Hong Kong Institute of CPAs

Board diversity among listed companies in Hong Kong

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Hong Kong Institute of
Certified Public Accountants
香港會計師公會

The Hong Kong Institute of Certified Public Accountants is the statutory body established by the Professional Accountants Ordinance responsible for the professional training and development of certified public accountants in Hong Kong, as well as the setting of professional standards for the profession. Currently, the Institute has over 47,000 members and over 14,000 registered students.Members of the Institute are entitled to the description "certified public accountant" and to the designation CPA.

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Message from the chair of the 2022 Best Corporate Governance and ESG Awards Judging Panel

Dear members,

The board of directors is a crucial structure that should provide oversight of the management, and establish sound corporate policies, set the strategic direction, as well as ensure that an effective risk management and internal control environment is in place. An effective board from both the corporate governance (CG) and environment, social and governance (ESG) perspectives is critical, therefore, to a company's ability to deal with a rapidly changing business environment, and to establishing the values and vision of a company that should cascade down to senior management and to front line staff.

In order to achieve this, we believe the composition of the board is key and that more and more people are coming round to the conclusion that it must include individuals who can reflect different views and are willing to ask challenging questions, where necessary, and who, as a group, encapsulate relevant experience and expertise, as well as high standards of business ethics and integrity. Diversity and inclusion (D&I) are considerations are part of the ESG agenda and, when it comes to the composition of the board, D&I can help improve CG.

In September 2013, following a consultation exercise, Hong Kong Exchanges and Clearing Limited (HKEX) first introduced a requirement in the Corporate Governance Code (CG Code) for listed companies to have a board diversity policy. CG Code Provision A.5.6 required, on a comply-or-explain basis, that a company's nomination committee (or the board) should have a policy concerning diversity of board members, and should disclose the policy or a summary of the policy in the company's CG report. In January 2019, HKEX upgraded the Code Provision to a Listing Rule requirement and, in April 2022, launched a new diversity repository[1], making available data on all issuers' boards of directors, by age, gender and years of tenure. On 1 January this year, a revised CG Code and Listing Rules came into effect, raising the bar for both listed companies and independent non-executive directors (INEDs).

Starting from July 2022, HKEX no longer accepts applicants for initial public offerings with single gender boards. Existing listed issuers with single gender boards have until 31 December 2024 to appoint at least one director of a different gender. The amended rules also require issuers to appoint a new INED if all their current INEDs have served on the board for more than nine years, and additional disclosures have to be made explaining why long-serving INEDs should still be regarded as independent and should be re-elected.

The Institute believes that embedding diversity into an organization's culture can improve its business performance. Research backs this up, showing a significant correlation between gender diversity and better financial performance. A better gender balance may also attract more talent, and provide a stronger mix of knowledge and experience that can contribute to more effective decision-making and empower innovation. Diversity is beyond just being "nice-to-have" and leaders should consider how it adds value to their companies, talent, clients, and society as a whole

Message from the chair of the 2022 Best Corporate Governance and ESG Awards Judging Panel (cont'd)

One fundamental area that the board of directors is collectively responsible for, is the integrity of the company's financial statements. The directors are charged with approving the financial statements prepared by the accounting team, presenting them for audit, and laying them before the annual general meeting of the company. They are expected to understand and assess the company's accounting policies and processes and internal financial controls, review the financial statements, and enquire into and resolve issues that may arise. We believe, therefore, that it is more than simply advantageous for boards to also include full-time directors with professional accounting qualifications in order to assist the board on these matters; it is a must.

By looking at the composition of listed company boards in Hong Kong, in terms of their size, involvement of INEDs, and the directors' age, gender, and accounting experience and qualifications, this report provides a snapshot of the current status of boards in terms of certain key areas of diversity, and allows us to gauge a very important area of CG performance in Hong Kong's corporate sector and, by extension, its underlying health as an international financial centre. The Institute is firmly of the view that, in the final analysis, in today's complex and inter-dependent world, a company cannot demonstrate the highest standards of ESG practices and reporting without also having high-quality CG, nor can it demonstrate the highest standards of CG without also having high-quality ESG.

Loretta Fong
2022 - 2023 Institute President
and Chair of the 2022 Best Corporate Governance and ESG Awards Judging Panel

[1] https://www.hkex.com.hk/eng/BoardDiversity/index.htm

Background

In view of increasing importance, from both the CG and the ESG perspectives, of establishing an effective board to deal with rapidly changing business environment, the Hong Kong Institute of Certified Public Accountants (the Institute/ HKICPA) conducted a brief research on the board diversity status of all listed companies with their financial year ending on 31 December 2021, comprising 1,936 companies out of total of 2,564 companies, i.e. 75% of all listed companies. The research was also performed in the knowledge that HKEX has recently further enhanced the minimum CG standards and practices, including (i) requiring all listed companies with single gender boards to appoint a director of a different gender no later than 31 December 2024, and no longer approving new listing applications by companies with single gender boards after July 2022; and (ii) requiring boards all of whose INEDs are long-serving to appoint a new INED at the next AGM, and companies to explain to shareholders why an INED who has served more then nine years should still be regarded as independent and be reappointed.

With this in mind, our study mainly looks at the following areas:

1. Board size (Tables 1 – 2)
2. Number of INEDs and INEDs that have served on the board for more than nine years (Figure 1; Tables 3 – 4)
3. Gender diversity (Figures 2 – 3; Tables 5 – 6)
4. Age diversity - age of board members, and number of board members who are over 65 (Tables 7 – 8)
5. Professional skill sets - board members who are "qualified accountants (QAs)", i.e. a member an IFAC member organization (including the Institute), and from this, we also look at: (Figures 4 – 5; Table 9)
    a. number of QAs who are executive directors (EDs), and who are members of the Institute (Figures 6 – 7; Table 10)
    b. number of QAs who are non-executive directors (NEDs)/ INEDs, and who are members of the Institute (Table 11)
6. Where no board member is a QA, whether the chief financial officer (CFO)/ finance director is a QA, and a member of the Institute (Figures 8 – 9)
7. Whether diversity is stated to be one of the factors in companies' nomination policy and/ or a metric in board evaluations

Note

- Listing Rule 13.92 indicates that diversity of board members can be achieved through consideration of a number of factors (including but not limited to gender, age, cultural and educational background, or professional experience).
- When the research was conducted, 92 December-year-end companies had not published their 2021 annual reports and so were excluded from the study. In the end, we extracted the relevant data/ information from 1,844 companies, except for two companies for which some materials were not available, as further indicated below.

1. Size of boards

The average size of boards among all the companies studied was 8.2 members, which is at the level that promotes more efficient decision making, according to research performed by GMI Ratings for the Wall Street Journal (WSJ) in 2014. In that study of companies in the United States (U.S.), the average board size was found to be 11.2 directors[2]. The average U.S. public company board has 11 members, with most boards having between eight and 14.

Total number of board members in the listed companies studied (Table 1)

- **Mean= 8.18**
- **Min = 4**
- **Max = 20**

Number of board members	Number of listed companies	Percentage
4	10	0.5%
5	144	7.8%
6	272	14.7%
7	394	21.3%
8	315	17.1%
9	356	19.2%
10	89	4.8%
11	99	5.4%
12	64	3.5%
13	34	1.8%
14	23	1.3%
15	29	1.6%
16	3	0.2%
17	7	0.4%
18	3	0.2%
19	1	0.1%
20	1	0.1%
Total	**1,844**	**100%**

As shown in Table 1 above, boards ranging from six to nine members account for nearly 70% of the companies studied. The majority of boards in Hong Kong seem to be of a reasonable size, although there is still a minority of companies with relatively large boards.

