

# If only INEDs were independent

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# Listing rule: boards must have 3 Independent Non-Executive Directors



# INEDs

- Most markets require independent non-executive directors, but only in name
- If the controlling shareholder can vote on INED elections, then the INEDs are dependent on the controller, not independent of it
- Consequently, INEDs are often just rubber stamps for proposals by the controlling shareholder
- INEDs serve at the pleasure of the King, and are only as “independent” as the King wants them to be
- INEDs cannot be removed even if all votes cast by public shareholders are against them
- All the roles of INEDs in the Listing Rules and Takeovers Code, acting as a check and balance, fail.
- HK pretends to have INEDs, but about 90% of firms have a controlling shareholder who elects the entire board
- With no controller, the system works – I was elected to HKEX in 2003 on a 2-share nomination and 3 incumbents were ejected (but only 6/13 of HKEX directors are elected by shareholders – the Government is *de facto* controller).

# Roles of INEDs

- Opining on whether transactions with a controller/director are “fair and reasonable”, including acquisitions, disposals, subscription of shares, grant of share options, ongoing purchase of materials or sale of goods, deposits with parent finance companies etc.
- Opining on whether a privatisation offer is fair and reasonable
- Opining on highly dilutive placements and open offers/rights issues
- Acting as the audit committee, including reviewing accounts (prepared by EDs) and internal controls
- Acting on the nominating committee
- Acting on the remuneration committee to set the pay of directors, often including controlling shareholders
- Controlling shareholders are required to abstain from voting on connected transactions and privatisations, but not when electing the INEDs who opine on them!

# Solution: making INEDs independent

- Independent directors should be elected by independent shareholders in General Meetings. Controlling shareholders and other directors must abstain.
- Boards could still nominate candidates, but candidates would have to be acceptable to independent shareholders, who could alternatively nominate their own.
- INEDs would have a real mandate, and be held accountable at the next election
- An INEDs' report in the annual report should include confirmation of whether the INEDs are *each* satisfied with the corporate governance during the year, giving reasons if not.
- This is about moving from a 1-party state in the boardroom, to representative democracy and accountability for capital
- Alternatively, scrap the requirement to have INEDs rather than provide false comfort. Stop pretending. Boards would either be credible or not.

