Board Monitor Hong Kong 2019

Adapting to change

Hong Kong's public company boards are seeking new director skills and expertise. In this year's report, we track what experience is in demand and how recruitment of directors is evolving.

About Board Monitor
Hong Kong 2019

This is the second year for which we have captured the key attributes of new board appointees—their demographics, functional experience, and other background; mapped how those attributes flowed onto boards; and identified trends. This report on Hong Kong is one of a suite of annual Heidrick & Struggles reports that, together, cover most major global economies.

Data on appointments are tracked through BoardEx, proxy filings, and corporate websites. Information about executives is gathered from publicly available sources, BoardEx, and a Heidrick & Struggles proprietary database. In tracking the experience of new appointees, the report takes into account all of the significant industry experiences of each director (for example, a new director who has worked most recently in the consumer industry may also have valuable experience in the industrial sector or in technology.

Acknowledgment

Thank you to **David Hui**, regional managing partner of Heidrick & Struggles' Industrial Practice in Asia Pacific and leader of the CEO & Board Practice in Hong Kong, for his contributions to this report.

New director skills needed: A challenging economy and new regulations remaking Hong Kong boards

Amid protests at home, a more pessimistic global economic forecast, and more stringent listing guidelines, Hong Kong corporate boards are girding for change.

On a macro level, ongoing protests, the US–China trade war, and globally slowing economic growth have forced the boards of Hong Kong's large, public companies—those listed on the Stock Exchange of Hong Kong Limited—to assess whether they have the skill sets required among independent, non-executive directors to cope with these challenges.

The current crop of former CEOs and CFOs—still the positions most frequently tapped as potential directors—have performed well operating in more stable times but may lack the specific skills and experience required to lead successfully in a very different, challenging, and more rapidly changing economic environment.

Additional background we expect boards will be seeking includes experience working with China, as a result of the US–China trade war, which will also continue to redefine the economic relationship between Hong Kong and China. It's still too early, however, to gauge the real impact or precisely what new director background will be desirable.

In addition to new competencies and experience required for directors, there is also likely to be a significant impact on director recruitment, as well as board best practices, as a result of recent regulatory guideline changes.

The impact of new regulations

Board nominations in Hong Kong are undergoing fundamental change as a result of regulatory changes introduced in January 2019, when the Stock Exchange of Hong Kong Limited amended its Corporate Governance Code and related listing rules. The change features increased focus on strengthening board independence and diversity through greater transparency and accountability of boards and nomination committees. In addition, there is now a greater emphasis on electing truly independent, non-executive directors and improving transparency about directors' relationships where there could be potential conflicts. Promoting greater board diversity is one key objective of the new rules, which also includes recommendations on term limits.[1]

While adherence to these recommended changes in listing rules is voluntary—like the UK model[2]—with investors everywhere thinking and investing more globally, due to both greater overseas investment in Hong Kong and listed companies in Hong Kong becoming more global in their businesses, there is now far greater pressure for companies to comply with regulations widely viewed as best practices regardless of the market.[3]

We are already seeing ripple effects from these regulatory changes in our client work. Hong Kong boards are becoming more similar to boards of large public companies in other global markets, adopting acknowledged and time-tested best practices, including a focus on director independence and board evaluations. In addition, overall, nomination committees increasingly understand the importance of recruiting a different profile of directors to their boards—those who are focused more on the future of the business as opposed to the past or even the present.

Addressing "overboarding"

The new regulations and pressure from large investors, highlighted in the press, have also prompted increased scrutiny of directors' relationships with other companies and the sheer number of directorships some hold.

