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*"Market response on
corporate governance"*

The benefits of corporate governance : Hong Kong as a model for Asia ?

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The benefits of corporate governance Hong Kong: a model for Asia ?

Introduction:

Corporate governance = an essential but quite indefinite concept

I. Corporate governance in Asia:
Often misunderstood benefits, leading to potential risks

II. Hong Kong:
A model for a better corporate governance in Asia ?

" Corporate governance "

An essential but quite indefinite concept

Definition No1: *Guideline of the HKMA on corporate governance of locally incorporated authorized institutions:*

" Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders"

Definition No2: *OECD principles on corporate governance :*

" Good corporate governance should provide proper incentives for the Board and management to pursue objectives that are *in the interest of the company and shareholders*"

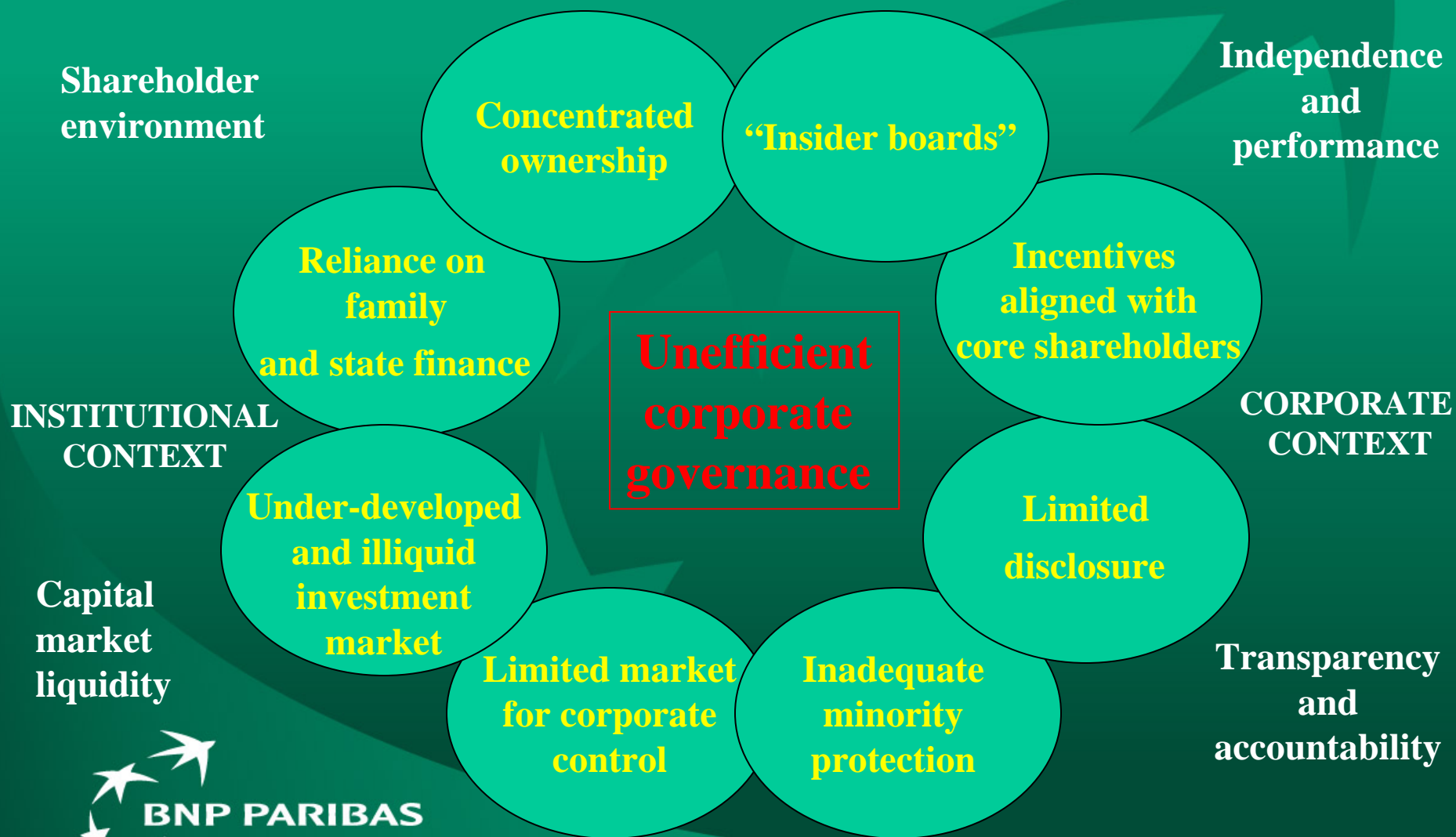
But even the OECD recognizes that:

" There is no single model of good corporate governance"



I. Corporate governance in Asia:
benefits often misunderstood
leading to potential risks

Corporate governance in Asia : a neglected issue ...



