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Comments and Reactions to the Concept Paper of the New Board by SEHK

By Dr. Gregg Li

Thank you very much for introducing this concept paper. For starter, please note I am fully supportive of this thinking and mindful of the numerous intricacies that must be put in place. Having introduced and designed a few of these "unconventional" governance practices in the past, I am delighted to learn that you are willing and open-minded to considered such unconventional practices.

Below are my humble views for your consideration.

Background

There are five questions that we need to solve I believe. You have addressed a few of them in your concept paper but not all five questions. I don't have answers for these and I am hopeful these questions can stimulate positive actions and brainstorming.

To frame this thinking, I have used an analogy of a new free and open market with many unknown sellers and buyers, and have considered that how some of your initial suggestions will narrow the shortfalls; while at other times, may widen the misunderstanding in the market as well.

My background as an Economist, Company Doctor, and Company Board Surgeon has contributed and biased my thinking. Please bear these in mind. We are all limited in our faculty in how we perceive our world.

To start this journey, I imagined myself walking into this new market selling goods along the Silk Road, and thinking about your Concept Paper (using a backdrop of the One Belt One Road). The five questions that had arisen as I walk into this new market with intent to purchase something, are these…

1. *How to deal with the changing value of the medium of exchange?*
2. *How does a buyer know that the people and products that are being sold are real? That the claims by these companies are real?*
3. *How can the market governor ensure the "quality" of these firms? What governance mechanics and behaviors should be endorsed or encouraged by the market governor?*
4. *If a buyer changes his mind within say a few days, can he return his purchase, perhaps with a minor administrative expense?*

5. *What new name to call this market as the "New Board" is extremely confusing?*

Please bear with me on using this analogy, but I thinking the flow of thinking should help us see and recognize some potential shortfalls.

Let me now try to address this question one by one, as I walk through this new market with an intent to purchase or contribute to the growth of a new company.

Relevant Questions

1. How to deal with the changing value of the medium of exchange?

While James Fok was presenting the concept paper at Cyberport last week, I imagine I was walking into this new market and presented with an opportunity to purchase something.

In an open market we may have bargaining and trading, but I know the medium of exchange, a dollar, is still worth a dollar. With this fixed value, I can negotiate and find a right price with the various sellers. And with this medium of exchange, I can roughly assess the value of one item (or one company) over another, sold by another.

With weighted voting shares that indirectly acts as the medium of exchange, that assessment becomes more difficult as I would need to know and assess the value of every share used as the exchange. Perhaps one way to minimize having too many options is that we can fix this by having a few weights only and not allow undefined and multiple weight factors. Common standards allow for faster assessment and trading. If a buyer has to assess the value of every medium of exchange at every purchase, this surely will slow down market transactions.

In the back of my mind, I am also reminded of Gresham's Law, that bad money drives out good. That is, if there are two forms of commodity money in circulation, the more valuable commodity will disappear from circulation. Have we allowed bad money to be introduced into the game?

2. How does a buyer know that the people and products that are being sold are real? That the claims by these companies are real?

Quality buyers are always attracted to a market that has quality products and sellers. Inevitably, quality raises transactions and liquidity. Thus, any means to raise the quality (as to be defined by the buyers) would help to improve this game. By allowing professional investors and particularly those with investment experience into nascent companies as the "first buyer" would be a preferred way.

But even professionals need certain amount of assurances. Certain information is essential; some are nice to have. For example, would we know who really owns the company, in exact quantity and where shadow directors are not allowed? Would we know if these persons are who they say they are, with the proper degrees, and background? (Since getting into Science Park and Cyberport is a vetted process, perhaps they would receive extra points by going through such independent validated process.) Perhaps we can engage and encourage independent professionals to provide a point system for others to consider?

In terms of transparency, would we have any clues as to how past key decisions have been debated, voted on, and agreed upon? What are the risks and would we have a standard template where risks are self-reported by the founders? Perhaps risk reporting is a mandatory submission.

Finally, are there other investors and angels on their board? Who are they? Do they have pre-emptive rights? What are the backgrounds and qualifications of these angels?

3. How can the market governor ensure the "quality" of these firms? What governance mechanics and behaviors should be endorsed or encouraged by the market governor?

Perhaps one of the most important things that I am seeking for, as a buyer, is information on the quality of the management team or on the company. Governance is a learnt process and any information to tell me that these governance behaviors have now become a habit, the more wiling I am to believe in participating at the equity level.

For reference, I see both management and governance as art. Many of these companies will have nascent management team and understanding, and probably shallow understanding of the purpose and mechanics of governance.

In my experience, new boards have governance challenges and if the HKEx can provide some level of confirmation of these, the more a buyer is willing to buy and trade. Buyers can make their own decisions to quality. The obvious ones, in my experience, are these:

- No board meetings
- Board meetings where minutes are not taken
- Founders act as tyrants and reinvest the proceeds into their new toys
- Founders have no time or will not set aside time for strategic discussions
- The six elements of governance are not being practiced
- The board doesn't even review its own performance once a year, because it has no intention to improve the quality of meetings
- Frequent addition of staff because they are somehow related, but often incompetent.
- Use of proceeds for private affairs
- Company secretary does not exist

- Frequent violation of pre-agreed authority matrix and no one to audit such violation
- Have to chase the founders for monthly or quarterly financials
- Existence of Exco which has equivalent power of the board
- Financial numbers that are often late and inaccurate
- Company committing into long-term engagement or liabilities (longer than one year) without permission or notification to the board.
- The power reserved to the Board is not made explicit
- Simple management policies do not exist and management has few clues or few intentions to establish this within the year, and so on.

If these behaviors can be made transparent then the buyers can assess themselves. What safeguards can the Exchange install so as to minimize non-compliance on these while on the other hand, not to impose too rigid a structure that this becomes a tick-box exercise. **We should just let the company explain and be forthcoming with such information.**

Perhaps we can provide a system of points of good practices (self reporting) such that the higher the points, the more attractive they would be for the buyers? We start with 100 points and the more points they have along some spectrum of minimum governance, the higher would be their points. Then as a buyer, I can easily mandate an independent audit firm to confirm these values.

Having the SEHK provide some of the company secretarial support, using Blockchain is a great idea. Nonetheless, it will take sometime for Blockchain to be adopted and practiced, and that reality will affect the viability of this concept paper.

4. If a buyer changes his mind within say a few days, can he return his purchase, perhaps with a minor administrative expense?

I suppose one sign of assurance is the ability to return goods and services. Warranty programs do work. Perhaps the Exchange can provide a 30-day money back guarantee? Or even a 90-day? Or can the Exchange work with some insurance provider to offer such assurance for a fee. Risk is reduced as long as a price can be set to cover such risk. Some level of administrative expenses is expected of course.

Perhaps an insurance policy can be set up and spread the risks for business interruption?

5. What new name to call this market as the "New Board" is extremely confusing?

These nascent companies are forming new boards. At the same time, the Exchange is calling this their New Board. This is extremely confusing.

Why not call it "Springboard?"

Closing Remarks

Lastly, if the shares that I have brought can increase in value, then I certainly would purchase them. If the underlying company can have a stepwise progression to the mainboard, then the values of these shares would certainly increase.

These are my initial reactions and I hope in some small ways these can help expand your thinking. Good luck. I do look forward to actively participating as an investor.

Gregg Li