HONG KONG

KEY POINTS

- Hong Kong's regulatory protection for outside investors is amongst the best in the region with well regarded institutions enforcing sound rules governing business activity.
- The equity market is East Asia's largest outside Japan, supporting active equity and bond markets, fully open to foreign investors and securities brokers.
- However, large family owned conglomerates dominate many sectors, raising concerns about risks to outside investors. Many large companies' closely held family ownership limits turnover of listed stocks, weakening discipline on managers.
- Despite recent strengthening, the structure and independence of publicly listed company boards also are a potential concern; and Hong Kong's Code of Corporate Governance Best Practice is less detailed than some others.
- Hong Kong's goods and services markets are extremely open to foreign business, providing good discipline on firm management in traded sectors.
- However, competition policies are needed to allow new players to enter several less competitive non-traded sectors, particularly services.

Hong Kong arguably leads East Asia in corporate governance standards, sharing the British common law system and offering open and competitive markets for goods and many services (Stannard et al., 2000). Several large 'blue chip' companies set high corporate governance standards and have ready access to international capital markets (Bailey, 2000). Regulators aim to act only as a last resort, with market stakeholders expected to demand high corporate governance standards and discipline corporate activity (Jones, 2000). Nevertheless, family owned companies dominate, ownership is concentrated and relationships remain important, resulting in some corporate governance problems.

CORPORATE SECTOR STRUCTURE

Despite its modern regulatory system and deep markets, Hong Kong, like most other economies in East Asia, carries a legacy of powerful family owned conglomerates, which prefer debt over equity finance. Although the equity market is East Asia's largest outside Japan, limited trading of many local stocks and concentrated ownership weakens discipline on corporate managers. While emerging institutional investors should increase shareholder discipline, the large banking sector also is highly concentrated. Hong Kong's extremely open trade and investment regimes mean family businesses confront much stronger competition in goods markets than in some financial and service markets.

Family Ownership High

Family owners dominate Hong Kong corporations. In a sample of 330 companies, individual families controlled 72 per cent of corporations by market capitalisation (Claessens et al., 1999a). Furthermore, in 53 per cent of listed companies, individual families own more than half the stock. Also, the majority shareholder often serves as CEO and family members dominate boards of directors. While some large companies, including Hong Kong Shanghai Banking Corporation, HSBC and Giordano, have dispersed ownership, these are relatively rare.

Unlike elsewhere in Asia, family ownership dominates large rather than small and medium sized firms. Only 7 per cent of corporate control rights, weighted by market capitalisation, are widely held, and these mainly focus on smaller companies (Claessens et al., 1999b).

Families avoid issuing equity to new investors by raising bank finance, pushing debt to equity ratios in Hong Kong far higher than in the United States and Australia, increasing the risk of insolvency and outside investor risk. In 1996, Hong Kong's average debt to equity ratio was 160 per cent. While this is well above the 110 per cent of the United States, it is still below leveraging levels in most other East Asian economies (Claessens et al., 1999a).

Large Diverse Conglomerates

Family owned firms often form part of large complex business groups, connected by cross shareholding and pyramid structures. This complex mix of listed and unlisted companies can pose risks to minority shareholders (Lang, 2000). As in many parts of Asia, businesses cover several sectors, reflecting family owners' preference for maximising market share over profit. Return on assets in Hong Kong corporates traditionally is low (Claessens et al., 1999b).

MARKET FORCES GENERALLY STRONG

With a highly globalised and competitive economy, market forces reinforce Hong Kong's strong prudential and legal framework, producing a corporate environment more familiar to Australian business.

BANKING SYSTEM

Hong Kong's large and well capitalised banking system is relatively independent of local corporates and generally efficient. However, the banking sector serving the domestic market is highly concentrated. HSBC controls more than 40 per cent of Hong Kong dollar deposits and also owns a majority of the Hang Seng Bank, the third largest bank by deposits. Despite this, both HSBC and Standard Chartered, the second largest bank, are listed on overseas stock exchanges and are widely held. Banks account for about 30 per cent of stock market capitalisation. The Bank of China Group, accounting for another 25 per cent of deposits, is 100 per cent owned by the Chinese Government. As well, several major banks, including Bank of East Asia, CITIC, Ka Wah Bank, Dao Heng Bank and Hang Seng Bank, are listed but less than half the 31 licensed banks are listed on the Hong Kong Stock Exchange.

