Global Review of Accounting and Finance
Vol. 10. No. 2. September 2019 Issue. Pp. 49– 65

A Study of Corporate Governance Practices in Financial Sector

Annie Hin-cheung Ko*, Feida Zhang**, and Stella So***

This study aims to examine (1) the strengths and weaknesses of the financial sector in terms of governance practices; and (2) the governance compliance level of the sector in Hong Kong. A rating instrument is designed to test four major governance areas: 'Board Responsibilities', 'Disclosure and Transparency', 'Equitable Treatment of Shareholders', and 'Role of Stakeholders'. Results show that companies perform best in 'Role of Stakeholders' and worst in 'Disclosure and Transparency'. The total corporate governance score of the sector has improved by almost twofold during 2003 to 2017. However, it is disappointing to see that most of the companies barely meet the merest requirements specified by the regulators; only a few of them allot resources to support good governance voluntarily. According to the literature review, this is the first over-a-decade-long longitudinal research to study the trends of the corporate governance performance of the financial sector.

JEL Codes: G32, Z31

1. Introduction

The Hong Kong Stock Exchange (HKEx) released the Hong Kong Corporate Governance Code (CG Code) in 2003. Inspired by the Sarbanes-Oxley Act in US, the CG Code consists of specific guidelines on various corporate governance areas, including accountability and audit; communication with shareholders; company secretary; delegation by the board; directors; and remuneration of directors and senior management and board evaluation.

The CG Code sets out the principles of good governance, and there are two classes of principles: (1) code provisions; and (2) recommended best practices. Under code provisions, listed companies are expected to comply with the rules, but may choose to deviate. If companies choose not to comply, they must justify in the interim and annual reports. As for the recommended best practices, they are for guidance purposes only, companies are encouraged, but not required, to state whether they have complied with the recommended best practices and give considered reasons for any deviation. In summary, it is not mandatory for listed companies to comply with the CG Code.

*Dr. Annie Hin-cheung Ko, School of Professional Education and Executive Development, The Hong Kong Polytechnic University, Hong Kong. Email: spanniek@speed-polyu.edu.hk
**Dr. Feida Zhang, School of Business and Governance, Murdoch University.
***Dr. Stella So, Department of Accountancy and Law, Hong Kong Baptist University, Hong Kong.

Under such laissez-faire regulatory environment, the objectives of this paper are to examine (1) the strengths and weaknesses of the financial sector in terms of governance practices; and (2) the governance compliance level of the sector in Hong Kong. Based on the literature review, this is the first paper to conduct over a decade-long research on the governance level of the financial sector. The financial sector is chosen because it is one of the four key industries in Hong Kong. The aggregated market capital of the listed companies in the sector is US$20 billion in 2017. The total employment of the financial sector is over 209,000. The value added of the financial sector is US$ 60 billion in 2017, which contributes 17.7% of the total GPD of the city (Hong Kong Trade Development Council 2017). Therefore, the financial sector plays crucial economic and social role in Hong Kong.

This paper scrutinizes the governance level of the financial sector from 2003 to 2017. A rating instruments is created based on the Principles of Corporate Governance (OECD, 1994, 2004, 2015) and Report on the HKIoD Corporate Governance Score-card (Cheung, 2012). This rating instrument includes four corporate governance aspects: ‘Board Responsibilities’, ‘Disclosure and Transparency’, ‘Equitable Treatment of Shareholders’, and ‘Role of Stakeholders’. All listed companies in the sector are included in the sample, excluding the ones listed after 2003. The results show that companies perform best in ‘Role of Stakeholders’. ‘Board Responsibilities’ ranks second; ‘Equitable Treatment of Shareholders’ ranks third; and the companies perform worst in ‘Disclosure and Transparency’.

The governance level of the financial sector kept improving in the past fifteen years. The overall average score has doubled during the period. In-depth investigation was conducted on how companies perform in each aspect, and results show that the companies are willing to promote corporate citizenship, sustainability and green culture. However, companies do the bare minimal on executive compensation disclosure, results show that shareholders are not allowed to participate in setting executive pays and the disclosed information is very difficult to understand.

This paper is organized as follows. In section 2, we review the related literature; in section 3, we develop the methodology and explain how the data are collected. In section 4, we analyze results and section 5 concludes.

