Boardroom characteristics, ownership structure and corporate fraud:
Evidence from Hong Kong listed companies

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Declaration

I hereby certify that the work embodied in this Dissertation Project is the result of original research and has not been submitted for a higher degree to any other University or Institution.

______________________________

Pang Chui Ling

Oct 30, 2013
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Abstract

In response to a couple of remarkable revelations of corporate fraud and the increasing level of domination of mainland companies on the Hong Kong stock market that has occurred over the past two decades, this study examines whether boardroom characteristics, financial reporting credibility and corporate ownership structure have an effect on corporate fraud in Hong Kong. In addition, it explores how these factors affect the severity of fraud, and examines possible distinctive features of fraud committed by Chinese companies compared to their local counterparts. The data are obtained from enforcement reports from various regulatory bodies in Hong Kong, together with court reports from local news clippings. This study uses a trimmed sample of 116 event observations comprising 69 suspicious fraud observations and 8 defendant fraud observations. A sample of no-fraud companies with comparable characteristics is used as a control group. Data for the reporting period from 2002 to 2011 are chosen for empirical analyses. Probit models are used to examine factors contributing to the likelihood and severity of corporate fraud.

The empirical results indicate that board size, board tenure, multiple board appointments across audit committee members, as well as management turnover, are crucial in explaining corporate fraud and fraud severity. In particular, the first three explanatory variables are negatively related to fraud likelihood and fraud severity while the fourth is positively related. The negative association between outside directors and corporate fraud has been widely documented in
prior studies. Surprisingly, this study shows that the proportion of outside directors, as well as corporate ownership structure and financial performance indicators, have no significant effect on corporate wrongdoings in Hong Kong. This study has practical implications regarding the design of appropriate corporate governance mechanisms for the listed entities.

One implication is that most listed entities barely meet the required number of independent non-executive directors who must be selected by substantial shareholders. As a result of this, it is a concern that the directors’ independence may be impaired and their effectiveness in curbing management may be lowered.