# NOT a solution:

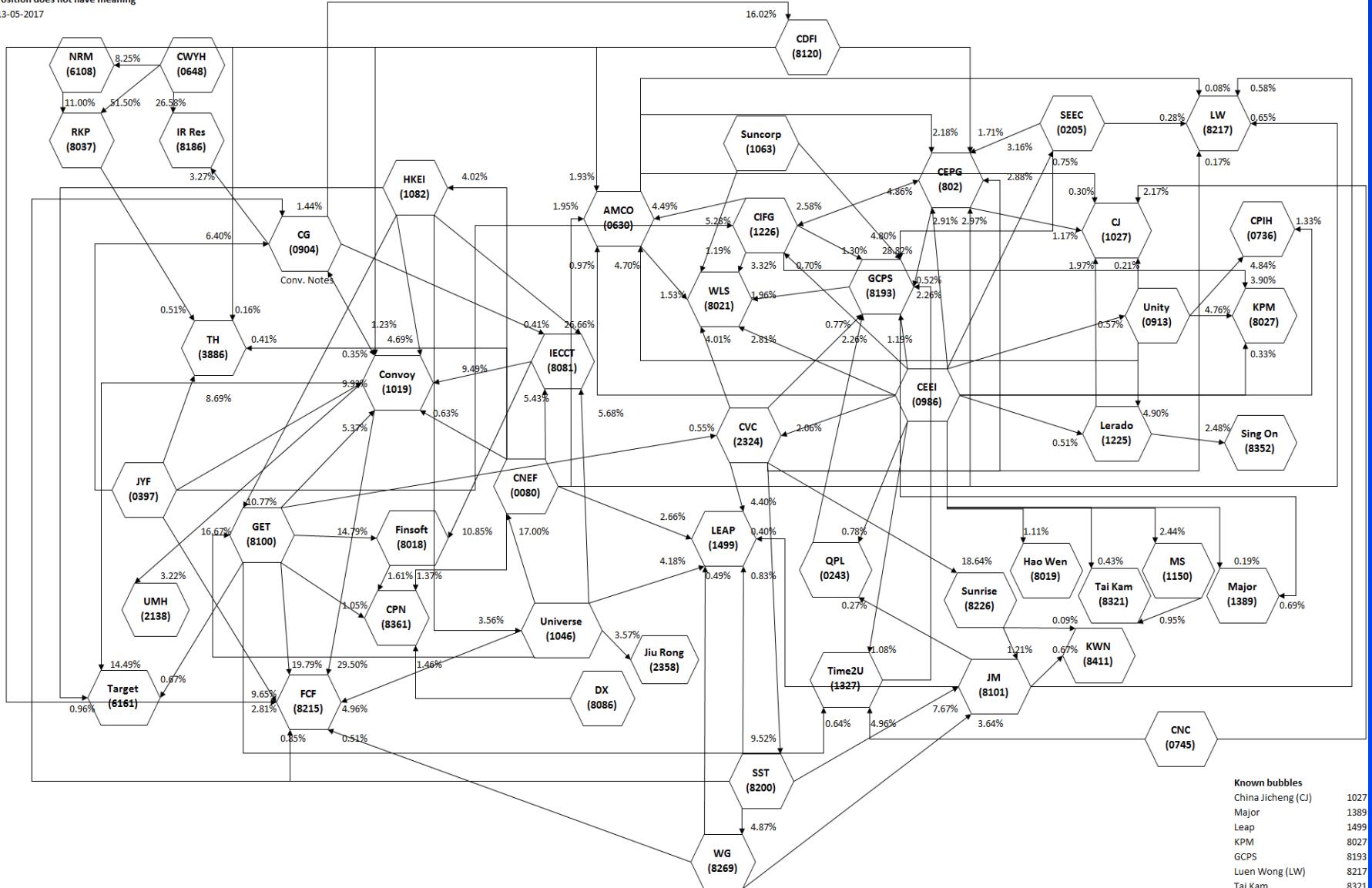
- Fiddling with the Rules to somehow make controllers elect more “independent” INEDs without addressing the election system. The consultation paper from HKEX, 3-Nov-2017, completely fails to address the issue.
- *Requiring* boards to say why they think their candidates are independent, not too busy, and sufficiently diverse. We, the independent shareholders, will be the judge of that, and it is up to boards to persuade us.
- Requiring boards to “disclose a diversity policy”. Actions and data speak louder – independent shareholders will judge.
- Setting regulatory limits on number of seats held: independent shareholders can judge a candidate’s suitability
- Hoping that companies will just behave better
- Requiring INEDs to have particular qualifications – independent shareholders would not normally elect incompetent INEDs but let them judge!
- Deflecting the issue with distractions like requiring new committees, rearranging the deck-chairs on the Titanic.

# And by the way...

- The HKEX consultation paper proposes to scrap the CG Code requirement that INEDs should “attend general meetings and develop a balanced understanding of the views of shareholders” (Code A.6.7).
- That really says it all – HKEX does not consider that INEDs should care what outside shareholders think.
- And why would an INED care, as long as the controlling shareholder elects her?

# The Enigma Network: 150 INEDs hard at work

Position does not have meaning  
13-05-2017





# Some statistics on boards

Source: [Webb-site Who's Who](#)

# Directors per company, 31-Dec-2011

No. of dirs	No. of cos	Share of cos	Mean age in 2011	Cumulative cos
20	2	0.10%	65.3	2
18	5	0.30%	55.3	7
17	9	0.60%	58.7	16
16	8	0.50%	57.8	24
15	27	1.80%	55.5	51
14	18	1.20%	55.1	69
13	43	2.90%	54.3	112
12	63	4.20%	54.0	175
11	130	8.70%	53.5	305
10	143	9.60%	53.8	448
9	260	17.50%	52.8	708
8	229	15.40%	52.4	937
7	269	18.10%	51.6	1206
6	173	11.60%	51.6	1379
5	88	5.90%	51.1	1467
4	13	0.90%	49.7	1480
3	4	0.30%	49.2	1484
2	3	0.20%	45.8	1487
0	0	0.00%	-	1487

