Doctor of Business Administration

Thesis

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The Effectiveness of Independent Non-Executive Directors in Hong Kong Listed Companies

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Synopsis

The separation of ownership and control in modern corporations has given the manager the incentives and opportunities to pursue their interest at the expense of the owners, explained by the agency theory. To reduce the agency problem, the board of directors, and in particular, the Independent Non-executive Directors (“INEDs”) who have no business affiliation with the listed companies are introduced to monitor the management decisions.

Hong Kong has a business environment in which many companies are dominated by concentrated family ownership. It is argued that the presence of family ownership and control may reduce the ability of the managers to hide their poor performance and this enhances firm performance. The effectiveness of the INEDs to monitor firm performance given the unique institutional environment of Hong Kong is the main area of research interest here.

Moreover, the research topic is triggered by a recent corporate governance reform in Hong Kong. The Listing Rule of the Hong Kong Exchange and Clearing Limited (“HKSE”) was amended in 2012 to require that all listed companies must have INEDs representing one third of the board by the end of 2012. At least one of the INEDs needs to have a professional background in accounting and financial reporting. The qualification and expertise of the directors, as well as their proportion on the board, may possibly influence how effectively the board can function. Thus the author is interested to investigate whether the INEDs are effective given this regulatory context and whether the qualifications of the INEDs do make a difference.

This research was done by using secondary data. The information about directors and shareholding is collected manually from the annual reports of the listed companies and the financial data are downloaded from the financial database. The data cover a three year
period from 2009 to 2011. The final sample consists of 308 firm-year observations which cover most of the top 100 listed companies for each year.

The analysis result shows that the presence of INEDs is positively related with firm performance for both market-based measures and accounting-based measures. Furthermore, the presence of family control and ownership is found to be positively associated with firm performance, supporting the conjecture that family ownership concentration enhances firm performance. However, it is inconclusive whether the presence of family ownership weakens the positive relationship between INED’s proportion and firm performance, suggesting no conclusion is drawn on if INEDs are working as effectively in a family dominated business. Lastly, the qualities of INEDs, proxied by the proportion of INEDs with higher degrees, are also confirmed to have a positive effect on firm performance.

The findings from the thesis have some implication for the researchers and policy makers. Firstly, the results confirm the effectiveness of the INED system in Hong Kong. So more effort could possibly be made to continuously improve this system, for example, by turning an eye to those companies not observing the regulations and not upholding requirements on the appropriate qualifications that the independent directors need to possess.
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