2. Literature Review

2.1 Measuring Corporate Governance Mechanisms

In the past decade, studies on corporate governance mechanisms are quite limited in the Eastern market. Ko and So (2012) examine the identity of remuneration committee chairman and the independent level of the committee as a proxy for good governance. They found that appointing independent non-executive director (INED) to lead the remuneration committee and higher percentage of INED in the committee lead to good corporate governance. Ko and Chan (2014) investigate whether ownership structures affect the positive correlation between pay-performance sensitivities and industry competitions. They conclude that industry competition advance good governance only when the firm is not owned by family; and in concentrated ownership structure environment, industry competition loses its effect on enhancing pay-performance sensitivity. Leung and Horwitz (2004) study the correlation between director ownership and corporate governance level of listed companies. They conclude that high board ownership lead to poor disclosure and low transparency. Chen and Jaggi (2000) adapt board composition and ownership structure as proxy to evaluate firm's governance level, and conclude that the ratio of INED to total number of directors on corporate boards positively correlate to good governance.

Comparatively, the Western world has started studying corporate governance mechanisms decades ago. Back in the late 1990s, Morck, Shleifer, and Vishny (1998) and McConnell and Servase (1990) propose using ownership structure a new method to measure firm's corporate governance level. Hermalin and Weisbach (1991) use board composition as a proxy for firm's governance level. Lee, Rosenstein, Rangan, and Davidson (1992) examine board members' roles in mitigating agency problems between managers and shareholders in buyout transactions. They conclude that board members with more stocks are a good governance mechanism during corporate buyouts. By studying the correlation between firm value and board size of US firms, Yermack (1996) find that small board is positively related to favorable values for financial rations, better CEO performance incentives, which lead to good corporate governance.

Bhagat and Black (2002) examine the independent level of a board and find that board with high independent level does not necessarily represent better corporate governance. They also conclude that a more independent board does not always improve profitability. These results exhibit that when low profitability firms attempt to solve business problems by hiring more independent directors, these companies tend to do even worse. Karuna (2007) finds that industry competition is an important element to good corporate governance, and in a more competitive industry, managers have to work hard to get more pay.

2.2 Corporate Governance Ranking Tools

In 2002, the US Congress passed the Sarbanes-Oxley Act, and the first commercial corporate governance score-card was established after that. In US, the three major companies offer commercial rating services are, Governance Metrics International (GMI), Institutional Shareholder Services' Corporate Governance Quotient (CGQ) and The Corporate Library's TCL rating (TCL). These rating systems are designed to evaluate the corporate governance levels of the targeted listed companies.

The GMI rating offers a comprehensive range of ratings on corporate governance mechanisms; environmental, social and governance issues and accounting risk. The GMI scoring algorithm system is complicated and sophisticated; they collect data on hundreds of governance mechanisms, whether firms comply with securities laws and listing rules, listing requirements from stock exchange and corporate governance codes.

The Institutional Shareholder Services established the CGQ metric in 2003, it aims to evaluate "the strengths, deficiencies and overall quality of a company's corporate governance practices and board of directors" (Institutional Shareholder Services, 2017). The company updates the database on daily-basis on over 7,500 companies worldwide. Scores will be given to companies based on eight ratings criteria: anti-takeover provisions; audit issues; board issues; charter/bylaws; director education; executive & director compensation; progressive practices; and ownership.

Whist GMI and CGQ are more quantitative oriented; TCL on the contrary, embraces qualitative approach. TCL ratings demand professional expertise and subjective judgment. Rather than applying checklist and ranking by scores, the analysts of TCL provide assessment of firm's governance qualities based on their professional know-how and intuition. The ranking structure is built on four sections: board-level accounting concerns, CEO compensation practices, company's board and succession planning, and takeover defenses. And then a grade (from A to F) will be given to firms, where A and B represent significant risk in the four sections is not found in the firms, C means companies exhibit risk in no more than one category, D represents companies exhibit risk in two or more categories and F represents companies were either bankrupt, delisted or "where management has achieved effective control over the company … and conducts its business with flagrant disregard for the interest of nay minority public shareholders" (Daines et al. 2010).

Concerning the academic research, previous studies incorporate individual governance elements into one single score or rating to present a firm's governance level. La Porta, Lopez-de-Silanes, Schleifer, and Vishny (1998) design a comprehensive global index, (including legal rules pertaining to the rights of investors; the quality of enforcement of these rules; voting powers; ease of participation in corporate voting; and legal protection against expropriation by management) of shareholder protections around the world. Gompers, Ishii and Metrick (2003) invent the governance score (G-score), which measures twenty four governance rules: anti-greenmail; blank check; business combination laws; bylaw and charter; cash-out laws; classified board; compensation plans; contracts; control-share acquisition laws; cumulative voting; directors' duties; fair-price; golden parachutes; director indemnification; director liability; pension parachutes; poison pills; secret ballot; severance; silver parachutes; special meeting; supermajority; unequal voting; and written consent. Cheung (2012) used a corporate governance scorecard to examine the overall corporate governance performance of 121 listed companies in Hong Kong. There are two limitations in Cheung et al. (2012). Firstly, the samples only include the largest companies in the market which might lead to biased results because previous works show that big blue chip companies have more resources for corporate governance, ergo, their corporate governance is better the than small to medium listed companies. Secondly, there is only one sample year; therefore, the trends of the performances remain unknown. The goal of this paper is to fill these research gaps. Compared to Cheung (2012), this study offers a full picture on how the corporate governance has progressed in the past decade.

