

GENDER DIVERSITY AMONG
HONG KONG BOARDS

BLACKROCK[®]



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EXECUTIVE SUMMARY

The issue of gender diversity on boards has attracted considerable global attention in recent years. Governments, investors and third-party stakeholders have increased their demands to benefit from the financial and non-financial returns, which can come from more balanced and effective boardrooms.

Several European jurisdictions have now mandated gender diversity quotas for boards, while other jurisdictions have taken action to incorporate diversity requirements into the listing rules of their stock exchanges or into their corporate governance codes.

Across Asia, the issue of gender diversity is also receiving greater attention. With the establishment of the '30% Club', for example, a group of chairmen and business leaders have shown their commitment to bringing more women on to Hong Kong corporate boards.

There is a considerable body of global research supporting the business case for gender diversity on boards and within senior management positions, in the form of increased returns, reduced risk, more effective decision-making and enhanced boardroom function. A more diverse board also allows a company to better represent and understand its own workforce, customers and geographic footprint.

It is crucial that companies also address gender diversity at senior executive levels, which often act as a pipeline for the recruitment of non-executive directors.

The Hong Kong Stock Exchange (HKEx) published a consultation paper in September 2012 seeking submissions on a proposal to introduce a code provision (i.e. subject to "comply or explain"¹) stating that the nomination committee (or the board) should have a policy concerning diversity in the boardroom, and should disclose the policy or a summary of the policy in the corporate governance statement. Later that year, the HKEx announced that the consultation revealed strong support for its proposals, which were subsequently adopted through revised Listing Rule amendments on 1 September 2013.

In 2012, when HKEx first released its consultation paper, the gender diversity statistics on Hong Kong's corporate boards were:

- ▶ 10.3% of listed company directors were women
- ▶ 40% of listed companies had no female directors
- ▶ 37% of listed companies had one female director.

Gender balance at senior executive levels within organisations is an excellent basis for diversity more generally. To investigate if the current gender diversity situation was any different, BlackRock reviewed 35 companies that will be subject to the new diversity reporting requirements. In particular, we wanted to analyse the diversity of boards differentiating between executive and non-executive directors. The distinction between the two roles is quite important as senior executive ranks provide an important pool for non-executive directors.

Our research revealed two key findings:

1. The current representation of women on Hong Kong's corporate boards for both executive and non-executive directors compares favourably to other jurisdictions, creating a strong base for HKEx's new diversity measures;
2. The level of disclosure of board nomination processes among the companies reviewed was relatively limited, suggesting a need for greater transparency by issuers as the new measures are adopted.

BlackRock therefore encourages companies in Hong Kong to consider how the benefits of new diversity measures can be communicated in the medium term. We also encourage these companies to aim for a higher standard and ensure that the benefits identified in the HKEx consultation are consistently articulated and reflected in their approach to board diversity.

BlackRock will revisit this research in future to assess progress and identify for investors what action has been taken by listed companies to improve board diversity and its disclosure in Hong Kong.

1. Comply or explain means companies are required to comply with the Code or otherwise provide an explanation for non-compliance.

THE GLOBAL ENVIRONMENT OF DIVERSITY

The issue of board diversity is growing in importance around the world. Several European jurisdictions have mandated gender diversity quotas for boards, while other jurisdictions² have taken action to incorporate diversity requirements into the listing rules of their stock exchanges or into their corporate governance codes. For example, in Australia, the Listing Rules of the Australian Securities Exchange (ASX) require a company to report against the guidelines established by the ASX Corporate Governance Council which includes a requirement for listed entities to establish and disclose a diversity policy (or a policy summary) on an “if not, why not” basis.

Across Asia, the issue of gender diversity is also receiving greater attention. This year, The Women’s Foundation³ in Hong Kong took an important role with the establishment of the ‘30% Club’, a group of chairmen and business leaders committed to bringing more women on to Hong Kong corporate boards.

Unrelated to this, the Hong Kong Stock Exchange (HKEx) took a leadership role by publishing a consultation paper in September 2012 seeking submissions on a proposal to introduce a code provision (i.e. subject to “comply or explain”⁴) stating that the nomination committee (or the board) should have a policy concerning diversity in the boardroom, and should disclose the policy or a summary of the policy in the corporate governance statement. Later that year the HKEx announced that the consultation revealed strong support for its proposals, which were subsequently adopted through revised Listing Rule amendments on 1 September 2013.

THE BENEFITS OF DIVERSITY

There is a considerable body of global research supporting the business case for gender diversity on boards and within senior management positions. Much of the existing research has focused on North America, Europe and Australia, but more attention is now being paid to board diversity in Asia. The overwhelming majority of this research supports the business case for diversity generally in the form of increased returns, reduced risk, more effective decision-making and enhanced boardroom function. Additionally, a more diverse board allows a company to better represent and understand its own workforce, customers and geographic footprint, thus improving the delivery of strategy and future performance.

