

Consultation Paper: Board Diversity September 2012

Consultation Questions

Q.1 Do you agree that the Exchange should promote board diversity?

Yes.

Q.2 If your answer to Q.1 is “yes”, do you agree that our Corporate Governance Code and Corporate Governance Report is the appropriate place for the new measures on board diversity?

Yes. As board diversity is a very broad concept, susceptible to multiple interpretations, the new measures should be located in the Corporate Governance Report

Q.3 Do you agree with our proposal to introduce CP A.5.6 (*the 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 corporate governance report*)? Please give reasons for your views.

HKEx's Consultation Paper outlines the benefits of board diversity under the following categories: effective decision making; utilizing the talent pool; access to resources and connections; career incentives; and corporate reputation, investor relations and social responsibility. I strongly support all these justifications and, in addition, would stress the issues outlined in the following paragraphs.

Board Diversity is not a new concept

The need to diversify the pool from which INEDs have been selected in Hong Kong has been recognised for a long time. The Standing Committee on Company Law Reform's Consultation Paper on Proposals made in Phase II of the Corporate Governance Review in 2003 and two detailed studies undertaken by the HKICS in 2003 and 2006 considered that Hong Kong needed to build up a larger pool of

INEDs.¹ Similarly, the Higgs Report in the UK recommended that there should be a broadening of the individuals from whom INEDs can be identified and recruited.² The Tyson Group, chaired by Dean Tyson of the London Business School, which was set up pursuant to this recommendation, considered in greater detail how companies can draw on broader pools of talent with varied background, experiences and perspectives so as to enhance board effectiveness. The HKICS Study in 2006 stated that ‘companies shouldrecruit INEDs with such skills and experience which according to their own assessment are lacking in their companies. The reference to and the recommendations in respect of NEDs in the Tyson Report are equally applicable to NEDs in Hong Kong.’³

The International Dimension

It is very clear from the Consultation Paper that provisions regarding board diversity are becoming the norm in many commercially significant jurisdictions. In particular, it is noted that both the UK and US have a greater number of female directors on listed company boards while the UK Corporate Governance Code was amended in 2010 to contain a provision on board diversity. On the face of it, Hong Kong does not compare too badly with other jurisdictions in terms of overall percentages. However, a significant number of the surveyed jurisdictions, irrespective of whether they have either higher or lower percentages of female directors than Hong Kong, are taking steps to improve the situation. In this respect, both Singapore and Malaysia have amended their corporate governance codes to include provisions on diversity. Hong Kong must follow suit if it is not to be increasingly isolated in this area.

The position of the UK and US in this respect is particularly important. As Hong Kong has positioned itself as the world’s third major international financial and business centre, together with London and New York, we should have particular regard to corporate governance reforms introduced in these jurisdictions. In this respect, both the UK and US have higher percentages of female directors and diversity provisions in their corporate governance codes. Until and unless, the Hong Kong Corporate Governance Code (“CGC”) is amended to include provisions

¹ CGR Phase II, paras 14.28–14.29; The Duties and Responsibilities of Independent Non-Executive Directors of Hong Kong Listed Companies (September 2003); and the Duties and Responsibilities of Independent Non-Executive Directors of Hong Kong Main Board Listed Companies (January 2006).

² *ibid* paras. 10.29-10.31.

³ *ibid* p 41.

regarding board diversity, Hong Kong will slip further and further behind international best practice in this very important area.

Hong Kong's "Double Standards"

There is a clear tension between Hong Kong's oft-quoted aspiration to be "Asia's World City" and the reality on the ground. If Hong Kong is to be "Asia's World City" in corporate governance, it needs to adopt a more robust approach to corporate governance reform. In turn, this means that we have to adopt international practices and standards and not shelter behind the increasingly threadbare excuse of such reforms being somehow contrary to local business culture and traditions. We cannot have it both ways: either we are a World City or we are not.

Equity and Fairness

The need for diversity goes beyond the boardroom. It is also about equity and fairness. At present, Hong Kong is denying around half of its population, and an increasingly well-educated and affluent half at that, the opportunity to sit on company boards. As such, it cannot be said that there are "equal opportunities" for women in the corporate sector. This stands in marked contrast to the civil service and professions, such as accountancy and the law, where women are very well represented at senior levels. Given the critically important role which companies, in particular listed companies, play in Hong Kong this is a quite unacceptable and untenable situation.

