JK Capital Management Ltd.

12th June 2023

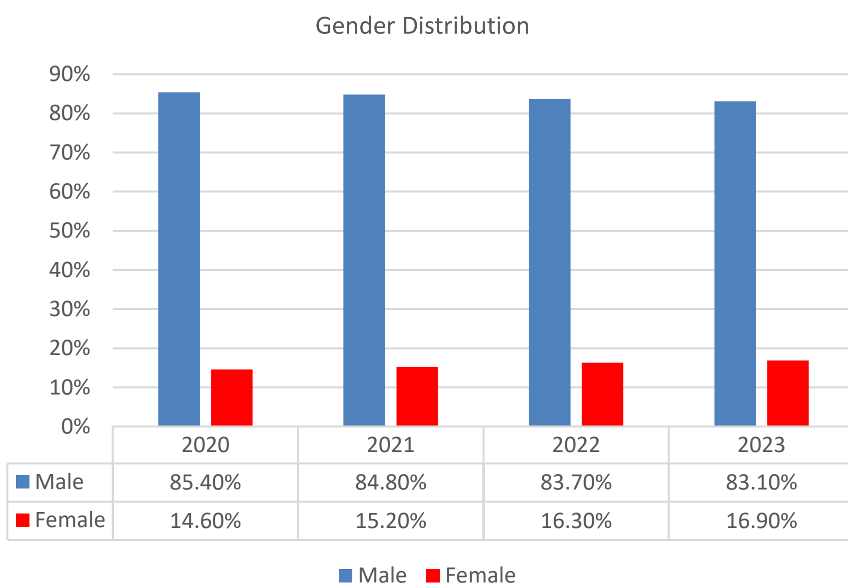
Board Independence and Diversity in Hong Kong – An update

Board independence and diversity have been one of the key focuses of our ESG practices to improve the overall corporate governance performance of our investee companies, as we believe they are important gauges of transparency and inclusiveness. To better engage and communicate with our investee companies, JK Capital has been a long-term supporter of Board Diversity HK and of the 30% Club Hong Kong. We closely keep track of regulatory updates and gather statistics across Asian markets.

We discussed in a previous newsletter that the Stock Exchange of Hong Kong (HKEX) outlawed single-gender boards by 2024 by revising its Corporate Governance Code, along with a set of stricter rules on tenure limits and independence criteria. This month, HKEX published a set of updated statistics on board independence and gender diversity, delivering a mixed bag of governance improvements and disappointments.

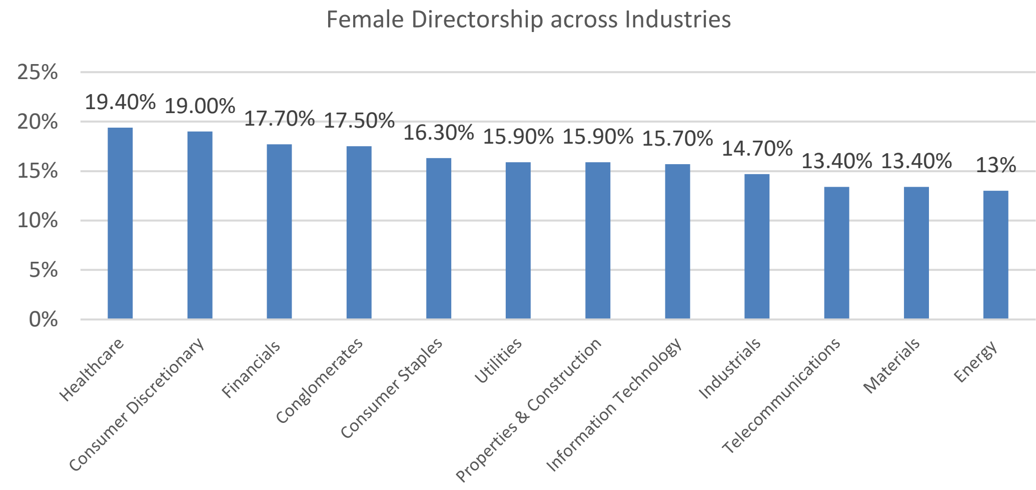
There are today 2,611 companies listed on HKEX which together bring the number of total directorships to 20,352. Among these, independent non-executive directors account for 43.1%, executive directors account for 40.1% while the balance 16.8% are classified as non-executive directors. Combining the number of both executive and non-independent non-executive directors, it is only fair to say that the vast majority of HKEX-listed companies are still operating without a majority independent board and that there is still a long way to go before that goal can be reached. It is worth mentioning that the non-executive directors which in many other markets would be understood to be independent directors are indeed NOT independent in the case of Hong Kong-listed companies. Non-independent non-executive directors are in most instances family members or connected parties of the major shareholder. They are not involved in the company's operations, but they typically act in concert with the executive directors. Therefore it is highly unlikely that the major shareholders and executives would gladly give up their majority control of their board anytime soon, therefore effectively capping the share of independent directors below the 50% mark.

On the bright side, thanks to the aforementioned ban on single-gender board, the overall percentage of female directors on company boards has been rising consistently over the past few years from 14.6% to 16.9%. However the overall female ratio remains relatively low in Hong Kong when compared to other markets across the region such as Australia (35%), Singapore (19%) and Thailand (19%). Among Hong Kong-listed companies, Hang Seng Index (HSI) constituents would tend to have a higher (18.9%) percentage of female representation compared to non-HSI companies (16.7%). Seven out of 76 HSI constituents are currently without any women on their boards.



