Board Composition and Financial Performance of Hong Kong Listed Property Companies

Henry G. Lam
Master of Business Administration (Lingnan University, Hong Kong)
Bachelor of Social Sciences double major in Economics and Politics (University of Ottawa)
Bachelor of Administration (University of Ottawa, Canada)

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Newcastle Business School

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Statement of Originality

This work contains no material which has been accepted for the award of any other degree or diploma in any university or other tertiary institution and, to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text. I give consent to this copy of my thesis, when deposited in the University Library, being made available for loan and photocopying subject to the provisions of the Copyright Act 1968.

Signature: Date: 19 March 2013
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Abstract

In the last decade, the global financial crisis, triggered by bankruptcy of poorly governed companies such as Enron, AIG, Lehman Brothers and Merrill Lynch led the U.S. and other nations including Hong Kong to introduce stricter corporate governance rules and regulations in order to protect the interests of stakeholders. Hong Kong Exchanges and Clearing (HKEX) Main Board Listing Rules Appendix 14, issues a number of changes to Code of corporate governance in January 2005, covering five major areas. The main area that attracts the most attention from people is the number of Independent Non-Executive Directors (INEDs) in the new Code of corporate governance practices (HKEX, 2005). This Code takes into consideration the latest development in corporate governance, and is benchmarked against the revised UK Combined Code.

In Hong Kong, prior to 1\textsuperscript{st} January 2005, the Code of corporate governance on board composition only requires a listed company to have at least two Independent Non-Executive Directors (INEDs). However, with effect from 1\textsuperscript{st} January 2005, the new Code of corporate governance requires a balanced composition of INEDs and Non-INEDs so that there is a strong and effective leadership. As a result, the new Code requires listed companies to include at least three INEDs or one-third INEDs on the board. Furthermore, the roles of Chairman and CEO should be separate and should not be performed by the same individual (HKEX, 2005).
One of the driving factors, which forces Hong Kong to adopt a new Code is that poor corporate governance weakens a company’s financial performance and causes financial difficulties and even fraud (OECD, 2004b).

It is widely believed that good corporate governance adds value to a company. A good corporate governance practice is a necessary condition but not a pre-condition to better financial performance. Since board composition plays a vital role in corporate governance (Brennan, 2006), the aim of this study is to answer two major questions: Does board composition affect financial performance in Hong Kong listed companies? The general view is that corporate governance in Hong Kong is easy to comply with, just like another “box ticking” exercise to check compliance simply to meet the regulators’ requirement. This leads to the second question of the study: Does compliance with the Code of corporate governance on board composition improve financial performance of Hong Kong listed companies? These two questions are addressed by using a sample of Hong Kong listed property companies on the Main Board of the Hong Kong Stock Exchange.

The study examines: (a) the correlation between board composition and financial performance in Hong Kong listed property companies; and (b) the correlation between compliance with the Code of corporate governance on board composition and financial performance in Hong Kong listed property companies.

The board composition in this study includes four key elements: board size, percentage of INEDs on the board, CEO-duality and percentage of women on the board. The sample consists of 66 out of a total of 108 Hong Kong listed companies under the “Properties” industry classification on the Main Board of the Hong Kong Stock Exchange (SEHK) over the period 1999-2010 (approximately 792 firm years). The results of the study confirm that there is a positive association between board size and financial performance. There is a
Positive association between the percentage of INEDs on the board and financial performance. There is no association between CEO-duality and financial performance. There is no association between the percentage of women on the board and financial performance. And finally, there is no association between compliance with the Code of corporate governance on board composition and financial performance in Hong Kong listed property companies.

In the Hong Kong context, there are a few studies on corporate board practices and corporate governance. However, there is a lack of empirical evidence on the relationship between corporate governance and performance of family-controlled companies in Hong Kong (Ho, 2003). A recent study finds more than 90 percent of the property companies listed on the Main Board of Hong Kong Stock Exchange is under family control (Jordan, 2008). This study extends the literature on board composition and financial performance by providing empirical evidence from Hong Kong listed property companies over the period 1999-2010.

Keywords: corporate governance, board composition, financial performance, board of directors, women on the board, board diversity, independent non-executive directors (INEDs), board size, CEO-duality, Hong Kong listed property companies.