

Temasek Holdings: Building a Sustainable Institution  
Lunch Remarks by Ms Ho Ching  
Executive Director and CEO, Temasek Holdings  
Institute of Policy Studies  
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Professor Tommy Koh, Chairman of the Institute of Policy Studies,  
Ladies and Gentlemen, good afternoon.

#### Introduction

1 Temasek celebrated its 35th anniversary on 25th June this year.

2 Five years ago, when Temasek turned 30 years old, I was privileged to share some thoughts at an IPS lunch. Today, I am privileged to have the opportunity again to provide some perspectives on our journey to build a sustainable institution as we move forward.

#### Institutionalising Discipline

3 Temasek is a long-term investor. As I had outlined five years ago, this means we will act to enhance long-term value, and will not divest for divestment's sake. We don't intend to raid the larder, nor sell the family jewels, for short-term gains. We will jealously guard our interests, and will invest; rationalise, consolidate or divest where it makes sense, and where we can achieve clear sustainable value.

4 Our goal was to build a robust framework to maintain discipline and deliver value over the long term as a sustainable institution.

5 As one of our founding leaders, Mr S Rajaratnam said in 1966:

"We must learn to do things today  
with tomorrow very clearly in our minds."

6 It has been an intense journey. There was no path, we walked to make the path for ourselves. We unfolded and refined our investment strategy in public view, even while we were simultaneously transforming our portfolio and upgrading our core engine of people, systems and processes.

7 In October of 2004, we published our first Temasek Review. As an exempt private company, we were not required to do so. Our core purpose was not transparency per se, but to instil the discipline, the professionalism and the open willingness to be tested and measured.

8 Such an annual review would serve more than one purpose. It provides a public marker of our performance, whether good or bad. Today, the market is generally aware that we have had an annual return of about 18% a year since inception. Our year-to-year volatilities are visible. In our Temasek Review last year, we reported an annual Value-at-Risk of almost S\$40 billion last March. This meant a 16% probability for our portfolio value to drop more than \$40 billion by March this year. Indeed, it had turned out to be so, and more.

9 Our Temasek Review was also meant to introduce us to our friends and potential partners; as well as to our portfolio companies, and other interested parties or stakeholders in the market. Our first Temasek Review marked the beginning of a new phase in Temasek's journey to engage and be engaged with the wider community.

10 Shortly after, we obtained our credit ratings with two leading international credit rating agencies. These have been based on full confidential disclosure.

11 We have continued to be credit rated ever since. This establishes a public marker of our financial position and credit risks. Our strategic actions and commercial choices would be bounded by this clear bright tripwire or public OB marker. Any move to shift our credit risk stance would require deep and deliberate debate within our Board and senior management.

12 Our credit ratings were followed by an international 10-year US\$ bond in September 2005. The bond spreads are a real-time indicator of our credit risks, much like the role of a singing canary in a coal mine. This was also a deliberate move to create a new group of sophisticated stakeholders for ourselves.

13 As I have just highlighted, we have today established three sets of public markers; our annual Temasek Review, our credit ratings, and our bond spreads. They are like the 18th hole in a long game of golf, our credit ratings the tripwires or OB markers, and our bond spreads the singing canary - they signpost the no-go zones and outline the broad perimeter of our playing field. These are but one strategic facet of our commitment to build not just for this generation, but to lay the foundations for a robust and disciplined institution for the future.

14 In the same vein, we have applied the highest practical standards of governance upon ourselves, no different from our expectations of our

portfolio companies.

15 One example, as we had explained in 2004, was the process of CEO evaluation and succession planning. We believe it is crucial for any board to continually review its CEO succession options. To this end, we have put in place an annual CEO succession review with our Board. This provides the Board with a full view of its options for all contingencies. The first such review for our Board was in early 2005, after we had done our preliminary work in 2004. Thereafter, our Board has been engaged annually to review potential successors for various time frames; from an immediate interim need, to longer horizons where we deliberately add promising individuals in their 30s for us to track or bring on board over time. We include our internal management as well as external candidates on our list, Singaporeans as well as non-Singaporeans, promising leaders from TLCs<sup>3</sup> and non-TLCs.

16 It is through this process that we identified Chip Goodyear as an excellent potential successor.

17 The strength of the Temasek team and the confidence of the Board played a part in our decision to invite Chip to be the next CEO for Temasek.

18 It is unfortunate that both the Board and Chip recently came to the amicable and mutual conclusion that it was best not to proceed with the CEO transition. This does not mean, however, that we should stop this discipline of succession review. We will continue to do so, regardless of who takes the helm as CEO at Temasek. This is part and parcel of our institutional discipline and board governance to build for the long term.

19 Apart from CEO succession, we have also worked to improve our other systems and processes.

20 To enable us to operate efficiently, effectively and responsively to the market, we are mindful of the continual need to keep our systems and processes updated and well-honed. This we have been doing and will continue to do.