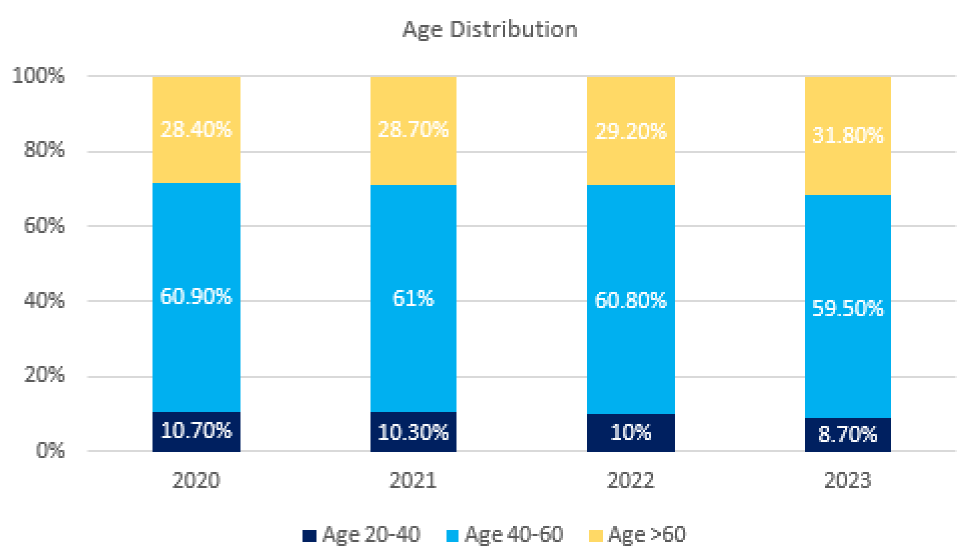
Source: HKEX

Breaking down the number further into industries, Healthcare has the highest female ratio at 19.4% followed closely by Consumer Discretionary at 19% while the laggards are Energy (13%), Materials (13.4%) and Telecommunications (13.4%). One of the reasons put forward is that many healthcare companies listed in Hong Kong are young biotech companies with a more liberal mindset while state-owned enterprises that dominate the telecommunications, materials and energy sectors tend to move slower when it comes to inviting more women to their board of directors.



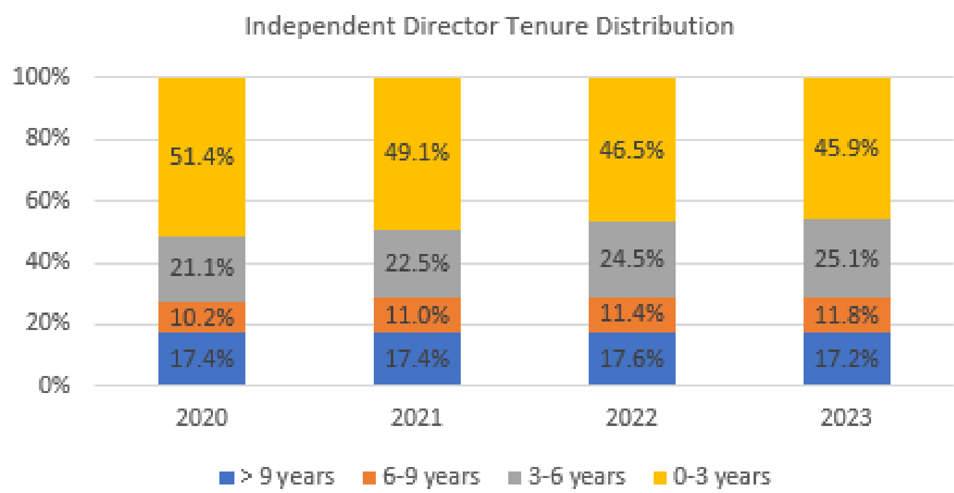
Source: HKEX

Age and tenure are also important factors to consider when appointing and re-electing directors, particularly for independent directors. According to HKEX data, director age distribution has remained broadly stable in recent years with a slowly ageing trend. Despite the majority of board members falling into the age group of 40-60 years old, the over-60 group is gradually becoming a concern as companies seem to have difficulties to replace their ageing directors on time.



Source: HKEX

In terms of tenure for independent directors, HKEX has a tenure rule of maximum nine years unless the company files an exception. Despite the rule, the percentage of companies with independent director(s) serving more than nine years still account for more than 17% and shows little signs of coming down. In particular, 76 companies have all of their independent directors having served more than nine years. The "independent" status of these directors is highly questionable after more than nine years on the same board.



Source: HKEX

Despite considerable improvement in some indicators, Hong Kong-listed companies have a long way to go to match their global peers in terms of governance practices. As a rule of thumb, regulatory push and investor engagement are always the most effective methods to facilitate better governance performance. While continuing to carry out engagement efforts with our investee companies, we expect more guidelines to be issued, not only by Hong Kong regulators but also by other Asian regulators, prompting companies to enhance their overall corporate governance standards and practices.