:** situational corporate governance, agency theory, institutional theory, south-east Asia, state-owned enterprises (SOEs), government-linked companies (GLCs), government investment holding