[2] https://www.wsj.com/articles/smaller-boards-get-bigger-returns-1409078628

1. Size of boards (cont'd)

Total number of board members across industries (Table 2)

	Number of board members																	
	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	Total
Conglomerates	0	0	2	4	1	3	1	1	0	1	2	1	0	1	1	0	0	18
Consumer Goods	1	28	66	84	85	92	22	28	17	5	6	3	0	0	0	0	0	437
Energy	0	7	7	11	11	12	2	8	3	0	0	1	0	0	0	0	0	62
Financials	2	12	21	25	24	23	9	14	13	13	9	10	2	3	1	0	0	181
Industrial Goods	1	17	29	34	23	27	6	9	5	1	0	0	0	1	0	0	0	153
Information Technology	1	16	31	45	27	25	5	2	6	2	0	0	0	0	0	0	0	160
Materials	2	11	15	35	11	21	4	6	1	2	1	1	0	0	0	0	0	110
Properties & Construction	2	25	42	79	61	81	12	9	5	3	2	6	0	0	1	0	0	328
Services	1	22	51	59	56	47	18	15	11	4	2	4	0	2	0	0	1	293
Telecommunications	0	2	7	5	4	9	3	3	1	0	1	0	0	0	0	0	0	35
Utilities	0	4	1	13	12	16	7	4	2	3	0	3	1	0	0	1	0	67
Total	10	144	272	394	315	356	89	99	64	34	23	29	3	7	3	1	1	1,844

1. Size of boards (cont'd)

From the perspective of different industries, conglomerates and financial institutions, in general, have a higher proportion of bigger boards than other industries, i.e. 12 or more members (33% and 28% of the companies in those sectors respectively). Looking at the composition of the former, given that several of the companies are family businesses, the reasons could include the desire to appoint additional family members, especially the second generation, to the boards, which then also requires more INEDs to be appointed to meet minimum requirement of one third or three INEDs, whichever is the higher, under Listing Rule 5.05A. Among financial institutions, a bigger board may be due to their business needs and for more widely-held institutions with a global presence, to represent the different interests of a range of stakeholders.

It was observed in the WSJ research that smaller boards are generally more effective than larger boards. Companies with smaller boards are more collaborative and can outperform companies with larger boards in many situations. Reasons for favouring smaller boards may include the following[3]:

- Directors have greater ownership and accountability
- The boards can dedicate more time to tackling issues in greater detail
- There is less chance of a dominant member swaying the group, and of problems with groupthink, because smaller boards encourage more participation from all members
- Meetings tend to be less formal, which makes it easier for board directors to open up and share ideas, and there is less chance of board directors not actively participating
- Small boards are more likely to identify and act on poor performance of the chief executive officer
- Directors know each other better, and such relationships are more conducive to cohesiveness and a sense of common purpose

Researchers have concluded that[4] the optimal number of participants is seven or eight, which is small enough for good discussions to take place, but large enough for a diversity of opinions. Sociologists observe that many participants in large meetings do not feel a responsibility to contribute, and instead are content to rely on others to carry things forward.

[3] https://www.diligent.com/insights/board-composition/why-your-board-size-matters-how-a-smaller-board-can-be-more-effective/
[4] https://hbr.org/2018/07/what-ges-board-could-have-done-differently

2. Independent Non-Executive Directors

2.1 Number of INEDs:

Conglomerates and financial institutions have a higher average number of INEDs, which does not come as surprise, given that these sectors have larger boards and so need more INEDs to meet their minimum requirement under the Listing Rules. As there are a number of family businesses among conglomerates, it could also be that the appointment of more INEDs is seen as way of boosting the confidence of investors and other stakeholders that independent views are being considered. Meanwhile, for the financial sector, due to the complexity of their business and broad geographical reach of many international financial institutions, it is common for their boards to represent a wider range of stakeholders and, generally, to provide more independent oversight of the managements that run the day-to-day business operations. In addition, globally, financial sector entities tend to be more heavily regulated by regulators that expect, or even require, more impartial and independent, as well as experienced and expert, input on boards.

Demographic information on INEDs across industries (Table 3)

	Number of companies	Mean	Range
Conglomerates	18	4.39	3-7
Consumer Goods	436	3.36	2-9
Energy	62	3.37	3-7
Financials	180	4.09	2-12
Industrial Goods	153	3.29	2-7
Information Technology	160	3.21	2-5
Materials	110	3.26	2-9
Properties & Construction	328	3.28	2-6
Services	293	3.42	3-14
Telecommunications	35	3.34	3-6
Utilities	67	3.49	2-7
Total	1,842*	3.42	2-14

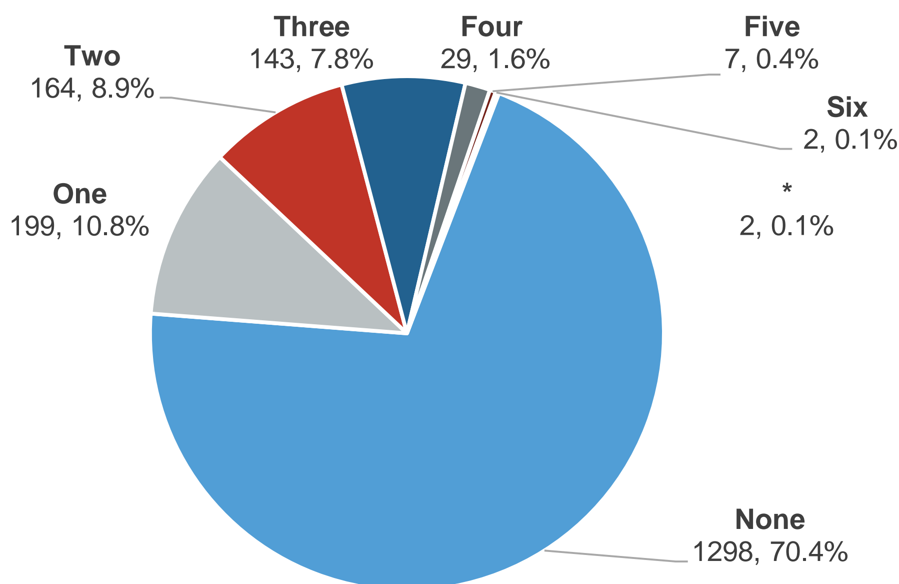
** Two listed companies did not provide the relevant information.*

2. Independent Non-Executive Directors (cont'd)

2.2 Long-serving INEDs:

Around 70% of the companies studied did not have any INEDs who had served their boards for more than nine years. While the remaining 30% companies had at least one long-serving INED, the majority of these companies did not seem to provide detailed reasons in their annual reports as to why these INEDs should be reappointed. Meanwhile, as shown in Table 4, conglomerates had the highest percentage of long-serving INEDs among other categories. This is not too surprising, because, among other reasons, it is quite likely that the family businesses in this sector would prefer to stay within their familiar comfort zone, rather than appointing new INEDs and increasing the risk of some friction or conflicts arising.