A recent article on Bloomberg.com noted Hong Kong Exchanges and Clearing Limited's attempt to address what it calls "overboarding." According to Bloomberg News analysis, there are 113 companies in Hong Kong with a director who serves on more than six boards, compared with only 39 companies on the New York Stock Exchange and 8 in London with a director who does so.[4]

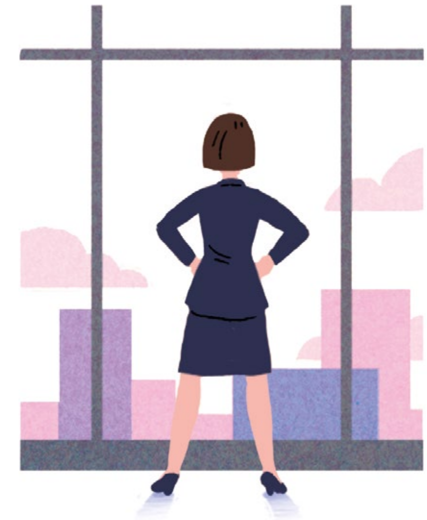
Given that Hong Kong boards generally recruit retired executives, to avoid potential conflicts of interest, and professional services firms don't allow partners to serve on boards, the pool of potential board candidates is relatively small. Further limiting the pool for prospective directors is the need to travel to, typically, eight meetings a year, which we have seen as a significant recruitment hurdle for boards in Hong Kong seeking

[1] Alexander Que, Eugina Chan, Gary Wong, Kelvan Cheung, Maynard Leung, Rhoda Yung, Ronny Chow, and Sabrina Fung, "Hong Kong Stock Exchange amends corporate governance requirements, effective from January 1, 2019," Deacons, August 6, 2018, deacons.com.

[2] See Heidrick & Struggles, *Board Monitor Europe 2019*, September 25, 2019, heidrick.com.

[3] Strictly speaking, these guidelines are applicable only to publicly listed companies, but, in fact, they set the bar for best practices for all companies that wish to remain competitive.

[4] Bruce Einhorn and Benjamin Robertson, "Hong Kong's 'old boys' club' faces threat of board shakeups," Bloomberg, November 8, 2018, Bloomberg.com.



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directors from other markets. And while technology can help, in the current, challenging environment, boards we are familiar with see no adequate substitute for directors meeting in person.

Growing emphasis on board succession planning

While compliance with the new regulations is not mandatory, they have also cast a spotlight on board tenure, particularly as it relates to director independence. According to the guidelines, directors on the listed boards of Hong Kong companies should serve only a maximum of nine years, after which, according to the Corporate Governance Code, a director is no longer considered to be independent and any further service must be approved by a shareholder resolution.

Term limits support a holistic approach to board succession planning, which can be helpful, our experience shows, particularly in turbulent times. By assessing the skills and experience the board currently possesses and what the strategy dictates it will need in the future, boards can start to plan new nominations early, based on anticipated retirements. This approach also maintains focus on refreshing the entire board rather than on the performance of individual directors, which can be helpful in managing board dynamics and the ability to work as a team. Indeed, one of the major challenges in director recruitment, particularly with first-time directors, is assessing the ability to apply skills that have yielded success in a corporate environment to board service, which is less hierarchical and more collegial.

Looking ahead

To expand options for new directors to meet both independence and overboarding concerns, nominating committees might consider executives in traditionally untapped functional areas, including human resources, technology and IT, marketing, and even PR and communications, who are knowledgeable about doing business in Hong Kong and would add useful perspectives.

Furthermore, augmenting the current pool of director candidates with less traditional candidates who would add diversity in terms of gender, nationality, sector experience, or even age would also appear to be a logical step, but that objective is not an easy one to achieve. For example, there are not many female executives in their late 50s and early 60s, a typical age for directors, with a significant track record as business leaders. There is a much larger pool of female executives in their late 40s and early 50s; however, issues around age and experience then come to the fore. Hong Kong board nominating committees, like those around the world that have been seeking similar diversity, will benefit from loosening traditional selection criteria to further enlarge their pool of candidates and gain competitive advantage by adding more diverse views to enhance discussions and deliberations. Based on our data, Hong Kong boards appear to be heading in the right direction, including relying less on traditional director candidates (e.g., strictly those with CEO and CFO experience) and adding directors with new competencies in areas such as digital and risk.

