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About HKICS and ICSA

The Hong Kong Institute of Chartered Secretaries

The Hong Kong Institute of Chartered Secretaries (HKICS) is an independent professional body dedicated to the promotion of its members’ role in the formulation and effective implementation of good governance policies in Hong Kong and throughout China as well as the development of the profession of Chartered Secretary.

HKICS was first established in 1949 as an association of Hong Kong members of the Institute of Chartered Secretaries and Administrators (ICSA) of London. It became a branch of ICSA in 1990 before gaining local status in 1994. HKICS has more than 5,300 members and 2,900 students (as of September 2010).

HKICS issues two sets of post nominal to its Members who qualify locally:

i. One set on behalf of HKICS: FCS for Fellows and ACS for Associates,

ii. One set on behalf of the international body ICSA: FCIS for Fellows and ACIS for Associates.

The Practitioner’s Endorsement (PE) will be entitled to members who undertake a minimum number of CPD hours (15 hours) to ensure that their specialist knowledge is up-to-date; it is an added element of the programme for those members in the corporate secretarial sector. For more information, please visit http://www.hkics.org.hk

The ICSA

The ICSA is the leading professional body for company secretaries and senior administrators across all sectors.

Established by Royal Charter and with over 100 years’ experience, ICSA qualifies Chartered Secretaries through its Qualifying Schemes; provides its members and students with a range of support services; enforces a strict code of conduct with which all members are required to comply; promotes and supports best practice in all areas of corporate governance and provides a global voice on boardroom and regulatory issues.

ICSA has 34,378 members and 11,556 students in over 70 countries (as of 31 December 2009). ICSA’s headquarters are in London with separate Divisions in Australia, Canada, Hong Kong, Malaysia, New Zealand, Singapore, South Africa and Zimbabwe.
Chartered Secretaries Brand Synopsis

Good governance is at the core of good business decisions

Good governance is critical in all areas of every business, yet many businesses still find aspects of governance hard to grasp. As a result, key areas are often neglected through a lack of understanding, rather than a lack of relevance.

Against this background, Chartered Secretaries play a major role as custodians of sound business ethics and practices. Chartered Secretaries bring experience, knowledge and integrity in their advice to the board thereby creating the environment for more enlightened decisions based on strong governance principles.

To bring greater prominence to the work of Chartered Secretaries, The Hong Kong Institute of Chartered Secretaries (HKICS) has realigned its brand with a greater focus on the impact of their professional role in businesses. With a new tagline, ‘More than meets the eyes’ HKICS draws attention to their often understated but crucial function in strategic decisions, as well as to the complexity of the issues within their sphere of responsibility as professionals at the heart of an organisation.

HKICS is a professional body dedicated to further study and practice of secretaryship; being the effective governance of modern businesses and other organisations. HKICS assesses and qualifies candidates for the Chartered Secretary profession. It also upholds and advances the high standards of that profession by providing continuing education, ensuring its membership upholds the principles of the profession, and participating fully in developing the legal and regulatory framework that supports our business community.
Foreword

I am delighted to write this foreword to the winning papers of the Institute's Corporate Governance Paper Competition publication. The topic for the competition this year is “Disclosure and Transparency” – complementary partners in good governance.

With repeated corporate scandals, stakeholders demand for comprehensive, accurate and reliable information, both financial and non-financial, have become more and more intense. Shareholders, customers, employees, creditors and even the general public all welcome good quality information in their assessment of investing in, contracting with or patronizing the businesses of, a corporation. The learning achieved through this competition is most important and timely.

As Chairman of the Education Committee of the Institute, I am pleased to note the superb quality of papers submitted and presentations made. It is evident that these reflect both breadth and depth in the deliberation of the students. Their output bears witness to their achievement. A big round of applause to all participating teams.

In closing, I wish to convey my heartfelt gratitude and appreciation to the reviewers, judges and panelists who spent time on reviewing and judging the papers and presentations; and to the Education and Examinations Department colleagues at the Institute for their efforts in putting together such a successful competition.

Thank you all and congratulations!

Edith Shih FCIS FCS(PE)
Vice President and the Education Committee Chairman
The Hong Kong Institute of Chartered Secretaries

November 2010
Champion

Lam Wing Ally
Tsang Ying Ming Evan

Chinese University of Hong Kong

Edith Shih FCIS FCS(PE) presenting certificates to Lam Wing Ally (left) and Tsang Ying Ming Evan (right), the Champion of the Corporate Governance Paper Competition 2010.
Introduction

The recent financial crisis has highlighted the importance of corporate disclosure and transparency. Without timely and accurate disclosure of information, investors cannot make informed investment decisions. This leads to an inefficient market with a biased and unfair reflection of the value of the company, prospects of the industry or even the economy as a whole.

This study examines how to achieve good corporate governance through enhancing corporate disclosure and transparency. First, it explains the concepts of disclosure and transparency, their relationship with corporate governance and the benefits they bring about. Second, it provides an overview of the current regulatory framework for corporate disclosure in Hong Kong. Third, it explores the latest developments and their advantages and disadvantages. It concludes by recommending disclosure practices to attain good corporate governance.

Background

Corporate Governance

Corporate governance is defined basically as "the whole system of controls by which companies is directed and controlled". It aims at improving the efficiency and attractiveness of the capital market. The idea of corporate governance embraces certain essential elements:

- systems of controls within the company;
- relationships between the company's board/shareholders/stakeholders;
- the company being managed in the interests of the shareholders (stakeholders); and
- greater transparency and accountability to enable users of corporate information to determine whether the business is being managed in a way that they consider appropriate.

Corporate governance seeks to address the classic principal-agent conflict of interest between shareholders and management resulting from the separation of ownership and control. However, family-controlled companies, which are prevalent in Hong Kong, share the same problem, even though the ownership and control are combined to a great extent. The problem becomes more acute when minority shareholders have significantly reduced power to influence management.

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5 S Fong and W Shek, "Corporate Governance Disclosure and Company Performance of Hong Kong Based and China Based Family Controlled Property Development Companies", The IUP Journal of Corporate Governance, July-October 2009, p.8.
Where the interest of the controlling shareholders differs from that of the company, controlling shareholders may use the company for their personal interest and to the detriment of the company.\textsuperscript{6} Minority shareholders may not want to invest in such companies and their confidence in the market may decrease, thereby increasing the cost of capital of companies and affecting the efficiency of the market.\textsuperscript{7} This eventually leads to short-termism in the market and a lack of proactivity from shareholders, which exacerbates the problem.

\textit{Disclosure and Transparency}

Corporate transparency and disclosure are inter-connected concepts. Corporate transparency is "the widespread availability of relevant, reliable information about the periodic performance, financial position, investment opportunities, governance, value, and risk of companies".\textsuperscript{8} Disclosure is "any purposeful release of information that is likely to have an impact on the company's competitive performance and on the strategic decision making of its internal and external audiences".\textsuperscript{9} Disclosure can be seen as a way to achieve transparency. The three types of disclosures are mandatory disclosure,\textsuperscript{10} voluntary disclosure,\textsuperscript{11} and disclosure through information intermediaries such as financial analysts, the financial press or institutional investors.\textsuperscript{12}

\textit{Relationship between Disclosure and Corporate Governance}

Disclosure and transparency are essential to corporate governance. They address the aforementioned principal-agent problem by promoting management accountability and ensuring that corporate information is publicly available for supervision of the management's activities.\textsuperscript{13} They offer the best protection against improper management actions or policies. As stated in OECD's fifth principle, a corporate governance regime should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, its financial situation, performance, ownership, and governance.\textsuperscript{14} Specifically, to attain good transparency, a company must:

- Adopt accurate accounting methods
- Make full and prompt disclosure of information relating to the company
- Make disclosure of conflicts of interest of the directors or controlling shareholders
- Give shareholders adequate advance notice of meetings and voting\textsuperscript{15}

\textsuperscript{6} Hsu et. al., op. cit., p.268.
\textsuperscript{7} Ibid.
\textsuperscript{10} Mandatory disclosure is corporate disclosure required by law or regulations, such as financial reporting requirements.
\textsuperscript{11} Voluntary disclosure is corporate disclosure that is not required by law or regulations.
\textsuperscript{13} A Carver and S Goo, \textit{Corporate Governance: The Hong Kong Debate}, Sweet \& Maxwell Asia, Hong Kong, 2003, p.27.
\textsuperscript{14} Ibid., p.23.
Benefits for Enhancing Corporate Disclosure and Transparency

Corporate disclosure and transparency underpin the working of an efficient and fair capital market. Securities markets function efficiently if the share price fully reflects the information about the issuer company. An efficient market therefore protects investors because efficient share prices allow investors to trade at fair and unbiased prices. Otherwise, the information asymmetry between investors and the company may lead to an inefficient market, which discourages investment.

Moreover, disclosure and transparency also enhance the performance of a company in the following ways:

- **Management Restraint**: Access to information allows investors to exercise their rights effectively against the management's activities. It also reduces the risk premium required by investors for "the risk of loss from expropriation by opportunistic managers".

- **Financing Advantage**: Good disclosure practice helps companies attract external financing and long-term investors, lower the cost of capital by reducing information risk and liquidity risk, and increase credibility and shareholder loyalty. With reliable and accessible information, human and financial capital can flow towards areas with higher returns and be utilised more efficiently. Consequently, it becomes easier for company managers and investors to identify and evaluate investment opportunities.

- **Governance Premium**: A high level of quality disclosure increases the investors' valuation of the company, which strongly depends on information available to them. Broad, timely, and accurate disclosure contributes to good governance and investors are willing to pay a governance premium for a well-governed company. A survey indicated that the premium raises the market valuation of companies by between 10 and 12 per cent on average. This premium is expected to increase in the future due to the continual rise in corporate governance awareness after the Enron debacle and the more recent financial crises.

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17 Ibid.
19 Ibid.
22 D Easley and M O'Hara, “Information and the Cost of Capital”. Journal of Finance, vol.59 (4), 2004, pp.1553-1583. Here, the former refers to any risk of loss relating to the lack of company information and the latter refers to the risk in trading with more informed investors as a result of information asymmetry among investors. See also Bushman and Smith, op. cit., p.68.
23 Hsu et. al., op. cit., p.268.
24 Bushman and Smith, loc. cit.
In summary, enhancing corporate disclosure and transparency is crucial to achieving good corporate governance. It staves off improper management activities by allowing supervision by shareholders, and brings significant benefits to the operation of companies and financial markets as a whole.

**Regulatory Framework in Hong Kong**

Since corporate disclosure and transparency is the cornerstone of an efficient market, statutes set out the minimum standard which companies must comply with. The regulatory framework in Hong Kong mainly is formed by the Companies Ordinance (Cap. 32), the Securities and Futures Ordinance (Cap. 571), and the Listing Rules. The major mandatory disclosure requirements under the current regulatory framework in Hong Kong can be summarized as follows.

**Accounting Records**

Accounting records are the most fundamental source of information for investors to understand the financial status and position of the company, and how well the company is managed by the directors.