Although most banks are independently owned, large conglomerates own some banks (Asian Corporate Governance Association, 2000). For example, China Resources and the Lippo, part of Li Kai-shing's Cheung Kong group jointly own Hong Kong Chinese Bank. However, DBS Group recently acquired Dao Heng Bank, the fourth largest bank, formerly owned by a large family owned conglomerate (*Far Eastern Economic Review*, www.feer.com, 30 August, 2001; Backman, 1999).

Hong Kong is the third largest international banking centre, hosting 76 of the world's 100 largest banks either as foreign or locally incorporated entities (Deloitte Touche Tohmatsu, 2000). As of June 2000, Hong Kong hosted 31 licensed, listed and unlisted banks. However, the operations of new foreign bank entrants are tightly controlled.[1]

GIORDANO, A WIDELY HELD FIRM

Giordano is a locally listed firm with wide ownership. The largest shareholder, Harris Associates, owns just under 9.5 per cent of the stock; directors hold less than 1 per cent of the company's total share capital.

Among large Hong Kong companies, only Giordano and HSBC feature such dispersed ownership. Giordano's management is highly effective, producing strong profit growth each year since the financial crisis. This may reflect minority shareholder benefits from more dispersed ownership.

Source: *South China Morning Post*, www.scmp.com, 20 July 2001.

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[1] Foreign banks can enter the market by acquiring an existing bank or setting up a branch office as a licensed bank or a restricted licence bank. However, they face considerable restrictions on branching and the number of automatic teller machines they can operate (East Asia Analytical Unit, 1999).

Direct Finance Markets Deepen

Hong Kong's equity market capitalisation is over three times its GDP, making it one of the deepest in the world. The total number of listed companies rose to 738 in March 2001 from 709 a year earlier and funds raised through equity finance boomed in 2000 (Figure 10.1). With increasing exposure to the stock market, ratings agencies report strong corporate demand for corporate governance ratings to reduce their financing costs (*South China Morning Post*, www.scmp.com, 2 January 2002). However, market capitalisation is concentrated in few companies, with the largest 50 companies accounting for close to 90 per cent of total market capitalisation as at December 2000. Also, only 10 to 15 per cent of listed stocks trade daily, resulting in only moderate liquidity. Thin trading of family company stocks weakens discipline share price movements impose on managers (Naughton, 2001).

DEMAND STRONG FOR CORPORATE GOVERNANCE SCORE CARD

Ratings agency Standard and Poor's reports strong demand for its corporate governance score service in which it provides companies with an independent assessment of their management and transparency. The score covers four main areas of a corporation: ownership structure, board of director composition, shareholder relations and financial disclosure. All else being equal, a family owned company gets a lower score than one widely held. In December 2001, Hong Kong Exchanges and Clearing became the first local company to receive a score, obtaining 8.3 out of a possible 10 and other blue chip companies are showing interest in obtaining a score. Standard and Poor's expect strong demand from mainland H shares, SOEs listing in Hong Kong. A company decides whether or not it will disclose its rating to the public, weakening the rating's impact.

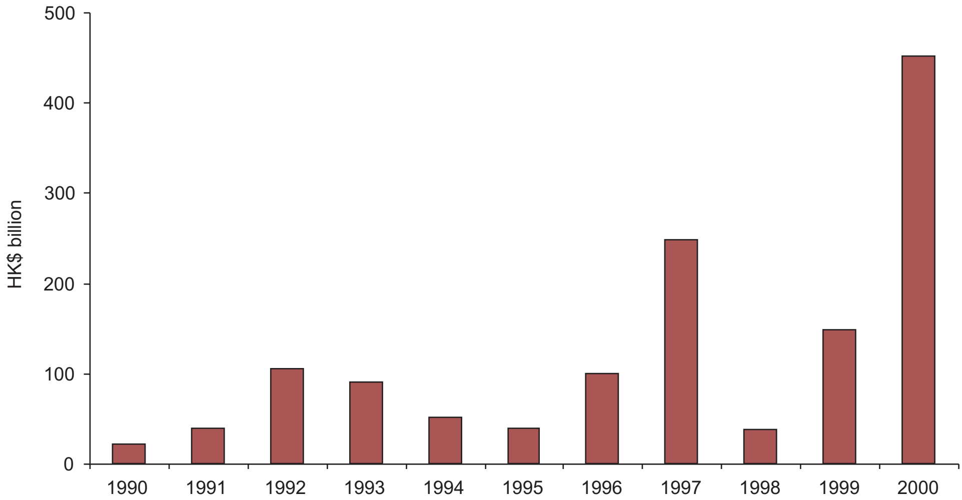
Source: *South China Morning Post*, www.scmp.com, 20 July 2001.