Source: Mc Kinsey, 2001

... Because the benefits of good corporate governance are often misunderstood ...

Some commonly repeated *clichés* within the region (even in Hong Kong ...):

- "I do not need to raise any capital anytime soon. Why should I worry about corporate governance?"

- "I would rather have a higher cost of capital than the higher taxes that I would be forced to pay under greater disclosure"

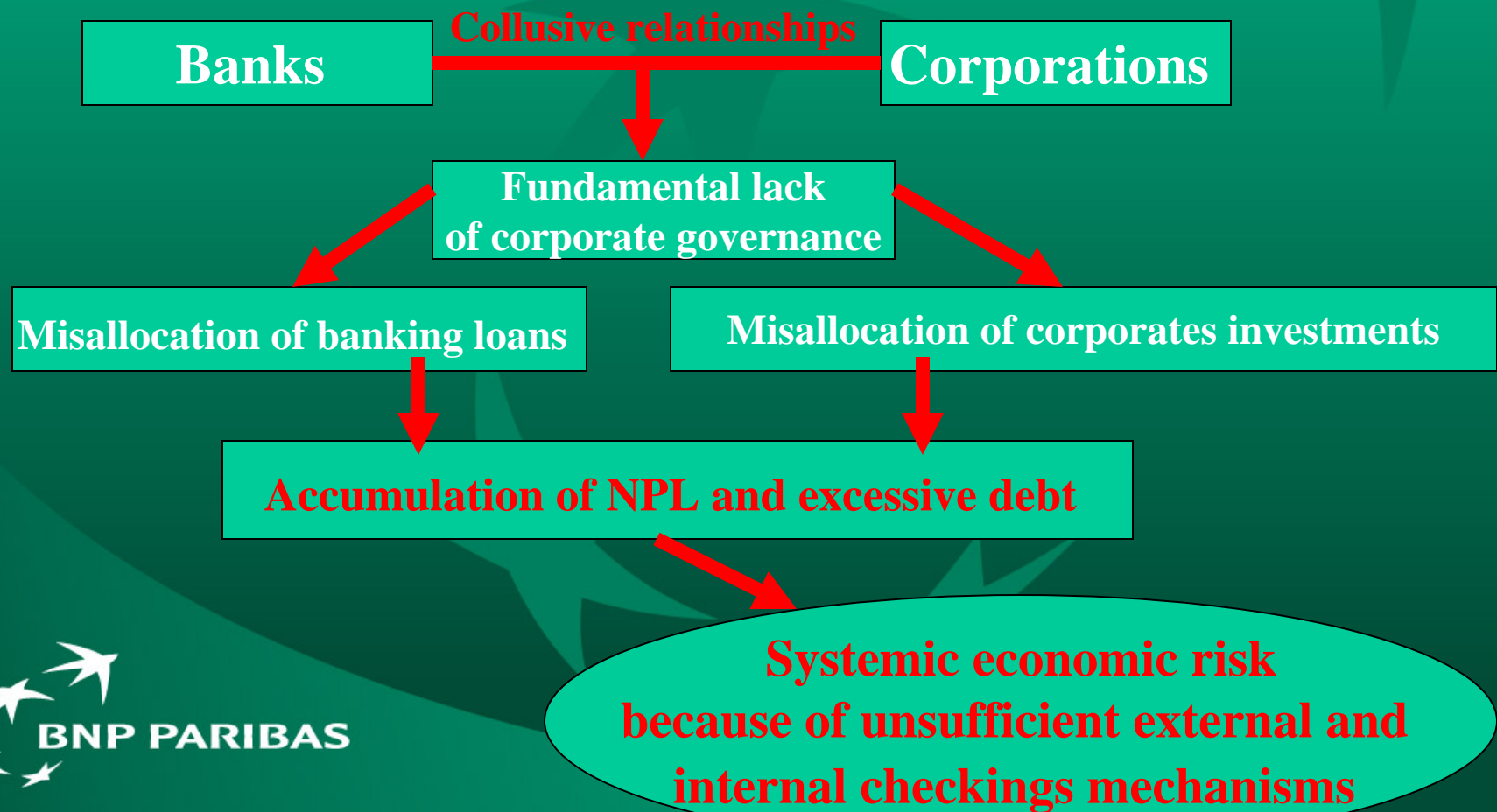
- "Why should I appoint independent non-executive Directors? My company is well run."