A company has a specific duty to maintain proper accounting records, prepare them in a specified form, ensure that they present a true and fair view of the state of affairs of the company, and present them to its members. Listed companies are required to publish annual reports and half-yearly reports in accordance with the specific content requirement on a timely basis.

**Prospectus**

A prospectus ensures that the public has access to a true and fair description of the state of affairs of the company so as to facilitate their investment decisions.

Where there is a public offering for shares or debentures, a company is required to issue a prospectus compliant with the requirements of the Companies Ordinance. The requirements ensure that the information contained in the prospectus is true and accurate.

**Transactions of the Company**

Certain transactions are significant to shareholders either because of their magnitude or nature of the transaction, and thus they require disclosure or approval by the shareholders.

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26 Includes both the Main Board Listing Rules and the GEM Listing Rules.
27 Section 121-123, Companies Ordinance (Cap. 32).
28 See Chapter 4 and Appendix 16 of the Main Board Listing Rules for Main Board companies; Chapter 7 and Chapter 18 of the GEM Listing Rules for GEM companies.
29 Sections 38D & 48A, Companies Ordinance (Cap. 32).
30 See sections 38(1B), 40, 40A, 342E, 342F, Companies Ordinance (Cap. 32); sections 107, 108, 277, 298, Securities and Futures Ordinance (Cap. 571).
Listed companies are obliged to provide specific information or seek prior approval from the shareholders when the company undertakes two types of transactions: notifiable transactions and connected transactions.

Notifiable transactions are transactions noteworthy to shareholders due to their size. Chapter 14 of the Listing Rules requires listed companies to inform the SEHK and publish an announcement as soon as possible after the terms of the transaction have been finalised. Quantitative tests are applied to determine the level of shareholder disclosure or involvement required. The following transactions are defined as notifiable transactions:

- Share transactions;
- Disclosable transactions;
- Major transactions;
- Very substantial acquisitions;
- Very substantial disposals; and
- Reverse takeover.

Connected transactions are transactions noteworthy to shareholders due to their nature. Chapter 14A of the Listing Rules requires listed companies to make an announcement, obtain independent shareholders’ approval, or issue circulars for connected transactions unless waived by Hong Kong Stock Exchange (HKEx) or exempted under the de minimis transaction rule. Any transaction between a company and a connected person is a connected transaction. A connected person primarily refers to:

- Any director,31 chief executive or substantial shareholder32 of the company;
- A promoter and the supervisor of a PRC company;
- Any associate of the foregoing; or
- Subsidiaries of the company which are not wholly owned but in which any of the foregoing persons are a substantial shareholder.33

*Transactions by Directors*

Transactions by directors may sometimes lead to corporate governance problems. First, they may create conflicts of interest between the person's role as the director of the company and the person's interest as an individual shareholder. Second, they may allow the director-cum-shareholder to have preferential access to confidential and price-sensitive information about the company.

31 Including persons who were directors within the preceding 12 months.
32 A person who is entitled to exercise, or control the exercise of, 10 per cent or more of the voting power at any general meeting of the company. See 1.01 of Listing Rules.
33 Chapter 14A.11 of the Main Board Listing Rules; Chapter 20.11 of the GEM Listing Rules. See also other cases which are regarded as connected transactions in 14A.13 the Main Board Listing Rules for Main Board companies; Chapter 20.13 of the GEM Listing Rules for GEM companies.
Generally, directors who have material interests, whether direct or indirect, in a contract or proposed contract with the company, are required to declare the nature of their interest. In addition, all interests of directors and chief executives in the shares and debentures of the listed company and its associated corporations must be disclosed, with no percentage thresholds. Directors may be subject to the substantial holding disclosure requirement when they come to be interested in 5 per cent or more of a listed company's voting shares, including the underlying shares of equity derivatives.

Common law and equity also impose fiduciary duties on directors.

**Disclosure of Price-Sensitive Information**

Listed issuers are required to keep the market and SEHK informed as soon as reasonably practicable of any information relating to the group which:

(a) is necessary to enable them and the public to appraise the position of the group; or
(b) is necessary to avoid the establishment of a false market in its securities; or
(c) might be reasonably expected materially to affect market activity in and the price of its securities.

Until an announcement in relation to such information is made, such information should be kept strictly confidential. Information should be disclosed to the market as a whole and all users of the market have simultaneous access to the same information. If price-sensitive information is inadvertently divulged to outside parties or it is believed that such information may have been inadvertently divulged, the company must immediately issue an announcement to disseminate the information to the market as a whole.

**Continuing Obligations**

Listed companies are subject to continuing disclosure obligations once their securities have been listed on the SEHK. Major areas covered include:

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34 Section 162, Companies Ordinance (Cap. 32); Chapter 13.68 of the Main Board Listing Rules; Chapter 17.90 of the GEM Listing Rules.
35 It extends to underlying shares of equity derivatives.
36 Including cessations and changes in those interests, both as to amount and nature.
37 See Part XV, Securities and Futures Ordinance (Cap. 571). Directors are also required to comply with the “Model Code for Securities Transactions by Directors of Listed Issuers” in Appendix 10 of Main Board Listing Rules: Chapter 3.17 & 13.67 of Main Board Listing Rules.
38 Thereafter, a cessation of a notifiable position and changes which take a holding up or down through a whole percentage level require disclosure, as do changes in the nature of a person's interests, subject to the de minimus exemptions.
39 13.09, Main Board Listing Rules.
41 Ibid.
42 Chapter 13, Main Board Listing Rules; Chapter 17, GEM Listing Rules.
• Disclosure of price-sensitive information;\(^{47}\)
• Response to enquiries made of the issuer by SEHK concerning unusual movements in the price or trading volume of its listed securities or any other matters;\(^{44}\)
• Compliance with the prescribed minimum percentage of listed securities in public hands at all times.\(^{45}\)
• Pre-emptive rights, being circumstances under which the directors of the listed issuer must obtain the consent of shareholders in general meeting prior to allotting, issuing or granting securities;\(^{46}\)
• Arrangements for annual general meetings and board meetings;\(^{47}\)
• Disclosure of financial information;\(^{48}\)
• Notification to SEHK of changes with regard to a listed issuer’s memorandum or articles of association or equivalent documents, its directorate or supervisory committee, rights attaching to any class of listed securities, auditors or financial year end, its secretary or registered address;\(^{49}\)
• Submission to SEHK of draft announcements, circulars and other documents for review;\(^{50}\)
• Trading and settlement arrangements;\(^{51}\) and
• Directors’ dealings, service contracts, nomination and contact information.\(^{52}\)

**Compliance with the Model Code**

The Model Code for Securities Transactions by Directors of Listed Issuers (Model Code) contained in Appendix 10 of the Listing Rules mandates the set of standard behaviour that directors should comply with in relation to dealings in securities of the company. Essentially, when a director is aware of, or privy to, notifiable transactions under Chapter 14, or connected transactions under Chapter 14A, or any price-sensitive information, he must refrain from dealing in the securities until proper disclosure of the relevant information is made.\(^{53}\)

\(^{43}\) Chapter 13.09, Main Board Listing Rules; Chapter 17.10, GEM Listing Rules.
\(^{44}\) Chapter 13.10, Main Board Listing Rules; Chapter 17.11, GEM Listing Rules.
\(^{45}\) Chapter 13.32, Main Board Listing Rules; Chapter 17.36, GEM Listing Rules.
\(^{46}\) Chapter 13.36, Main Board Listing Rules; Chapter 17.39, GEM Listing Rules.
\(^{47}\) Chapter 13.37-13.45, Main Board Listing Rules; Chapter 17.44-17.49, GEM Listing Rules.
\(^{48}\) Chapter 13.46-13.50, Main Board Listing Rules; Chapter 17.50A, GEM Listing Rules.
\(^{49}\) Chapter 13.51, Main Board Listing Rules; Chapter 17.50, GEM Listing Rules.
\(^{50}\) Chapter 13.52-13.57, Main Board Listing Rules; Chapter 17.53-17.61, GEM Listing Rules.
\(^{51}\) Chapter 13.58-13.66, Main Board Listing Rules; Chapter 17.62-17.49, GEM Listing Rules.
\(^{52}\) Chapter 13.67-13.78, Main Board Listing Rules; Chapter 17.78-17.91, GEM Listing Rules.
\(^{53}\) Model Code rule B.8. There are certain exceptions, such as when the director has notified the board of directors and received an acknowledgment, and when the director has disclosed to the market and SEHK that he has to meet a financial commitment.
Corporate Governance Code and Corporate Governance Report Rules

The Listing Rules has recommended principles and practices of good corporate governance in the Code on Corporate Governance (“Corporate Governance Code”)\(^\text{54}\) and the Rules on the Corporate Governance Report (“Corporate Governance Report Rules”).\(^\text{55}\)

The Corporate Governance Code covers principles, code provisions (which companies are expected to comply with), and recommended best practices (for guidance only). Although companies may choose to create their own code of corporate governance practices, and compliance with the Code is not mandatory, they must report on whether the Corporate Governance Code provisions are complied with and explain deviations from its provisions.\(^\text{56}\)

The Corporate Governance Report Rules set out the mandatory reporting requirements\(^\text{57}\) and recommended disclosures.\(^\text{58}\) Failure to comply with the mandatory requirements is a breach of the Listing Rules.

Latest Developments: Codification of Disclosure Requirements of Price Sensitive Information


Definition of Price Sensitive Information

The definition of price-sensitive information (also referred to as inside information) will replicate the definition of relevant information\(^\text{59}\) under the Securities and Futures Ordinance. It is the same set of information which is prohibited from being used for insider dealing.

Disclosure Obligation

The statutory obligation is to disclose to the public as soon as practicable\(^\text{60}\) any inside information that has come to the knowledge of the listed corporation. Directors and officers must take all

\(^{54}\) Appendix 14, Main Board Listing Rules; Appendix 15, GEM Listing Rules.

\(^{55}\) Appendix 23, Main Board Listing Rules. Appendix 16, GEM Listing Rules.

\(^{56}\) Chapter 3.25, Main Board Listing Rules & Corporate Governance Report Rules.

\(^{57}\) Corporate Governance Report Rules, Rule 2.

\(^{58}\) Corporate Governance Report Rules, Rule 3.

\(^{59}\) See section 245, Securities and Futures Ordinance. In relation to a corporation, it means specific information about the corporation; a shareholder or officer of the corporation; or the listed securities of the corporation or their derivatives.

\(^{60}\) It means that the corporation should immediately take all necessary steps that are reasonable in the circumstances to disclose the information to the public.
reasonable measures from time to time to ensure that there are proper safeguards to prevent the listed corporation from violating the statutory disclosure requirements. If a listed corporation is found not to be complying with the statutory disclosure requirements, and if such a breach is a result of any intentional, reckless or negligent act on the part of any individual director or officer, or any individual director or officer has not taken all reasonable measures to ensure compliance with the statutory disclosure requirements, they will be liable for the breach.

