Corporate Governance in Hong Kong

Stephen Y. L. Cheung
Professor (Chair) of Finance
Department of Economics and Finance
City University of Hong Kong
Corporate Governance

Characteristics of Asian Equity Markets

- Single majority shareholder
- Family control
- Lack of institutional investors
- CEO and chairman are not separated
- Underdeveloped corporate control market
Corporate Governance

A Successful Market Depends On:

- ‘Right’ Regulatory Framework
- Quality Listed Companies
- Quality Intermediaries
Corporate Governance: ‘Right’ Regulatory Framework

- Small Shareholders
  - Look for short-term capital gain
  - Ignore issues of corporate governance
  - Do not pay attention to shareholder’s right
  - Inadequate shareholder protection
IPO’s Performance
- Sample period: January 1986 – December 1996
  - 404 IPOs
- Regulatory change in 1994
  - Requirements on size, pre-listing earning, operating history, etc…

Findings:
- Tougher requirements improve IPO’s long-term performance
- STILL IPO’s long-term performance is BAD (similar to other overseas markets)
Corporate Governance: Quality Listed Companies II

IPO's Long-Term Performance

Period

10-month 20-month 30-month

-0.6 -0.5 -0.4 -0.3 -0.2 -0.1 0 0.1

Buy & Hold Return
Subscribe & Hold Return
Corporate Governance: Quality Listed Companies III

IPO's Long-Term Performance (Buy & Hold Return)

<table>
<thead>
<tr>
<th>Period</th>
<th>Before Change</th>
<th>After Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>10-month</td>
<td>-10</td>
<td>-5</td>
</tr>
<tr>
<td>20-month</td>
<td>-30</td>
<td>-15</td>
</tr>
<tr>
<td>30-month</td>
<td>-50</td>
<td>-25</td>
</tr>
</tbody>
</table>

Legend:
- Before Change
- After Change
Corporate Governance: Quality Listed Companies IV

- A successful market does not depend on:
  - Number of listed companies
  - Market capitalization

- Depends on:
  - Number of good listed companies
  - Liquidity
  - Ability to attract funds
Relation between director’s pay and company’s performance

- Sample period: 1991-1995
- 10% director’s pay > company’s earnings
- No relation
Corporate Governance: Quality Listed Companies VI

Corporate governance

- Independence of the Board

- Problem
  - Connected parties transactions
  - Information disclosure
Corporate Governance: Quality Listed Companies VII

- Connected parties transactions
  - Sample period: 1998-2000
    - All transactions (328)
    - 11 categories including sell stake to parent, sell assets to parent, acquire assets from parent, strategies (JV) deals, etc…
Corporate Governance: Quality Listed Companies VIII

- Connected parties transactions
  - Results:
    - CLEAR evidence of expropriation of minority shareholders
    - Degree of expropriation is positively related to the percentage of ownership by the main shareholder
    - Information disclosure about connected transaction appears significant
    - The likelihood of incomplete disclosure is positively related to ownership by the main shareholder
Corporate Governance: Quality Listed Companies IX

All connected

CARs

Month

-16% -14% -12% -10% -8% -6% -4% -2% 0% 2%
Corporate Governance: Quality Listed Companies X

- Enhance independence of the Board
  - Recruitment details of independent non-executive directors
  - Greater transparency
    - Financial
    - Non-Financial
  - Performance evaluation
Corporate Governance: Quality Listed Companies XI

Suggestions

- Licensing for directors
- Director’s education
- Scorecard for corporate governance
  - Investors
  - Peer Pressure
Corporate Governance: Quality Intermediaries

- Intermediaries
  - Accountants
  - Auditors
  - Lawyers
  - Financial Analysts
Conclusion

- Market creditability
- Investor confidence
- Ability for further funding
- Ability to attract quality companies
~ The End ~

Thank you