3. Methodology & Data Collection

A rating instrument is designed based on the Principles of Corporate Governance (OECD, 1999, 2004), Report on the HKIoD Corporate Governance Score-card (Cheung, 2012). The rating instrument consists of four sections: (A) Board Responsibilities, (B) Disclosure and Transparency, (C) Equitable Treatment of Shareholders, and (D) Role of Stakeholders. There are seventy six questions and the questions are presented in Appendix 1. For each good corporate governance practice, one score will be given; therefore, high score represents the company has good corporate governance practices.

There are ninety-two listed companies in the financial sector, deducting the thirty-four companies which are listed after 2003; the final sample includes fifty-nine companies. The study period spans from 2003 to 2017. All the data are hand collected from the companies' financial reports, companies' websites and Hong Kong Exchange News website. In order to exhibit the findings in a more use-friendly way, the results will be presented in percentage. For example, if 1 out of 59 companies complied, it will be translated to 1.7%.

4. Results and Analyses

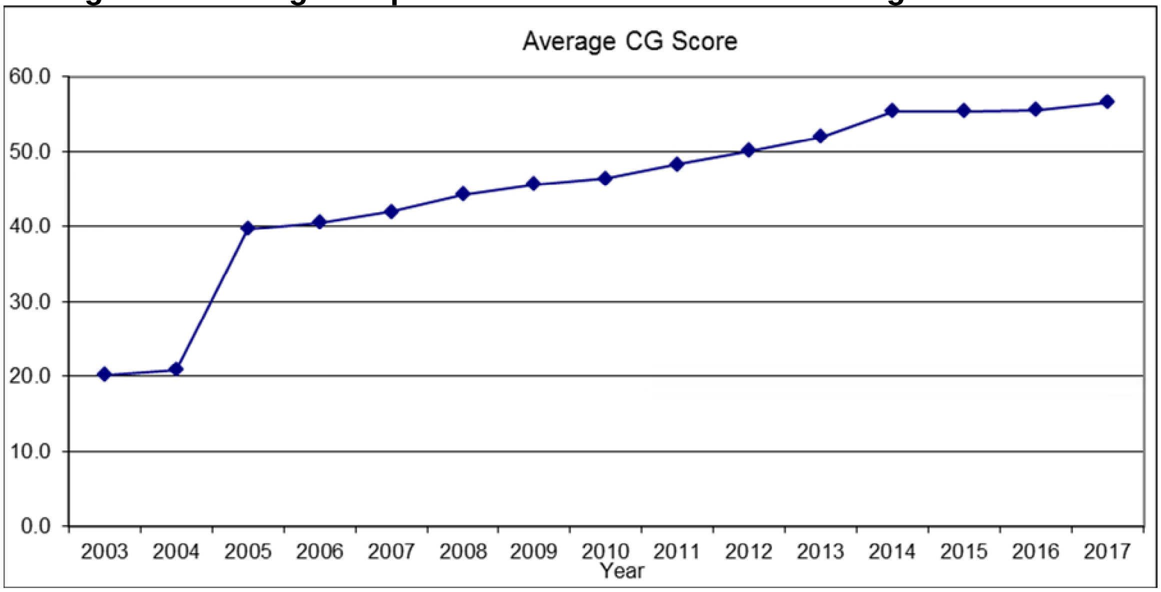
4.1 Overall Performance

The descriptive statistics are presented in Appendix 2, results show that the corporate governance practices in the financial sector has kept improving over the decade. This finding is consistent with Cheung (2012). Figure 1 presents the average scores during the period of 2003 to 2017.

The increment pattern is not linear and this is an interesting finding. The overall average scores in 2003 and 2004 are 20 and 21, respectively; as the full mark is 77, these scores are rather low. In 2005, the score starts to progress and reaches 39.7, there is 89% increment compare to the score in 2004. The scores keep improving from 2-6.5% every year during 2005 to 2009; and the increment slows down to 1-5.5% every year from 2009 to 2012. During 2013 to 2017 the scores climb very slowly at around 2.4% increment per year. These figures exhibit that the scores in 2003 and 2004 are low because the corporate governance concept was newly introduced to the market in 2003 by the regulators. Therefore companies needed time to comprehend the CG regulations and construct relevant implementation plans. In 2005, the scores surge as companies started to allocate resources to promote good corporate governance. The companies then further improve their corporate governance practices progressively; as a result, the scores ascend slowly from 2005 to 2013. During 2014 to 2017, the scores keep increasing but at a very slow rate, and the increment is almost insignificant. It is because the companies might feel that they have already done what they could to comply with the CG codes and are not willing to allot more resources to further enhance their governance.