Key findings for newly added non-executive directors

Less reliance on traditional director candidate pool

- Of the 37 new non-executive director seats filled on the boards of the Hang Seng Index, 43% went to current or former CEOs and CFOs versus 67% last year.

A step back for female representation on boards

- Only 5% of new director seats went to women versus 20% in 2018.

Increased demand for prior board experience and financial, digital, and risk backgrounds

- Of the newly appointed director seats, 78% were filled by directors with previous board experience versus 61% in 2018, and 41% had previous audit committee experience.
- The financial services sector represented the largest share of industry experiences, at 54%.
- Though last year almost none of the newly appointed directors had experience in digital, social media, cybersecurity, or financial risk, this year the numbers rose, to 8% for digital or social media experience, 8% for cybersecurity, and 5% for financial risk.

Hong Kong: Key findings

Overall findings

Boards of the 50 companies on the Hang Seng Index (HSI) filled 37 independent, non-executive director seats last year. Perhaps reflecting growing and increasingly complex challenges in the economy as well as greater regulatory oversight, boards seem to be focused on recruiting directors with corporate governance experience; that said, they're also seeking people with functional and industry expertise outside of traditional CEO or CFO profiles.

- Of the newly appointed directors, 43% have CEO or CFO experience, which is markedly down from 67% last year. At 57%, there are slightly more current executives compared to last year, when the shares of current and former executives were evenly split.
- A notably greater proportion of the newly appointed directors (78%) have previous board experience compared to last year (61%). And 41% have audit committee experience compared to 33% last year.
- Women lost traction this year in terms of representation—only 5% of appointments were women, down from 20% last year.
- In terms of the newly appointed directors' overall career experiences, over half (54%) of that experience was in the financial services industry, followed by industrial, with 21%. While last year almost no new seats were filled by people with digital, social media, cybersecurity, or financial risk experience, this year those numbers jumped to 8% for digital or social media, 8% for cybersecurity, and 5% for financial risk.

A global perspective

As boards in Hong Kong encounter increasing pressure from a number of directions, it's important to understand the region's unique challenges and relationships to major economies such as China; at the same time, in a global economy that is becoming more and more interconnected, Hong Kong's boards can be put into a global context. In the latter context, Hong Kong boards have made strides in recruiting directors outside of traditional CEO profiles who can bring new areas of expertise to the table, but they still have much to do in terms of increasing diversity broadly speaking.

- Relative to other countries in the Asia Pacific region we study, appointments in Hong Kong with CEO or CFO experience (43%) fell right in the middle. On the upper end is Australia, with 59%, and on the other end is Singapore, with 29%.
- Hong Kong had the second highest proportion (78%) of newly appointed directors with previous board experience in the Asia Pacific countries in our study, behind only Australia (81%). In the face of some regulatory concerns in Hong Kong on the question of whether individual directors are sitting on too many boards, this trend could speak to a continued strong focus on mitigating risk through appointing experienced directors.
- Nearly a quarter (24%) of appointments in Hong Kong are non-nationals, down slightly from 30% last year. This is below the figure for non-national appointments in Australia and Singapore, both of which are at 35%.
- The proportion of Hong Kong board seats that went to women this year decreased to only 5%, well below any of the other countries we've looked at around the world. This low figure underscores the importance of a regulatory push in Hong Kong for greater diversity and the need for boards to shift the types of backgrounds they prioritize to ensure they gain critical experience and diversity.

