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Singapore Government

PRESS RELEASE

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**OPENING ADDRESS BY MR LIM HNG KIANG, MINISTER FOR
HEALTH AND SECOND MINISTER FOR FINANCE AT THE
OFFICIAL OPENING OF THE WHARTON-SINGAPORE
MANAGEMENT UNIVERSITY CONFERENCE
“ROLE OF STOCK OPTIONS IN STAFF COMPENSATION
PACKAGES” AT 9.05 AM ON 14 JANUARY 2000, TOWER
BALLROOM, SHANGRI-LA HOTEL, SINGAPORE**

Good morning.

National Archives of Singapore

1. We are all aware that the knowledge-based economy of the future will place a premium on developing and utilizing knowledge, much of which is created by and resides in the heads of employees. This therefore means that the most successful enterprises are likely to be those which create cultures that attract and hold highly skilled and knowledgeable employees.
2. How these high skilled and knowledgeable employees are motivated to align their interests to enhance the value of the company will distinguish the successful ones from those who are unable to keep them. The shorter cycle time and rapid obsolescence

of products brought about by rapid technological changes and globalisation has increased the competitive business environment. Businesses are being formed and dying at faster rates. The rate of churn will increase. Competition for skilled and knowledgeable people will intensify.

3. In this environment, employers may not be able to build Knowledge Age workforces using Industrial Age compensation systems. Entrepreneurially-oriented pay systems of the future will undoubtedly include employee stock ownership as a fundamental component. In other words, companies will hold on to human capital by linking it to financial capital.

4. If we want to continue to retain and motivate staff, we will have to turn employees from what I call “bond workers” to “equity partners”. Let me explain the difference between a “bond worker” and an “equity partner”.

5. A “bond worker” is someone who will work the required number of hours and put in sufficient effort to get a job done well. His main purpose is to earn a fixed income, and is only concerned of the company’s progress, to the extent that it impacts the security of his income. I use the word “bond” as the concept is similar to that of a bond, where the purchaser is primarily concerned by the income he derives from it and is only interested in the company to the extent that it affects the security of the bond.

6. The equity holder on the other hand, owns a stake in the company. Every decision he makes would have been evaluated on how it would affect the company. His fortune is directly tied to the progress of the company, and he will do everything in his capacity to ensure that the company succeeds. In the knowledge age, the shift in employee compensation will be focused on transforming the bond worker to the equity partner.

7. The giving of stock options is one of the ways of sharing equity ownership. But in addition, stock options have a special effect of decreasing risk involved in share ownership as it is an option. When employees receive stock options, they can choose to exercise it when the share prices go up, or not to exercise it when the share

prices go down. It is therefore a no risk proposition with potential gains which allows it to be effectively used for higher risk emerging companies.

9. However, no risk does not equal no cost. The question is, who should bear the costs and whether such costs are correctly reflected should be better understood.

10. Some opponents of employee stock options have suggested that the company bears the hidden costs, since in financial accounting, stock options are not listed as a cost which understates costs and correspondingly overstates the net profits. They further suggest that increases in share prices are sometimes not directly due to employee contributions, especially during times of booming stock markets which like a rising tide "lifts all boats".

11. On the other hand, proponents argue that while stock options are a hidden cost, they only come about when there is also a hidden gain since the stock options are only exercised when there is an increase in shares price which is also not reflected in financial accounting. It is therefore only fair to share hidden gains with the employees who helped to create them.

12. These are issues and concerns that the conference will no doubt deliberate on. Where everybody seems to agree is that for stock option programmes to be applied successfully, there is a need for them to be implemented properly. This will require an understanding by both employer and employee of the cost of stock options.

13. Empirical evidence suggests that employee equity ownership has a favourable impact on corporate performance. A Deutsche Bank study found that 99 per cent of the companies in the Standards & Poor's 500- stock index offered employee stock options. Another survey by Coopers & Lybrand of America's fastest growing companies reported a 39% higher revenue growth rate in companies with employee stock option programmes than in the companies that did not offer stock options to employees. Although these illustrations may not prove cause-and-effect conclusively, there seems to be a deep and well-established stream of evidence in support of the

proposition that stock options can play a pivotal role in good corporate performance. This is perhaps the reason why there is an increase in the total percentage of stock options as a component of total compensation packages.

14. Some countries have therefore accorded tax benefits to employee stock options. Examples include the US and UK, which under certain restrictions, have allowed some stock option schemes to be exempt from income tax, so that only capital gains tax is levied. Singapore's environment is favourable towards stock option in that we do not have capital gains tax. Only income tax is levied. Moreover, we have recently introduced a "Qualified ESOPs Scheme" that allows for the deferment of income taxes for up to 5 years. This will serve to encourage more to exercise their employee stock options, since employees who may face cashflow difficulties in exercising their options can now defer their tax liability for up to 5 years. This should make it more favourable for stock options to be used.

15. This is not to say that stock option programs are a panacea for all companies trying to strengthen the link with their employees. Obviously, such programs will be most effective in the context of rising markets generally and growth-oriented companies in particular. We see this in the Internet businesses today. The question is what happens when companies start to experience slower growth and markets become less buoyant. Would stock options continue to be enough to keep and motivate the knowledge worker of tomorrow in such a situation, especially when human capital will be the primary driver of knowledge-based growth? Peter Drucker has advocated that the mentality of partnership will then have to go further than financial rewards and include social recognition and social power. Companies have to turn subordinates into fellow executives and employees into partners.

16. Stock options as instruments of compensation for the knowledge economy are becoming more popular in Singapore, though the percentage of companies using stock options is still low. It will be interesting to understand the reasons why some companies are moving into stock options, and why others have not yet done so. This seminar on "The Role of Stock Options in Staff Compensation

Packages” couldn’t have been more timely. I would like to commend the Singapore Management University and Wharton School of Business for bringing this important topic to the forefront of discussion. I hope that the discussions will spark much debate and deliberation. I hope Singapore companies will follow your lead and seriously consider stock options as part of their compensation package. I wish you all a fruitful day.

Thank you.

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