**Safe Harbours**

The consultation creates safe harbours to cater for certain circumstances where non-disclosure or delay in disclosure would be permitted. These circumstances include:

(a) when the disclosure would constitute a breach against an order made by Hong Kong court or any provision of other Hong Kong statutes;
(b) where the information is related to impending negotiations or incomplete proposals, the outcome of which may be prejudiced if the information is disclosed prematurely;
(c) when the information is a trade secret; and
(d) when the Government's Exchange Fund or a central bank provides liquidity support to the listed corporation.\(^61\)

The safe harbours will be applicable only if the corporation has taken reasonable precautions to preserve the confidentiality of the inside information and there is no leakage of the inside information.

**Regulation and Enforcement**

The Securities and Futures Commission (SFC) would be the enforcement authority, which, upon receipt of a referral from the Stock Exchange of Hong Kong (SEHK), investigates possible breaches and initiates follow-up proceedings before the Market Misconduct Tribunal (MMT). Persons suffering from pecuniary loss as a result of others breaching the disclosure requirement could rely on the MMT findings to take civil action.

The consultation suggests civil sanctions against non-disclosure of price-sensitive information by listed corporations, and keeps under review the effectiveness of the regime in light of local and international market experience. The proposed civil sanctions include:

(a) a regulatory fine of up to $8 million on the listed corporation and/or the director;
(b) disqualification of the director or officer from being a director or otherwise involved in the management of a listed corporation for up to five years;
(c) a "cold shoulder" order on the director or an officer (i.e. the person is deprived of access to market facilities) for up to five years;

(d) a "cease and desist" order on the listed corporation, director or officer (i.e. an order not to breach the statutory disclosure requirements again);
(e) an order that any body of which the director or officer is a member be recommended to take disciplinary action against him; and
(f) payment of costs of the civil inquiry and/or the SFC investigation by the listed corporation, director or officer.\(^2\)

**Benefits**

The proposed reform aims at achieving good disclosure practice by giving statutory backing to the disclosure obligations and strengthening enforcement. The benefits of the proposal are as follows:

- **Effective Sanctions:** Under the existing regime, the SEHK may only delist an issuer who is in breach of the disclosure obligations, which was said to have little deterrent effect on a company that "cares little for its share price or which would prefer to delist anyway".\(^3\) After delisting, as the retail investors are generally desperate to get out of illiquid stock, the controlling shareholder may then be able to buy back the shares at a very low price.\(^4\) In the proposed regime, more effective sanctions, such as disqualification orders or fines, can be imposed upon the companies in breach. These sanctions are more specific and well-targeted to suit different circumstances.

- **Better Investor Protection:** The proposal allows people who suffer a financial loss to rely on the decision of the MMT to bring proceedings against the companies in breach, whilst the current regime does not provide such a channel to claim loss.\(^5\) It provides for a more expedient court procedure and facilitates civil claims by investors.

- **Balance between Different Interests:** The proposed statutory regime strikes an appropriate balance between facilitating timely disclosure and preventing premature disclosure which might unduly prejudice a corporation's legitimate interests by providing safe harbours.\(^6\) It anticipates practical problems by recognizing the legitimate need of companies to defer disclosure.

**Concerns and Difficulties**

Despite a more stringent compliance regime, there are concerns from companies that it would be unfair to impose a statutory burden to disclose in a realm of uncertainties. The two major concerns are as follows:

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\(^4\) Ibid.


\(^6\) Ibid., p.9
• **Difficulty in Determining Price-sensitive Information**: It is extremely difficult for the directors to determine, beforehand, whether the information would be likely to materially affect the price of the company's shares. Nevertheless, the SFC and MMT can always conclude with hindsight and knowledge that the non-disclosed information has a material impact on share prices. As the judgment involves a subjective internal management decision, penalties are not justified for directors who made an honest and reasonable mistake as to the need for disclosure.

• **Superfluous Disclosure**: With the severe civil sanctions, the proposed law may result in over-disclosure, or premature disclosure of incomplete or indefinite matters, leading to "disruption of businesses, mishandling of confidential information, and unnecessary and confusing surplus of information in the market". Consequently, the market may be overwhelmed by unnecessary information which is not useful to investor decision-making, while companies have to endure the increased costs arising from frequent disclosure.

**Recommendations:**

**Good Corporate Governance via Voluntary Quality Disclosure**

**Value-Based Disclosure Approach**

From an investment perspective, disclosure provides information to investors so as to enable them to determine the company's ability to generate cash flow, namely its intrinsic value, and decide whether to invest in its stock. However, mere compliance with the mandatory disclosure requirement is not sufficient to fulfil this function satisfactorily. The reported data may not form a reliable basis for forecasting future performance, as it may reveal little about the company's investment risks or its key drivers of performance such as its customer relations. Consequently, contemporary corporate reporting has been moving towards an integrated approach with increasing amount of voluntary supplemental disclosure.

In relation to voluntary disclosure, companies listed in Hong Kong need to improve the "quality and range of disclosures in areas such as risk management and sustainability". To determine what information is material to the investors and should be disclosed in companies' reports, it is suggested that a value-based disclosure approach should be adopted. Under this approach, apart

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71 Such as annual reports or interim reports.
from fulfilling the regulatory disclosure requirements, the company should voluntarily disclose information relevant to investors’ valuation of the company. The practical aspects of the recommended approach are detailed below:

- Identify the key value drivers of the company's performance and explain the value-creating process of the company. Choose accounting methods and estimates that are "consistent with what management has identified as the drivers of the company's success".\(^2\)

- Supplement the required financial reports with disclosures which "either enhance the credibility of the reports, or fill in the holes left by the reports".\(^3\) For example, Amazon.com, the American online retailer, discloses in its quarterly report the number of active customers, sales per customer, and percentage of orders placed by repeat customers, as the company views these figures as key drivers of growth.\(^4\)

- Give clear explanation of the company's stakeholders, and its competitive and macro-economic environment. In the management discussion and analysis section of annual reports, more information should be provided about the "industry and business trends, key performance indicators and industry benchmarks, risks and uncertainties affecting the business, etc."\(^5\)

- Provide information about intangible assets, including details about research and development, human capital, or customer relations.

- Provide conservative forecasts. Forecasts may assist investors in understanding the future direction of the company. However, although increased forecasting disclosure will only increase the risk of reducing the company's competitive advantage in the market to a limited extent, it will increase the risk of law suits where the predictions are not realised. Therefore, it is safer for the management to simply release general statements about the future of the company.\(^6\)

- Give information about the company's governance and organisation.

- Provide a sustainability report. Reporting on how the company deals with environmental, economic and social issues is considered vital to building trust and credibility in the management’s ability, thereby indirectly creating value for the company.\(^7\) An example of such issues is where a manufacturing company has to keep a stable supply of goods and low emissions of pollutants, while keeping manufacturing costs low.\(^8\) Another example is the


\(^{3}\) Ibid.

\(^{4}\) Hutton op. cit., p.13

\(^{5}\) Ibid.

\(^{6}\) Schuster and O’Connell, op. cit., p.5.


\(^{8}\) Ibid.
award-winning sustainability report published by CLP Holdings Ltd, which details the group’s investment in renewable energy generation.\textsuperscript{79}

In addition, the company can connect with the investors by enquiring what type of information they need through the channels discussed in the next section. The company may then provide the information needed, if possible using a cost/benefit analysis.

**Establish Effective Investor Relations Programmes**

A high level of corporate disclosure and transparency can be attained through effective communication with investors. To achieve this goal, the company must have extensive disclosure channels and good investor relations. Firms with more extensive investor relations programmes have more analyst coverage and higher disclosure quality.\textsuperscript{80} Hence, to attract investor capital, the company must ensure that, by maintaining good investor relations, investors have an adequate flow of simple and readily accessible information relating to the company.

**Step 1: Establish an Investor Relations Department**

The investor relations department should strategically manage corporate disclosure. It ensures that the company gives consistent messages and establishes the company’s identity and reputation to the market, in accordance to the management’s vision. Its duties include:

- Gathering information relating to investors’ perception of the company through surveys, stock surveillance and other market-intelligence gathering methods.\textsuperscript{81} For example, the investor relations department should inform the management of any rumours, changes in analyst recommendations, or its competitive status in the market.
- Maintaining the company’s relationship with investors, analysts, the press and other disclosure channels.\textsuperscript{82}
- Developing a company-wide awareness of the importance of consistent corporate disclosure and co-ordinating the release of company information. It also has to ensure that employees of the company recognise their legal duties or risks relating to issues such as disclosure of price-sensitive information.\textsuperscript{83}

\textsuperscript{79} CLP Group website <https://www.clpgroup.com/ourvalues/sustainability/Pages/sustainability.aspx>


\textsuperscript{82} To be discussed below.

\textsuperscript{83} Ibid.
Step 2: Systemic Disclosure Approach

Companies should adopt a systematic disclosure approach to suit the needs of the investors. There are two parts to this:\(^64\)

- *Positioning*: The investor relations department should review the key value drivers of the company’s business, its target audience, and the qualities which distinguish the company from its competitors. This enables the investor relations department to define the company’s position in the market and decide what kind of information is material to the investors and should be disclosed. Effective re-packaging of information already disclosed with another form or focus will attract the attention of the market and increase the company’s visibility and transparency.\(^65\)

- *Reaching Out*: Having determined the company’s market position and the information to be disclosed, the company should adopt proactive investor relations strategies. Such an approach reduces the market participants’ information search costs and time, stimulates greater analyst coverage of the company,\(^66\) and increases shareholders’ participation in corporate matters and understanding of the company.

Interactions with the public may take different forms depending on the target and the purpose of disclosure. The recommended ways of disclosing information are listed below:

**Interaction with Current and Potential Investors**

- *Web Disclosures*:

  The company website should include financial reports, press releases, regulatory disclosures, non-financial and strategic information, analyst or management presentations and frequently asked questions.\(^67\) Information on the website should be up-to-date and accessible to the general public. Although the current regulations only require companies to publish their financial reports annually and half-yearly, it is recommended that quarterly financial reports should be published to meet international standards of corporate governance.

  The company may also offer interactive communication with investors by allowing them to post questions on the website, issuing email updates on company information,\(^68\) and conducting shareholders’ meetings online. For example, Siemens’ annual general meeting can

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\(^{64}\) This approach is developed, with certain variations, from the definition-delivery-dialogue approach proposed by T Ryan and C Jacobs, *Using Investor Relations to Maximize Equity Relations*, John Wiley & Sons, Hoboken, 2006.


\(^{68}\) Tyco’s e-mail alerts: http://investors.tyco.com/phoenix.zhtml?c=112348&tp=irol-alerts
be viewed via a live webcast and shareholders may submit voting instructions on the internet. The methods of web disclosure presented provide cost-effective ways to disseminate the latest information to investors and they overcome geographical barriers of communication.