To conclude, there are three crucial years: the first one is 2003, where the CG Code commences; the second one is 2005, the scores start to surge; and the third one is 2014, the scores peak and no significant improvements are shown. This phenomenon is also found when the four categories are analyzed individually. Therefore, the rest of the analyses will focus on these three important years.

Figure 1: Average Corporate Governance Scores during 2003 to 2017



4.2 Performance of 'Board Responsibilities'

The goal of this section is to measure the boards' performances in taking the monitoring and ethical leader role. Board of director is crucial in the governance system because their main role is to monitor the management and business operation on behalf of the shareholders. Therefore, board of director is the most important internal governance mechanism.

There are twenty-three questions in this section. The average scores increase from 10.1 to 22.6 during 2003 to 2017 (as shown in Appendix 2). These questions target four governance areas: (1) code of conduct (including corporate governance code, ethics code, internal audit and whistle-blowing policy); (2) quality of the sub-committee report (including audit committee and remuneration committee); (3) training for directors; and (4) independency of the boards. The listed companies in Hong Kong are required to set up sub-committees, such as audit committee and remuneration committee by the CG Code. Also, the CG Code demands companies to provide trainings for directors and stipulates the minimum requirement for board independency. With this regulatory background, companies are expected to have satisfactory performance in these areas.

In order to scrutinize whether companies in the financial sector are willful to promote good governance practices voluntarily, we deliberately chose three good governance mechanisms that are not requested by the regulators as the key questions. As shown in Table 1, the results of these three major questions are not very satisfactory. In 2003, no company took the initiation to cultivate ethical work environment. In 2005, 6.8% of the companies started to issue code of ethics to promote good work ethic; and the number has climbed to 21.7% in 2014. As for the whistle-blowing policy, none of the companies has such policy in both 2003 and 2005; and 18.6% of the companies introduced such policy in 2014. The last key question is to test whether the boards conduct annual self-assessment, and it is disappointing to see that only 8.5% of the companies have done so. These findings exhibit that the companies in the financial sector are passive in cultivating ethical atmosphere. The results are consistent with Ko, Tavitiyaman, Wong & Chan, 2018.

Table 1: Key questions in Section A – Board Responsibilities

		% of companies promote good CG practices		
No.	Question	2003	2005	2014
A2	Does the Board of Directors provide a code of ethics or statement of business conduct for all directors and employees?	0%	6.8%	21.7%
A11	Does the company provide the whistle-blowing policy?	0%	0%	18.6%
A14	Does the board conduct an annual self-assessment?	0%	0%	8.5%

4.3 Performance of 'Disclosure and Transparency'

There are twenty-two questions in this section; and they are designed based on three aspects: (1) disclosure quality of the annual report, (2) transparency on the shareholding structure and (3) communication channels provided by companies. As shown in Appendix 2, the average scores increase from 4.8 to 12.1 during 2003 to 2017.

Two key questions are created to investigate if companies are willing to voluntarily disclose the details of the remunerations of the directors and senior management, such that the shareholders can judge whether they are worthy for their pays. Results are shown in Table 2, and it is very disappointing to see that none of the companies are willing to do so.

According to the CG Code, companies are required to disclose directors' fees and any other reimbursement in the annual reports. We found that all companies comply this requirement. However, they all do the bare minimal on the disclosure, which means they simply give a big number for "salaries, allowances and benefits in kind", shareholders do not know the breakdown of these numbers nor what kinds of allowance and benefits they are referred to.

Also, the CG Code requires companies to disclose the "remuneration of the five highest paid individuals in one aggregate number" (HKEx 2017), but it does not require companies to disclose the identity of these five individuals nor the breakdown of the remuneration numbers. Under this rather loose disclosure requirement, none of the companies in the sample is willing to take the initiative to disclose more on the remuneration figures. This is very ironic because shareholders are the ultimate owners of the companies and they have every single right to be informed about how much they are paying their employees.

Table 2: Key questions in Section B – Disclosure and Transparency

		% of companies promote good CG practices		
No.	Question	2003	2005	2014
B9	Does the company voluntarily disclose the details of the individual directors' remuneration?	0%	0%	0%
B10	Does the company voluntarily disclose the details of the senior managements' remuneration?	0%	0%	0%

4.4 Performance of 'Equitable Treatment of Shareholders'

This section is to investigate whether shareholder are treated equally and justly, including whether shareholders have adequate time to articulate their views, and whether companies have policies to prevent insider trading. There are six questions and the average scores increases from 6.5 to 20.0 during 2003 to 2017 (as shown in Appendix 2).