Snapshot of 2018 Hong Kong findings

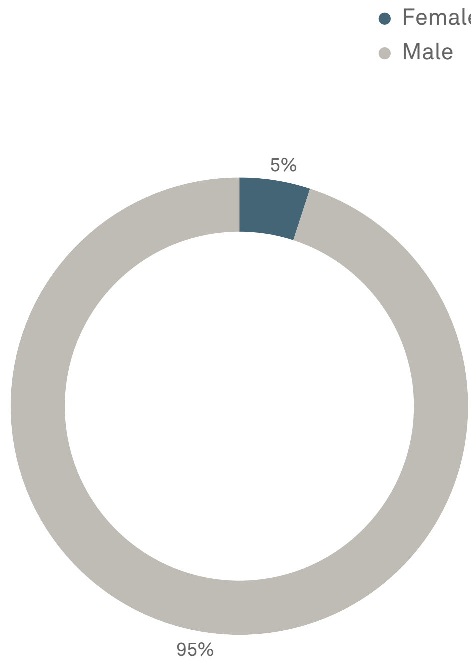
Director seats filled

37

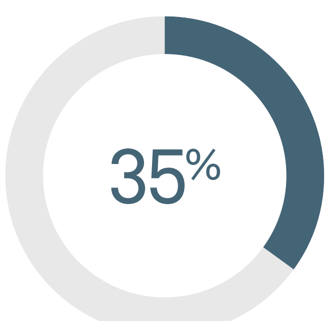
Average age

59

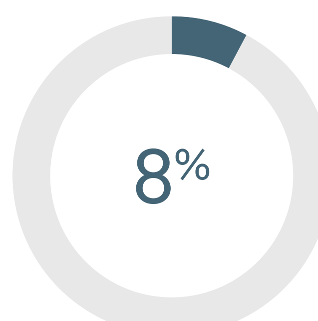
Gender



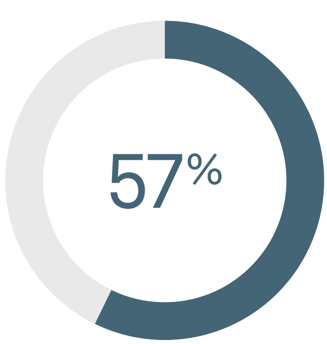
Current and former CEOs



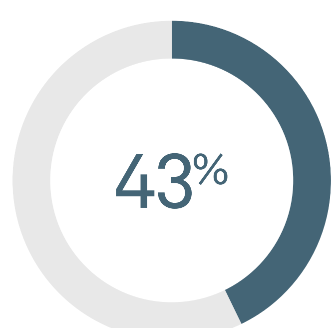
Current and former CFOs



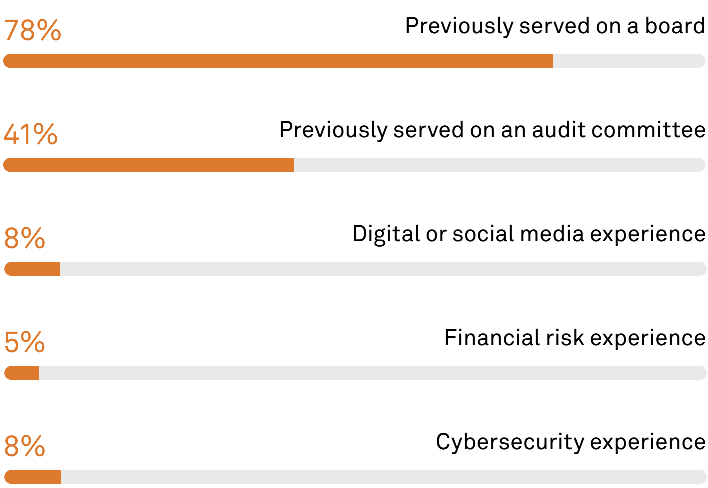
Current executives (n=21)