WOMEN IN EXECUTIVE LEVEL ROLES – THE IMPORTANCE OF SUCCESSION

The issue of gender diversity is not limited to boards. It is also crucial that companies address diversity at senior executive levels, which often act as a pipeline for the recruitment of non-executive directors. Research shows that in Australia, for example, there is a bias for non-executive directors to be recruited from the ranks of former CEOs and senior executives of ASX200 companies⁵. The US experience is similar.

By introducing diversity at the senior executive level, companies can increase the pool of talent for women non-executive directors and develop a sustainable pipeline of female candidates as they move from their executive roles to non-executive. This pool of talent also ensures that companies receive the same benefits from diversity throughout their senior executive ranks as they do at board level. To help address diversity at senior executive levels, BlackRock encourages companies to report on programs aimed at identifying and addressing women with high potential.

Although our research was not able to measure diversity below board level, it is our expectation that companies should take action to ensure that gender representation at senior executive levels is also included in any diversity policy.

THE HONG KONG POSITION

In September 2012, HKEx released a consultation paper⁶ on board diversity that sought comments on proposed amendments to the Corporate Governance Code and Corporate Governance Report (“Code”). In particular, HKEx proposed introducing a Code Provision (i.e. subject to “comply or explain”) stating that the nomination committee (or the board) should have a policy relating to diversity in the boardroom, and should disclose the policy (or a summary) in its corporate governance report. Additionally, HKEx proposed that an issuer should include any measurable objectives it has set for implementing its diversity policy, and the progress made towards achieving those objectives.

In December 2012, HKEx published the conclusions of its consultation, after receiving 139 submissions from issuers, market practitioners, professional bodies and industry groups, non-government organisations, individual investors, individuals and others. The vast majority of respondents supported HKEx’s proposal to introduce a Code Provision (i.e. subject to “comply or explain”), while a small number felt the provision on board diversity should be a Recommended Best Practice. HKEx subsequently adopted the proposals outlined in its consultation paper, implementing the revised Listing Rule amendments (see Appendix) on 1 September 2013.

2. Norway, France, Belgium, Iceland, Italy, The Netherlands and Spain

3. Established in 2004, The Women’s Foundation is a non-profit organisation dedicated to improving the lives of women and girls in Hong Kong through research, community programs and education and advocacy. www.thewomensfoundationhk.org

4. Comply or explain means companies are required to comply with the Code or otherwise provide an explanation for non-compliance.

5. Regnan Governance and Research found that 65% of independent non-executive directors were former CEOs and executive directors of ASX200 companies

6. <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201209.pdf>

In 2012, when HKEx first released its consultation paper the gender diversity statistics on Hong Kong's corporate boards were:

- ▶ 10.3% of listed company directors were women
- ▶ 40% of listed companies had no female directors
- ▶ 37% of listed companies had one female director.

The Exchange stressed that the amendments are not intended to prescribe particular corporate structures or to require compliance with hard and fast rules. Instead, the disclosure (or explanation) is aimed at delivering sufficient information to allow investors and stakeholders to understand companies' performance and governance practices, and act accordingly.

BLACKROCK'S RESEARCH

BlackRock undertook research to gain an understanding of the gender diversity of both executive and non-executive directors on boards in Hong Kong. While the HKEx gender diversity statistics provide an initial measure of board diversity – gender balance at senior executive levels within organisations is an excellent basis for diversity more generally – BlackRock decided to investigate whether the current gender diversity situation was any different.

BlackRock reviewed 35 companies from within the Hang Seng 50 index that were listed on the HKEx and accordingly subject to the new diversity reporting requirements.

In particular, we wanted to analyse the diversity of boards differentiating between executive and non-executive directors, an area not covered by the HKEx study.

As part of the research, we also reviewed the processes undertaken by either the nomination committee or the entire board (where there was no nomination committee) as disclosed in their annual reports or websites.

Using this study as a baseline, BlackRock plans to revisit this research on a regular basis to assess progress among Hong Kong listed companies, measure the level of transparency in the disclosure of board nomination processes and identify any issues that may be hindering the adoption of greater board diversity.

OUR FINDINGS

A strong start for Hong Kong issuers

Among the Hong Kong companies reviewed, our analysis showed 13% of the non-executive directors are women and 13% of executive directors are women. The percentage for non-executive directors is consistent with other jurisdictions, such as the US, the UK and Australia, where the levels stand at around 16%⁷, 17%⁸ and 17%⁹ respectively.

However, given that Hong Kong is at an earlier stage in the process of introducing boardroom diversity policies, the percentage of female executive directors on boards already reflects significant progress on gender diversity by Hong Kong issuers. This proportion is already higher, for example, than that found in Australia when recommendations to report on diversity policy disclosure were first issued for public consultation in 2010 and compares extremely favourably with other countries where diversity rules are better established.

BlackRock expects that as the issue of gender diversity attracts increasing attention in Asia, this progress will stand Hong Kong companies in good stead, especially now that diversity requirements have been introduced into the listing rules (September 2013).