The three key questions are presented in Table 3 and the results are not satisfactory. Firstly, no company allows minority shareholders to influence board composition. Secondly, no company allows cumulative voting in the election of board members. In US, some states make it mandatory for companies to offer cumulative voting under the corporate laws, but this is not the case in Hong Kong. The West's Encyclopedia of American Law (2008) explains cumulative voting is "a system of voting by shareholders for directors in which the shareholder can multiply his or her voting shares by the number of candidates and vote them all for one person for director". The principle of cumulative voting is to "allow shareholders to cast all their votes for a single nominee for the board of directors when the company has multiple openings on its board" (SEC). The purpose is to offer minority shareholders a chance to elect at least one director whom they favor. For example, if there are four directors to be elected and a shareholder holds 500 shares, with the regular voting method, the shareholder could vote a maximum of 500 shares for each candidate (500 votes per each candidate, therefore, 2,000 votes in total). On the contrary, with cumulative voting, the shareholder is given 2,000 votes and could choose to vote all 2,000 votes for one candidate, 1,000 each to two candidates, or divide the votes whichever he/she wishes.

In terms of facilitating voting by proxy, 40.7% of the companies offer such voting choice since 2003, and the number kept improving to 100% in 2014. A lot of companies facilitate proxy vote because the Codes on Takeovers and Mergers and Share Buy-backs issued by the Securities and Futures Commission has specific regulations on facilitating proxy votes, therefore, companies are already familiar with the procedures and rules and they do not need to allocate additional resources on accommodating proxy vote.

Table 3: Key Questions in Section C – Equitable Treatment of Shareholders

		% of companies promote good CG practices		
No.	Question	2003	2005	2014
C2	Does the company have any mechanism to allow minority shareholders to influence board composition?	0%	0%	0%
C4	Does the company facilitate voting by proxy?	40.7%	90%	100%
C6	Does the company use cumulative voting in the election of board members?	0%	0%	0%

4.5 Performance of 'Role of Stakeholders'

There are thirteen questions in this section, they are designed to scrutinize whether companies value their stakeholders, namely, community, creditors, customers, shareholders and suppliers. In particular, we would like to examine if companies value corporate social responsibilities. There are thirteen questions and the average scores increase from 11.2 to 36.2 during 2003 to 2015 (as shown in Appendix 2). The results show that all companies explicitly mention the importance of their customers and elaborate their obligations to the shareholders in the annual reports in details. In other words, amongst all the stakeholders, companies value their customers and shareholders most.

The three key questions are presented in Table 4, in 2003, 17% of the companies explicitly mentioned the safety and welfare policy of their employees in their annual reports, and the number has increased five times to 84.7% in 2014. However, it is disappointing to find that no company has policy to employ a certain percentage of underprivileged workers.

In 2003, 10.2% of the companies elaborate their obligations to the society, and the number has increased almost six-fold to 69.5% in 2014. We conducted in-depth investigations in the companies' documents and found that most of the companies have emphasized on their obligations and commitments to "green policies" and "green investment".

The result of the last key question exhibits that companies in the industry have strong sense of identity as corporate citizens compare to the hospitality and tourism industry (Ko, Tavitiyaman, Wong, & Chan, 2018). 5.1% of the companies explicitly mention its action to cultivate corporate citizenship in 2003, and the number has increased more than ten-fold to 55.9% in 2005. In other words, the companies are able to recognize that they have obligations to the society.

Table 4: Key Questions in Section D – Role of Stakeholders

		% of companies promote good CG practices		
No.	Question	2003	2005	2014
D6	Does the company explicitly mention the safety and welfare policy/benefits of its employee?	17.0%	59.3%	84.7%
D11	Does the company explicitly mention its broader obligations to society and/or the community?	10.2%	25.4%	69.5%
D12	Does the company explicitly mention its action to cultivate corporate citizenship?	5.1%	55.9%	79.7%

5. Conclusion

This study aims to examine (1) the strengths and weaknesses of the financial sector in terms of governance practices; and (2) the governance compliance level of the sector in Hong Kong. The results help regulators, the public and listed companies to scrutinize the existing governance practices and diagnose the aspects that need further improvements.

The listed companies in the financial sector are evaluated based on four corporate governance areas: 'Board Responsibilities', 'Disclosure and Transparency', 'Equitable Treatment of Shareholders', and 'Role of Stakeholders'. Among the four areas, companies perform worst in 'Disclosure and Transparency' and best in 'Role of Stakeholders'.

The governance practices in the financial sector kept advancing in the past fifteen years, and this is an encouraging finding. However, we also see that most of the companies are reluctant to promote good governance voluntarily; they merely follow the thresholds set by the regulators and doing the minimum. Therefore, if the regulators in Hong Kong or other Asian markets have determination to improve the governance level in the market, they should review the existing CG Code and further enhance it by adding more mandatory good governance mechanisms for companies to comply.