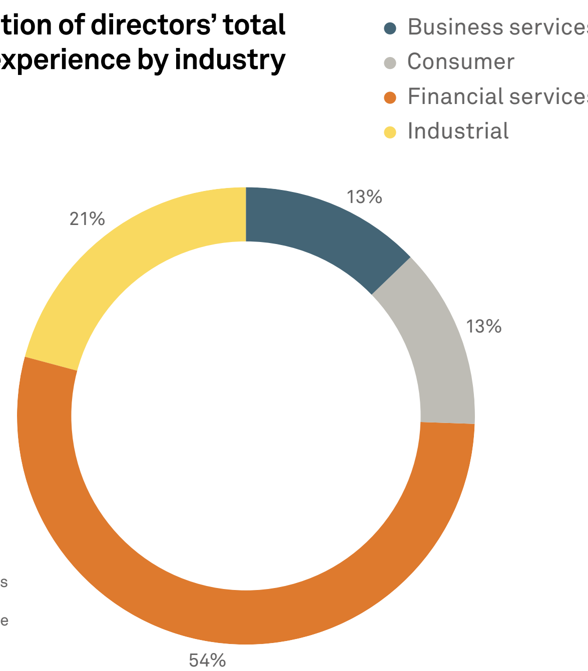
Former executives (n=16)