21 However, one over-riding priority is to expose, train, build up and empower all our staff, young and not so young, experienced and new alike. This interest in giving our people the maximum opportunity to learn and grow, to stretch and test them, professionally and individually, is underpinned by our firm belief that our people, equipped with the right values, are the core foundation for Temasek over the long term. Where it made sense, we were sometimes prepared to sacrifice opportunities when we were not ready to take certain risks. But when it comes to developing our team, we are almost always prepared to sacrifice some efficiency or effectiveness to maximise training and learning opportunities for our staff, both individually and as a team. We are prepared to take the short-term inefficiency pains for long-term people gains.

Growing with Asia

22 I have just outlined how we have built a framework for good governance and discipline, and shared our trade-offs against the goal of developing people. Meanwhile, we also saw an evolving investment strategy.

23 To understand our opportunities, we stood back and asked ourselves what the key ingredients of our success have been since the founding of Temasek. We had two important success factors: first, the people with the passion, commitment and capability to think long term and deliver; and second, the success of Singapore itself. With Singapore's success, companies like Singapore Airlines, SingTel and PSA<sup>4</sup> have both benefited from as well as contributed to Singapore's success as a business hub and an economy.

24 It is not a surprise that many of our portfolio companies have outgrown Singapore. Singapore Airlines could not have succeeded by flying between Seletar and Changi. Beyond Singapore, we were confident that the transformation of Asia was going to be an exciting story which also adds to Singapore's own growth potential. The Asia story would also significantly multiply the opportunities that we and our TLCs have had in growing with Singapore. Asia, including Singapore, was where we wanted to be.

25 Thus, we decided to shift our portfolio stance from about 85% exposure to Singapore and the OECD economies. We articulated our Asia interest in the shape of a re-balanced portfolio transformation, with one third underlying exposure<sup>5</sup> to Singapore, one third to the OECD economies, and a new one third share for the rest of Asia. This is a doubling of our previous exposure to Asia in our portfolio.

26 This projected portfolio shift was not a target cast in stone, but a broad sketch of our risk appetite. We felt comfortable to dial up our risk exposure by moving into the then emerging Asia, because we already had a stable and low risk portfolio, particularly in our Singapore blue chips. At the same time, we were also signalling our confidence in the long-term prospects of Asia. We saw four main engines of growth for ourselves in Asia – from India and South Asia, to ASEAN, from Singapore, to China and North Asia.

27 As a result of Asia's strength over the last few years, we ended up with a 40% exposure to the rest of Asia, while our OECD exposure, largely in Australia, shrank to about 20% over the last two years. We mulled over this resultant balance.

28 We remained very comfortable with Asia. We understand that growth will not be a straight line trajectory. We can expect bumps along the way, but the longer term potential remains strong. By longer term, we mean 20, 30 years. As Asia continues on its development curve, it will also de-risk. We had also planned to add new exposures such as the Latin America, Africa, Middle East and Russia. This saw us opening new offices in Mexico City and Sao Paulo, Brazil, last year, after more than a year of analyses and study.

29 After two years of introspection, our conclusion was to maintain our 40:30:20:10 portfolio mix. My friends joked that this sounds like a football formation. I explained that it signals our continued focus on Singapore at 30% with rest of Asia at 40%, giving us an overall exposure to Asia, including Singapore, of 70% or more. OECD exposure would be around 20%, plus up to 10% exposure to new geographies like Latin America, Africa and others.

#### Building an owner mindset

30 Even as we maintain focus on Asia and add new geographic exposure, we remain obsessed about building our institution for the long term. A critical element is an owner mindset in our culture. How do we nurture a 'think-owner, act-owner' DNA in Temasek?

31 Apart from culture and values, we embarked on developing a compensation framework geared towards a strong alignment with long-term shareholder value. Compensation philosophy and frameworks are complex subjects which can be emotional. There are no perfect solutions. The trade-off is how to weigh short-term competitive pressures from the market versus the long-term goal we have set for Temasek. Ideally, all our employees would "think owner, act owner", and work as one team. To support this ideal, we lean heavily towards having a well-balanced compensation structure which would reinforce a one-team culture, and an incentive philosophy which puts the institution before self, emphasises long-term over short-term, and aligns employee interests with that of the shareholder.

32 Our compensation framework has two dimensions. One dimension is time. This covers short, medium and long-term pay-out horizons. The other dimension is the different levels of difficulty to earn out the incentives. One key principle is for our employees to share in the institution's performance, both for positive and negative results. We share gains and pains alongside our shareholder. This is in essence having an owner's approach to our business and operations.

33 For senior management, the bulk of their incentives are deferred between three to 12 years. Some of these deferred components are subject to market risks, and rise and fall with Temasek's total shareholder returns. The remaining components are subject to a "no-floor clawback" - these deferred components could potentially be totally wiped out if and when we deliver well below our cost of capital target. This "clawback" feature is tied to the principle of rewarding only for sustainable performance.

34 This return above the risk-adjusted cost of capital is what we call Wealth Added, which we report in our Temasek Review.

