

Hong Kong Institute of Chartered Secretaries Annual Dinner

Good Corporate Governance - Whose Responsibility?

Speech by Mr Eddy Fong

Chairman of the SFC

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Ladies and gentlemen, it is an honour to be asked by the Hong Kong Institute of Chartered Secretaries to speak at your Annual Dinner. I will be brief as I am all that stands before the enjoyable part of the evening.

My topic this evening is “Good corporate governance - whose responsibility?” If I asked you to answer this question, I am sure that as company secretaries many of you would answer: “I am, or at least that is what my chairman and the board of directors think”.

Company secretaries do have a key role to play. However my answer would be: we all have a responsibility for ensuring that Hong Kong is seen to embody good corporate governance as this is essential to our position as an international financial centre.

Before explaining my answer, I want to ask another question: Why do we want good corporate governance? Surely all we need is to have just enough governance to meet external expectation.

The Cadbury report on Corporate Governance came out just 15 years ago. For many of us, this was the first time we heard people speaking about this subject. Over the last 15 years, so much has been written and spoken about the subject that we are all now used to this term. Indeed I did a Google search and found close to 10 million references to it. So why does the world write so much about corporate governance. Why is it important?

There is a danger that we think of corporate governance as something imposed by regulation and rules. If that is the case, then the answer to my second question would be just enough of it to meet the expectation of the market or its regulators, such as having the minimum number of independent non-executive directors, setting up an audit committee and ensuring that directors’ interests are disclosed etc. This is wrong. Corporate governance is not about ticking the boxes. It is about embracing the right principles.

Good corporate governance is important in:

- enhancing shareholders’ confidence in the governance processes; and
- ensuring the entity is better run.

Shareholders’ confidence is reflected in the price of shares. Although many investors will invest in companies which, in the immediate term, can yield maximum return, academic papers from countries as diverse as Brazil, Germany, Korea, PRC and USA all give the clear message that in the long run investors value good governance and are willing to pay a premium for it.

In addition to improving investors' perception of the entity, good corporate governance also leads to better management and therefore better performance. Researches show that clear internal accountability, well defined responsibilities, and a fuller understanding by management of risks are some of the elements of good corporate governance that add to a company's performance.

Good governance does not just add value to an individual entity, the reputation and success of a financial market is also dependent on it. It is no coincidence that the world's two leading international financial markets, New York and London, are recognised as leaders in setting such standards.

Hong Kong is also seen as the leader in setting the best standard in this region. The CLSA report 2007 on Corporate Governance in Asia ranks Hong Kong the highest of 11 jurisdictions. Senior officials in the PRC continue to support listings in Hong Kong as the best way for PRC companies to learn about good corporate governance practices.

So back to today's topic: Who is responsible? I see three key groups:

- First, the authorities;
- Second, the market; and
- Third, the persons responsible for the entity – the board of directors assisted by the company secretary.

Firstly, authorities set the benchmark requirements for Hong Kong to be an international financial market. The authorities have to ensure that our rules are on a par with international standards. The role of regulators such as the SFC is to facilitate the development of good governance standards. Support from the market is indispensable.

That brings me to the second group, the market. One of the basic lessons we learn is successful companies react to market forces. If the market calls for higher standards, the companies will respond. As I have already said there is clear evidence that shareholders are prepared to pay higher prices for companies known for having better corporate governance.

Investors are a very important element of all markets and they have a key role to play. Investors have to speak up if they want high standards. In some cases, this is best achieved privately through conversations with the companies or by the way investors vote their shares.

In the USA, we see more active investors such as CalPERS¹ taking public stances on issues, either generally or in respect of individual companies.

In the UK, the National Association of Pension Funds and the Investment Management Association have for many years advised their members on matters relating to corporate governance. Proposals by listed companies that fall outside the parameters adopted by these organisations are voted down by investors. For example, the limits on the size of the general mandates in London are set according to standards suggested by these bodies.

I have to say that in Hong Kong outspoken investors either as individuals or as a group are not as many or as visible as we would hope.

¹ CalPERS is the California Public Employees Retirement Scheme that provides pensions for some 1.5 million people and at Oct 2007 had around US\$ 250 billion of assets.

But we should not just leave it to shareholders to reflect the views of the market. Public organisations and professional bodies also have a role to play in better corporate governance. The Hong Kong Institute of Certified Public Accountants has its best Corporate Governance Awards, your Institute organised a successful conference, “Corporate Governance at the Crossroads”, only a few days ago. In addition to the professional bodies, last year the ICAC’s Ethics Development Centre organised a half day forum to train company directors to master the evolving governance and ethical challenges.

Now, I come to the last but most important group, the people who run companies: the board of directors. As I said at the start, entities benefit from good governance. That is not just about abiding by the rules nor listening to what investors want. It is about working out how best to organise the governance of a company to meet its objective. It includes:

- actively seeking advice from experienced independent directors as to the best strategy to adopt;
- setting in place structures that ensure that the operations of the company are well controlled and the risks are well understood; and
- ensuring that the information which decisions are based is well founded, reliable and made available on a timely basis.

Without the active support from those in charge of a company, corporate governance will be just a chore delegated to company secretaries.

Good corporate governance is too important to be left to others, be they the authorities, the investors, the public bodies or the directors. We must all accept responsibility for getting the message across that good corporate governance is important for individual entities and essential for Hong Kong’s continued development as an international financial market.

Thank you.