The market also is prone to price movements unrelated to firm performance. Unlike tightly held large firms, smaller listed firms' stocks often are volatile, driven by bubbles and price manipulation. Shareholding periods average only four weeks, compared to four months in the UK, suggesting much speculative trading occurs. During the crisis, the Government intervened in the share market to counter speculation against the Hong Kong dollar. Whilst this averted a price slump, it effectively subsidised credit to companies whose stock the Government bought, reducing market discipline on them. Also, insider trading remains a problem despite Securities and Futures Commission efforts to end it; in March 2001, in one example, New World Development allegedly leaked details of its earnings ahead of their publication, disadvantaging other investors (*South China Morning Post*, www.scmp.com, 31 December 2001).

Figure 10.1

Equity Financing On The Rise

Funds Raised Through Equity Finance, 1990-2000



Source: CEIC, 2001

Despite these limitations, Hong Kong, with Singapore and Australia, is one of only three regional portfolio investment destinations listed as suitable by the large California based institutional investor, CalPERS (Naughton, 2001). No restrictions exist on foreign investment in domestic firms. Although the numbers of mergers and hostile takeovers are low relative to market size reflecting cultural preferences, Richard Li's Pacific Century Cyberworks acquired Cable and Wireless HKT for US$35.9 billion, the largest acquisition in non-Japan Asia that year.

Growth Enterprise Market

In 2000, the Hong Kong Stock Exchange launched the Growth Enterprise Market to source finance for new technology based start-up firms. Controversy over the subsequent plunge in many dot-com company prices and perceptions tycoons exploited price movements prompted a regulatory review in early 2001 (Stannard et al., 2000). In the best known example, a well known family raised US$800 million from an initial public offer for Tom.com although the company comprised little more than a home page and a weak business model (Hopkinson, 2001). Nevertheless, the Hong Kong Stock Exchange expects the board to improve and encourages private firms to list, hoping it will increase incentives for good governance (PricewaterhouseCoopers, 2001).

Corporate bond market

In 2000, bond market capitalisation reached HK$697 billion (US$89 billion); one quarter of which were corporate bonds. Portfolio investment flows totalled HK$15.4 billion in December 2000, down from HK$20.2 billion a year earlier. In 1997, the Hong Kong Stock Exchange launched regional derivative warrants and convertible bonds to stimulate the regional corporate bond market and promote Hong Kong as its hub (East Asia Analytical Unit, 1999).

Institutional Investor Activity

While Hong Kong's institutional investor community is large and vibrant, many domestic securities investors are relatively passive, and inattentive to dividends; however, the recently commenced Mandatory Provident Fund should boost institutional investor presence in the local share market. Some 200 insurance companies are present in Hong Kong, more than any other economy in Asia; 104 of these are foreign owned.[2] In addition, foreign securities firms can enter the market freely, via branching, acquiring operating companies or establishing subsidiaries (Naughton, 2001). However, few shareholders actively scrutinise their investments. Most institutional investors and managed funds invest in the Hang Seng Stock Index's 33 stocks. Trading by insiders dominates other stock activity, often involving the owner and the company. Fund managers generally are passive about corporate governance standards; most investors vote with their feet rather than their shares (Allen, 2001; Brewer, 1997). Some institutional investors appear more interested in making short term gains than building governance infrastructure (Hopkinson, 2001); an exception is the Templeton Emerging Markets Fund (Allen, 2001).

