

Research Assessment Exercise 2020
Impact Case Study

University:	Hong Kong Baptist University
Unit of Assessment (UoA):	21 – Economics and Finance
Title of Case Study:	Promoting Best Practices in Corporate Governance
(1) Summary of the impact	
<p>Hong Kong is keen to promote best practice in corporate governance in its listed companies. Drawing on a body of academic research conducted at HKBU, the research team has had a significant impact on the corporate governance policies and practices of regulators, policy makers, and the business sector in Hong Kong and mainland China. This work has led to concrete improvements in the corporate governance practices of publicly listed companies, has helped raise the standards of best practice advocated by professional associations, and has been incorporated in the educational materials for seminars on corporate governance conducted by professional associations.</p>	
(2) Underpinning research	
<p>The underpinning research at HKBU commenced in the late 2000s and is on-going. It was carried out by Yuk-Shing Cheng (Professor, 1989-present), Yan-Leung Cheung (Chair Professor, 2009-2013), Aris Stouraitis (Professor, 2010-present), and Weiqiang Tan (Assistant Professor, 2010-present) (all dates refer to employment at HKBU). The research focuses on corporate governance and corporate finance, and consists of two overlapping themes:</p>	
<u>a) Research on a corporate governance scorecard</u>	
<p>The researchers constructed a measure of the quality of corporate governance practices in a specific company, in the form of a scorecard derived from the Organization for Economic Cooperation and Development (OECD) <i>Principles of Corporate Governance</i>, and the Hong Kong Exchanges and Clearing Limited's <i>Code of Corporate Governance Practices and Recommended Best Practice for Corporate Directors</i>. This research provides important insights into how the quality of corporate governance affects firm value and risk, whether an improvement in corporate governance predicts future market returns, and on how directors representing controlling shareholder interests impact corporate governance practices.</p> <p>This research demonstrates empirically that good corporate governance is associated with both higher stock returns and lower risk, whilst firms that exhibit an improvement in the quality of corporate governance exhibit subsequent increases in market valuation. Family firms, firms with concentrated ownership structures, and those where close connections between the Board of Directors and the controlling shareholder are present appear to have lower quality of corporate governance. [(1) & (2)]</p>	
<u>b) Other related corporate governance research</u>	
<p>The HKBU Team has also conducted a body of research on various facets of corporate governance. Although this research lacks a narrowly-defined unifying theme, it has allowed</p>	

the team to develop insights on corporate governance that have directly influenced the design of the scorecard (discussed above) and were transferred to the impact (to be discussed in section 4).

One theme examines corporate governance in family firms, a significant issue given the predominance of such firms in Hong Kong and other Asian economies. The main findings include: (i) that transferring funds from one firm to another for assisting firms that belong to family business groups is less pronounced when the firms have larger boards, higher proportion of independent directors and a Chairman not from the controlling family; (ii) that auditor appointments effectively constrain intragroup value transfers and mitigate the agency conflicts between controlling families and minority shareholders; (iii) that firms issuing stock for the first time in an initial public offering (IPO) sell these shares at a larger discount when the founders also act as Chairman/CEO, possibly because of various incentive and behaviour mechanisms. [(3) & (4)] Research also demonstrates that firms with more powerful CEOs (where “power” is measured relative to other members of the Board of Directors or executives) pay these CEOs higher compensation following a deterioration in the CEO’s living environment, which suggests that CEO power is a significant driver of executive compensation. (5) Finally, researchers examine and illustrate the impact on firm value of corruption (bribery) activity, an obvious manifestation of a failure in corporate governance mechanisms. (6)

(3) References to the research

- (1) **Cheung, Y. L., Stouraitis, A., & Tan, W.** (2010). Does the quality of corporate governance affect firm valuation and risk? Evidence from a corporate governance scorecard in Hong Kong. *International Review of Finance*, 10(4), 403-432.
- (2) **Cheung, Y. L., Connelly, J., Jiang, P., & Limpaphayom, P.** (2011). Does corporate governance predict future performance? Evidence from Hong Kong. *Financial Management* 40(1), 159-197.
- (3) **Cheung, Y. L., Haw, I. M., Tan, W., & Wang, W.** (2014). Board structure and intragroup propping: Evidence from family business groups in Hong Kong. *Financial Management*, 43(3), 569-601.
- (4) **Cheung, Y. L., Dai, Y., Ouyang, Z., & Tan, W.** (2018). Who leaves money on the table? The role of founder identity in Hong Kong. *Applied Economics*, 50(7), 774-788.
- (5) **Dai, Y., Rau, P., Stouraitis, A., & Tan, W.** (in press). An Ill Wind? Terrorist Attacks and CEO Compensation. *Journal of Financial Economics*.
- (6) **Cheung, Y.L., Rau, P.R., Stouraitis, A.** (2012). How much do firms pay as bribes and what benefits do they get? Evidence from corruption cases worldwide, *National Bureau of Economic Research Working Paper Series, Working Paper 17981* (<http://www.nber.org/papers/w17981>), Cambridge, Massachusetts, USA.

