Speech

Speech by SFST at HKIoD Annual Dinner cum Presentation of Directors of the Year Awards 2013 (English only)

Tuesday, December 3, 2013

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Hong Kong Institute of Directors Annual Dinner cum Presentation of Directors of the Year Awards 2013 today (December 3):

Mr Kelvin Wong (Chairman of the Hong Kong Institute of Directors), distinguished guests, ladies and gentlemen,

Good evening. Thank you for inviting me to join you in this special occasion. No doubt you all take pride in the Directors of the Year Awards as it is very important to celebrate and promote excellence in innovation and business leadership. I would like to extend my congratulations to this year's award winners, who have shown how to guide their companies to go the extra mile in the face of tough economic times and market conditions.

The corporate governance system is the cornerstone of the modern joint-stock companies and today's free capital markets. Corporate governance structures are also widely adopted in administration of many public bodies in Hong Kong and other parts of the world. Good corporate governance enhances investors' confidence and the appeal of our markets, which underpin the stability of our financial system.

At the same time, there are long-standing debates on how best to balance the rights between different stakeholders, and good governance standards vary across countries and markets.

If corporate governance rules are to align the interests of various stakeholders in a company, such as between management and shareholders, or between controlling shareholders and minority shareholders, is there evidence that these rules are good for the long-term interests of the companies? To answer this question, one can investigate the relationship between stock price performance and corporate governance. Over the years a body of research has been developed that largely points to a positive relationship between good governance and shareholder value.

An example is a research paper on "Materiality of Corporate Governance" published by Deutsche Bank in 2005, conducted at the request of a group of 14 asset managers working on a United Nations initiative. Spanning five years and almost 2,000 companies, the research concluded that there was a positive relationship between corporate governance and long-term equity performance across the US, Europe and the UK.

To properly measure corporate governance, the researchers took into account 50 factors, which were widely regarded as international best practices and indicators of equity risk, including board independence, shareholder treatment, information disclosure and executive remuneration.

Of particular importance was the separation of the roles of chairman and chief executive officer, and the independence of the chairman, the directors and the board committees. They found that in the UK, companies with an independent chairman outperformed companies without an independent chairman by as much as 12.5 per cent over a three-year period between December 2000 and December 2003.

Another area under close examination by the researchers was the impact of unequal voting rights, multiple share classes and other forms of unequal treatment of shareholders. Differential voting rights constituted corporate governance risk and ultimately had an impact on the economic value of the shares, especially during times of corporate takeovers. In the UK, companies with equal voting rights outperformed companies with unequal voting rights by nearly 55 per cent over the same three-year period.

Other highlights of the report were the importance of an independent audit committee and the size of the audit fees in relation to compensation the auditor received for non-audit services. When the proportion of fees from non-audit services was high, the risk of conflict of interest increased.

All these forms of proper corporate governance were sound and good, but did these practices pay off financially?

The report gave the thumbs up. In the UK, companies in the top quintile in terms of corporate governance outperformed those in the bottom quintile by a whopping 34 per cent between December 2000 and July 2005. It showed that companies that have improved or deteriorated in regard to corporate governance saw corresponding ups and downs in the performance of their shares.

Taking into account the regional and regulatory variances between markets, it is fair to say that the common standards of governance such as board independence, fair shareholder treatment, information disclosure and a proper executive remuneration system benefit all shareholders, be they the majority or minority shareholders, since all their shares would be worth more.

Coming back to the research findings I have cited, I should add that there could be firm-specific characteristics in corporate governance arrangements that would not be captured by this kind of large sample research. The situation of any individual firm may well be explained by other factors that fall outside the model. The research findings, however, seek to uncover the average relationship between long-term stock performance and a number of common corporate governance standards. And from these findings we can gain assurances that our general policy on regulation is on the right track.

More recently, the UK Financial Conduct Authority (FCA) published the feedback on its proposals to enhance the Listing Regime. Notwithstanding the concerns expressed by some respondents that ruling out super-voting shares would have an undesirable effect on London as a listing destination, the proposed package of measures aims to introduce a Listing Principle requiring each share to have equal voting power.

The FCA also seeks to provide additional protection to minority shareholders in the presence of a controlling shareholder. Means will be given to independent shareholders to veto all transactions between the company and the controlling shareholder, to approve independent directors as a separate class, and to have a greater say if the company's listing is to be cancelled.

Corporate governance principles always seek to strike a balance between the powers and interests of different stakeholders. No doubt, the proposed rules by the FCA will engender a new round of debates on this subject. The key takeaway for us sitting here tonight is that, as your companies look to the future, the roles you play as directors have never been more important. As practitioners in the governance of companies, you can help your businesses to rise to the challenges and bring long-term value to your shareholders.

Finally, I must say it is a privilege to be among the leaders of our top businesses who are champions of good corporate governance. You have set examples of excellence for our business community to follow. Once again, thank you for providing me with the opportunity to talk to you this evening.

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