Experience

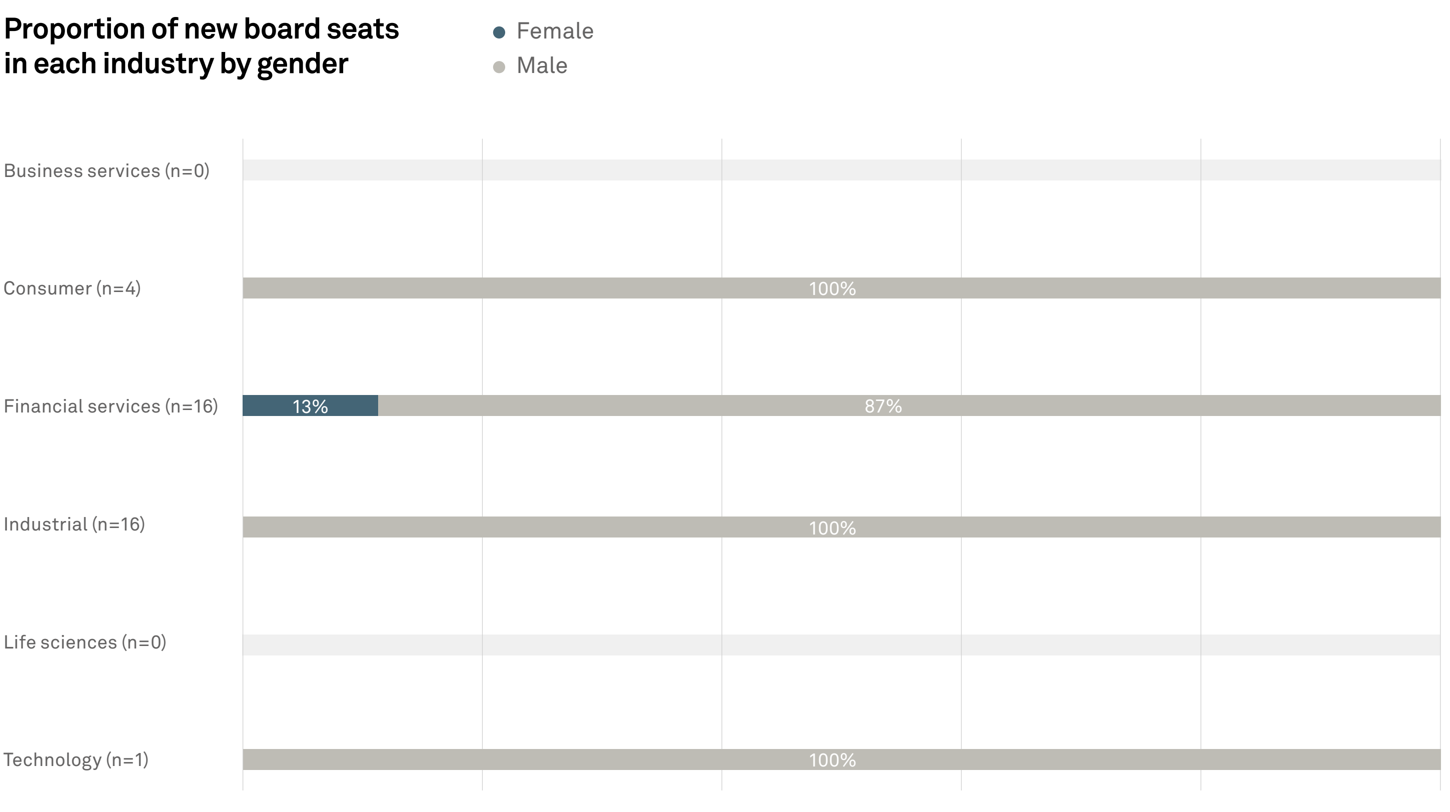


Distribution of directors' total career experience by industry (n=23)



Note: Numbers do not sum to 100%, because of rounding.

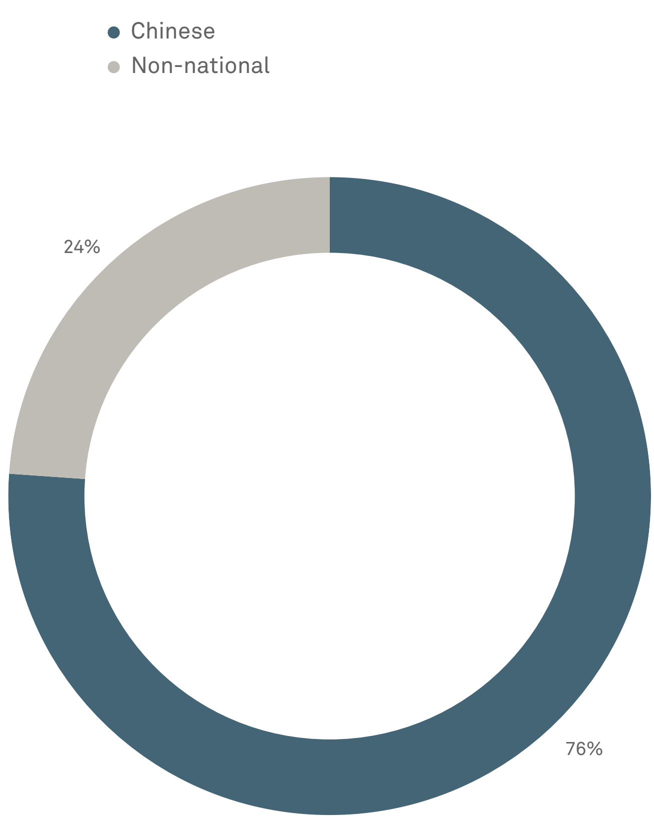
Proportion of new board seats in each industry by gender



Seeking executive expertise from non-nationals

- Of the 24% of non-national appointments, a third are from the United Kingdom and a third are from the United States. The last third are directors from countries ranging from Japan to the Netherlands.
- At 65, the average age of the group of non-nationals is significantly older than the Hong Kong group overall (59). Nearly all the non-national appointments had previous board experience (89%), and 78% had previous audit committee experience.
- Unlike the broader Hong Kong group, the non-national appointments were more often former executives (67%) and slightly more often had digital, social media, financial risk, or cybersecurity expertise (all at 11%).
- In terms of overall career experience of the non-national appointments, over half was in financial services (54%), followed by consumer (23%), business services (15%), and industrial (8%). Over half (56%) of the non-nationals had CEO experience, compared to 35% overall, and 22% had CFO experience, versus 8% overall.

Proportion of Chinese vs. non-national appointments



CEO & Board Practice

Heidrick & Struggles' CEO & Board Practice has been built on our ability to execute top-level assignments and counsel CEOs and board members on the complex issues directly affecting their businesses.

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