Identifying and recruiting INEDs

The HKICS Study concluded that the major problem regarding INEDs in Hong Kong was not the lack of supply but rather 'a lack of effective means to identify and recruit the right talent (for the boardrooms of listed companies).'⁴ Until recently, there have been, generally speaking, no formal structures and systematic processes to identify the skills-sets, experience and expertise which a board requires⁵. The usual practice is for listed companies to invite people with boardroom or top management experience to be their INEDs. The selection process is informal, opaque and uncompetitive. It depends to a very considerable extent on having the right contacts and "who you know" rather than "what the board needs".⁶ In other

⁴ *ibid* p.41.

⁵ Nomination Committees are now a code provision in the CGC.

⁶ *ibid*.p.42

words, it is an excellent example of the “old boy network”.

The HKICS Study noted that the current means of recruitment to company boards was probably the main reason why young people and women were so underrepresented in the boardroom as people with boardroom experience tend to be elderly males and elderly males will tend to recruit elderly males!⁷ In a context where middle-aged men (who themselves may not have university degrees and/or professional qualifications) are largely doing the choosing, it is, not particularly surprising that younger men and women (even if, or perhaps even because, they are highly qualified and have relevant experience, expertise and skill-sets) are unnecessarily and unfairly losing out. This will inevitably perpetuate the current board composition until and unless a determined effort is made to break this pattern by the deliberate injection of new blood in terms of age, gender and skill sets. **In other words, the current practices are incapable of self-reform and external pressure will be required to bring about any significant reform** (emphasis added).

By comparison, entry to and promotion in the civil service and professions is on the basis of passing competitive examinations and/or obtaining the necessary professional qualifications. It is, therefore, hardly surprising that women are far better represented in these sectors, particularly at the senior levels.

Now that Nomination Committees have been made a code provision (CP A.5.1) in the revised CGC, all listed issuers in Hong Kong must establish Nomination Committees and, if they do not, must give reasons for not doing so. This provides a golden opportunity to adopt a much more systematic and objective approach to identifying new talent for listed company boards. Furthermore, it could be argued that adopting a code provision on board diversity is a logical consequence of having a code provision on Nomination Committees.

Board Quality

The quality of a company’s board is fundamental to the company’s success. The hard commercial reality is that the environment within which companies operate changes all the time. It is, therefore, vital to ensure that a board’s membership comprises, at all times, the right skill-sets, experience and expertise to ensure that the company is capable of meeting existing and future challenges. **The key factor**

⁷ *ibid.*

is ensure that the best candidates are recruited to company boards, irrespective of their age, gender and race: a “diverse board” does not necessarily mean that there are more female directors (emphasis added).

Diverse membership will enhance board discussions as it will ensure that a wider range of views and perspectives are brought to bear on policy and strategy issues, than if the directors were all of the same sex within the same age cohort and from similar backgrounds. In turn, this will lead to better outcomes and decisions.

Market Considerations

Given that women and young people constitute such a significant percentage of retail shoppers, it is only good common sense, let alone business sense, for a board to contain a certain number of female directors and directors in, say, the 30 to 40 age cohort. The case to have some female directors is particularly strong if the goods and services marketed by a company are primarily aimed at women e.g. designer clothes, handbags, jewellery, cosmetics, perfume etc. In this respect a female director will be able to give advice and insights on production and marketing such goods and services which it is simply not possible for a male director to give.

Ways of Identifying New Talent

The HKICS’s Study mentioned some possible ways, suggested in the Tyson Report, of extending the search for new NEDs to new pools of talent as follows:-⁸

- (1) The “marzipan layer” of corporate talent just below the board level eg, senior management.
- (2) Private companies.
- (3) Organisations in the non-commercial sectors, eg, charitable and public sector bodies. The Higgs Report noted that this is a largely unexploited source of NED talent.⁹
- (4) Professionals such as lawyers, accountants and chartered/company secretaries. Given that women are better represented in professional services than in the top management positions in the corporate sector, recruitment of these professionals will probably result in an increase of women serving as NEDs at the same time¹⁰
- (5) The human resources profession, particularly given that the skills and

⁸ ibid p 42.

⁹ The Higgs Report, paras 10.26-10.27 and 10.30-10.31.