THE HONG KONG SECURITIES INSTITUTE

The Hong Kong Securities Institute sets standards for securities market professional conduct. Members must comply with the institute's code of conduct. A disciplinary panel cooperates with other relevant government authorities in investigating alleged professional misconduct. The Hong Kong Securities Institute has assumed responsibility for monitoring behaviour in the securities industry from the Stock Exchange.

Source: PricewaterhouseCoopers, 2001.

EFFECTIVE PRODUCT MARKET COMPETITION

Hong Kong's extremely open international trade and investment regimes, with zero tariffs on manufactured goods and few non-tariff barriers, makes goods markets very competitive. Most sectors allow foreign direct investment, with flows directed mainly into financial services, tourism and infrastructure, including ports; in these sectors, competition is high (Hopkinson, 2001). In 2001, the Heritage Foundation ranked Hong Kong the freest economy in the world, reflecting authorities' lack of market interference (*South China Morning Post*, www.scmp.com, 13 November 2001). However, in several non-traded sectors, including property and banking, local cartels operate creating barriers to entry, discouraging foreign investors and compromising competition (Allen, 2001).

2 Six of the world's top ten insurance companies, by assets, are incorporated in Hong Kong and premium income from insurance services is the fifth highest in East Asia, after Japan, the Republic of Korea, Taiwan and China.

With markets generally working well, the Government believes competition policy is unnecessary. Antitrust laws do not apply in services, where competition is weaker. The Hong Kong Consumer Council believes the residential property, retail, wholesale, banking, telecommunications and energy sectors need regulating to ensure greater competition (Jones, 2000).

REFORMS BOOST MARKET PRESSURES

Recent reforms gradually should lessen dominant families' influence on the share market and permit institutional investors greater scrutiny.

Institutional Investment Boosted

Institutional investors investing funds from the Mandatory Provident Fund should enhance share market liquidity and disperse ownership.[3] The Mandatory Provident Fund schemes allocate 30 per cent of fund managed assets to Hong Kong dollar-denominated securities, developing local bond and share markets. Hong Kong companies must establish defined contribution pension plans or join master trust schemes; employers and employees contribute up to 5 per cent of an employee's salary. Employees can choose to place their funds in domestic and global equities, international bonds or money market funds. Contributions commenced on 1 December 2000, and should channel US$3 billion to US$4 billion per year into investment opportunities.

Because 30 per cent of funds must be invested in Hong Kong assets, funds will need to scrutinise local companies as potential investment destinations. The Mandatory Provident Fund, like Australia's compulsory superannuation scheme, relies on private fund managers who compete to manage assets. By late 2000, about 43 joint alliance and single entity firms had applied to manage Mandatory Provident Fund trusts. Participating institutions must follow a strict code of conduct, ensuring efficient and astute management (Allen, 2000). As institutional investors increase their profile, they increasingly will scrutinise dividends from domestic shareholdings, applying pressure to prevent unwarranted retention of dividends by dominant owners (Wong, 2000).

Family Ownership to Decline

Sales of government shareholdings acquired during the crisis also should disperse Hong Kong's corporate ownership.[4] These holdings totalled US$25 billion, over one quarter of total share market capitalisation. The public can buy deeply discounted units from this holding; 60 to 70 per cent of investors are new to the market.[5] In 2000, the Hong Kong Investment Funds Association estimated

3 The Mandatory Provident Fund, established in 1998, is a compulsory but privately managed pension program covering all Hong Kong workers not otherwise covered, or about two-thirds of the workforce.

4 In August 1998, at the height of speculative attacks against the Hong Kong dollar, the Hong Kong Monetary Authority purchased substantial shares in major listed conglomerates, including Swire Pacific (12.3 per cent), Cheung Kong, (10.3 per cent) and HSBC (9 per cent). Authorities transferred these shareholdings to a new company, the Exchange Investment Fund, alleviating concerns about political interference in corporate operations.

5 Sales are through the Tracker Fund, launched in 1999; with US$3.5 billion in assets, it is Asia's largest mutual fund.

8 per cent of the adult population owned shares, one third more than in 1999. However, this is still well below rates in the United Kingdom with 15 to 20 per cent penetration, the United States, with 40 per cent penetration and Australia (*Australian Financial Review*, 21 May 2001, p. 9).