The major limitation of this paper is only one industry is evaluated, more extensive research is required to compare the governance level of the financial sector with the other key industries, such as logistics industry and the tourism industry.

References

Bhagat, S & Black, B 2002, 'The non-correlation between board independence and long-term firm performance', *Journal of Corporation Law*, vol. 27, pp.231-273.

Chen, JP & Jaggi, B 2000, 'Association between independent non-executive directors, family control and financial disclosures in Hong Kong', *Journal of Accounting and Public Policy*, vol. 19, pp.285-310.

Cadbury, A 1992, '*Report of the committee on the financial aspects of corporate governance'*, Gee Publishing, London.

Census and Statistics Department 2014, ‘Hong Kong annual digest of statistics. Census and Statistics Department’, *The Government of the Hong Kong Special Administrative Region*.

Cheung, S 2012, ‘Report on the HKIoD corporate governance score-card’, *The Hong Kong Institute of Directors.*

Cumulative Voting. (n.d.) ‘West’s Encyclopedia of American Law’, edition 2. 2008. Retrieved July 5, 2015 from http://legal-dictionary.thefreedictionary.com/Cumulative+Voting

Daines, RM, Gow, ID & Larcker DF 2010, ‘Rating the ratings: how good are commercial governance ratings?’ *Journal of Financial Economics*, vol. 98, p. 439-461.

Gompers, P, Ishii, J & Metrick, A 2003, ‘Corporate governance and equity prices’, *Quarterly Journal of Economics*, vol. 118, pp. 107-155.

Hermalin, B & Weisbach, M 1991, ‘The effects of board composition and direct incentives on firm performance’, *Financial Management*, vol. 20, pp. 101-112.

Hong Kong Trade Development Council, Economic and Trade Information of Hong Kong, 2017, HKTDC.

Institutional Shareholder Services, 2003. *ISS Corporate Governance: Best Practices User Guide & Glossary*, Revision 2.4, October 8, 2003.

Karuna, C 2007, ‘Industry product market competition and managerial incentives’, *Journal of Accounting and Economics*, vol. 43, pp. 275-297.

Ko, HCA & Chan, SYR 2014, ‘How ownership structures affect the relations between product market competition, and pay-performance sensitivity’, *Journal of Accounting Finance and Economics*, vol. 4, no. 1, pp. 53-67.

Ko, HCA & So, HHS 2012, ‘How does corporate governance affect CEO pay in family and non-family firms?’ *Global Review of Accounting and Finance*, vol. 3, pp. 18-31.

Ko, HCA, Tavitiyaman, P, Wong, BKF & Chan, SYR 2018, ‘Examine the corporate governance level of the hospitality and tourism industry in Hong Kong’, *International Review of Business Research Papers*, vol. 14, pp. 1-18.

La Porta, R, Lopez-de-Silanes, F, Schleifer, A, & Vishny, R 1998, ‘Law and finance, *Journal of Political Economy*, vol. 106, pp. 1113-1155.

Lee, C, Rosenstein, S, Rangan, N & Davidson, W 1992, ‘Board composition and shareholder wealth: the case of management buyouts’, *Financial Management*, vol. 21, pp.58-73.

Leung, S &Horwitz, B 2004, ‘Director ownership and voluntary segment disclosure: Hong Kong Evidence’, *Journal of International Financial Management & Accounting*, vol. 15, pp. 235-260.

McConnell, J & Servaes, H 1990, ‘Additional evidence on equity ownership and corporate value’, *Journal of Financial Economics*, vol. 27, p.595-612.

Morck, R, Shleifer, A & Vishny, R 1988, ‘Management ownership and market valuation: an empirical analysis’, *Journal of Financial Economics,* vol. 20, pp.293-315.

Organization of Economic Co-operation and Development (OECD), Principles of Corporate Governance, 1999, OECD.

Organization of Economic Co-operation and Development (OECD), Principles of Corporate Governance, 2004, OECD.

Organization of Economic Co-operation and Development (OECD), Principles of Corporate Governance, 2017, OECD.

The Hong Kong Exchange and Clearing Limited 2012, 'Corporate governance code and corporate governance report', Retrieved May 8, 2018, from http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/appendix_14.pdf

Wood, DJ 1991, 'Corporate social performance revisited', *The Academy of Management Review*, Vol 16, No. 4 pp. 691-718.

Yermack, D 1996, 'Higher market valuation of companies with a small board of directors', *Journal of Financial Economics*, vol. 40, p.185-211.