- "We have been managing our company for years within the family with a great deal of success. Why should I change this?"



... Whereas the cost of bad corporate governance may be higher than it seems

Conclusions of A World Bank study on the Asian crisis



... Whereas the cost of bad corporate governance is often underestimated

Similar conclusions of a study of the City University of HK

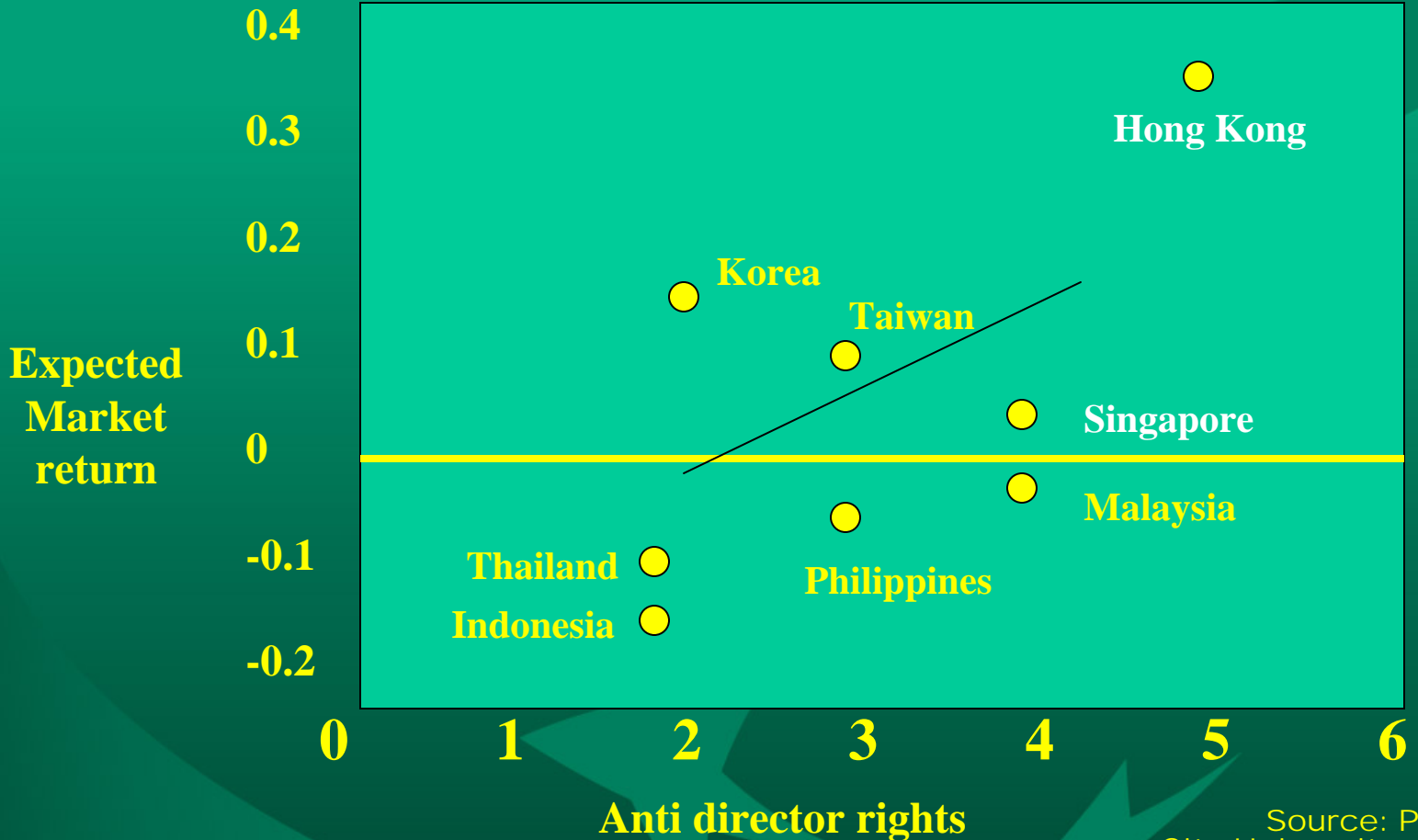
Correlation in Asia between bad corporate governance and poor economic performance:

- valuation and depth of capital markets is greater in countries with better investor protection
- economic growth and market returns are lower, the level of debt and NPLs are higher in countries with:
 - low director-controls rights
 - lack of rule of law, judicial inefficiency
 - low transparency and financial disclosure
 - weak protection of minority shareholders
 - ineffective boards of directors
 - low participation of shareholders



Source: Professors Gul / Tsui
City University of Hong Kong

The benefits of corporate governance in Asia : Expected market return and anti-director rights

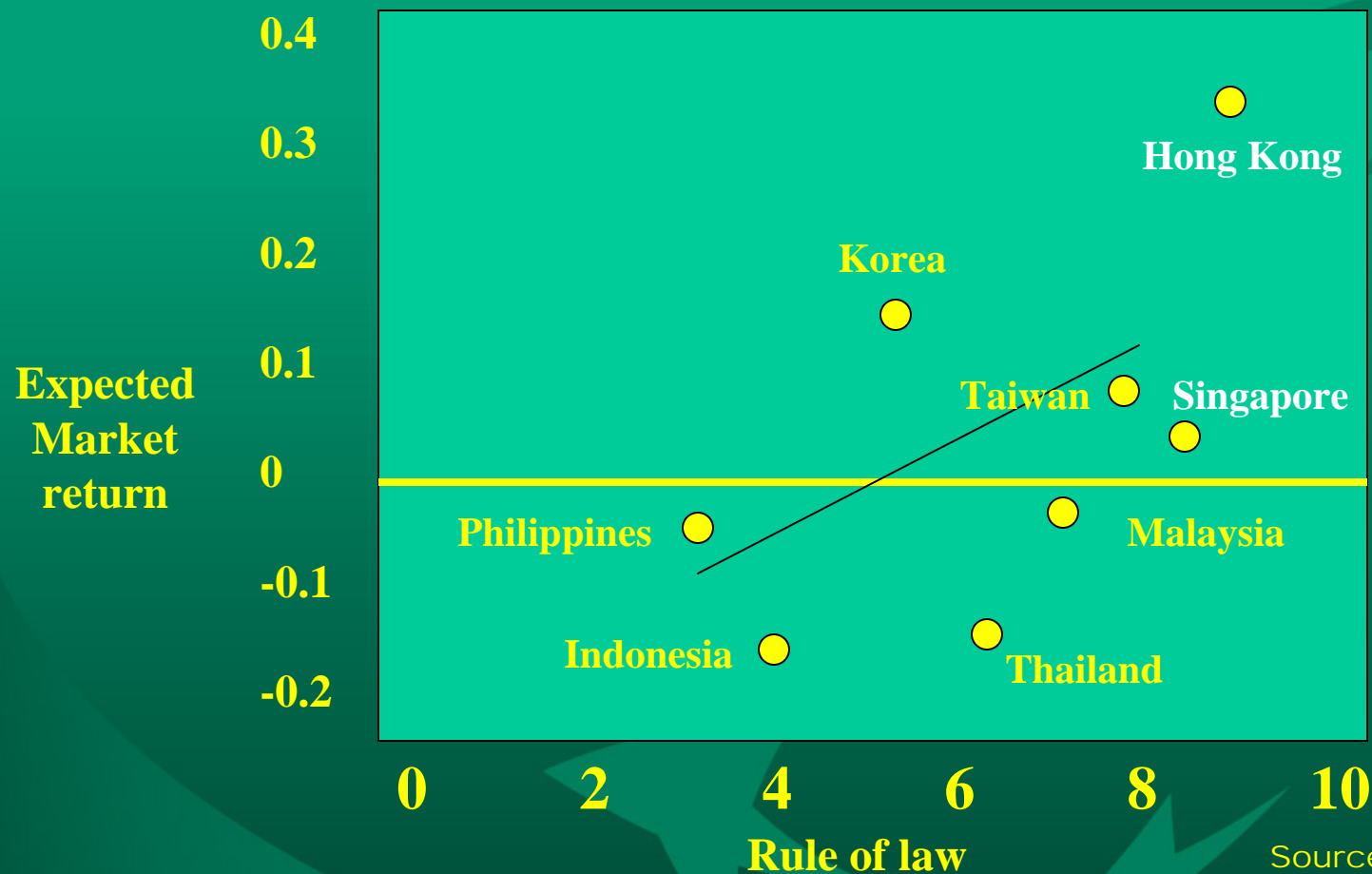


Source: Professor Gul
City University of Hong Kong, 2001



Anti-directors rights is an index from 0 to 6, with a higher score indicating better protection for minority shareholders
Expected market return is an index from -0.2 to + 0.4, with a higher score indicating a higher expected stock market performance for 10 Asian places published in the FEER

The benefits of corporate governance in Asia : Expected market return and rule of law



Source: Professor Gul
City University of Hong Kong, 2001



Rule of law is an index from 0 to 10, with a higher score meaning a stronger tradition of law and order
Expected market return is an index from -0.2 to + 0.4, with a higher score indicating a higher expected stock market performance for 10 Asian places published in the FEER

Corporate governance in Mainland China : A specific case in Asia, but not an exception

Despite recent and strong efforts by Chinese regulatory bodies ...

- Short history of corporate culture (> 1979)
- Company Law (1993): a necessary but insufficient framework
- Some new proposals from the CSRC:
 - * encourage insitutional investors
 - * develop a critical mass of independent directors
 - * invest in education programs
 - * restructure management compensation

... practices are still not really geared towards corporate governance:

- Still little distinction between the functions of government and those of the enterprises (at least for SOEs)
- Management still often responsible not to shareholders, but to local authorities
- Conflict of interest between controlling shareholders and listed companies, resulting in harm to minority shareholders

II. Hong Kong: a model for corporate governance in Asia ?

Hong Kong also has to cope with some
"Asian obstacles " to corporate governance ...

The disadvantages of relation-based governance:

- *Study of Hong Kong Society of Accountants (HKSA, 1997)*

More than 50 % of HK's listed companies have one shareholder or family that owns at least 50 % of the capital