REGULATIONS EXCELLENT

Hong Kong's corporate governance framework is, with Singapore's, East Asia's strongest, and ongoing reforms continue to update and strengthen it.[6] Major statutory elements of the corporate governance framework include the Companies Ordinance, Securities (Disclosure of Interests) Ordinance, Securities (Insider Dealing) Ordinance and Takeover Codes. Non-statutory Listing Rules cover board structure, disclosure of connected transactions and directors' remuneration. The Hong Kong Society of Accountants, the Stock Exchange of Hong Kong, the Hong Kong Monetary Authority and the Securities and Futures Commission all enforce this framework (Tsui et al., 2000).

Despite recent strengthening, local experts consider listing rules on board meetings and audit committee requirements need tightening (Asian Corporate Governance Association, 2000). Furthermore, Hong Kong's Code of Corporate Governance Best Practice is not as detailed as some others, including Malaysia's. Finally, the structure and independence of publicly listed company boards remain weak elements of Hong Kong's corporate governance framework.

TRANSPARENCY

Disclosure requirements generally are good and are tighter since the financial crisis. Nevertheless, a recent Standard and Poor's survey ranked Hong Kong companies' disclosure standards behind those of Singapore and Australia; it placed no Hong Kong company in the top quarter of the survey (*South China Morning Post*, www.scmp.com, 19 November 2001).[7]

Corporate Reporting

Hong Kong's market regulatory regime is part disclosure and part merit based (Fok, 2000). Public issuers must inform investors and the public about all factors that may affect their interests and all companies, whether listed or not, must submit annual accounts. Additional requirements apply to banks, securities dealers and insurance companies. The Companies Ordinance describes minimum disclosure required in financial statements. Currently main-board companies must report semi-annually; authorities plan to increase this to quarterly (*South China Morning Post*, www.scmp.com, 22 January 2002).

Under the Securities (Disclosure of Interests) Ordinance, directors, chief executives and substantial shareholders must disclose their interest in listed companies to the Hong Kong Stock Exchange.

[6] Simon Copley, Duncan Fitzgerald, Yoko Butt, Belinda Wong and Anna Guthleben, PricewaterhouseCoopers and PricewaterhouseCoopers Legal, contributed to this section.

[7] Standard and Poors surveyed companies' annual report disclosure of 98 items covering ownership structure, financial information and board and management structures.

Shareholders holding in excess of 5 per cent of a listed company must notify the Hong Kong Stock Exchange of any acquisition or disposal of relevant shares. This ordinance also outlines how to report connected transactions.

The Registry of Companies acts against companies if they fail to submit annual reports (Jones, 2001).

New Securities Laws

Several recent regulatory reforms support finance market development. These include the new Composite Securities and Futures Bill, which consolidated Hong Kong's securities laws, and demutualised and merged the stock and futures exchanges.[8] Also the Securities and Futures Commission now can investigate extensively companies suspected of wrongdoing, and the Insider Dealing Tribunal can examine price rigging and provision of misleading information (*Financial Times*, 6 June 2000, p. 12). The Securities and Futures Commission also requires brokers to pass its diploma program (*South China Morning Post*, www.scmp.com, 16 May 2001). New insider dealing legislation reduces the level of securities ownership to be disclosed from 10 per cent to 5 per cent and covers derivatives (Stannard et al., 2000). Despite these efforts, around 60 per cent of market players do not understand the Securities and Futures Commission's role, although most rank it as one of the best in Asia (*South China Morning Post*, ww.scmp.com, 19 December).[9]

Accounting Standards

In many areas, Hong Kong accounting standards are nearly identical to International Accounting Standards. However, there are some differences between the two, with Hong Kong yet to adopt some standards. Since April 2001, companies listed on the Hong Kong Stock Exchange have been able to adopt International Accounting Standards instead of Hong Kong General Accounting and Auditing Principles.[10] Overseas incorporated issuers and applicants with a secondary listing can follow US General Accounting and Auditing Principles. Standards cover related party transactions and consolidated reporting (Tsui et al., 2000).

Related party transactions that undermine shareholder value are difficult to detect; consequently, the Hong Kong Stock Exchange is pressuring the Hong Kong Society of Accountants to enforce standards better (Allen, 2001).