Number of INEDs (and applicable companies) serving the board for over 9 years (Figure 1)
(Notes: from the date of the appointment to the date when the annual report was issued)



**Two listed companies did not provide the relevant information*

One of the duties of INEDs is to challenge and offer a counterbalance to the company's management, thereby mitigating the so-called agency problem of corporations, which can be particularly important when assessing related-party transactions. However, this role could be impaired when the INEDs concerned have served their boards for a number of years and become too closely knit with other board members. The lack of effective INEDs could potentially lead to insider control, less regard for shareholder needs, less objective decision making, and, in extreme cases, corporate misconduct.

2. Independent Non-Executive Directors (cont'd)

In order to encourage board refreshment and succession planning, with effect from 1 January 2022, listed companies are required to disclose additional reasons as to why long-serving INEDs, i.e., those who have served their boards for more than nine years, should be reappointed. The additional disclosures should include the factors considered, the process, and the board's, or the nomination committee's discussion in reaching the conclusion that such INEDs are still independent and should be re-elected. With this new requirement in place, there may be increased focus on, and scrutiny, of the explanations and justifications provided by companies for retaining long-serving directors. However, whether this measure will be effective in speeding up the process of board refreshment remains to be seen. Where all the INEDs are long serving, the company will be required to appoint a new director at the next AGM. This more prescriptive approach will have a more direct impact on highly entrenched board compositions.

Number of INEDs serving the board for more than 9 years by industry (Table 4)

Number of companies (A)	Industries	1	2	3	4	5	6	Total companies with INEDs serving over 9 years (B)	Percentage (B/A)
18	Conglomerates	1	2	7	0	1	1	12	66%
436	Consumer Goods	46	32	27	6	2	0	113	25.9%
62	Energy	14	7	3	1	0	0	25	40.3%
180	Financials	17	11	9	3	0	1	41	22.7%
153	Industrial Goods	16	13	18	1	0	0	48	31.4%
160	Information Technology	19	11	9	2	1	0	42	26.3%
110	Materials	13	25	3	0	0	0	41	37.3%
328	Properties & Construction	30	37	32	6	2	0	107	32.6%
293	Services	25	15	30	6	1	0	77	26.3%
35	Telecommunications	9	4	1	2	0	0	16	45.7%
67	Utilities	9	7	4	2	0	0	22	32.8%
1,842	Total	199	164	143	29	7	2	544	

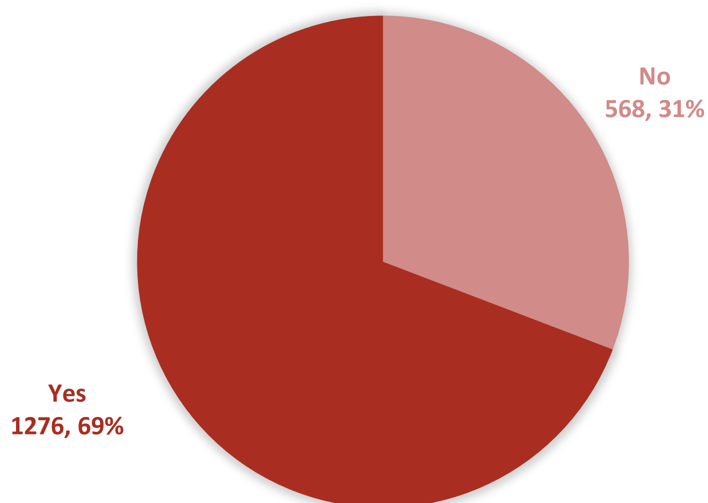
- The research did not take into account whether INEDs had previously served their boards as EDs/ NEDs. Had this factor been considered, it could be that other INEDs' terms of office on the board would also have exceeded nine years.

- When ascertaining years of service of INEDs, in most cases, trying to obtain this information was not straightforward. It was necessary to identify the information regarding the date of directors' original appointment and the date on which annual reports were published.

3. Board diversity

3.1 Gender of board members:

Number of the listed companies with at least one female board member (Figure 2)



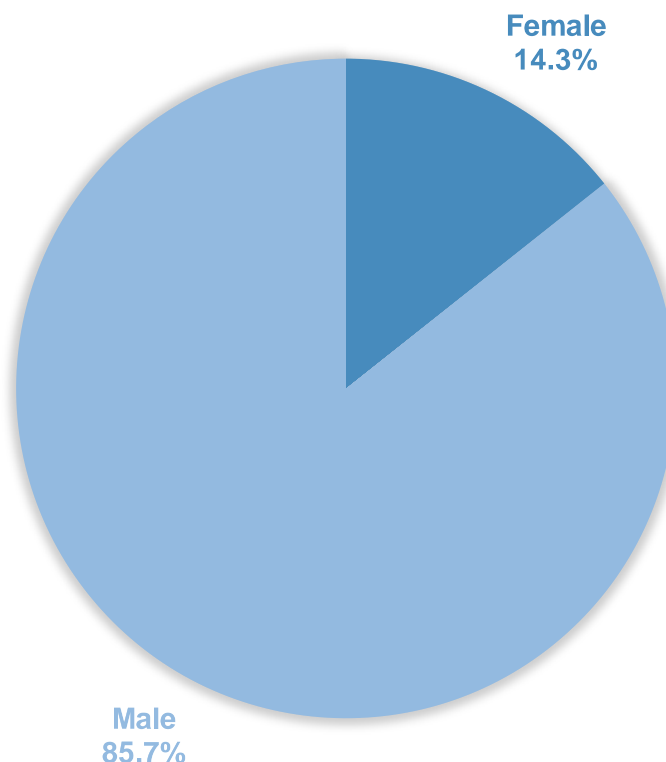
Further analysis of listed companies with at least one female board member (Table 5)

Number of female members on board	Number of companies with at least one female member on the board	Percentage (%)
1	679	53.2%
2	398	31.2%
3	128	10%
4	56	4.4%
5	12	1%
6	3	0.2%
Total	1,276	100%

3. Board diversity (cont'd)

Out of around 15,080 board members covered in our research, it is noted that the number of female directors accounted for about 14.3% (Figure 3 below), which is far below the often-quoted international benchmark of 30%, advocated by the 30% Club, one of the world's largest and most influential organizations advocating for more women on boards. In fact, as shown in Figure 2 on p. 10, it should be stressed that over 30% of the companies studied had no women at all on their boards.

Percentage of women on boards overall (Figure 3)



With single gender boards being required to appoint a director of a different gender no later than 31 December 2024, the percentage of female board members is likely to increase by a few percentage points in the coming few years, but it can be expected to stay below 20%. It seems likely that Hong Kong will continue to lag behind many other developed economies, as progress in appointing more female board members has been slow for a long time. Some boards suggest that the number of suitable female candidates available in the market is limited, and those companies that have already met the minimum requirement going forward, of having at least one female board member, may not be incentivized to appoint more women, but may instead adopt a wait-and-see approach. That is the conundrum: In trying to improve the situation in terms of gender diversity, could introducing a bare minimum baseline end up sending a mixed signal?

3. Board diversity (cont'd)

The current gender imbalance in the composition of boards is something that needs to be addressed. Diversity is considered by many to be essential to generating innovative ideas and encouraging better communication with stakeholders. The decisions made by boards with greater gender diversity tend to be more accommodative and well-thought-out, according to international research[5]. Additional considerations include:

- Companies with female directors on their boards perform better than those without women by specific metrics. For example, when Fortune-500 companies were ranked by the number of women directors on their boards, those in the highest quartile in 2009 reported a 42 percent greater return on sales and a 53 percent higher return on equity than the rest.