- **Informal Disclosure:**

Informal disclosure is another proactive measure to disseminate information. It includes blogs, Twitter, Facebook, RSS feeds, and chat rooms. These popular social media platforms allow the company to receive instant feedback from investors. However informal the platform is, it is important for the companies to ensure regulatory compliance in relation to the information given.

**Interactions with Financial Intermediaries**

The company should foster a strong relationship with key capital market intermediaries, such as financial analysts and institutional investors, who are in a position to disseminate their understanding of a firm’s business propositions to a broad group of investors. Through their recommendations or forecasts, these intermediaries can deepen other market participants' understanding of the company’s business models and performance. Apart from disclosing information, the company can benefit from their feedback and questions, either to understand the needs of the market or to receive advice on how to improve its business. In cases where the company needs to release negative news, they may provide support to the company, based on their knowledge of and their relationship with the company. Also, the company may direct the market’s expectations of the company by communicating with the analysts. The following are the major channels through which the company can communicate with intermediaries and recommended best practice:

- **Conference Calls:**

Companies hold conference calls for earnings releases, strategic announcements, or in response to accidents. A typical conference call comprises prepared comments presented by the management and a question and answer session. With the help of the Internet,
companies can disseminate information to a large group of geographically dispersed audience at a low cost and at the same time. This is particularly useful when companies need to comment quickly on events after a press release or for crisis management. As the session for management comment in conference calls often only lasts for 20-30 minutes, every word of the comment must be scripted to bring the key message clearly to the analysts.

- **Road Shows:**

Road shows are marketing events which can generate interest in a firm's stock before a stock offering. They can be deal or non-deal road shows, depending on whether they are used for raising capital at the time. Normally, they are composed of group and one-to-one meetings so managers can meet with and answer questions from the buy-side in a more private setting. For companies conducting an initial public offering, road shows are a good opportunity for the institutional investors to familiarise themselves with the company's management.

**Improving Corporate Governance Infrastructure**

The establishment of an internal control system within the company indirectly enhances corporate transparency by monitoring the quality of disclosure. Under the current Listing Rules, the board must include at least three independent non-executive directors (INEDs). An audit committee, the majority of which must be INEDs, must be set up for the review and supervision of the financial reporting process and internal controls. However, these INEDs are appointed by the board of directors, so they are normally appointed by the controlling shareholders. This raises doubts over their independence. Although they must satisfy the requirement of independence in the Listing Rules, the controlling shareholder has the power to remove them in a shareholder's meeting.

In the light of the prevalence of family-controlled companies in Hong Kong, it is recommended that INEDs should be appointed by the minority shareholders and the board must provide reasons to explain the removal of INEDs. Although this is not mandatory under the current law, a company may include clauses to this effect in its constitution to improve its corporate governance infrastructure.

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101 Ibid.
102 Ryan and Jacobs op. cit., p.164.
103 Spaseska op. cit., p.26
104 Ibid.
106 Ibid.
Conclusion

Information is the driving force behind financial markets. Corporate disclosure and transparency are the vehicles which deliver information to investors. If these vehicles are not well-developed in a market, capital will flow to another market with a higher standard of corporate disclosure and transparency. To maintain Hong Kong's status as an international financial centre, the government should strengthen the regulatory framework of corporate disclosure, and corporations in Hong Kong should adopt a value-based disclosure approach, establish effective investor relations programmes and improve their corporate governance infrastructure. In today's globalized world, Hong Kong's commitment to enhancing corporate governance is more important than ever.
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First Runner up

Ho Yuen Ting Wendy

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Edith Shih FCIS FCS(PE) (right) presenting certificate to Ho Yuen Ting Wendy (left), the First Runner up of the Corporate Governance Paper Competition 2010.
Part 1: Importance of Transparency in Corporate Governance

1.1 Corporate Governance, Transparency and Disclosure

Corporate governance can be defined as “ways designed to make the management work for the best interests of the corporation and to ensure a reasonable return to the suppliers of capital (i.e. the investors)”\(^{107}\). From an individual corporate point of view, good corporate governance brings about good management and a prudent allocation of company resources, which together enhance corporate performance\(^{108}\). From the overall perspective of the securities market, good corporate governance helps “create market confidence, the efficiency of capital allocation, the renewal of countries' industrial bases and ultimately, nations' overall wealth and welfare.”\(^{109}\) Therefore, the importance of corporate governance has been repeatedly highlighted by governments worldwide and many corporations embrace the notion of promoting good corporate governance.

The success of corporate governance depends, to a large extent, on the degree of transparency of corporations\(^ {110} \). The degree of transparency of a corporation can be measured by the availability to the corporation’s investors of matters regarding the corporation, including its financial situation, performance, ownership and governance. The quality of the disclosure mechanism greatly affects the degree of transparency of a corporation. Ideally, a disclosure mechanism should be able to achieve the following\(^ {111} \):

- ensure all material information is fully disclosed
- ensure information disclosed is complete, accurate and reliable
- ensure information is up-to-date and disclosed in a timely manner
- ensure the dissemination of information is cost-effective and fair, i.e. all investors, whether insiders or outsiders, must have as equal as possible access to the information

1.2 Importance of Transparency

Transparency is vital for good corporate governance, and an effective disclosure mechanism is a powerful preventive measure in reducing the risk of corporate failures and market irregularities.

1.2.1 Micro-economic Viewpoint

From a micro-economic point of view, transparency provides the best protection to shareholders against improper management actions or policies.\(^ {112} \) Nowadays, almost all corporations, especially

\(^{107}\) Yu Guanghua, “Towards an Institutional Competition Model of Comparative Corporate Governance Studies”, 6 JCHINCL 31 (2003), 33
\(^{108}\) Goo, SH & Carver, Anne. Corporate Governance: the Hong Kong Debate Hong Kong, Sweet & Maxwell Asia, 2003, 14
\(^{109}\) Ibid, 19
\(^{111}\) The list is not intended to be inclusive and it only reflects the author’s findings in the research for the present paper
\(^{112}\) Above 2, 27
large listed ones, adopt the separation-of-ownership-and-management approach to governance: shareholders, the owners, are responsible for supplying corporations' capital while the board of directors and the managers, are responsible for the daily operation of the corporations. To ensure the capital invested is appropriately and wisely used, shareholders need an effective mechanism to monitor the management. To a large extent, shareholders' ability to monitor management against expropriation or other wrongdoing depends on whether they have sufficient information about the transactions complained of. Therefore, an effective disclosure mechanism and thus a high degree of transparency are vital safeguards of shareholders' interests.

Transparency is also essential for protecting minority shareholders from being exploited by the majority shareholders. It is a norm in modern corporations that, on the one hand, the minority shareholders are usually the 'outsiders' of the corporation who play almost no role in the operation of the corporation's daily activities apart from providing the necessary capital; on the other hand, the majority shareholders, who may be the founders of the corporation's business, are usually the 'insiders' of the corporation and in addition to supplying capital, continuously play a significant role in the management of the corporation's day-to-day business, assuming the positions of the corporation's managers or directors. Thus information asymmetry exists between the insider minority shareholders and the outsider majority shareholders. To make matters worse, under the majority rule, majority shareholders can easily pass resolutions according to their preference disregarding minority shareholders' interests. The majority shareholders may expropriate earnings by paying low dividends, selling assets at low prices and approving excessive executive remuneration. Enhancing transparency on the basis of equal access to material corporate information is an important tool with which minority shareholders are able to supervise the acts of the majority shareholders. With sufficient information, even though minority shareholders may not be able to change the main policies decided by the majority, they may choose to withdraw from the corporation in a timely manner by selling their shares or taking legal actions should there be any illegal expropriation by the majority.

1.2.2 Macro-economic Viewpoint

From a macro point of view, a high degree of transparency of listed companies is crucial to the efficient and stable operation of securities markets, both domestically and globally. Public investors of listed corporations usually suffer from information asymmetry since they are almost fully excluded from, and thus ignorant of, the business affairs of the corporations they have invested in. Their only participation in the corporations' business is attendance at the corporation's annual general meeting and their examination of the corporations' annual reports as well as interim financial reports, should there be any. Therefore, public investors take a risk in investing in listed corporations and the magnitude of the risk varies with the amount of the information available to them. A high degree of transparency through full disclosure of material corporate information is essential for public investors to make informed investment decisions. Thus, effective disclosure

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113 胡光志. 内幕交易及其法律控制研究. 中國. 法律出版社, 2002, 7
114 Above 2, 415
115 Above 2, 377
helps protect the investing public\textsuperscript{116}. A low degree of disclosure of corporate information results in a high degree of investment risk which deters many potential investors from investing and thus hinders market development. It must be noted that the economic cost of insufficient transparency suffered by the global economy is far greater than the economic losses incurred by natural disasters\textsuperscript{117}. More importantly, by reducing information asymmetry, enhanced transparency also helps ensure fair competition among investors, both inside and outside\textsuperscript{118}. Fairness is not only a realisation of good business ethics but is also conducive to the operation of a free securities market.

Sufficiency of transparency is measured not only in a quantitative manner but also in a qualitative manner\textsuperscript{119}. The information disclosed should be sufficient in amount and of high quality in terms of its accuracy and reliability. Misstatement of corporate information can be disastrous. For instance, the misstatement of corporate information by the America Corporation, Enron, and its subsequent sudden bankruptcy caused great losses to public investors: they lost not only all of their investment, but also their confidence in the securities market\textsuperscript{120}. Enhancing transparency is crucial for the prevention of insider dealing – a practice by which insiders make use of the information known in advance to obtain their personal interests\textsuperscript{121}. A lack of transparency is also one of the main causes of the recent series of failures of large complex global financial institutions including the Lehman Brothers, Merrill Lynch and American International Group\textsuperscript{122}. The debacles demonstrate not only the failure of these large corporations, but also the failure of the disclosure and financial reporting systems. In the aftermath of these incidents there have been calls for regulatory reforms, both domestically and internationally. Central to these reforms is the identification of disclosure mechanisms that are sufficient to support market discipline\textsuperscript{123}.

1.3 Issues Related to Disclosure Mechanisms

At the international level, there is a common commitment to improving transparency of corporations worldwide. "Disclosure and transparency" is one of the five principles of good corporate governance proposed by the Organization for Economic Co-operation and Development (OECD), a worldwide organisation that plays a significant role in promoting good corporate governance\textsuperscript{124}. "Strengthening transparency and accountability" is also one of the five principles of the Declaration of the Summit on Financial Markets and the World Economy made after the G20 meeting in 2008\textsuperscript{125}. Thus, creating and ensuring an international corporate culture based on transparency is high on the agenda in the modern commercial world\textsuperscript{126}.

\begin{itemize}
\item \textsuperscript{116} Ibid, 12
\item \textsuperscript{117} 上面 7, 48
\item \textsuperscript{118} Ibid, 7
\item \textsuperscript{119} Above, 2, 332
\item \textsuperscript{120} Above, 7, 7
\item \textsuperscript{121} Arner, Douglas W. and Norton, Joseph J. “Building a Framework to Address Failure of Complex Global Financial Institutions” 39 HKLJ 95 (2009), 95
\item \textsuperscript{122} Ibid, 100
\item \textsuperscript{123} Above, 2, 21
\item \textsuperscript{124} Above, 16, 102
\item \textsuperscript{125} Cheung, Stephen Y.L. Report on the HKIoD Corporate Governance Score-Card 2009 Hong Kong, Hong Kong Institute
\end{itemize}
However, at the domestic level, different countries have adopted different types of disclosure mechanisms to achieve this common goal. Some countries focus mainly on a mandatory disclosure mechanism by law enforcement, while others prefer a higher degree of voluntariness in their disclosure mechanisms.