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8 The Stock Exchange of Hong Kong and the Hong Kong Futures Exchange fully merged on 6 March 2000, and the Hong Kong Stock Exchange demutualised and listed its shares on 27 June 2000.

9 The Securities and Futures Commission surveyed 345 senior executives at fund management companies, brokerages, law firms, accountants and listed companies.

10 The Companies Ordinance outlines required accounting standards; and the Hong Kong Society of Accountants and the Listing Rules of the Stock Exchange issue interpretations. The Hong Kong Society of Accountants first issues draft updates of standards for comment, then issues the statements. By May 2001, it had issued 26 accounting standards.

Auditing Standards

Auditing standards are issued by the Hong Kong Society of Accountants; statements on these follow closely the International Standards on Auditing. Auditors report non-compliance to the Hong Kong Stock Exchange, which can inquire into, then delist offenders (Kwong, 2000). Since 1999, listed companies also must establish audit committees, as auditors occasionally miss complex transactions between related parties. In an extreme, albeit rare example, after auditors signed off on Guang Dong Enterprises' accounts, they were shown to be fraudulent, so the company directors were prosecuted (Wong, 2001).

MINORITY SHAREHOLDER RIGHTS

A major corporate governance concern is to protect minority shareholders from large family owners. Issues include the frequency of dividend payments, remuneration of directors and access to corporate information (Stannard et al., 2001).

PROPOSED LEVY TO ASSIST MINORITY SHAREHOLDERS

Investment adviser, David Webb, proposed a levy of 0.005 per cent on each securities purchase and 0.01 per cent of each sale to fund a Hong Kong Association of Minority Shareholders. The association would lobby for investors, provide corporate governance rankings for companies and initiate law suits against offenders on its members' behalf. Webb also investigates company behaviour, publishing findings on his web site, Website.com. The Government remains open minded about the scheme.

Source: *South China Morning Post*, www.scmp.com, 13 March 2001,

Listing Rules

Many Hong Kong listed companies are incorporated offshore, limiting the reach of Hong Kong's courts. Hence, listing rules provide an alternative source of corporate governance. The Hong Kong Stock Exchange's Code of Best Practice recommends voluntary guidelines for listing companies, covering frequency and notification of board meetings, disclosure of directors' remuneration and conflicts of interest. Under listing rules, an issuing company must demonstrate it meets profit requirements, maintains a stable management, possesses an open market for its securities, meets minimum size requirements and has at least two directors residing in Hong Kong. Listing rules also contain provisions to protect minority investors from abuse and provide checks and balances on directors' activities. The Growth Enterprise Market's listing rules are somewhat more stringent than those for the main board, especially relating to the independence of audit committees (Tsui et al., 2000).

In 2002, authorities proposed sweeping changes to listing rules to bring them into line with international best practice. These include tougher transparency rules and requiring listed companies to appoint different people to the chief executive and board chairman positions (*South China Morning Post*, www.scmp.com, 22 January 2002).

ASIAN CORPORATE GOVERNANCE ASSOCIATION

In August 1999, business leaders from across East Asia formed the Asian Corporate Governance Association, a non-profit organisation, as a private sector initiative to advocate the commercial and economic value of higher corporate governance standards in East Asia. The organisation conducts original research, disseminates its findings, runs seminars and comments on relevant matters. A founding sponsor, Lombard Asian Private Investment Company (HK), is a private equity fund management company based in Hong Kong and investing in Asia. Lombard values corporate governance highly and actively works to raise standards of transparency and accountability in its investee companies.

Source: Asian Corporate Governance Association, 2000; Allen, 2001.

Representation

Shareholders are reasonably well protected, although some small improvements are needed. Companies must notify all shareholders of upcoming meetings and provide relevant material before the annual general meeting. Shareholders have proportional voting rights and proxy voting. While a simple majority can pass members' resolutions, under the Companies Ordinance, 75 per cent of equity holders present must approve certain major decisions. One or more shareholders holding 10 per cent of equity between them can call a general meeting; however, many economies including Taiwan and Republic of Korea have reduced this minimum to a cumulative 5 per cent or less. Furthermore, these meetings must conform to standard company procedures, so controlling shareholders can abort the meeting, blocking minority actions. If shareholders can provide prima facie evidence of wrongdoing, shareholders with 10 per cent of equity between them may ask Hong Kong's Financial Secretary to investigate the company.