35 Returns above the cost of capital target means we have gains to share with our staff. Returns or losses below our risk adjusted cost of capital hurdle means we have negative bonuses to be distributed. It is a tough challenge to share negative bonuses when we fail to deliver at least a return to match our cost of capital. It is even tougher to deliver a positive Wealth Added every year.

36 While we are certainly not happy with the negative Wealth Added in March, both last year and this year, this has enabled us to test our compensation framework through at least one very difficult market cycle. As an example, most of us understand the idea of sharing profits or gains, but how do we share a negative bonus in an equitable and fair way among our staff? Even though we had delivered almost 7% of positive total shareholder return as at 31st March last year, this meant a negative Wealth Added. A share of this negative Wealth Added meant a negative bonus pool. This in turn was allocated among our staff. And so, from CEO to office attendants, all our staff were allocated negative bonuses last year and will be allocated more negative bonuses this year once we have approved our audited financials.

37 Our experience over the down-cycle also enabled us to rethink and refine some of our incentive elements. These refinements strengthen the core concept of ensuring that there is, on balance, a strong element of alignment with sustainable long-term shareholder value. In effect, our incentive system is designed to support that owner mindset among our staff.

#### Expanding our stakeholder base

38 Last but not least, I would like to touch on one more element of institution building - to build a broad stakeholder base for the institution.

39 While the Minister for Finance (Incorporated) is our formal shareholder, we recognise that the ultimate shareholders of Temasek are the past, present and future generations of Singapore. As Temasek continues to engage and invest in Asia, we also recognise the wider community in Asia as part of our stakeholder base. Temasek succeeds because of friends and supporters all over the world. It is in our long-term interest to contribute steadily to a prospering Asia, a vibrant Singapore and a peaceful world.

40 It is in this context that we had set up Temasek Foundation and Temasek Cares to add substance to our engagement with the wider community. The business of community engagement is very different from managing money and making investments. Our expertise is not in community engagement per se, though we have a strong culture of staff volunteerism. We have been very privileged to have the support of independent, capable and experienced community and business leaders from Singapore and from all over Asia to help evaluate and drive these engagements within Singapore and across Asia.

41 We set up Temasek Trust two years ago. Governed by a highly distinguished Board of Trustees, the Trust looks after the donated funds. For every year of positive Wealth Added since 2003, we had committed to set aside a portion for the community. Funding for Temasek Trust comes from these provisions for the community. In turn, the Trustees will determine how and when they will distribute funds to the various approved non-profit units to fulfil their various mandates to serve the community. The Temasek Trust and our various non-profit philanthropic organisations re-affirm our commitment as a corporate citizen to support the continued progress and success of Asia and her people. More than that, we have created one more group of stakeholders who would be tracking the performance of Temasek closely, benefitting both

from Temasek's success and contributing to the larger community by sharing that success.

42 Over the longer term, we are exploring the feasibility of creating one more group of stakeholders. We can do this by inviting the public to co-invest with Temasek. We hope to start this by first piloting the relevant structures and rules of engagement with Temasek and other sophisticated co-investors. It is important to test this over at least one market cycle during the next five to eight years. If this pilot is successful, we may then consider a co-investment platform for retail investors in perhaps eight to ten years' time. This will add to our stakeholder base - from shareholder and bondholders, to the boards and employees of Temasek and our portfolio companies, from Temasek Trust and the non-profit units to our co-investors. A broad base of stakeholders will be part of our ecology for discipline and performance in the decades ahead.

#### Redefining our Charter

43 This year is the 35th anniversary for Temasek. In 2002, we launched our inaugural Temasek Charter. It is a living document that outlines our relationships with our shareholder, portfolio companies, the community and other stakeholders. Our 2002 Charter helped to provide some compass points as we embarked on our journey into Asia.

44 As we evolved, we had also been reviewing our Charter in close consultation with our shareholder over the last four years. This year, in conjunction with our 35th anniversary celebrations, we will be releasing our updated Charter. This Charter will remain a living document. It frames our engagement with our stakeholders, and guides us in our continued journey with Asia and beyond.

#### Conclusion

45 To conclude: as we gear up for the next phase of our development, we will continue to focus on our core purpose of delivering sustainable long-term value. We continue to anticipate opportunities, not just within Asia, but also in Latin America and elsewhere too.

46 As an investor with the flexibility of a long or short time horizon, Temasek is focused on the end goal of creating and maximising long-term shareholder value as an active investor and shareholder of successful enterprises.

47 The Temasek journey will not always be smooth. As we sail in choppy waters, we may need to take shelter if we see dark clouds coming. We may need to wait for the storm to pass before we continue our journey. Because of the changing winds and shifting currents, we may have to adjust our sails and tack off-course for a while. Meanwhile, we need to keep our ship in good order and sea-worthy at all times. From time to time, we may even have to jettison some load, repair some damage or cut some rigging to keep our ship and crew safe. But we aim to bring everyone home safe, and will maintain discipline for a safe journey.

48 As an institution, we build not just for ourselves, but for our shared future with the wider community and also for our next generation, in Singapore, in Asia and around the world. This will guide us, and the institution that we in Temasek are working to build, in the years ahead.

49 Thank you.