90 % of these companies have a major shareholder who owns 25 % or more of the capital

Figure probably higher for non-listed companies

As shown by the HKSA, "this kind of traditional ownership tends to lack many of the checks and balances and transparency that are the hallmark of good corporate governance"

= A quite unfavourable environment to corporate governance



=> So, how have changes towards better cg become possible in HK ?

Hong Kong shows that corporate governance
begins to improve
when its benefits are understood

" Our aim is to establish Hong Kong as a paragon of
corporate governance"
D. Tsang, Budget Speech, March 2001

Why ?

Because Hong Kong has understood that high corporate
governance standards are essential to maintain its status
of major international financial centre

= > Still a long way to go, but the change of mindset,
which is essential, has taken place in Hong Kong

Hong Kong: a first-class international centre

1. A strong and favourable regulatory environment:

- Rule of law:

long British tradition / strict prudential approach / strong regulatory bodies

- Liberal economy:

no restriction on capital flows / very attractive tax system

2. A truly major international place :

- * the 1st stock exch. in Asia ex-Japan (market cap)
- * 285 banks of which 253 foreign banks (end 2000)
- * banking operations : 60% in foreign currencies

= > Maintaining this status is essential to the success of Hong Kong in general

In what corporate governance will help Hong Kong to maintain this status ?

1. To be part of the globalized trading of securities:

= > Need to reach the highest global standards of disclosure and accounting practices

= > Need to participate in the global harmonization of these standards and norms

2. To continue to largely attract foreign investors:

= > First-rank financial places are today competing with each other to attract institutional investors

= > Institutional investors are increasingly focusing on standards of management and corporate governance

= > A study mentioned from Mc Kinsey (2000) found that 80 % of institutional investors would pay a premium of 18 % for shares of companies with sound corporate governance practices



= > Corporate governance :
a major comparative advantage
of Hong Kong financial place

As such, corporate governance has become a priority in Hong Kong ...

**Hong Kong
Stock exchange
initiatives**

2001: New GEM guidelines

1999: Specific guidelines for the GEM:

- quarterly financial reporting
- one executive director as compliance officer
- audit committee chaired by an independent non executive director ...

