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Asia embraces more diversity and independence when choosing directors

MARY LEUNG
CFA Institute

"Getting governance right and getting the independence element right is crucial to the protection of investor rights"

Why did you do recently publish a report on Independent Directors in Asia Pacific? Why is board independence and diversity important in APAC?

Mary Leung, CFA, Head, Advocacy, Asia Pacific, CFA Institute
CFA Institute considers improving corporate governance as a key cornerstone in protecting shareholder rights because independent directors mitigate the agency problems of corporations, where the agent doesn't fully represent the best interest of principles because of the inherent conflict of interest. They also have a very important function in counter-balancing executive management and controlling shareholders. Most importantly of all, they make sure that all decisions are made in the best interest of the company and are fair to all shareholders.

Now, it may all sound very abstract. What does it mean in the real world? I can assure you, Michael, that it has real-world relevance, especially for a market like Hong Kong and, indeed, in much of the region, where ownership of listed companies is concentrated in the hands of a few controlling shareholders. These controlling shareholders may be a single individual or a few individuals, a family, another corporate entity, or even a government.

Getting governance right and getting the independence element right is crucial to the protection of investor rights because these are the people who would be scrutinizing related-party transactions and opining if they are fair and reasonable. Whether it's to acquire assets from controlling shareholders or spinning off the crown jewel back to the family, or sometimes taking the company private, these are the people who are also heavily involved in the audit, remuneration, and nomination committees. That's why we think a deeper dive into independence of directors is crucial in investor protection in this region.

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SIVANANTH RAMACHANDRAN
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What key issues need to be addressed in APAC, and what are CFA Institute's recommendations?

Sivananth Ramachandran, CFA, Director, Capital Markets Policy India, CFA Institute
First of all, independent director issues are generally complicated. Take director tenure, for example. Independent directors need time to learn about the company about the industry and be effective. But long tenure can lead to entrenchment. We have cited studies, which show that tenures provide the right balance between effectiveness of independent directors and enrichment. Director tenure is one of the key issues that regulators across the region have been trying to tackle. They are trying to limit the prevalence of long-tenured directors.

The second issue is overboarding. Now, once again, directors with a lot of directorships bring a lot of connections and knowledge of best practices they're seen elsewhere and so on, which is quite appealing for companies. But overboarded directors may not provide the desired level of attention for companies, and regulations have also tried to limit onboarding in some form or the other. There are other issues, which are relevant for the region, one of which is related-party transactions. These issues are prevalent in markets where controlling shareholders have a significant influence. We have seen that in markets like India, Malaysia, and Hong Kong, where related-party transaction-related abuses can be quite detrimental for minority shareholders. Those are the top issues that I would want to highlight about independent directorship.

Piotr Zembrowski, CFA, Manager, Advocacy Research and Content, Asia Pacific, CFA Institute
We have a series of recommendations for the markets in Asia Pacific. Our first recommendation is that a majority of directors on the company board should be independent. This is a gold standard of corporate governance and the common practice in markets, such as United States, the UK, and Australia. In addition, independent directors should play a significant role on board committees, such as the nomination, audit, and remuneration committee.

Another recommendation is that the role of CEO and chair of the board should be separated. This is the case in most modern half of the companies that we surveyed in Hong Kong. But still, companies here lag behind Singapore, Malaysia, Australia on this matter. Ideally, we would also like to see the chair of the board to be an independent director. This is still quite rare in their region. As an intermediate step, if the chair is not independent, the majority of the board should be.

A third recommendation is that board diversity, in particular, diversity of gender should be promoted. Gender diversity is only one aspect of diversity, in addition to cultural background, age, professional experience education, but one where much progress still can be made in the region. Independent directors should engage with shareholders. That's our fourth recommendation. This is not very common. But we feel that it is necessary in order for independent directors to be able to adequately represent the interests of the shareholders. Boards should designate a lead independent director accountable to public shareholders.

Our fifth recommendation is that independent directors should be adequately trained. This should include comprehensive training before or at the time of the appointment and also include continuing professional development.

What were the Key Hong Kong insights from the report?

Mary Leung, CFA, Head, Advocacy, Asia Pacific, CFA Institute
Michael, thank you for that question. They say that a picture is worth a thousand words. I'm going to start my answer with this slide, which shows the market average of independent directors on boards of listed companies in the six APAC markets that we cover, and also including UK and the US. In the six markets we cover, three markets, on average, had majority independent directors on their boards, including Australia, Singapore, and Malaysia. India's close, but not quite. But Hong Kong, as you can see, is probably doing just the statutory requirements of having three independent directors on the board or one-third as a minimum, whichever is higher. This is an area that definitely has room for improvement. This slide shows direct independence.

PIOTR ZEMBROWSKI
CFA Institute

The next slide shows overboarding. In Hong Kong, there's no cap on the limit of concurrent directorships. But if an independent director wants more than six directorships, then on the seventh one, a listed company must explain why they still have sufficient time to devote to this new directorship. Now, we all know that there are lots of talented people in Hong Kong. I'm sure lots of independent directors are very talented as well. But no matter how talented they are, they only have 24 hours a day. It begs the question that if you have too many directorships, whether you can devote sufficient time and energies to the affairs of one company. That's the second issue.

The last issue that I wanted to talk about is board diversity. This is something that my colleague, Piotr, had alluded to earlier. This chart shows the percentage of female directors across a number of markets. Now, as you can see in Hong Kong, there's definitely room for improvement. Hong Kong currently lags behind a number of international financial centers on gender diversity on the board. But, obviously, some people will say, "Well, it's not too different from other markets in the region, such as Singapore or India." But recent trends paint a somewhat mixed picture. Although in most markets, the number of all-male boards has decreased between 2019 and 2020, we have seen an opposite trend in Hong Kong. In fact, 37% of boards of Hong Kong companies included in the MSCI or Share World Index had no women directors, compared to 32% in 2019.

What's being done, especially in the area of diversity? In the April 2021 consultation issued by the Hong Kong Stock Exchange, they wanted to enhance a number of corporate governance features in Hong Kong. One of the areas that they zoomed in on was diversity. What they effectively said was that single-gender boards are no longer acceptable, effectively putting a target of one female director per listed company. Is that enough? Well, that's certainly a lot better than what we have seen. But if you think about how other markets have approached this issue, markets in Australia and the UK are already setting targets as high as 30 or 40%. Even in the region, Singapore and Malaysia have targets of 30% female board representation. In India, as far back as 2014, they have stipulated to have one female director on the boards of each listed company. That's recently been upgraded to include one female independent director on those boards. Can Hong Kong do better? Absolutely. ■