¹⁰ ibid para 10.29

experience of the HR profession are particularly relevant to the remuneration and nomination committees. The Higgs Report also noted that ‘part of the reason for the small number of female directors may be that areas where women tend to be more strongly represented are in roles such as human resources, change management and customer care which are not regarded as traditional ways to the board. Yet the issues dealt with in such roles are important ones for the board, and the roles themselves encourage skills and attributes that are highly relevant to the boardroom.’¹¹

Q.4 Do you agree with our proposal to introduce a note under CP A.5.6 to clarify what we mean by diversity and do you agree with the content of the note? Please give reasons for your views.

Many of the provisions which are to be contained in a note are contained in code provision B.2.4 in the UK Corporate Governance Code as follows:-

‘A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.’

By comparison, the proposed guidance on “diversity” in the proposed note to the Hong Kong CGC is more detailed and it would not be appropriate to include this in the proposed code provision. However, as gender is a very important sub-set of board diversity and there is growing concern with the need to consider gender when making board appointments, I suggest that this is specifically mentioned in proposed code provision A.5.6.

Furthermore, it seems clear from the UK code provision that the Nomination Committee is expected to use either an external search consultancy or open advertising to appoint, inter-alia, the NEDs, and to give an explanation if neither of these approaches has been adopted. As these requirements would help the process

¹¹ ibid para 10.25.

of board diversification, it is not known why it has not been proposed to adopt them in Hong Kong.

In view of the above, I propose that the wording of proposed code provision A.5.6 follows UK code provision B.2.4. If, however, the use of external search consultancy and open advertising is considered to be a step too far, the code provision should, at the very least, make specific reference to “gender”.

Separately, it would also be useful to have a provision similar to UK code provision B.2.2. as follows:-

‘The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.’

By preparing detailed specifications of the role and capabilities required for a particular appointment, this will help to reinforce the need to recruit the best person, irrespective of age, gender etc., and thereby help to promote board diversity and quality.

Q.5 Do you agree with our proposal to introduce a new mandatory disclosure provision in the Code stating that if the issuer has a policy concerning diversity, it should disclose details of the board’s policy or a summary of the policy on board diversity, including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives? Please give reasons for your views.

I agree that there should be a new mandatory disclosure provision regarding an issuer’s diversity policy. There is no point in having a policy on diversity if there is to be no subsequent disclosure by the issuers on what is actually being done in practice.

It may be difficult in practice to set “measurable objectives” for implementing board diversity given the very wide definition of diversity and the danger that setting “measurable objectives” is only a short step from setting quotas for, say, the total number of female directors in five years’ time. However, as it will be up to the individual companies to decide whether or not to set such objectives, I do not have

any objections to such a provision, particularly as it may encourage the more advanced companies to start thinking along these lines.

Board diversity is a dynamic concept if it is to remain real and relevant. The current composition of a board, no matter how diverse, will not necessarily be appropriate to meet a company's challenges in several years' time and a new mix of skill-sets, expertise and experience will be required. This leads automatically to the whole issue of board evaluation which, regrettably, has only been accorded the status of a recommended best practice in the CGC and needs to be reviewed

Q.6 Which of the following would you prefer as the implementation date of the amendments set out in this paper?

- (i) 1 January 2013**
- (ii) 1 April 2013**
- (iii) 1 June 2013**
- (iv) 1 September 2013**
- (v) other (please specify)**

I would suggest that the implementation date is 1 June 2013 as, allowing sufficient time for HKEx to consider the results of the consultation exercise, this should give a clear six months for companies to make the necessary adjustments to their corporate reporting arrangements which should be adequate.

The need for HKEx to take a lead

Given the overwhelmingly male-dominated and conservative viewpoints of listed company boards, it seems likely that the majority reaction to HKEx's balanced and sensible proposals will be largely negative. However, the combination of a number of factors argue very compellingly for change. These include: international best practice; ensuring equality and fairness; improving the quality of listed company boards; promoting good corporate governance; and market considerations. The retention of the status quo is not an option if Hong's international reputation and position in the corporate governance league table are not to be adversely affected.

It is, therefore, very important that, when assessing the public response, HKEx gives greater weighting to the quality rather than the quantity of the submissions and, if necessary, be prepared to reject unthinking, negative comments supporting

no change. It is self-evident that, if this particular proposal is to be held hostage to the views of blinkered, conservative and vested interests in listed companies, it (and many other much needed corporate governance reforms) will never happen. HKEx should stick firmly to its proposals, irrespective of the strength of the opposition.



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