(4) Details of the impact

Impact work on corporate governance at HKBU is conducted by the Centre for Corporate Governance and Financial Policy (CCGFP). The two channels of impact for the body of research described above have come through collaborations with the following practitioner

organisations (both impacts apply to Hong Kong and mainland China-based companies listed in Hong Kong).

(a) Collaboration with Hong Kong Institute of Directors (HKIoD) – Hong Kong Corporate Governance Scorecard

The HKIoD Corporate Governance Scorecard consists of surveys, conducted by CCGFP in 2012, 2016 and on-going in 2019, which evaluate the corporate governance of the 120 most representative listed firms in Hong Kong, constituents of 4 indices. The project aims to assist Hong Kong companies and policy makers to improve corporate governance practices. This impact draws directly on HKBU's academic research on the corporate governance scorecard discussed above.

The 2016 report was publicly released on 14 Feb 2017 through a media conference, which generated 40 reports on TV, radio, print media, financial terminals, online media, in English and Chinese. The report was distributed through the HKIoD website and emails to regulators, listed companies, institutional investors, business associations, professional bodies, libraries (public and tertiary educational institutions), and internationally to member institutes of the Global Network of Director Institutes [1]. Companies ranked 1-10, 11-30, and 91-120 in the scorecard were sent a letter from the HKIoD. [2] The letter received by the bottom group of companies includes a paragraph asking them directly to arrange a visit by HKIoD officers in order to discuss improvements (a handful of companies also requested detailed reports on their performance). The identities of companies below the top 10 are confidential.

The HKIoD also organises over 100 courses of director training annually, and material from the scorecard was used in updating relevant educational and training programmes for directors (Dr Carlye Tsui, CEO HKIoD quoted). [3]

(b) Collaboration with Chamber of Hong Kong Listed Companies (CHKLC) – Hong Kong Corporate Governance Excellence Awards

CHKLC's 291 members include some of the largest companies listed in the Hong Kong Stock Exchange, with market capitalization exceeding 33% of the entire market. One of the major activities of the CHKLC is the annual conferment of the "Hong Kong Corporate Governance Excellence Awards" in collaboration with the CCGFP. The aims of the six awards are to foster continuous improvement in corporate governance by recognizing companies that have made significant improvements in these areas. [4]

Stouraitis (Director CCGFP), oversees the analysis and the initial screening of candidate companies, shortlists candidates for interviews, and subsequently sits on the Panel of Judges that interviews the shortlisted companies and confers the Awards.

In 5 rounds of competition 2014-2018, 87 publicly listed companies (64 unique companies if we exclude those entering more than once) have submitted entries for the 1st stage of the competition (half are HK-based and half are Mainland China-based - company names are

confidential). For each applicant, the CCGFP research team writes an investigative report, containing, among other things, whether the applicant-company has been accused of engaging in questionable related-party transactions or in any corrupt practices, the profiles and diversity of the Board of Directors, CEO compensation, succession, risk management practices etc. (the emphasis on uncovering fraudulent activities and on related party transactions, risk management practices etc draws directly on the academic research conducted by the HKBU team on these topics). Following the initial screening, 54 publicly listed companies (38 unique companies) have been invited for interviews in front of the Panel of Judges (company names are confidential) [5]. The Judges are presented with the investigative reports prepared by the CCGFP team. 24 publicly listed companies have won CG Excellence Awards, and 8 companies have won Sustainability Excellence Awards during 2014-2018 [6].

The Awards are presented during the Annual Gala Dinner of the CHKLC, attended by around 400 participants including prominent government and business figures, and receive media coverage. They are reported in a 4-page inlet in the English-language newspaper *The Standard*, and in the CHKLC's official quarterly magazine *Momentum*. The conferment of the Awards is highly visible to society, allowing their impact to go beyond applicant companies and award winners [7].

As testified by the CEO of CHKLC [8], this is the pre-eminent corporate governance award in Hong Kong and fosters peer competition among companies to improve, in line with the Awards' aims on continuous improvement. Numerous companies report improvements in corporate governance that have been made directly following the comments that they received from the Panel of Judges in previous interviews.

(5) Sources to corroborate the impact

- [1] Extract of report submitted by Corporate Governance Foundation (CGF) to Internal Revenue Department (IRD)
- [2] Sample letter sent by the HKIoD to companies ranked 1-10, 11-30, and 91-120 in the scorecard
- [3] Statement by CEO of HKIoD that the 2016 scorecard results will be used to update training and materials in director training programs conducted by the HKIoD.
- [4] CHKLC website on "Hong Kong Corporate Governance Excellence Awards" aims <http://www.chkcl.org/CGExcellenceAwards19/eng/about.html>
- [5] List of members of the judging panel of the "Hong Kong Corporate Governance Excellence Awards" (2014-2018).
- [6] List of winners of the "Hong Kong Corporate Governance Excellence Awards" (2014-2018).
- [7] Articles announcing the 2017-2018 "Hong Kong Corporate Governance Excellence Awards" in *Momentum*.
- [8] Testimonial from the CEO of the Chamber of Hong Kong Listed Companies (CHKLC) on number of companies competing for the "Hong Kong Corporate Governance Excellence Awards" and on how advice from the HKBU research team help improve their governance practices.