There have been debates on which type of disclosure mechanism, mandatory-government-regulation-oriented or voluntary-self-regulation-oriented, should be adopted to ensure a maximum degree of transparency. There are also questions over whether there should be a universal disclosure mechanism to achieve maximum transparency for all the countries worldwide in view of the increasing degree of globalisation. This study addresses these two issues by comparing the corporate governance models in the Hong Kong Special Administrative Region (HKSAR) and the People's Republic of China (PRC). The next part of this paper examines and evaluates the different disclosure mechanisms adopted under these two distinctive corporate governance models. Following an account for the difference between the two disclosure mechanisms, we attempt to answer the question of whether there is a universally good disclosure mechanism that should be applied to all corporate regimes worldwide.

Part 2: HKSAR vs. PRC: A Comparative Observation on Disclosure Mechanisms

2.1 Types of Disclosure Mechanism

There are two main types of disclosure mechanism: self-regulation and government-regulation. While self-regulation is voluntary in nature, government-regulation is mandatory in nature. The former is implemented by self-regulatory authorities as well as the markets, while the latter is implemented by government departments. A self-regulation mechanism consists of a set of non-statutory rules and codes of best practice; a government-regulation mechanism consists of a set of laws and regulations that have statutory status. The effective operation of the former relies heavily on the integrity and trustworthiness of individuals; the effective operation of the latter relies heavily on the government’s ability to enforce the relevant laws.

It must be noted at the outset that these two mechanisms are not mutually exclusive and they can be dually implemented. It is common for a regime to adopt a mix of the two. It is the proportions of these two mechanisms that vary from one regime to another. On the one hand, at first glance, it seems that the use of self regulation results in lower costs than government regulations. Undeniably, a self-regulatory disclosure mechanism has the advantages of expertise and flexibility; however, it also has disadvantages including fragmentation of regulations and the problem of effective enforcement. On the other hand, too many prescriptive rules and laws might result in

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126 Above 11, 11
127 Above 4, 30
128 Above 2, 168
too much government intervention, hindering the free operation of the market; thus it may be preferable for the board, management and controlling shareholders to develop a culture of self discipline with simultaneous market discipline to monitor the performance of listed companies. After all, it is a balancing exercise. On the one hand, necessary market regulations, including rules on disclosure and related-party transactions, must be implemented effectively; on the other hand, the securities market should be encouraged to grow and expand without excessive government intervention and over-regulation.

The following analysis identifies the characteristics of the disclosure mechanism under the HKSAR corporate governance model and the PRC corporate governance model respectively. It compares the effectiveness of the two disclosure mechanisms and addresses the issue of whether a self-regulation-oriented disclosure mechanism performs better than a government-regulation-oriented mechanism.

2.2 HKSAR Model: Self-Regulation-Oriented Disclosure Mechanism

Although there is a strong mix of self-regulation with government-regulation in the HKSAR disclosure mechanism, self-regulation plays a comparatively larger role in the supervision of corporation affairs and the securities market.

2.2.1 Regulatory Institutions

There is a three-tier system of regulatory institutions:

1. The Securities and Futures Commission (SFC), an independent statutory body completely outside the government, is responsible for monitoring and regulating the behaviours of all market participants.
2. The Hong Kong Stock Exchange (HKSE), the market operator, plays a self-regulatory role in performing risk management and market surveillance.
3. The Financial Service and Treasury Bureau and the Financial Secretary are responsible for broad government policies.

Under the HKSAR government’s “minimum government intervention” policy, the third-tier regulatory body, i.e. the government, plays a limited role in the daily supervision of the market, while the first and second tier regulatory bodies, which are independent of the government, play a dominate role in monitoring the market by implementing various non-statutory disclosure rules and codes.

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130 Ibid, 33
131 Leng Jing. Corporate Governance and Financial Reform in China's Transition Economy, Hong Kong, Hong Kong University Press, 2009, 119
132 Above 2, 90
133 Ibid, 168
134 Ibid, 154
2.2.2 Regulatory Instruments

There is a mixture of laws and non-statutory rules under the HKSAR corporate governance model. The major laws in relation to corporate disclosure include the Securities and Futures Ordinance, the Companies Ordinance and the Insolvency Ordinance. The major non-statutory rules related to corporate disclosure includes the Rules Governing the Listing of Securities on the Stock Exchange, which has the legal status as a contract between the Exchange and listed issuers, as well as the Hong Kong Codes on Takeovers and Mergers and Share Repurchase. There are also a number of Codes of Best Practice which act as reference for corporations’ directors, accountants and chartered secretaries. Although these codes do not have statutory backing, they provide clear guidance on the disclosure of corporate information and they provide the mutually-agreed standard for listed corporations in HKSAR.

Thus, we can see that the HKSAR corporate governance model operates under a mainly self-regulatory disclosure mechanism both at the institutional and the instrumental level.

2.2.3 Effectiveness of HKSAR Disclosure Mechanism

As an international financial centre, the HKSAR maintains a high standard of corporate governance. According to the Report on Corporate Governance 2009, “companies did fairly well in aspects of disclosure and transparency”\(^\text{135}\). The HKSAR’s securities market is famous for its fairness and high degree of transparency. This can be seen by the fact that many PRC enterprises have come to HKSAR for their initial public offerings (IPOs): as of 30 April 2006, 344 mainland enterprises had listed in Hong Kong and the largest 10 IPOs in the HKSAR were all by mainland enterprises.\(^\text{136}\) Thus, the self-regulatory-oriented disclosure mechanism operates fairly well in enhancing transparency in the HKSAR corporate regime.

2.3 PRC CG Model: Government-Regulation-Oriented Disclosure Mechanism

Compared with the HKSAR, the disclosure mechanism under the PRC corporate governance model focuses much more on government regulation than on self regulation.

2.3.1 Regulatory Institutions

Apart from the State Economic and Trade Commission, the main market regulator is the China Securities Regulatory Commission (CSRC), which is a central statutory body responsible for the supervision of listed corporations’ compliance with disclosure and financial reporting requirements in the Shanghai and Shenzhen exchanges\(^\text{137}\). However, unlike the Hong Kong SFC, the CSRC is a quasi-government agency, which lacks independence and is subject to the central government’s

\(^{135}\) Above 20, 24
\(^{136}\) Above 25, 122
\(^{137}\) Above 2, 104
The CSRC also has two conflicting roles: it is not only in charge of supervising and monitoring the securities market by promoting good behaviour and truthful disclosure; it also has a duty to facilitate the raising of capital for state-owned enterprises (SOEs) to help mitigate their financial distress in accordance with the Central People's Government's instructions. Therefore, taking into account the quasi-governmental nature of the CSRC and its government-controlled operation, we can conclude that the regulatory institutions in PRC are largely government-oriented.

2.3.2 Regulatory Instruments

Unlike the case in the HKSAR, the PRC corporate governance model places far more emphasis on the enactment and implementation of laws rather than non-statutory guidelines and rules. Since the early 1990s, a huge number of laws related to corporate governance have been enacted. The major laws related to corporate information disclosure include the 1993 Provisional Regulation on the Issuance and Trading of Shares, the 1993 Method on Prohibition of Fraudulent Behaviour in Relation to Securities Trading, the 1999 Securities Law, the Companies Law and the Enterprise Bankruptcy Law. Frequent amendments are made to these laws by the CSRC so as to improve the transparency and financial reporting of listed corporations in the PRC. For instance, in 1998, the CSRC introduced new disclosure rules and accounting standards, while in 2001 it required all listed companies to provide quarterly financial statements.

Apart from laws, the first Code of Corporate Governance for Listed Companies, which makes reference mainly to the OECD Corporate Governance Principles, was released in January 2001; nonetheless, its implementation has not been satisfactory. Therefore, the main regulatory instrument is the law rather than non-statutory codes.

2.3.3 Effectiveness of PRC Disclosure Mechanism

Despite the enactment of laws in relation to mandatory disclosure by listed companies in recent decades, many corporate governance problems remain unaddressed, reflecting a low degree of transparency in the PRC corporate regime. These problems include:

- **The ‘Quanqian’ problem**: insiders, including the managers or the controlling shareholders, cheat the investing public by speculating the capital raised on their own accounts instead of investing it as promised in their IPO prospectuses. The case of Shanghai Jiabao Industrial (Group) Co. Ltd in 2000 is an example of this.

- **Rampant insider dealing**: managers and directors buy or sell their corporations' securities when in possession of material, non-public information. The Zhang Jia Jie Tourism Development Company Ltd Insider Dealing Case in 1994 is one of many examples of this.

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138 Above 25, 133
139 Ibid, 132
140 Ibid, 162
141 Ibid, 244
142 Ibid, 140 and above 1, 45
143 Above 25, 131 and above 7, 4
- **Deliberate misstatements on prospectus**: corporations' managers cheat public investors' of their money at the time of a listing by falsifying the company's profit record. The case of Chengdu Hong Guang Industrial Ltd in 1996 is an example of this.\(^{144}\)
- **Abuse of funds**: the controlling shareholders abuse the funds raised by the listed corporations for personal purposes. The case of Sanjiu Medical and Pharmaceutical Co. Ltd in 2001 serves as an example here.\(^{145}\)

The above cases are only the tip of the iceberg and there are still many incidents yet to be discovered. In fact, the PRC's securities markets have been described by critics as "little more than funny-money casinos built on foundations of sand and populated by manipulators."\(^{146}\)

Even though strict laws that meet the international standard have been written into legal and regulatory documents, their implementation and enforcement are usually ineffective. For instance, it is clearly stated in the Provisional Regulation on the Issuance and Trading of Shares that if there is a falsehood, misleading statement or major omission on the companies' prospectus, financial or accounting reports, listing documents or annual reports, which causes investors to lose money in securities trading, the personnel in charge shall be jointly and severally liable for the damages; nevertheless there have been no single case where issuers bore civil liability in accordance to this regulation despite the frequent occurrence of these incidents.\(^{147}\) There has also been very limited enforcement of administrative sanctions by the CSRC. For example, from 1993 until 2001, only 17 listed companies were found to have been in violation of the laws on information disclosure. Among these, only 29 companies were penalized with a warning and others were mainly criticized internally or condemned publicly.\(^{148}\) "Implementation is much more difficult than writing nice rules into law"\(^{149}\) precisely describes the current operation of the disclosure mechanism under the PRC corporate regime.