1994: Guidelines on the roles of independent non-executive directors

1993: Code of Best Practice to enhance the accountability of directors to shareholders

1992: Regulations governing conflicts of interests between listed companies and third parties

As such, corporate governance
has become a priority in Hong Kong ...

**Major initiatives
in HK**

Specific SFC Bill on corporate governance
currently under discussion

Creation of the Hong Kong Association of
Minority shareholders (HAMS)
= A major non-governemental initiative
Even the market is changing ...

2001: Large Consultation Paper on Corporate
Governance by the Standing Committee
on Company Law Reform (99 pages ...)
Currently under discussion

2000: Guideline of the HKMA
on corporate governance of locally incorporated
authorized institututions (more than 20 pages ...)

Some concrete initiatives taken in Hong Kong

The example of financial institutions :

As mentioned in the guideline of the HKMA on “Corporate governance of locally incorporated authorised institutions” :

The board’s responsibilities

Ensure competent management

Approve objectives, strategies and business plans

Ensure that operations are conducted prudently, within the framework of laws and policies

Ensure that the institution conducts its affairs with a high degree of integrity

= More than the strict compliance with the law. Some examples:

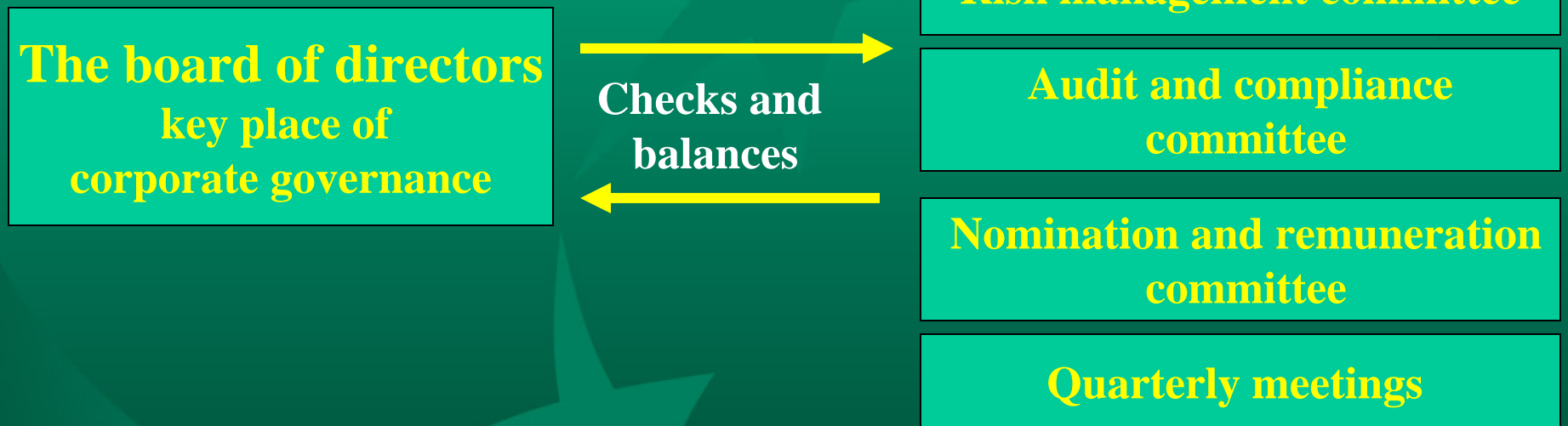
- set up adequate procedures and systems to monitor compliance
- ensure compliance with ethical values of the company
- standards and procedures regarding conduct and integrity

= These procedures to be set up by the company itself



Some concrete initiatives taken in Hong Kong The example of financial institutions:

A way to comply with the HKMA's guidelines :



= Specialized independent committees with real powers of investigation and a capacity to advise and control the Board, with the active participation of independent non-executive directors

Conclusion

Corporate governance and Asia: Enemies today, allies tomorrow ?

Some lessons for Asia from the experience of Hong Kong :

- Asia, which is largely described as a continent with poor corporate governance is not condemned to such a situation
- The patterns of family-held business in Asia may be an obstacle to corporate governance, but are not insurmountable
- In fact, changes rely on understanding by the players involved of the benefits of higher standards of corporate governance, despite the new constraints it creates

= > Asia may become a model of corporate governance

When ?