Appendix 1: Rating Questions

	Section A Board Responsibilities
A1	Does the company have its own written corporate governance rule that clearly describe its value system and board responsibilities?
A2	Does the Board of Directors provide a code of ethics or statement of business conduct for all directors and employees?
A3	Does the company have an internal audit operation established as a separate unit in the company?
A4	Quality of the Audit Committee Report in the annual report: Attendance.
A5	Quality of the Audit Committee Report in the annual report: Internal control.
A6	Quality of the Audit Committee Report in the annual report: Management control.
A7	Quality of the Audit Committee Report in the annual report: Proposed auditors.
A8	Quality of the Audit Committee Report in the annual report: Financial report review.
A9	Quality of the Audit Committee Report in the annual report: Legal compliance
A10	Quality of the Audit Committee Report in the annual report: Overall concluding opinion
A11	Does the company provide the whistle-blowing policy?
A12	Have board members participate in the professional / accredited directors' training?
A13	Does the company clearly distinguish the roles and responsibilities of the board and management?
A14	Does the board conduct an annual self-assessment?
A15	Every director is subject to retirement by rotation at least once every 3 years.
A16	Charter / role and responsibilities of the audit committee are disclosed.
A17	Profile / Qualifications of the audit committee are disclosed.
A18	Independence of the audit committee is disclosed.
A19	Charter / role and responsibilities of the compensation committee are disclosed.
A20	Is the compensation committee composed of a majority of independent directors?
A21	Is the chairman of the compensation committee an independent director?
A22	Performance / meeting attendance of the compensation committee is disclosed.
A23	The proportion of Independent non-executive director on the Board is over 30%.

	Section B Disclosure and Transparency
B1	Is the breakdown of shareholding structure clear?
B2	Is it easy to identify beneficial ownership?
B3	Are directors' shareholdings disclosed?
B4	Are management's shareholdings disclosed?
B5	Quality of the Annual Report: Financial performance.
B6	Quality of the Annual Report: Business operations and competitive position.
B7	Quality of the Annual Report: Operating risks.
B8	Quality of the Annual Report: Identification of Independent Directors.
B9	Does the company voluntarily disclose the details of the directors' remuneration on individual basis?
B10	Does the company voluntarily disclose the details of the senior managers' remuneration on individual basis?
B11	Quality of the Annual Report: Board meeting attendance of individual directors.
B12	Does the company fully disclose details of related-party transactions in public communications?
B13	Are there any accounting qualifications in the audited financial statements apart from the qualification on Uncertainty of Situation?
B14	Does the company offer multiple channels of access to annual report?
B15	Does the company offer multiple channels of access to company website?
B16	Does the company offer multiple channels of access to analyst briefing(s)?
B17	Does the company offer multiple channels of access to press conference(s) / press briefing(s)?
B18	Does the company provide contact details for a specific Investor Relations person or unit that is easily accessible to outside investors?
B19	Does the company provide a financial summary in annual report?
B20	Does the company issue the quarter report?
B21	Does the company mention its business risk?
B22	Does the company provide the information of the company secretary including his/her quantification and experience?
	Section C: Equitable Treatment of Shareholders
C1	Does the company offer one-share, one-vote?
C2	Does the company have any mechanism to allow minority shareholders to influence board composition?
C3	Have there been any cases of insider trading involving company directors and/or management in the past two years?
C4	Does the company facilitate voting by proxy?
C5	Does the notice to shareholders specify the documents required to give proxy?
C6	Does the company use cumulative voting in the election of board members?

	Section D: Right of Shareholders
D1	Is the decision on the remuneration of board members or executives approved by the shareholders annually?
D2	Does the company allow shareholders to elect board members individually?
D3	Appointment of directors, providing their names and backgrounds.
D4	Appointment of auditors, providing their name(s), profile, and fees.
D5	Dividend policy, providing the amount and explanation.
D6	Objective and reason for each item on the shareholders' meeting agenda.
D7	Director's comments and opinion for each agenda item.
D8	Voting method and vote counting system are clearly explained.
D9	Did the Chairman of the Board attend the last two AGMs?
D10	Did the CEO / Managing Director / President attend the last two AGMs?
D11	Did the Chairman of the Audit Committee attend the last two AGMs?
D12	Did the Chairman of the Compensation Committee attend the last two AGMs?
	Section E: Role of Stakeholders
E1	Does the company publish its Corporate Social Responsibility (CSR) report?
E2	Does the company explicitly mention how the company's CSR impact the society?
E3	Does the company mention its CSR policy as one of its corporate goals?
E4	Does the company explicitly mention the safety and welfare policy/benefits of its employees?
E5	Does the company explicitly mention professional development training programs for its employees?
E6	Does the company have policy to employ underprivileged workers?
E7	Does the company explicitly mention the role of customers?
E8	Does the company explicitly mention environmental issues in its public communications?
E9	Does the company explicitly mention the role of suppliers/business partners?
E10	Does the company explicitly mention its obligations to shareholders?
E11	Does the company explicitly mention its broader obligations to society and/or the community?
E12	Does the company explicitly mention its action to cultivate corporate citizenship?
E13	Does the company explicitly mention its obligations to creditors?