Rule change: 31-Dec-2012: all boards required to have 1/3 INED

# Directors per company, 31-Dec-2012

No. of dirs	No. of cos	Share of cos	Mean age in 2012	Cumulative cos
22	1	0.10%	63.9	1
20	1	0.10%	67.4	2
19	1	0.10%	60.1	3
18	7	0.50%	56.4	10
17	11	0.70%	57.6	21
16	5	0.30%	56.0	26
15	31	2.00%	54.0	57
14	25	1.60%	57.1	82
13	20	1.30%	56.6	102
12	79	5.10%	55.0	181
11	110	7.20%	54.2	291
10	68	4.40%	55.4	359
9	345	22.40%	53.0	704
8	244	15.90%	53.0	948
7	292	19.00%	52.3	1240
6	199	12.90%	51.7	1439
5	85	5.50%	51.6	1524
4	9	0.60%	55.5	1533
3	2	0.10%	46.7	1535
2	3	0.20%	51.2	1538
0	0	0.00%	-	1538

# INEDs per company, 8-Nov-2017

No. of INEDs	No. of Cos	Share of Cos	Total INED seats	Cumulative Cos	Cumulative seats
14	1	0.0%	14	1	14
13	1	0.0%	13	2	27
10	2	0.1%	20	4	47
9	1	0.0%	9	5	56
8	3	0.1%	24	8	80
7	8	0.4%	56	16	136
6	30	1.4%	180	46	316
5	129	6.2%	645	175	961
4	394	19.0%	1576	569	2537
3	1480	71.3%	4440	2049	6977
2	17	0.8%	34	2066	7011
1	3	0.1%	3	2069	7014
0	7	0.3%	0	2076	7014

# INED seats per person, 8-Nov-2017

No. of INED seats	No. of people	Female	Cumulative people	Cumulative female	Cumulative seats	Cumulative female seats
15	2	0	2	0	30	0
13	1	0	3	0	43	0
12	2	0	5	0	67	0
11	3	0	8	0	100	0
10	1	0	9	0	110	0
9	6	0	15	0	164	0
8	10	1	25	1	244	8
7	19	0	44	1	377	8
6	21	1	65	2	503	14
5	42	0	107	2	713	14
4	91	8	198	10	1077	46
3	201	16	399	26	1680	94
2	576	47	975	73	2832	188
1	4182	548	5157	621	7014	736

# About Webb-site

- Founded in 1998. Not-for-profit, partly funded by speaker fees, but mostly by me. The site and related activity takes about half my time. The other half, I research and invest in HK small-caps, currently holding >5% of 18 listed companies
- Corporate horror stories end up in *Webb-site Reports* (time permitting), while under-valued well-governed companies go into my portfolio, and hopefully not *vice versa*
- Also covering economic governance, advocating transparency, accountability, civil liberties, tax reform, land lease reform, minimal intervention and economically-rational policy-making
- Frequent news flow from courts, tribunals, ICAC, HKICPA, SEHK, SFC and others
- Over 23,000 subscribers to a free newsletter, opt-in/out
- Opinion polling
- *Webb-site Who's Who* covers all HK-listed directors, auditors, advisers since 1990; legislators, district councils, statutory/advisory bodies, CE election committee, relationships between them. Covers all SFC licensees.
- *Webb-site Total Returns* series – since 1994, all HK stocks including delisted
- CCASS Analysis System for stock movements since 2007
- Directors' share dealings since 2003
- Basic data on all HK-incorporated companies, now extending to cover all UK-incorporated companies. Still waiting for HK to move to open data.

# Thank you!