Board Structure and Duties

All listed companies must include at least two independent non-executive directors on their boards and disclose directors' remuneration in their annual reports. However, directors' degree of independence often is questionable (Asian Corporate Governance Association, 2000). Individuals can hold any number of board positions.

The voluntary Code of Best Practice urges directors to keep abreast of their responsibilities as directors. In 2001, authorities reviewed fiduciary duty laws, judging them to be acceptable relative to other common law countries (PricewaterhouseCoopers, 2001). However, enforcing directors' fiduciary duties under the Companies Ordinance is difficult, as few independent directors will take on Hong Kong's powerful tycoons (Wong, 2000). Hence, authorities are reviewing whether they should adopt a statutory Code of Directors' Duties (Jones, 2001).

Following British tradition, courts do not entertain shareholder action against company management, except in extraordinary circumstances; this weakens remedies available to minority shareholders. However, minority shareholders can access a common law remedy if they can demonstrate their personal rights are being infringed or an act represents fraud against them. Other legal mechanisms overcome this, granting minority shareholders more power than their small shareholding normally allows.[11]

COLLAPSE REVEALS CORPORATE LAW WEAKNESS

In 1999, Akai Holdings Limited recorded Hong Kong's biggest ever corporate loss, US$1.72 billion and is now bankrupt. Liquidators examining the company books are unravelling a litany of misdeeds, including a director's handing over of a listed group company to another listed company, bad acquisitions, unusual deals and related party transactions. The accounts were falsified or are missing.

According to the Law Reform Commission's 1999 report, this case highlighted serious weaknesses in Hong Kong corporate governance enforcement. Few regulatory provisions exist for investigating company collapses, so directors can cheat shareholders and creditors in the expectation of avoiding criminal proceedings. Furthermore, most such court proceedings are secret at present.

Source: *South China Morning Post*, www.scmp.com, 10 May 2001.

CREDITORS' RIGHTS

Creditors' rights are generally well protected, encouraging arm's length lending, but bankruptcy is rare.

Bankruptcy Proceedings

Hong Kong insolvency laws are based on the British model and essentially are sound. Informal rescue processes support these laws (Harmer et al., 2001). After Law Reform Commission reviews commenced in 1990, the Government strengthened bankruptcy and liquidation law and practice; in the late 1990s, it reviewed and introduced new procedures for bankruptcy, provisional supervision and corporate rescue procedures under the Companies Ordinance (PricewaterhouseCoopers, 2001). However, as in most of East Asia, for cultural reasons, bankruptcy is uncommon; the law, most debtors and local creditors favour informal workouts.[12] Also, directors of bankrupt companies commonly

11 These are defined under Section 168A of the Companies Ordinance.

12 A shareholder can petition the court to wind up a company under the Companies Ordinance. However, to grant such a petition, the court must feel it is just and equitable to wind up the company. The Hong Kong Association of Banks' *Guidelines on Corporate Difficulties* also supports informal workouts (PricewaterhouseCoopers, 2001).

destroy or misplace financial records, hampering investigations. In 2000-01, authorities made 116 convictions related to such offences, although fines averaged less than 1 per cent of the maximum penalty (*South China Morning Post*, www.scmp.com, 7 January 2002).

Bank Supervision

The well regarded Hong Kong Monetary Authority supervises Hong Kong's strongly capitalised and basically sound banking system. In 2000, the Hong Kong Monetary Authority released new guidelines on complying with supervisory standards; now banks must appoint three independent directors to their boards. Banks must use audit committees, and most now do so, although in some cases their independence is questionable. The authority also tightened rules on connected lending, which cannot exceed 10 per cent of a bank's capital base. The Supervisory Department of the Hong Kong Monetary Authority regularly surveys banks' compliance with the new guidelines. It now meets at least annually with banks' boards of directors and with management, to ensure they meet statutory disclosure, risk management, capital adequacy and provisioning requirements.

Prudential supervision tightening is ongoing. The Hong Kong Monetary Authority's commercial credit reference agency should assist with bank transparency; it intends to vet senior management appointments, and all commercial bank heads of departments, and may further enhance disclosure requirements (Yeung et al., 2001). The Government also is considering establishing a deposit insurance scheme.