- Diverse boards often better mirror customer and client bases. This is particularly true in e.g. the health care sector, which is a complex space with a very diverse customer base. According the United Nations, women account for nearly 70 percent of health and care workers worldwide, but a recent report by the International Labour Organization and the World Health Organization found a significant gender pay disparity in that sector, which they believe could be due to gender discriminiation[6]. Gender discrimination and stereotyping are also plausible underlying factors in the lack of women on boards. However, having a diverse board can help companies better understand purchasing and usage decisions, particularly as studies have found that, in the U.S. for example, women drive 70-80 percent of purchasing. Without women on the board, companies may be missing a valuable opportunity to bring in voices that represent this broad swath of potential and actual customers and clients.

- Diversified boards help increase the number of potential board members, and thus increase the chances of finding a board member who has the necessary skills, experience, and intelligence to make beneficial decisions for the organization. In addition, when companies do more to widen the talent pool at the top of the company, it sends a signal that developing women as leaders is one of the company's priorities.

- There is often a tendency to choose people who "look like me" for boards, whether it is because it is assumed that people like the existing members will fit in better or that that is what the talent pool looks like. A survey of over 500 hiring managers found than 74 percent of leaders reported that their most recent hire had a personality similar to their own. However, when diversity is lacking on the board, the organization runs the risk of not hearing potentially useful ideas, as well as not examining the possible downsides of ideas. Female directors, it is suggested, deal more effectively with risk and focus more strongly on long-term priorities.

[5] https://www.hsph.harvard.edu/ecpe/why-diversity-matters-women-on-boards-of-directors/
[6] https://news.un.org/en/story/2022/07/1122462

3. Board diversity (cont'd)

The above outcomes are in line with some the findings of a recent research conducted by NEOMA Business School in the French city of Reims[7], which discovered that having more women in these senior roles leads to less excessive risk-taking and greater efficiency. Having women on boards also leads to less earnings management, i.e., adopting techniques to produce financial statements that may deliver an overly optimistic view of a company's financial position. However, the report also found this is far truer for nations where there are already higher levels of gender equality, like Scandinavia, whereas in countries with greater gender inequality, female directors appear to have less effect on how a company performs. This study, published in International Business Review, looked at 1,986 public firms from 24 countries or areas between 2007 and 2016. It suggests, therefore, that appointing women to boards in and of itself may not change gender biases, but if it is part of the process where changes and progress towards greater equality are happening in society at large, then, having more gender diverse boards can have greater impact and can be mutually reinforcing with those broader changes.

Demographic information of female board members across industries (Table 6)

	Number of the companies in the industries (A)	Number of the companies which have at least one female board member (B)	Percentage (B/A)
Conglomerates	18	13	72.2%
Consumer Goods	437	305	69.8%
Energy	62	38	61.3%
Financials	181	142	78.5%
Industrial Goods	153	95	62.1%
Information Technology	160	114	71.3%
Materials	110	57	51.8%
Properties & Construction	328	238	72.6%
Services	293	212	72.4%
Telecommunications	35	21	60.0%
Utilities	67	41	61.2%
Total	1,844	1,276	100%

From Table 6 above, it can be observed that the percentage of the companies with at least one female board member were comparatively lower in the energy, industrial goods, materials, telecommunications and utilities sectors than other sectors. This may not be surprising as these are traditionally male-dominated industries. When employees progress further up the career ladder, it would be quite natural for them to join the management of their employers. These industries may demand employees to work in environments that are located in remote areas (refineries and oil fields, power plants, telecommunications facilities, etc.) and require physical presence or regular travelling. This makes it more difficult for women, who may wish to maintain a better work-family life balance, to join these industries and work their way up, or gain the necessary experience.

[7] https://www.independent.co.uk/news/uk/home-news/women-company-boards-better-performance-b1776181.html

3. Board diversity (cont'd)

3.2 Age of board members:

The average age of board members among the companies studied was 54.4 years old. By comparison, a recent survey among S&P 500 companies found the average age of board members to be 63.5 years old[8]. It would seem, therefore, that Hong Kong cannot be regarded as having generally elderly boards. From the industry perspective, conglomerates, telecommunications, and energy companies had a higher proportion of board members who were over 65.

While the average age of the Hong Kong board members looks reasonable, this should not distract attention from the importance of also bringing younger directors into the boardroom[9]. This can add value, in terms of different generational perspectives and encouraging innovation, bearing in mind also that more than half of the world's population is under the age of 30. Millennials make up the largest proportion of the world's workforce, reflecting the fact that a significant portion of consumers are young people.

Average age of board members across industries (Table 7)

	Number of the companies in the industry	Mean
Conglomerates	18	58.27
Consumer Goods	436	54.14
Energy	62	55.14
Financials	180	54.48
Industrial Goods	153	55.69
Information Technology	160	52.05
Materials	110	53.99
Properties & Construction	328	54.99
Services	293	54.08
Telecommunications	35	55.67
Utilities	67	55.23
Total	1,842 *	54.40

** Two listed companies did not provide the relevant information.*

[8] https://cglytics.com/younger-directors-on-sp-500-boards-show-positive-effect-on-companies-performance-%EF%BB%BF/
[9] https://www.forbes.com/sites/forbesbusinesscouncil/2020/06/10/why-having-young-people-on-corporate-boards-is-a-game-changer/?sh=7ddca97759c8

3. Board diversity (cont'd)

Number of listed companies by industry with at least one board member who is over 65 (Table 8)

Number of companies within Industries (A)		1	2	3	4	5	6	7	8	9	11	12	13	17	Total (B)	B/A
18	Conglomerates	3	2	2	1	2	0	0	0	1	0	0	1	1	13	72.20%
437	Consumer Goods	100	78	35	17	12	4	3	0	0	0	0	0	0	249	57%
62	Energy	27	9	2	3	0	0	0	0	0	0	0	0	0	41	66.10%
181	Financials	40	33	17	13	2	1	3	1	0	0	1	0	0	111	61.30%
153	Industrial Goods	43	19	14	11	5	2	1	1	0	0	0	0	0	96	62.70%
160	Information Technology	36	15	6	6	2	1	0	0	0	0	0	0	0	66	41.30%
110	Materials	32	17	7	3	1	0	0	0	0	0	0	0	0	60	54.50%
328	Properties & Construction	86	51	19	20	10	7	1	1	1	1	1	2	0	200	61%
293	Services	69	39	27	14	9	3	1	5	2	1	1	0	0	171	58.40%
35	Telecommunications	8	8	2	5	0	0	0	1	0	0	0	0	0	24	68.60%
67	Utilities	17	14	4	1	0	0	1	1	2	0	0	0	0	40	59.70%
1,844	Total	461	285	135	94	43	18	10	10	6	2	3	3	1	1,071	100