### 2.4 HKSAR CG Model vs. PRC CG Model

From the above, we see that under the HKSAR corporate governance model, the disclosure mechanism is a combination of self-regulation and government regulation with the main focus on the former; while under the PRC corporate governance model, the disclosure mechanism focuses mainly on government regulation. Moreover, it seems that the securities market in the HKSAR is more stable than those in the PRC. The HKSAR corporate regime also has a higher degree of transparency than the PRC corporate regime, reflecting the fact that the HKSAR disclosure mechanism is more effective than the PRC one.

Does this mean that the HKSAR self-regulation-oriented disclosure mechanism is better than the PRC government-regulation-oriented disclosure mechanism? Is it possible and preferable to directly

\(^{144}\) Above 1, 45

\(^{145}\) Ibid, 46

\(^{146}\) Above 25, 118

\(^{147}\) Above 1, 54

\(^{148}\) Above 4, 46

\(^{149}\) Above 25, 166
transplant the HKSAR’s corporate governance model to the PRC corporate regime? We suggest that such a conclusion is unfair as it totally disregards the circumstantial differences between the two corporate regimes.

Part 3: Justifications for the Different Disclosure Mechanisms Adopted

Taking a closer look at the different circumstances between the HKSAR and PRC gives a better understanding of the reasons why the HKSAR disclosure mechanism focuses more on voluntary self-regulation while the PRC disclosure mechanism mainly emphasises mandatory government-regulation. This leads to the conclusion that it is neither possible nor preferable to directly transplant the HKSAR disclosure mechanism to the PRC corporate regime. This is illustrated by considering the following three factors:

1. Legal: Strength of Legal Foundation

A strong legal foundation is a precondition for the effective operation of a disclosure mechanism, be it government-regulation oriented or self-regulation oriented. Government laws must not only be enacted but also enforced while any breach of rules or codes must be disciplined by the self-regulatory bodies or challenged by the disadvantaged parties, such as the minority shareholders. The lack of enforcement by the judiciary explains why the disclosure mechanism in PRC performs worse than the one in HKSAR. With effective enforcement, the government-regulation-oriented disclosure mechanism will work well in enhancing transparency and corporate governance.

Unlike the HKSAR, which has a well-established rule of law and a well-developed independent judiciary, the PRC legal system is relatively new and fragile. The general legal institutions are not well enough developed to afford sufficient protection to public investors. The incompetence of the judiciary is still a serious barrier to effective punishment and deterrence for wrongdoers in the securities markets. For example, for years, courts in the PRC refused to hear securities-related lawsuits, denying investors legal remedies for damages suffered from violations of disclosure requirements and fraudulent securities dealings. Equally important is the low consciousness of legal rights by the PRC entrepreneurs. In PRC, it is often social and cultural forces such as social relationships, personal bonds, reciprocity and a sense of shame that have functioned to allocate and enforce property rights in practice, while formal legal institutions have been largely avoided. Therefore, the relatively weak legal foundation explains why the disclosure mechanism in the PRC does not work as well as the one in the HKSAR.

150 Ibid, 126
151 Ibid, 166
152 Ibid, 92
2. Cultural: Standard of Professional Ethics

Cultural differences also account for different disclosure mechanisms being adopted. A high standard of professional ethics is a prerequisite to the adoption of a self-regulation-oriented disclosure mechanism, which requires a strong sense of self-discipline. Relatively speaking, the standard of professional ethics is higher in the HKSAR than in the PRC. With a higher educational level and stricter professional qualification system, corporate-related professionals in the HKSAR, including lawyers, directors, accountants and chartered secretaries, possess a higher degree of professional ethics. A more moral corporate culture makes it possible for the HKSAR to develop a mature self-regulation-oriented disclosure mechanism. In contrast, a corporate culture of honesty is yet to be developed in the new PRC corporate regime and this kind of change cannot be achieved overnight. In a 2001 PricewaterhouseCoopers survey on global business opacity, the PRC was ranked the lowest among the 35 countries in the survey because of its serious corruption problems, and lagging legal, tax, banking, property rights and accounting reforms. Before a culture of ethical practices is well developed, a mandatory government-regulation-oriented disclosure mechanism is preferred to a self-regulation-oriented one.

3. Political: Government Policies

A self-regulation-oriented disclosure mechanism is the product of the HKSAR Government’s consistent minimum government intervention policy. The HKSAR has a long history of a free market economy and a voluntary self-regulation disclosure mechanism works well with it. On the contrary, the PRC corporate regime is in the process of transformation as part of the moves from a planned economy to a market economy. The features of government domination and power centralisation remain in the Chinese characteristics market economy. For example, the PRC’s two stock exchanges are still dominated by mostly poorly-run SOEs and the PRC government has developed a habit of influencing stock prices by controlling the flow of information – releasing periodic good news to the public while filtering out bad news. The PRC government may therefore be seen as one of the manipulators of the securities markets. With continuous government domination, it is unlikely that the PRC corporate regime will adopt a self-regulation-oriented disclosure mechanism, which only operates well in a fairly free market. Thus, the government-regulation-oriented disclosure mechanism is more suitable to the present government-dominated corporate regime in the PRC.

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153 Ibid, 4
154 Ibid, 2
155 Ibid, 128
Part 4 The Way Forward: Universal Goal But Different Disclosure Mechanisms

From the above discussions, we find that the difference in regional circumstances between the HKSAR and the PRC justifies the adoption of different disclosure mechanisms. Despite such a difference, the starting point of both HKSAR and PRC corporate governance is the same: enhance transparency so as to prevent a failure of the securities markets. In fact, as suggested by the OECD, there is no single model of good corporate governance; it is unlikely that a universally good disclosure mechanism can be identified that is appropriate to all corporate regimes. Not only is it impossible, but it is also undesirable to adopt a universal disclosure mechanism in ignorance of the regional circumstances. As correctly pointed by the Commonwealth Association for Corporate Governance, it is for each country and region to define for itself what its special circumstances and priorities are. Nevertheless, a universal standard of transparency in corporate governance should be introduced in view of increased globalisation.

Take the disclosure mechanism under the PRC corporate governance model as an example. It is wise for the PRC corporate regime to adopt a gradualist strategy for corporate governance reform instead of a ‘big bang’ type one. In searching for optimal solutions to the emerging corporate governance problems during the PRC’s transition, it is not always workable to import global best practices from developed corporate regimes, such as the one in HKSAR, since the local circumstances in the PRC regimes differ from those of more advance market economies. Instead, a step-by-step approach should be adopted. During the transition economy, what the PRC regime needs first is good disclosure rules which have sufficient legal force, as well as honest judges and regulators for effective implementation and enactment. To develop a disclosure mechanism based on self-regulation like the one in HKSAR should be the second step that follows since an efficient self-disciplined disclosure mechanism requires a stable foundation of legal institutions and, most importantly, a corporate culture of honesty, which needs time to develop gradually in PRC.

To conclude, although all jurisdictions should all work towards the same standard of a high degree of transparency, we do not need to use the same disclosure mechanisms to achieve this. As the proverb says, “all roads lead to Rome”.

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156 Above 2, 78
157 Ibid
158 Above 25, 259
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Journal Articles


Second Runner up

Chan Choi Fong Willa

Ng Ying Chui Amy

Chinese University of Hong Kong

Edith Shih FCIS FCS(PE) presenting certificates to Chan Choi Fong Willa (left) and Ng Ying Chui Amy (right) who are both the Second Runner up and the Best Presenter of the Corporate Governance Paper Competition 2010.
Introduction

From the chaos of subprime mortgage fiasco to the suffering of investors brought about by the closure of Lehmann Brothers, and from the Greek debt crisis to the recent 'internal sales' scandal at Sun Hung Kei Properties' Arch development, there has been public demand for better corporate governance practices because poor corporate governance does not only affect the global economy, but also local economy, industry, the community and the company itself.

Timely, complete, balanced and accurate disclosure of information is one of the indicators of better corporate governance. With this, more effective communication between different corporate stakeholders is achieved. As a result, transparency and accountability are experienced. To improve corporate governance, statutory requirements on disclosure have been made and the standard of sufficient disclosure is rising. Apart from the mandatory disclosure required by law, more and more companies are disclosing and reporting both financial and non-financial information voluntarily beyond what is required in order to improve management, forge accountability, improve communications among different stakeholders and attract investors.

The study seeks to, first, provide an analysis on how disclosure and transparency benefit a company internally and externally in light of corporate governance; second, reveal the shortcomings of the current disclosure requirements; and third, give recommendations for improvement.

Background

What is Corporate Governance?

Corporate governance is the system by which companies are directed and controlled and how companies report to stakeholders to demonstrate this. It is a multifaceted subject which involves how different stakeholders communicate and interact with each other within a legal, ethical and balanced set of systems, structures, regulations, processes and policies in order that the interests of them can all be satisfied with harmony. Corporate governance practices are encouraged in line with the use of regulations and laws to promote better management,

\[^{160}\text{International Finance Corporation (2010) Corporate Governance} \]

http://www.ifc.org/ifcext/corporategovernance.nsf/content/WhyCG#what_cg (accessed 1 August 2010)
communications and accountability of companies.

What makes a timely and accurate report?

Hong Kong listed companies must abide by the statutory requirements set out in the Companies Ordinance and the Listing Rules. These requirements are regarded as the minimum disclosure requirements for a company to have a higher quality of disclosure and transparency; timeliness and accuracy are of the utmost importance in determining the quality of the information.

In order to fit into the framework of timeliness and accuracy, companies are not expected to disclose information that may endanger their competitive position unless disclosure is necessary to fully inform the investment decision and to avoid misleading the investors.\(^{161}\)

Accuracy: The concept of materiality

To ensure a report is accurate, the concept of materiality applies. This means where the omission or misstatement of information would influence the economic decisions taken by the users of information, the information ought to be disclosed. Information published should inform investors of the material and foreseeable risks of the enterprise and also the system for managing and monitoring the risks. All these factors should be disclosed on comply or explain basis in order to disclose information on an accurate basis.

Timeliness: *Ex-ante* reporting

To ensure a report is timely, companies should disclose information not only in their annual, half-yearly or quarterly reports but also before any material transactions are entered into or decisions are made. Companies can analyse the consequences of different transactions and managerial decisions in detail with their *ex-ante* reports.

\(^{161}\) OECD Principles of Corporate Governance (2004)
www.oecd.org/dataoecd/32/18/31557724.pdf
Organisation for Economic Cooperation and Development p. 50
How Are Different Parties Affected by Good Corporate Governance?

Internal parties:

Directors
Directors are responsible for the governance of companies, which includes setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. Directors' actions are subject to laws, regulations and the shareholders in the general meeting 162.