In 2000, interest rate deregulation increased competitive pressures on the banking sector, resulting in consolidation through mergers. However, restrictions on new banks' operations still protect local banks from full market competition.

COMPLIANCE

Hong Kong's strong legal and civil service institutions ensure transparency and close compliance with corporate and financial market laws and prudential regulations. The Hong Kong Monetary Authority effectively supervises banks while the Securities and Futures Commission administers statutory requirements ensuring full disclosure and fair treatment of the investing public. The Commission's disciplinary action ranges from civil and criminal sanctions to the suspension of dealer licences. It refers more serious matters to the Director of Public Prosecutions. In 2000-01, the Securities and Futures Commission concluded 352 investigations, successfully prosecuting four market manipulators and 38 entities for unregistered activities and breaches of investment, and referring four suspected insider dealers to the Financial Secretary.

The emerging corporate governance environment also includes public announcements by the stock exchange. The stock exchange publicly censures directors and announces companies' delinquent behaviour, allowing market forces to regulate company behaviour (Cheung, 2000). For example, in July 2000 the stock exchange publicly censured Kin Don Holdings Limited for breaching the Listing Agreement and Directors' Undertakings.[13] It censured four directors; two resigned in September 2000.[14] Following a Stock Exchange Statement, the exchange can delist companies which continue to breach listing rules.

Independent Commission Against Corruption

Hong Kong has a highly transparent civil service and provides a level playing field in business, due largely to the Independent Commission Against Corruption.[15] Established in 1974, well resourced, and independent of the police and public service, it has spearheaded the battle against corruption. The Commission has focused on changing people's attitudes towards corruption, tackling investigation, prevention and education. It spends similar time investigating corruption allegations in the private and public sectors and its conviction rate is about 70 per cent (Wong, 2000). By eliminating official corruption, the Commission increased the public sector's capacity to enforce commercial and prudential laws and regulations.

Press

Hong Kong is home to several excellent financial media outlets, including *the Asian Wall Street Journal* and the *Far Eastern Economic Review*. While the owner of a large diversified conglomerate controls the well regarded *South China Morning Post*, the biggest selling English daily, editorial policy has not shifted discernibly since its takeover. For example, recently, it challenged conglomerate behaviour, criticising Li Kai-shing's Cheong Kong group's covert purchase at auction of a Kowloon property at a below market price (*Far Eastern Economic Review,* 6 September 2001, p. 24). However, as in many other East Asian economies, large tycoons control most of Hong Kong's mainstream media, possibly compromising its role as watchdog (Cheung, 2000).

IMPLICATIONS

Hong Kong possesses one of East Asia's best corporate governance regimes with its strong and transparent bureaucracy, independent judiciary and mainly open and competitive markets. Hong Kong authorities recognise the fast moving nature of the corporate and financial scene, and their oversight is constantly being refined and updated.

However, Hong Kong owned corporates share many characteristics of other East Asian corporates. Large diversified conglomerates with ownership highly concentrated in founding individuals' and their families' hands dominate the corporate scene. These characteristics can compromise corporate incentives to protect minority shareholder rights, requiring high and continuing vigilance from authorities, and ongoing efforts to maintain regulatory standards and market discipline, so Hong Kong can to retain and build on its hard won reputation.

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[13] In another case, on 20 June 2001, after the Listing Committee and Listing Appeals Committee of the Stock Exchange conducted hearings into the corporate behaviour of Dong Jian Tech.Com Holdings Limited, the exchange issued a public announcement warning shareholders and the investing public to exercise caution in dealing in company securities. It announced that the company failed to float at least 25 per cent of its issued shares, as listing rules require, and to use the proceeds raised from its new issue in accordance with its prospectus or to disclose this fact to the shareholders and investing public. The exchange stated retention of office by relevant directors prejudiced the interests of investors.

[14] The company failed to dispatch its annual results and report within five months of the end of the financial year. Directors responsible for the late reports were named in the public censure.

[15] Well resourced, with 1 100 staff, the Commission has adopted a zero tolerance policy towards corruption. It has made a major impact in the construction industry.

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