3. Board diversity (cont'd)

3.3 Professional skill sets of board members – qualified accountants:

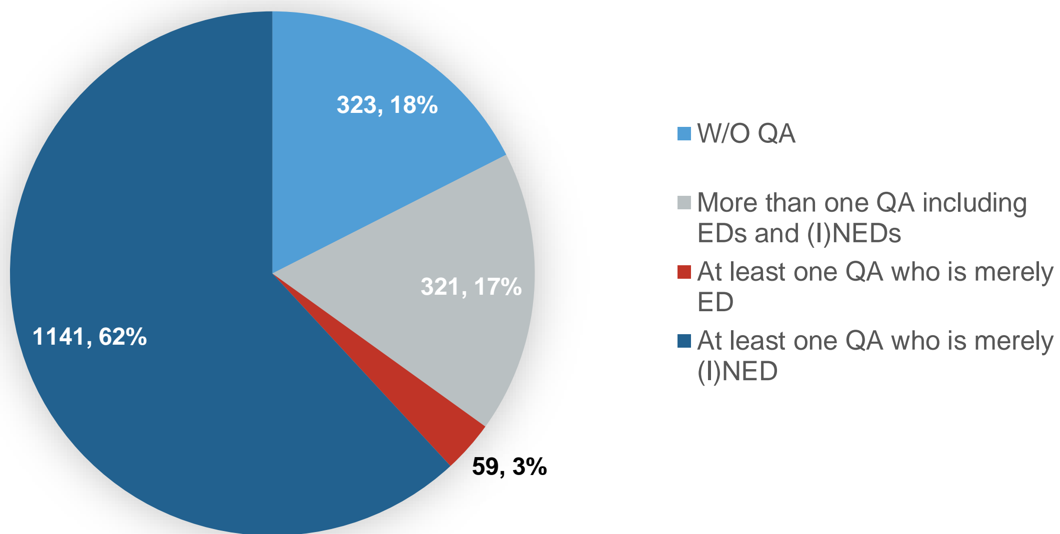
Previously, in Hong Kong there was a Listing Rule-requirement, for both Main Board companies and companies listed on the GEM, to have a qualified accountant (QA) as a member of senior management and preferably on the board, but this was dropped in 2009, despite some opposition, primarily on CG grounds. It was replaced with a requirement for an annual review of the adequacy of resources, staff qualifications and experience, training and budget of the company's accounting, internal audit and financial reporting functions (CG Code Provision D.2.2), as part of the review of the effectiveness of the company's risk management and internal control systems, overseen by the board.

Number of listed companies by industry with at least one QA on their board (Table 9)

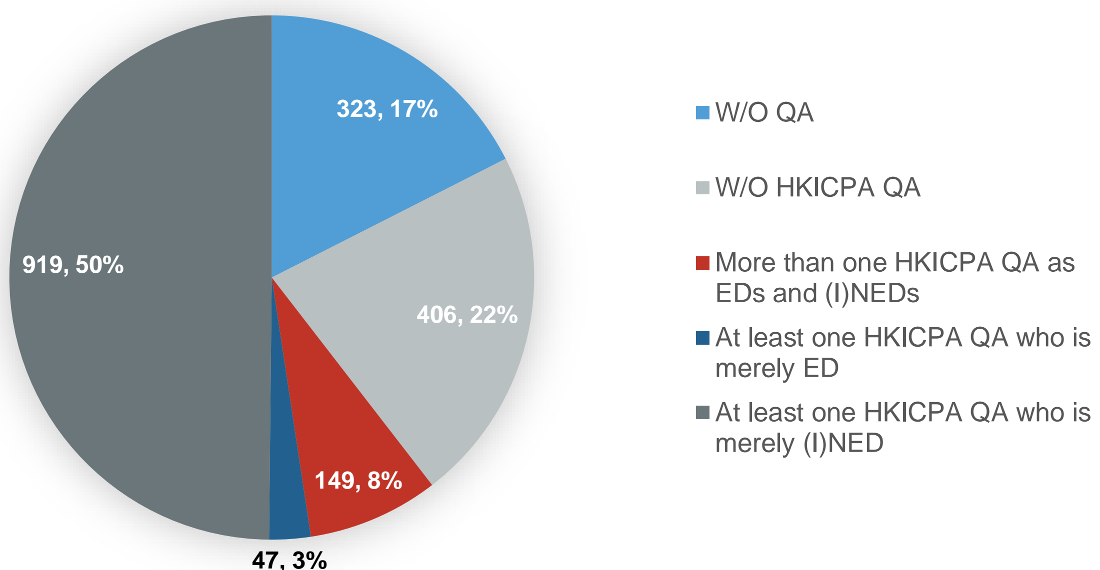
	Number of listed companies with at least one QA on their board		Number of listed companies with at least one QA who is an HKICPA member on their board	
	Number of listed companies	Range	Number of listed companies	Range
Conglomerates	16	1-4	9	1-4
Consumer Goods	356	1-5	241	1-5
Energy	50	1-5	36	1-5
Financials	141	1-5	101	1-5
Industrial Goods	135	1-3	100	1-3
Information Technology	122	1-5	80	1-5
Materials	90	1-5	61	1-3
Properties & Construction	294	1-4	231	1-4
Services	231	1-4	183	1-4
Telecommunications	31	1-3	26	1-3
Utilities	55	1-5	47	1-5
Total	1,521	1-5	1,115	1-5

3. Board diversity (cont'd)

Although around 82% (1,521/ 1,844 * 100) of the companies studied had at least one QA on their board (defined in the study as a member of one of the member organizations of the International Federation of Accountants[10]), this number reduced to around 60% (1,115/ 1,844 * 100) if only HKICPA members were counted, bearing in mind that only HKICPA members are regulated by the Accounting and Financial Reporting Council in Hong Kong. Furthermore, the vast majority of these QAs were INEDs or NEDs and only around 25% were EDs. Taking the total number of companies in the study, i.e. 1844, only around 20% (17% + 3%, see Figure 4 below) had a QA who was an ED, and only about 10.5% (8.1% + 2.5%, see Figure 5 below), had an ED who was also an HKICPA member.



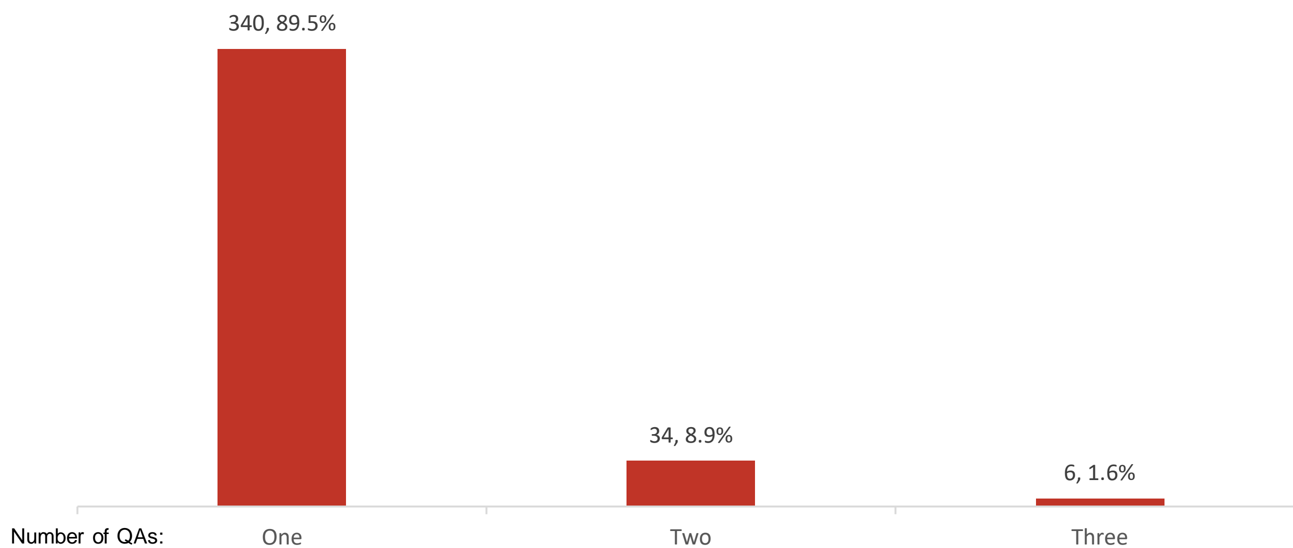
Distribution of QAs who are Institute members on boards (Figure 5)