Appendix 2: Corporate Governance Scores from 2003 to 2017

Year		Overall	(A)	(B)	(C)	(D)
2003	Mean	20.2	10.1	4.8	6.5	11.2
	Median	10.0	6.0	1.0	3.0	16.1
	Minimum	0.0	0.0	0.0	0.0	0.0
	Maximum	38.0	20.0	10.0	14.0	25.0
2004	Mean	20.9	10.3	4.8	6.5	12.0
	Median	10.0	7.0	1.0	3.0	20.0
	Minimum	0.0	0.0	0.0	0.0	0.0
	Maximum	38.0	20.0	10.0	14.0	28.0
2005	Mean	39.7	11.5	5.2	10.2	15.1
	Median	32.0	9.0	2.0	8.0	25.9
	Minimum	0.0	0.0	0.0	0.0	1.0
	Maximum	45.0	25.0	12.0	14.0	28.0
2006	Mean	40.5	11.5	5.3	11.3	15.9
	Median	33.0	9.0	2.0	8.0	26.9
	Minimum	0.0	0.0	0.0	0.0	1.0
	Maximum	45.0	25.0	12.0	16.0	28.0
2007	Mean	42.0	14.0	6.8	12.5	17.0
	Median	33.0	11.0	2.0	9.0	29.7
	Minimum	0.0	1.0	0.0	0.0	1.0
	Maximum	49.0	26.0	15.0	17.0	29.0
2008	Mean	44.3	15.0	7.5	12.5	17.5
	Median	36.0	11.0	3.0	9.0	29.8
	Minimum	0.0	1.0	0.0	0.0	2.0
	Maximum	49.0	27.0	15.0	17.0	30.0
2009	Mean	45.7	16.3	10.3	13.1	19.6
	Median	36.0	12.0	6.0	10.0	30.4
	Minimum	0.0	1.0	0.0	0.0	3.0
	Maximum	54.0	29.0	17.0	19.0	30.0
2010	Mean	46.4	17.9	10.6	13.8	20.5
	Median	37.0	13.0	6.0	10.5	31.0
	Minimum	0.0	1.0	0.0	0.0	3.0
	Maximum	57.0	30.0	17.0	20.0	30.0
2011	Mean	48.3	18.9	10.6	14.7	21.4
	Median	38.0	13.0	6.0	12.0	31.0
	Minimum	0.0	1.0	0.0	0.0	3.0
	Maximum	59.0	31.0	17.0	20.0	38.0
2012	Mean	50.1	20.3	11.1	15.6	22.2
	Median	38.0	14.0	7.0	13.0	33.0
	Minimum	0.0	1.0	0.0	0.0	3.0
	Maximum	60.0	33.0	18.0	21.0	40.0
2013	Mean	53.0	20.9	11.6	16.7	24.0
	Median	40.0	16.0	8.0	13.0	34.0
	Minimum	0.0	1.0	0.0	0.0	3.0
	Maximum	62.0	34.0	19.0	22.0	40.0
2014	Mean	53.0	21.6	11.8	17.4	26.0
	Median	42.0	16.0	9.0	14.0	36.0
	Minimum	0.0	1.0	0.0	0.0	3.0
	Maximum	63.0	34.0	19.0	22.0	43.0
2015	Mean	55.4	22.0	11.8	17.8	28.0
	Median	43.0	17.0	9.0	15.0	26.0
	Minimum	0.0	1.0	0.0	0.0	3.0
	Maximum	66.0	36.0	19.0	22.0	43.0
2016	Mean	56.6	22.0	12.1	19.0	31.4
	Median	44.0	17.0	10.0	16.01	29.0
	Minimum	0.0	1.0	0.0	0.0	3.0
	Maximum	67.0	36.0	20.0	23.0	47.0
2017	Mean	56.6	22.6	12.1	20.0	36.2
	Median	44.0	17.0	10.0	17.0	31.0
	Minimum	67.0	1.0	0.0	0.0	3.0
	Maximum	56.6	37.0	20.0	23.0	49.0

(A) represents the results of ‘Board Responsibilities’, which consists of 23 questions; (B) represents the results of ‘Disclosure and Transparency’, which consists of 22 questions; (C) represents the results of ‘Equitable Treatment of Shareholders’, which consists of 18 questions; (D) represents the results of ‘Role of Stakeholders’, which consists of 13 questions. For each good corporate governance practice, 1 score will be given.