Directors are accountable to the company's shareholders. The accountability is experienced by directors' disclosure of quality information to shareholders. Disclosure of directors' remuneration is one of the international trends in disclosure of quality information. In the United Kingdom, AIM Rule 19 has been amended so that companies with securities admitted to AIM will be required to disclose in their annual accounts details of the remuneration of each director, including emoluments and compensation including any cash or non-cash benefits received, share options and other long-term incentive plan details, and the value of any contributions paid by the AIM company to a pension scheme, for the financial year in question 163.

Managers
Managers are delegated their powers by shareholders to act in the company's best interests. A system of corporate governance controls is implemented to assist in aligning the incentives of managers with those of shareholders 164. The conflict between managers and shareholders is described by agency theory. One means to resolve this conflict is through monitoring via financial disclosures by the company 165.

With disclosure as a monitoring system, managers are disciplined to act in the company's best interests. With better quality disclosure, investors are more capable of linking the company's performance with managerial decisions. Managers are held more directly accountable for the performance of company. Thus, the operating 162 Goo, S.H. Case and Materials on Company Law United States Oxford University Press 2008 at 239
performance and company's value increase.

**Employees**

Employees are human assets to the company. Disclosure of the company's future plans prospect and human resource policies can help employees set their own individual career aims and, at the same time, work towards a common goal. In addition, it helps attract strong potential candidates. This favours the internal management and control of the company.

For example, Google Inc. informs employees of its future strategic plans and human resource policies, and its workforce is world-renowned for its satisfaction and team spirit. In addition, Google puts information about human resource policies and plans on its own official website. This helps to attract potential elite and talent which in return becomes part of Google’s workforce.

**Shareholders**

The shareholders’ role in governance is to appoint the directors and to satisfy themselves that an appropriate governance structure is in place. Shareholders also analyse the risks of placing their money in the company. Disclosure of timely, reliable, balanced and accurate financial and non-financial information about the company can enlighten them about the company's prospects, and thus help them decide whether or not to re-appoint the directors and keep their money in the company.

For example, ChinaSteel continuously updates its financial and non-financial performance and information on its official website and through the media. The Investor Relations page on its website provides abundant and transparent information about the company's performance. Shareholders are free to analyse whether or not to place their money in the company.

**External parties:**

**Potential investors**

Regular, reliable and comparable information given in sufficient detail helps potential investors to assess the stewardship of management, and make informed decisions about the valuation of the company.

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166 Goo, S.H. *Case and Materials on Company Law* United States Oxford University Press 2008 at 239

Good corporate governance helps companies attract investors because its high transparency gives potential investors a clearer picture of the company structure and potential risks; thus it gives investors more confidence about investing and eventually leads to better share price.

Good corporate governance also helps companies to finance its capital more easily. Banks are more willing to provide loans or other credits to the companies if they have a higher standard of disclosure and transparency.

**Government**
Companies with good corporate governance may also receive preferential credits from the government. With high transparency, the government is willing to offer or negotiate better terms such as simplifying the registration procedures or loosening export/ import requirements.

In the United States, organisations that make details of their finances and operations available to the public, when that information may not need to be included in their regular annual reports, may be exempted from tax\(^\text{168}\).

**Economy**
Good corporate governance promotes better market efficiency because shareholders can monitor their companies if they are given the rights to vote and amend the board’s decisions. It can also lower the cost and time of compliance. These then improve the economy as a whole in promoting efficiency.

**Importance of Disclosure and Transparency in Corporate Governance**

**Increase confidence among decision-makers within the organisation**
Reliable and timely information can strengthen confidence among decision-makers within the organisation and enables them to make good business decisions directly affecting growth and profitability. Directors and managers who can receive information, such as market updates and industry trends, reliably and timely enough,

\(^{168}\) The U.S. Nonprofit Organization’s Public Disclosure Regulations Site
can exploit the information and make early decisions\textsuperscript{169}.

**Enlighten investors about the risks and attract investment**

Information also affects decision makers outside the entity, such as potential shareholders, investors and lenders, who must decide where and at what risk to place their money.

To help world decision makers to analyse the risks of investment, Standard & Poors has established a Transparency and Disclosure ranking system to provide an evaluation of the public disclosure practices of companies in various markets throughout the world. In addition, the agency has recognised that companies with more transparent disclosure practices enable shareholders, creditors and other interested parties to more effectively monitor the actions of management and the operating and financial performance of the company\textsuperscript{170}. This increases investors' trust and confidence in the company, enabling them to analyse the risks and returns in light of the information.

**Have a material impact on cost of capital**

Empirical evidence has shown that high standards of transparency and disclosure can have a material impact on the cost of capital. University College London has published a report showing that there is a negative relationship between transparency and the cost of capital\textsuperscript{171}.

Uni-President has been very active in co-operating with government policies and has complied with all stipulations. In 2006 and 2007, Uni-President was ranked by the Securities & Futures Institute as an A+ company in voluntary disclosure of information for two consecutive years. This achievement has made investors even more confident about Uni-President. Most importantly, the company has also received several awards including "Corporate Citizenship" and "Corporate Social Responsibility". This has reduced the cost of capital due to the attendant increase in sales and investor confidence\textsuperscript{172}.

\textsuperscript{171} UCL Voluntary information disclosure and corporate governance the empirical evidence on earnings forecasts http://eprints.ucl.ac.uk/17648/
\textsuperscript{172} Uni-President (2010) Management Team http://www.uni-president.com/01aboutus/aboutus04-1.asp
Build a positive image of the company
Disclosure helps public understanding of a company's activities, policies and performance with regard to environmental and ethical standards, as well as its relationship with the communities where the company operates.

Disclosure of a company's environmental and ethical policies can bring a positive image. For instance, HSBC Hong Kong headquarters powers its electric blinds with solar energy; Body Shop's products are against animal testing to protect animal interests; tea sold in Marks and Spencer is bought under fair-trade policies to ensure farmers are reasonably paid.

On the contrary, delayed or partial disclosure can have a tremendous negative impact on a company's image. For example, frightened of plummeting sales, Sanlu Group tried to cover up the scandal of its melamine-contaminated milk powder in 2008. The scandal was later discovered and reported by media and Sanlu Group has faced a huge number of litigation actions, and its image and reputation has been seriously blemished. Another example is the delayed disclosure by the Bank of China (Hong Kong) Ltd of the effect on its cash flows from its holdings of sub-prime mortgages. The company made inconsistent disclosure about its provision for sub-prime assets and later received complaints.

Reduce further regulatory and compliance costs
Government regulations pose compliance costs to companies. If the general standard of corporate governance practiced by companies rises, the need for government regulations to monitor industry practices and company's administration will diminish.

The private sales at 39 Conduit Road developed by Henderson Land Development Company Limited once created the highest price per square feet of flats in the world, though this has now been denied now; it triggered an investigation by the Independent Commission Against Corruption and criticism and negative comments were made by different financial institutions, such as Goldman Sachs and Morgan Stanley. In addition, the stock price of Henderson Land Development Company Limited dropped 4.39% because of the company's denial of the private sales.

173 Lee, Klaudia 'Tests Find Tainted Baby Milk at 21 More Firms' South China Morning Post Hong Kong 17th September 2008 A1
The private sales practice has attracted further regulations prompted by legislators and the general public. The aim of private sales is to increase and forecast sales, which benefits the sales performance of a property. However, regulations prohibiting or limiting private sales pose compliance costs to developers and buyers.

**Promote a better business environment as a whole**

Good corporate governance practice can help to promote a better business environment as a whole. With timely, accurate, reliable and balanced disclosure, stakeholders have strengthened trust and confidence in the company and they can make use of more information in order to make their investment and management decisions. The whole economy benefits.

Australia has tightened its disclosure requirements for business since the 1990s to promote higher standards of corporate conduct. The standard for disclosure has been increasing and the latest requirements are set out in the Principles of Good Corporate Governance and Best Practice Recommendations issued by the ASX Corporate Governance Council in March 2003. The general public agrees that the business environment is better as a whole because businesses and the public are more concerned with corporate behaviour and the interactions with the community.176

**Arguments for disclosing more information and higher transparency**

Although promoting better corporate governance is the international trend, it seems that more disclosure and transparency do post problems:

**High Administrative Cost**

Higher transparency may help to reduce the monitoring cost. However the administrative cost in filtering and analysing the information to be disclosed can be high, and a higher level of management will divert their time and resources to disclosing information: in the end, market efficiency will not be attained.

**Response**

The benefits brought by greater disclosure are in fact greater than the administrative cost involved. Companies can build a positive image, more public confidence and

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higher credibility.

Absence of One Uniform Set of Successful Disclosure Principles
One particular set of disclosure principles may not be suitable for the other companies facing different situations and targeting different markets. For example, the requirements for disclosing quality control measures for a canned tuna manufacturer’s products may not be similar to disclosing the quality control measures for the services provided by an internet-marketing company.

Response
The statutory requirement now is the minimum disclosure requirement that will apply to all industries; specific disclosure requirements are imposed on particular industries if needed. Therefore there is no need for a uniform set of disclosure principles.

No Guarantee of Better Financial Performance
Disclosure consumes a lot of resources in preparing information to be disclosed. However, there is no guarantee that good corporate governance and higher transparency will result in better financial performance and help prevent a financial crisis.

Response
Although good corporate governance may not necessarily bring better financial performance, companies with good financial performance must have a comprehensive set of corporate governance practices.

Potential Threat to Company's Competitive Position
Information that may endanger company’s competitive position or sensitive information is always the information the public wants to know. The pricing strategies and 'secret formula' of companies are often protected because of the need to protect the company's edge in the industry and in the market.

Response
There are statutory rules protecting companies stating that if the disclosure would, in the opinion of the directors, be harmful to the business of the company or any of its subsidiaries and the Financial Secretary agrees that the information need not be disclosed, then companies may choose not to disclose certain information.177

177 Companies Ordinance (Cap 32) s 129 (3)
Manipulated Disclosure of Information

Companies often manipulate information disclosed and communication between directors and shareholders are kept to a minimum or discouraged. On the other hand, a company will never disclose information that will harm its share price and so the information available made to the public is often neutral and the financial report is often amended by companies by buying or selling assets or investment in order to amend its financial ratios.

Therefore, to ensure good corporate governance, shareholders’ participation is very important. However, there is no guarantee that there will be an active shareholder to question the companies and most of the public only wants higher dividends and share prices. Even though companies give shareholders their annual reports, without the knowledge of how to read and analyse the figures, these reports mean nothing to the shareholders. Therefore shareholders may not exercise their full rights in voting and in attending the general meetings of the companies and fail to play their role in monitoring the companies.

Response

There are many monitoring and regulatory systems in Hong Kong such as the power of the shareholders, the Independent Commission Against Corruption, the Securities and Futures Commission, etc. Also, it is a statutory requirement that a company hire an independent auditor, and this helps to prevent the manipulation of information.