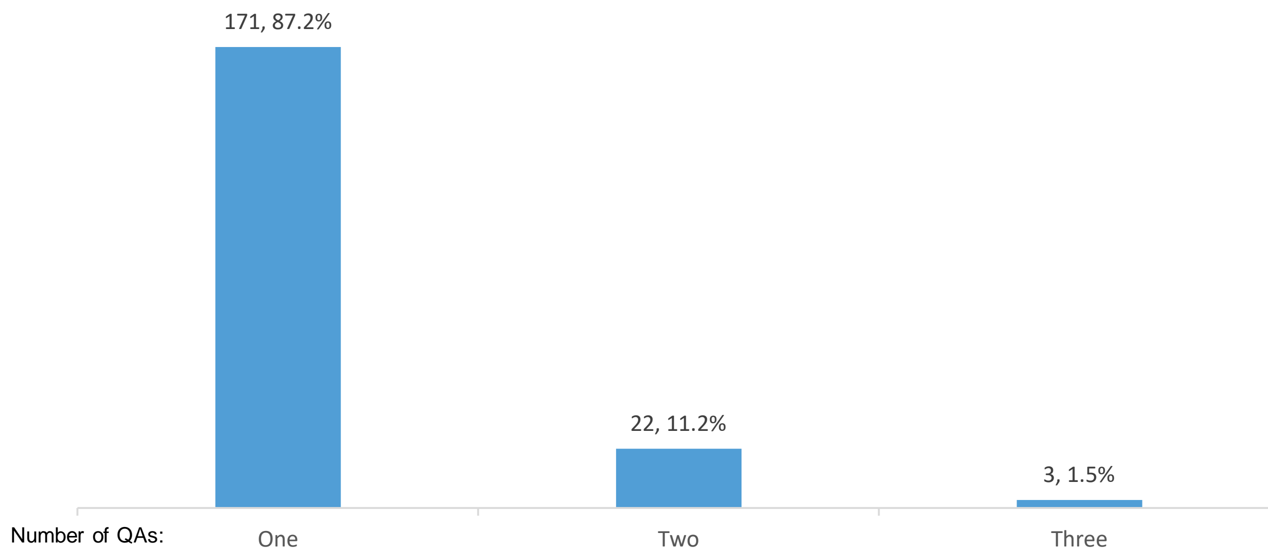
[10] https://www.ifac.org/who-we-are/membership

3. Board diversity (cont'd)

Listed companies with QAs at least one of whom is an ED (Figure 6)



Listed companies with QAs at least one of whom is an ED and HKICPA member (Figure 7)



3. Board diversity (cont'd)

Number of listed companies by industry with at least one QA who is an ED (Table 10)

	Number of listed companies with at least one QA who is an ED		Number of listed companies with at least one QA who is an ED and HKICPA member	
	N	Range	N	Range
Conglomerates	7	1-3	5	1-2
Consumer Goods	91	1-3	42	1-3
Energy	6	1-3	4	1-3
Financials	35	1-3	18	1-3
Industrial Goods	34	1-2	21	1-2
Information Technology	34	1-2	18	1-2
Materials	24	1-2	10	1
Properties & Construction	79	1-2	36	1-2
Services	52	1-2	29	1-2
Telecommunications	5	1-1	3	1
Utilities	13	1-3	10	1-2
Total	380	1-3	196	1-3

Number of listed companies by industry with INEDs/NEDs who are QAs (Table 11)

	Number of listed companies with INEDs/NEDs who are QAs		Number of listed companies with INEDs/NEDs who are QAs and HKICPA members	
	N	Range	N	Range
Conglomerates	13	1-3	8	1-2
Consumer Goods	342	1-4	232	1-3
Energy	50	1-4	35	1-4
Financials	138	1-4	100	1-3
Industrial Goods	129	1-3	98	1-3
Information Technology	116	1-3	80	1-3
Materials	87	1-3	59	1-3
Properties & Construction	278	1-3	226	1-3
Services	225	1-3	145	1-3
Telecommunications	30	1-3	22	1-3
Utilities	53	1-3	40	1-2
Total	1,461	1-4	1,045	1-4

3. Board diversity (cont'd)

Comparing Tables 10 and 11, it can be observed that listed companies with INEDs/NEDs who were QAs, or QAs and HKICPA members, significantly outnumbered those companies with QAs who were EDs or EDs and HKICPA members.

Among 1,521 companies with at least one QA on their boards, the research found that that only around 25% (380/ 1521*100%) of the boards (Table 11) had a QA who was an ED, i.e., a full-time employee of the company. The percentage reduced to about 13% (196/ 1521*100%) (Figure 8) if only HKICPA members were taken into account. Therefore, overall, fewer than 20% of the total number of companies in the study had a QA who was an ED on the board. These statistics give cause for concern.

The present situation could be viewed as a high risk. With developments in international sustainability standards and the need for businesses to, e.g., price in sustainability-related risks and opportunities, also discussions internationally around issues such as tax governance and ethics, this situation is likely to become increasingly problematic. Moreover, certain types of companies, such as biotech companies, can now list in Hong Kong and offer shares to the public, with a limited financial track record and without having ever made a profit; other similar proposals are in the pipeline for "special technology" companies to be able to list. Under such circumstances, it is not prudent to rely heavily on the expertise of part-time directors, who are generally regarded as inadequately remunerated, given their legal, fiduciary and regulatory responsibilities, to oversee the increasingly complex financial and non-financial reporting of many listed companies. To emphasize this point, a recent survey on the effectiveness of INEDs, conducted by The Hong Kong Independent Non-Executive Director Association, found that INEDs do not always get sufficient information from the management to perform their functions effectively[11].

3.3.1 Qualified accountants in senior management:

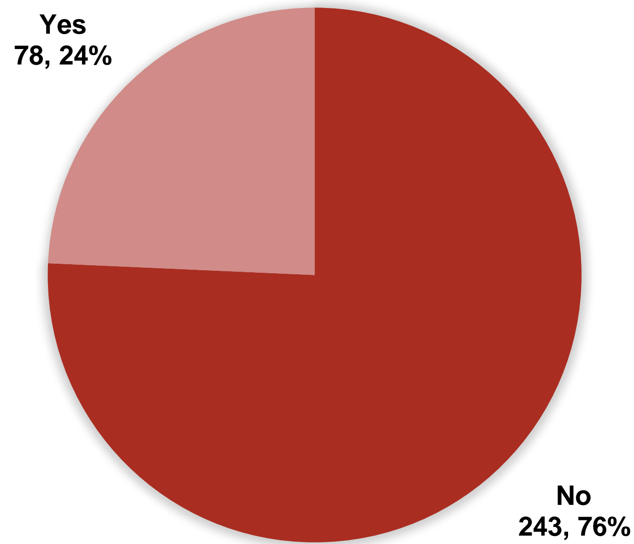
Where no board member was a QA, the research further explored whether the chief financial officer (CFO)/ finance director, who is a key member of the senior management, was a QA. Among 321 boards without a QA member, only around 24% (78 / 321 *100) disclosed that their CFO or finance director was a QA. If only HKICPA members were taken into account, the percentage dropped to roughly 16% (52 / 321 *100).

