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Transparency in the market

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Introduction

Many economic commentators are saying that this recent credit crisis may possibly be a precursor to the biggest bear market since the Great Depression. This doomsday prediction is not without grounds. The current economic conditions are very challenging to say the least.

It is during these exceptional times when problems at companies surface, even the good ones. When corporate captains are under tremendous pressure to deal with problems besetting their companies, it is easy to forget to tell their shareholders what is going on. There may also be great temptation to cover up bad news. As Warren Buffet once said, "*It's not until the tide goes out that you realise who's swimming naked*".

I won't discuss listed companies' general obligation of disclosure under the Listing Rules which Paul has discussed just now.

Today I wish to talk about the importance of timely and meaningful information by companies. Timely and meaningful information is crucial to the integrity of our market, especially in times of high market volatility.

Market integrity

Market integrity refers to a fair and transparent market where every investor has equal access to information. It is a fair and informed market where investors can deal with confidence. Such a market promotes investor confidence. Promoting and maintaining investor confidence is the key to an efficient and successful market.

When a company fails to provide meaningful and timely information to investors, investors grow anxious. Investors start to lose confidence in the company and finally the market in general. Speculation of a company's financial condition becomes rife and its share price may fluctuate for no discernible reasons.

Investors panic as a result of unexpected and unquantifiable bad news. Investors as a group become an irrational entity. They often fear the worse when left in the dark.

Take the huge industrial and financial conglomerate General Electric Company ("GE"). Often regarded as a bell-weather on the US economy, GE rocked the global markets earlier this year in April after it shocked Wall Street with a stunning drop of 5.8% in its first quarter profit and cut to its profit forecast for 2008. GE experienced the biggest one-day fall in its share price since 1987. Many market commentators attributed GE's fall from grace in part to its chief executive Jeff Immelt's earlier comments that GE's 2008 profits were "*in the bag*" – investors were 'surprised' with the uncertainty. Was the CEO out of touch – or had the situation deteriorated that rapidly?

Meaningful information

Meaningful information about a company refers to material information that investors need in order to make informed decisions about the company. It is information that might reasonably be expected to have effect on the demand and prices of the company's securities. The information must be clear, accurate and complete.

The disclosure must not be false or misleading. In April 2007, the SFC successfully prosecuted Daido Group Ltd ("Daido") and its chairman Mr To Shu Fai for making a false or misleading statement to the SFC in an announcement filed with the Exchange.

Daido submitted a false or misleading statement to the Stock Exchange when responding to a query by the Stock Exchange about a sudden surge in turnover of Daido's shares on the market. The company claimed it knew of no reason for the sudden increase in turnover. In reality, the turnover had increased because Mr To, Daido's Chairman, sold 200 million shares.

Both Daido and Mr To appealed their convictions in the High Court. The High Court rejected the appeals and upheld the SFC's arguments in February 2008.

This is an important case because it is the first successful trial of a case involving allegations of false or misleading information to the market under the dual filing regime.

Timely information

Timely information refers to prompt disclosure of material information. Companies must disclose major changes to their financial position promptly. Some companies seek to time their announcements, particularly if they have bad news. They may seek to delay announcing bad news until the very last moment, or they may try to hide it in their results announcements.

In 2007, the Exchange publicly censured Linfair Holdings Ltd (now known as China Jin Hui Mining Corporation Ltd) for failing to issue a profit warning in respect of its half year results ending 30 September 2005. Linfair's directors knew by 17 November 2005 that its financial performance was substantially worse than the corresponding period in 2004, and that it was not in line with their optimistic outlook in Linfair's prospectus and annual report for its financial year ending 31 March 2005. Yet the directors failed to issue a profit warning. Linfair chose to wait until its interim results announcement was due to announce the deterioration of its financial performance.

When Linfair announced its interim results on 20 December 2005, the results showed a 73% fall in turnover and a net loss of $21 million, compared with a net profit of $30 million for the corresponding period in 2004. The market reacted to the news by dumping its shares.

Compare General Electric and Linfair's cases with Sun Hung Kai's profit warning two weeks ago. On 27 November 2008, Sun Hung Kai announced that it expected its financial performance for the second half of 2008 to be adversely affected by the current widespread economic and financial uncertainty. Yet, its share price closed at $3.10 up 25% from $2.48 the next day.

Similarly China Oil Resources Holdings Ltd issued a profit warning on the same day (27 November 2008) that it expected its unaudited results for the 6 months ended 30 September will be substantially less, compared with the corresponding period in 2007. Yet, China Oil's share price kept steady at around $0.07 the next day, on 28 November 2008.

This goes to show that when a company maintains its investors' confidence, the market may not necessarily react negatively to bad news.

Good disclosure practices

Good disclosure practices enhance transparency and accountability. Transparency is necessary to enable the market to assess a company's position. Good disclosure allows the market to assess a company's position, and thereby promotes investor confidence.

Listed companies must establish effective and robust internal control measures to firstly, identify material information; and then to raise this information to the Board in a timely manner. Having good disclosure practices promotes good corporate governance practices. Companies must have robust internal control procedures in order to ensure timely disclosure of reliable information.

Transparent market

Disclosure of information does not automatically result in clearer or better transparency. Disclosure does not automatically equate to a transparent market either. There are two elements to a transparent market:

- Firstly, clear, accurate and complete information; and
- Secondly, even dissemination of information. In other words, information must not be disseminated to a selected segment of the market; but must be simultaneously disseminated as widely as possible.

One of the complaints against GE was the fact that not many (if any, at all) understood its operations. GE argued that it disclosed more than the minimum disclosure required. Yet, because of its sheer size and the complexity of its operations, even analysts did not fully appreciate and understand GE's operations. To quote one analyst covering the company "*[GE is] so complicated. You're never quite sure where your risks are*". So much so that the market was taken completely by surprise by GE's profit warning earlier this year despite the company's compliance with the disclosure requirements. Information disclosed must be clear, accurate and complete to enable investors to understand and to make informed decisions about a company.

There is a misguided perception that selective disclosure of unpublished price sensitive information during trading suspension is acceptable because no one can trade the securities during this period. It is argued that there is no prejudice to the market because investors cannot trade in the securities.

This is not true. Recipients of selectively disclosed information have more time to analyse the information than the other investors. Furthermore, they can conduct off-market transactions.

Selective disclosure of price sensitive information damages the integrity of the market and corrodes investor confidence.

Let me illustrate this point with the case of China Water Affairs Group Ltd. China Waters suspended trading of its shares on Tuesday, 3 July 2007 pending release of its announcement regarding a possible major transaction. That evening, China Water's investor relations staff told an analyst about the transaction. The analyst reported the transaction on 5 July, but the company only announced the transaction on 11 July – six days after the analyst's report. The investors who had access to the analyst's report had at least six days more than the other investors to analyse the impact of the transaction on the company's operations and finances. The Stock Exchange recently publicly criticized China Water for failing to disclose the transaction in a more timely manner.

The key here is to maintain investor confidence by providing investors with timely and reliable information. There must be positive flow of information from companies to investors. Companies must ensure timely and meaningful publication of price sensitive information or directors' dealings in shares of their company.

Conclusion

An informed market is the cornerstone to an efficient and successful market. Companies that provide meaningful and timely information to investors help promote and maintain investor confidence in their operations and financial performance, and ultimately shores up confidence in the market place. This will be essential to help us recover more quickly from the recent financial turmoil and investor uncertainty.

Thank you.