Contemporary disclosure and transparency practices in Hong Kong

Hong Kong market characteristics

In Hong Kong, most listed companies tend to be family-based. According to a survey conducted by the Hong Kong Society of Accountants in 1997 on the ownership structure of 553 listed companies in the economy in 1995 and 1996, 53 per cent had one shareholder or one family group of shareholders who owned more than half of the entire issued capital. The mean ownership percentage of the top five shareholders of Hong Kong companies was about 54 per cent, ranging from a high of nearly 99 per cent to a low of 1.1 per cent.
Contemporary practices
The corporate governance practices of Hong Kong compare favorably to governance practices elsewhere in the region\textsuperscript{178}. At present there are statutory and non-statutory requirements in Hong Kong.

Statutory requirements
The statutory requirements are mainly set out in the Companies Ordinance and the Securities and Futures Ordinance. The latter is the province of the Securities and Futures Commission, which is an independent non-governmental statutory body outside the civil service responsible for regulating the securities and futures markets in Hong Kong\textsuperscript{179}. It also administers statutory requirements to ensure full disclosure and fair treatment of the investing public.

Several sections of the Companies Ordinance focus on the disclosure of companies' information. For example, section 49G covers the disclosure by a company of the purchase of its own shares, section 158B is about the duty to make disclosure for purposes of section 158, section 161C covers the general duty to make disclosure for purposes of sections 161 and 161B, and section 162 is on disclosure by directors of material interests in contracts.

The Securities and Futures Ordinance has a specific section on disclosure of interests, which includes disclosure of companies' information.

Non-statutory requirements
Various non-statutory requirements act as guidelines and advice to companies. The Listing Rules require listed companies to disclose connected transactions, different components of directors' remuneration and the number of independent non-executive directors. The OECD principles of corporate governance have a section on disclosure and transparency to guide companies to achieve international standards of corporate governance. Furthermore, other regulatory bodies such as the Independent Commission Against Corruption, Financial Reporting Council and professional institutes and associations help monitor the operation of companies.

Main Problems of Current Hong Kong Disclosure Requirements

In a joint study of standards of disclosure conducted by Standard & Poor's and the National University of Singapore in 2004\textsuperscript{180}, Hong Kong firms were ranked third behind Singapore and Malaysia, and slightly ahead of Thailand. This study specifically cited a lack of independent directors and insufficient disclosure as two major governance shortcomings of Hong Kong firms.

Insufficient disclosure
The first problem is the insufficient disclosure of company information. The disclosure requirement now is rather narrow, and it only requires companies to reveal the factual structure or figures of the companies. Forecasts made by companies are always vague and important disclosure is often hidden for competitive reasons. Therefore current disclosure requirements did not help prevent the financial crisis.

Recently, the Octopus Company has been criticised for selling customers' information. This issue has sparked public awareness on the insufficient disclosure of the company's operations and the company's image has suffered as a result.\textsuperscript{181}

Lack of independent directors' power
Secondly, a lack of independent directors can give rise to the problem of conflicts of interest and lack of minority protection. This is particularly the case since the majority shareholders are often the executive directors and the minority shareholders are mainly the general public. If the executive directors try to conceal the information or if there is a conflict of interests, the minority has little or no protection; nor do they have the power to amend decisions made by the board of directors.

Most of Hong Kong's well-developed companies are family-based. For example, Chow Sang Sang was succeeded by his grandson and Lee Kum Kee is run by the founder's great-grandson\textsuperscript{182}. The family members and relatives take up most of the seats on the board of directors, and so the power of the independent directors is limited. In addition, independent directors are often referred by or appointed by other directors and therefore their independence is open to question.

\textsuperscript{180} Standards of disclosure(2004) Standard & Poor's and National University of Singapore
\textsuperscript{181} Hong Kong Daily 2010-08-06 狠批管治手法落伍 學者倡重建董事會
\textsuperscript{182} Takungpao 2009-06-21 香港富豪第三代表現受關注
Recommendations

Excellent disclosure certificate
To encourage companies to disclose more information to the public, the government or other regulatory bodies can organise a campaign encouraging disclosure. Companies which make voluntary disclosure that goes beyond minimum disclosure requirements in response to market demand will receive a certificate that proves the high transparency and excellent structure of the company. This certificate will help to give confidence to potential investors and indirectly help raise the company's share price.

"Disclose or explain" rule
Companies experiencing declining performance are not likely to participate in the above campaign and therefore a mandatory "disclose or explain" rule also needs to be implemented. A higher standard of disclosure requirements will be set and companies put on a "disclose or explain" rule to balance shareholders' protection with the disclosure of companies' confidential information. The U.S. Securities and Exchange Commission adopts this measure for some of its required disclosure information.\(^{183}\)

Disclosure of board members' background information
Since the lack of independent directors has been identified as a major problem disclosure of the background information of board members that hold more than half of the total shares is needed, because they can have a major influence on the whole company structure. Due to privacy reasons, background information should only include directors' past experience, present positions and other relevant business information. To prevent the directors from concealing the information and to avoid conflicts of interest, their background information helps shareholders to have a better understanding of the potential risks and better protection. A similar suggestion has been made in Canada in a publication by the Canadian Coalition for Good Governance; this suggests including director biographies in companies' disclosure.\(^{184}\)

Higher threshold for independent directors


Fama (1980) and Fama and Jensen (1983) argue that including outside directors as professional referees not only enhances the viability of the board but also reduces the probability of top management colluding to expropriate shareholder wealth. A survey in the study of “Determinants of Corporate Disclosure and Transparency: Evidence from Hong Kong and Thailand”\textsuperscript{185} shows that disclosure and transparency is a decreasing function of the number of executive directors on the board. Therefore the role of the independent director is very important and a higher threshold is needed to ensure their monitoring function in the board.

Conclusion

In this world of continuous business growth, society does not only require profits and economic development. Different parties and the general public are increasingly concerned about how businesses interact and communicate with society. Better corporate governance is needed. Higher standards of disclosure ought to be enforced and promoted to embody accountability and transparency so that internal controls and management, economy and society, can be improved.

Hong Kong companies do not have enough awareness of the importance of voluntary disclosure. The limited awareness is worsened by lack of independent directors who can monitor the management’s performance and who are accountable to shareholders and the company. Hong Kong ought to increase the awareness of disclosure among the business community and the public by promoting voluntary disclosure in line with mandatory disclosure by law. This would enhance the standard for disclosure and transparency and lead to better corporate governance practices.

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The Hong Kong Institute of Chartered Secretaries presents the Seventh Biennial Corporate Governance Conference 2010

22 & 23 October 2010
JW Marriott Hotel Hong Kong

Telling it the way it is – Disclosure and Transparency in Corporate Governance

Conference Highlights:
• Why didn’t we see it coming? Disclosure and the Financial Crisis
• Does reporting matter?
• Is it only about money? The Importance of Financial and Non-Financial Reporting
• Someone ought to know and explain what’s going on: The Role of the Company Secretary in Disclosure and Transparency
• What’s next? The Future of Corporate Reporting

Who Should Attend?
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• Auditors
• CEOs
• CFOs
• Company Secretaries
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• COOs
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• Directors
• Fund Managers
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### Conference Programme

#### Day One – 22 October 2010

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<td>9.15 a.m.</td>
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<td>Ms Susie Cheung, FCIS FCS(PE), General Counsel and Company Secretary, Hong Kong Mortgage Corporation Limited Professor Kalok Chan, Synergis-Geoffrey YEH Chair Professor of Finance and Head of Finance Department, Hong Kong University of Science and Technology Professor William Q Judge, E.V. Williams Chair of Strategic Leadership and Professor of Strategic Management, College of Business &amp; Public Administration, Old Dominion University Editor-in-Chief, Corporate Governance: An International Review</td>
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<td>Session Three: Is it only about money? The Importance of Financial and Non-Financial Reporting</td>
<td>Mr Mervyn E King, SC, Chairman of the Global Reporting Initiative, of the King Committee on Corporate Governance in South Africa and of the Integrated Reporting Committee in South Africa Dr Christine Loh, JP, OBE, Chief Executive Officer, Civic Exchange; Adjunct Professor, Division of Environment, Hong Kong University of Science and Technology</td>
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<td>Session Three – Panel Discussion and Q&amp;As</td>
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<td>9.30 a.m.</td>
<td>Session Four: Someone ought to know and explain what’s going on: The Role of the Company Secretary in Disclosure and Transparency</td>
<td>Mr James D Spellman, Principal, Strategic Communications LLC; Adjunct Associate Professor – Public Relations Principles and Practices, The George Washington University Ms Edith Shih, FCIS FCS(PE), Head Group General Counsel &amp; Company Secretary, Hutchison Whampoa Limited</td>
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<td>11.15 a.m.</td>
<td>Session Five: What’s next? The Future of Corporate Reporting</td>
<td>Mrs April Chan Mr Keith Johnson, Partner, Head of Corporate, Asia, Linklaters, Hong Kong Mr John Brewer, Barrister, Pacific Chambers</td>
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<td>12.45 p.m.</td>
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The HKICS Corporate Governance Papers Presentation competition was held on 9 October 2010. There were five teams presenting their papers.

Three presentation judges, Alberta Sie FCIS FCS(PE); Tracy Sin FCIS FCS(PE) and Dr. Paul Mok FCIS FCS gave their feedback to each team.

Photos Gallery

Wendy Ho from the Chinese University of Hong Kong

Amy Wang, Daniel Zhou and Maggie Wang from the Lingnan University

Willa Chan and Amy Ng from the Chinese University of Hong Kong

Boogie Cheung, Fiona Fung and Suki Tang from the Hong Kong Baptist University
Ally Lam and Evan Tsang from the Chinese University of Hong Kong

Dr. Paul Mok FCIS FCS

Ms. Tracy Sin FCIS FCS(PE)

Ms. Alberta Sie FCIS FCS(PE)
Dr. Eva Chan FCIS FCS(PE) presenting the Best Presenter Award to Willa Chan and Amy Ng

Ms. Tracy Sin FCIS FCS(PE) presenting the 2nd Runner up award of the Paper Competition to Willa Chan and Amy Ng

Dr. Paul Mok FCIS FCS presenting the 1st Runner up award of the Paper Competition to Wendy Ho

Ms. Alberta Sie FCIS FCS(PE) presenting the Champion award of the Paper Competition to Ally Lam and Evan Tsang
The Institute would like to thank the papers reviewers, panel judges and sponsors of the Corporate Governance Paper Competition and Presentation Award 2010. They were invited to receive their souvenirs at the Corporate Governance Conference luncheon on 22 October 2010.

Mr. Joseph Jacobelli  
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Awardees of the Corporate Governance Paper Competition 2010
Acknowledgement

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Reviewers

Professor Alan AU FCIS FCS, Associate Dean, Lee Shau Kee School of Business and Administration, The Open University of Hong Kong

Mr. Samuel LEE, Visiting Lecturer, Department of Accountancy, City University of Hong Kong

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Panel Judges (for Best Paper)

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Ms. Jackie CHAN ACIS ACS, Senior Vice President, Orix Asia Limited

Ms. Tracy HO ACIS ACS, Vice President, Internal Audit Department, Hong Kong Exchanges and Clearing Limited
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