While most of companies concerned had at least one board member with accounting/ financial management expertise, due to the requirements of Listing Rule 3.10, this person was quite likely to be an INED. As indicated below, this situation is far from satisfactory and cannot be considered as giving adequate assurance to investors about the integrity of the financial management of the companies in question.

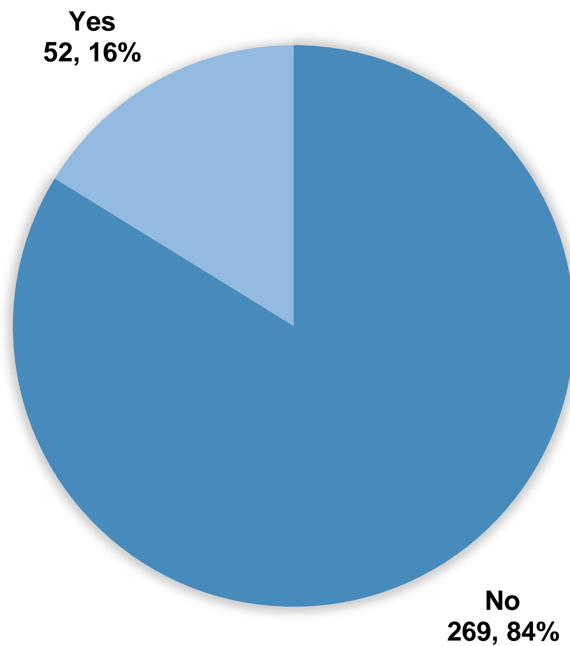
[11] https://drive.google.com/file/d/1TSoQ8-0Bi31Pnk8T04vCQTuubVUHU2Zv/view

3. Board diversity (cont'd)

Number of listed companies with CFOs/ finance directors who are QAs, where no board member is a QA (Figure 8)



Number of listed companies with CFOs/ finance directors who are QAs and HKICPA members, where no board member is a QA (Figure 9)



3. Board diversity (cont'd)

The above observations seem to accord with what has happened in the U.S. At the 1,000 largest U.S. public companies, the portion of CFOs who are certified public accountants fell gradually to from nearly 45% in 2014 to around 36% in 2019, according to data from organizational consulting firm Korn Ferry. The nuts and bolts of accounting are therefore increasingly being handled by chief accounting officers and controllers[12]. On the other hand, CFOs who are QAs will be familiar with both accounting rules and financial reporting requirements, and changes to these. They will also be knowledgeable about the business operations side of the company and, therefore, in a good position to ensure the accuracy, reliability and integrity of financial reporting and disclosures.

In addition, the modern accountant can be expected to have other business-related skill sets, such as corporate finance knowledge, as well as a good understanding of important regulatory and compliance matters, such as risk management and internal controls, CG more generally and anti-money laundering. With the promulgation, by the recently formed International Sustainability Standards Board, of the first international sustainability reporting standards just around the corner, the future accountant can also be expected to have a good understanding of ESG considerations and their actual and potential impact on the finances of companies. CFOs who are registered CPAs are bound by professional standards and a code of professional ethics; if they breach these, they could be suspended or lose their licence. There are strong arguments, therefore, for having an accounting-focused CFO, even where this is not mandatory[13].

Note

- A strict approach was adopted to confirm QA status. A company needed to disclose clearly which (IFAC member) organization a QA on the board was a member of in order be counted.

[12,13] https://www.wsj.com/articles/companies-appointing-fewer-finance-chiefs-with-accounting-skills-11580293801

3. Board diversity (cont'd)

3.4 Adoption of board diversity in nomination policies and as a metric in board evaluations:

While most of the companies studied have put in place board diversity policies, as required by Appendix 14 of the Main Board Listing Rules/ Appendix 15 of GEM Listing Rules, in many cases, details are lacking. Generally, companies do not disclose and explain numerical targets and timelines set for achieving gender or other types of diversity on their boards, and any measures being adopted to develop a pipeline of potential candidates for the board who have the right background and experience, and who can contribute to more diverse board.

Based on our observations, it is rare for board diversity to be considered in the content of board evaluations, which is a potential gap, particularly given that the Listing Rules now make it clear that diversity is an issue to be treated seriously and given some priority. In fact, even disclosures that a board evaluation has been conducted, to ensure that the board is operating effectively, are not very common, despite this being a recommended best practice under the CG Code, and where it is disclosed that an evaluation has been conducted, in most of the cases, information on the underlying process and issues considered tends to be boilerplate. There is certainly ample room for improvement in disclosures about the scope of evaluations, the questions asked, and general findings and recommendations.

Conclusions and recommendations

Conclusions

Based on our study of December-year-end listed companies in Hong Kong, which represent around 75% of all Hong Kong-listed companies, we can draw a number of conclusion and from these make several recommendations for stakeholders, primarily listed companies and the relevant regulatory bodies, to consider further.

Size of boards

The average board size of boards in Hong Kong, at 8.2 members is reasonable to promote active participation and effective decision-making. However, around 9% of boards comprise 12 or more members, and up to 15-20 members in a few cases. Companies with large boards should review whether all members are encouraged to participate actively in discussions, and whether meetings and decision-making are conducted as efficiently as they could be.

Independent non-executive directors

The average number of INEDs on the boards of conglomerates and financial services companies tends to be higher than in other industry sectors. However, this is likely to be due to there being a higher proportion of large boards in those sectors than others, rather than because of demand or desire to achieve a higher level of independence on boards in those sectors. Larger boards need to appoint more INEDs in order to meet the minimum requirement under the Listing Rules (Rules 3.10 and 3.10A) for boards to have at least one third INEDs, or a minimum of three, whichever is the higher. In general, it would seem that not many companies are exceeding the minimum number of three INEDs on the board.

There does not appear to be chronic and extremely pervasive issue of long-serving INEDs (i.e. serving for more than 9 years) in Hong Kong. However, around 27.5% of companies have one to three long-serving INEDs on the board and, bearing in mind that the average number of INEDs on boards is around 3 - 3.5, this suggests that there some reluctance to effect change and adopt of policy of board refreshment in a significant number of listed companies.

As many successful owners and leaders of family businesses already know, a business of any size can benefit from a board with independent directors. Such a board is able to provide an objective view for senior management, which can be beneficial for a family business that employs a number of family members in senior roles. It is important that when a family business decides to create a board, the composition includes INEDs with expertise and insights in key areas that can add value to the business[14], and who are also able to give an independent, objective and, where necessary, critical perspective. After more than nine years on the board, there must be some doubt whether an INED can continue fulfil all these criteria, despite good intentions. The newly implemented Listing Rule changes will force companies to think about these issues more carefully, and should help accelerate to processes of succession planning and board refreshment, among INEDs at least.

[14] https://www.silvercrestgroup.com/the-importance-of-independent-directors-good-corporate-governance-for-family-businesses/

Conclusions and recommendations (cont'd)

Board diversity – gender

The proportion of female directors on Hong Kong listed company boards, at around 14.3%, is well below that in a number of developed economies. Over 30% of companies have no female board members. This could be due, in part, to entrenched gender bias and stereotyping in the Hong Kong corporate sector. In some sectors, the problem seems to be more prevalent. More needs to be done to encourage the appointment women to boards. While the new Listing Rule changes will end single gender boards by the end of 2024, it remains to be seen whether this will really have an impact on companies that currently do not have a single gender board but still have a low proportion of female directors. In other words, will it change mindsets and stimulate more progress in gender diversity on board more generally, or is there is a risk that the change to the Listing Rules will just result in a new plateau, a few percentage point above 14%?

Board diversity – age

The average age of board members at 54.4 years old compares well with the average age of board members of large U.S. companies, which is 63.5 years old, according to a recent survey of S&P 500 companies. Overall, therefore, Hong Kong cannot be regarded as having generally elderly boards. However, if boards are not regularly refreshed, we are likely see an aging effect over time. From the industry perspective, conglomerates, telecommunications, and energy companies have a higher proportion of board members who are over 65.

Board diversity - professional skillsets: qualified accountants

Based on the 1844 companies covered in the study, overall, roughly 20% of companies have a QA on the board who is an ED, i.e. a full-time employee. Of those that have a QA on the board, the QA is an ED in only around 25% of cases. The latter percentage reduces to about 13%, if only HKICPA members are taken into account (and about 10% as a percentage of the total number of companies studied). This gives serious cause for concern.

It is not prudent to rely heavily on the expertise of part-time directors, i.e. NEDs and INEDs, who are generally regarded as not adequately remunerated in Hong Kong, given their legal, fiduciary and regulatory responsibilities, to oversee the increasingly complex financial and non-financial reporting of many listed companies. A recent survey on the effectiveness of INEDs, conducted by The Hong Kong Independent Non-Executive Director Association, found that INEDs do not always get sufficient information from the management to perform their functions effectively[15].

Where no board member was a QA, the study asked whether instead the CFO/ finance director, who is a key member of the senior management, was a QA. Among 321 boards without a QA member, only around 24% disclosed that their CFO or finance director was a QA; if only HKICPA members were taken into account, the percentage dropped to roughly 16%.

The above situation is far from satisfactory, and it is questionable whether it can be considered as giving adequate assurance to investors about the integrity of the financial management of listed companies in Hong Kong.

[15] https://drive.google.com/file/d/1TSoQ8-0Bi31Pnk8T04vCQTuubVUHU2Zv/view

Conclusions and recommendations (cont'd)

Board diversity and board evaluations

Most companies studied have put in place board diversity policies, as required by the Listing Rules, but, in many cases, details are lacking.

Based on our observations, it is rare for board diversity to be considered in the content of board evaluations, even though the Listing Rules now make it clear that this is an issue to be treated seriously and given some priority. Even disclosures that a board evaluation has been conducted, to ensure that the board is operating effectively, are not very common, despite this being a recommended best practice under the CG Code, and where it is disclosed that an evaluation has been conducted, in most of the cases, the disclosure of the underlying process, questions asked and findings tends to be boilerplate.

Recommendations

Where board evaluations are conducted, we recommend that they including look at the size of the board, as well as the composition, as part of their review of the effectiveness of the operation of the board, and whether the size facilitates the active participation of all members of the board in discussions. This information should be disclosed. Where evaluations are not conducted regularly, or at all, we recommend that companies look at doing this. Periodically, at least, such evaluations should involve independent external experts, rather than just internal, in-house processes, to ensure objectivity.

While boards, particularly in family companies, may prefer the familiarity of long-serving INEDs who may gain a deeper understanding of the business, for companies to be able to adapt to a dynamic business environment, look at issues from new perspectives and, where necessary, think "outside of the box", they also need to bring on new members. The recent Listing Rule changes send a clear message that it is not good for CG to have all long-serving INEDs on the board who have been in place for more than nine years. Companies need to appoint new INEDs periodically. They should also consider identifying members who are not just from the same mould as the retiring members and take the opportunity to review whether board diversity could be strengthened by the new appointments.

We recommend that where companies wish to retain INEDs after serving for nine years, they should provide an explanation and justification, not only in communications to shareholders, but also include a similar information, or a summary of it, in their annual reports. We suggest as well that companies wishing to be more transparent and improve their CG performance should consider indicating the tenure of all their directors in their annual reports.

When aiming to expand diversity companies should look bring more women onto the board. Research suggests that, in the right environment, having more women in these senior roles leads to less excessive risk-taking and greater efficiency, as well as less earnings management. A more gender diverse board can also help companies better understand purchasing and usage decisions. Studies in the U.S., for example, have found that women drive 70-80 percent of purchasing. Without women on the board, companies may be missing a valuable opportunity to bring in voices that represent this broad swath of potential and actual customers and clients. We would suggest that Hong Kong listed companies should target to achieve at least 20% - 25% female representation on boards over the next five years or so.

Conclusions and recommendations (cont'd)

While the current average age of board members in Hong Kong, at 54.4 years old is reasonable, with the current slow pace of board refreshment, there could be aging effect on boards. In this regard, boards should also look at age as another diversity factor and, depending on the industry sector, having younger members on the board can also be way of connecting more effectively with potential and actual customers and clients. With the increasing importance of ESG considerations for all businesses in future, appointing younger board members can help to strengthen companies' commitment to ESG, as younger generations tend demonstrate greater awareness and concern about ESG issues and, ultimately, they will be ones most affected by critical issues like climate change.

The current situation with a lack of full-time, professionally qualified accountants on boards leaves a lot to be desired. Only around 20% of boards have a full-time QA and only around 10% have a full-time QA who is an HKICPA member, regulated by the Accounting and Financial Reporting Council. Relying on the expertise of part-time directors, i.e. NEDs and INEDs, who will not have all the information that full-time staff will have, to oversee the accounting and financial reporting functions is highly risky and, potentially, creates an expectation gap..

Where there is QA on the board, in 75% of companies, the QA is not a full-time member of the staff. Where the is no QA on the board, in only 24% of cases is the CFO/ finance director a QA and that number drops to 16% when it comes a member of the HKICPA. The situation is getting increasingly risky rather than less so, with more companies now able to list and offer shares for sale to the public, as well as to institutional, investors, having only a limited financial track record and without ever having made a profit, including biotech companies and also, under current consultation proposals, "special technology" companies. In addition, the government is proposing that Hong Kong become, among other things, a hub for virtual asset trading, with participation by retail investors. Therefore, the argument for the involvement of a full-time QA on the board or in the senior management of listed companies is becoming stronger.

We recommend that the government and regulators to consider introducing a requirement in the Listing Rules that companies must have full-time QA on the board, or in the senior management, to take responsibility for overseeing the accounting and financial reporting functions, which is similar to the previous requirement for a QA under the Listing Rules, and, added to this, to oversee sustainability reporting, once international sustainability standards have been promulgated by the International Sustainability Standards Board, under the International Financial Reporting Standards Foundation, which is expected to start happening in 2023.

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