Nomination processes would benefit from greater transparency

The level of disclosure of board nomination processes in annual reports was relatively limited among the companies reviewed by BlackRock. If Hong Kong-listed companies plan to diversify their boards, we would encourage disclosure of nomination processes that ensure diversity is reflected in any candidate list. Although the charters of most nomination committees referred to the role of the committee in monitoring the structure, size and composition of the board, only two companies – VTech (Holdings Ltd) and HKEx itself – included any reference to diversity.

BlackRock also reviewed companies' websites to discover what, if any, disclosure was made in terms of policies on board diversity. Again, we found the level of disclosure to be limited. HSBC revealed that a related policy was adopted in 2012, and that the company has a target of women taking 25% of the board seats by 2015. Another five companies referred to board diversity on their websites¹⁰.

The level of disclosure is disappointing. The HKEx consultation paper said that reporting on the diversity policy of the issuer may also facilitate greater transparency and accountability by providing investors with information on corporate culture and governance practices, enabling them to make more informed voting and investment decisions¹¹.

BlackRock is supportive of this notion. As listed companies in Hong Kong introduce board nomination processes that aim to increase diversity, we encourage issuers to ensure their disclosures are transparent and accountable. Based on our assessment of current disclosures, significant change is required in terms of disclosing policies concerning board composition and the appointment and assessment process.

7. <http://www.catalyst.org/knowledge/women-boards>

8. Ibid

9. Refer to BLK 2013 research (the Glacial Change at ASX200 companies paper): <http://www.blackrockinvestments.com.au/content/groups/australiainsite/documents/literature/change-diversity-asx-200.pdf>

10. Hang Seng Bank, Henderson Land, Hutchison, MTR Corporation, Hong Kong Exchanges and Clearing House

11. <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201209.pdf>

In particular, companies in other jurisdictions that have implemented gender diversity measures often fail to disclose the governance framework for the effective implementation of any diversity policy. BlackRock's expectation is that, as an operational issue, accountability for diversity should lie with management, while being overseen by the board.

LOOKING AHEAD – AN OPPORTUNITY TO IMPROVE INVESTOR ENGAGEMENT

An additional benefit of greater transparency in the disclosure of board nomination processes is the opportunity to highlight to investors and stakeholders the positive action that an issuer is taking to improve board diversity.

Based on BlackRock's assessment, current disclosures provide little insight into an issuer's corporate culture and corporate governance practices, despite these areas being of particular interest to institutional investors. To allow investors to assess such attributes in an informed manner, the company should adopt a formal and transparent procedure for the appointment and re-appointment of directors. The board should disclose in its annual report the required mix of skills, experience and other qualities, including core competencies, that each director brings to the board; the process by which candidates are identified and selected (including whether professional search firms have been engaged to identify and/or assess candidates); the procedures used to ensure that a diverse range of candidates is considered; and any other factors taken into account during the selection process.

The annual corporate governance statement should also disclose the process adopted by the board to evaluate the performance of each director. BlackRock believes that annual performance reviews of non-executive directors, including the chairman, contribute to greater board efficiency and provide a more transparent way for investors to understand and assess a company's approach to board performance.

WHERE TO FROM HERE?

In BlackRock's recent paper considering diversity among ASX 200 companies¹², we noted that in addition to simply reporting on required diversity disclosures, companies should articulate the benefits of diversity policies, stating why they were introduced and how they assist in building the longer-term value of the company. We also suggested that companies should explain the corporate governance framework that exists to support such a policy, demonstrating who in the organisation is accountable for effectively implementing such policies.

In Hong Kong, therefore, we encourage companies to consider how the benefits of new diversity measures can be communicated in the medium term.

While the natural focus of introducing "comply or explain" measures will be to ensure companies have committed to diversity initiatives, and embedded these into the broader corporate environment, we encourage these companies to aim for a higher standard and ensure that the benefits identified in the HKEx consultation are consistently articulated and reflected in Hong Kong companies' approach to board diversity.

With the HKEx Listing Rule amendments now in place, BlackRock looks forward to continued progress on board diversity in Hong Kong. To assist companies seeking to improve transparency in their board diversity disclosures, we have set out several suggested best practices.

BlackRock intends to revisit this research in future to assess progress and identify for investors the action being taken by companies in Hong Kong to further improve board diversity and its disclosure.

RECOMMENDED BEST PRACTICES FOR IMPROVING TRANSPARENCY IN BOARD DIVERSITY DISCLOSURE

To improve the transparency of diversity reporting by HKEx-listed companies, BlackRock suggests a number of best practices for companies to adopt:

- ▶ Create ownership of a company's diversity policy and disclosure at the CEO/Board level to ensure real action and diverse outcomes
- ▶ Aim to increase transparency in the corporate governance processes; companies should explain what they are doing and why
- ▶ In terms of disclosure, companies are encouraged to articulate the following:
 - The governance structure;
 - The percentage of women on the board and whether the board sets any measurable targets for increasing the number of women on the board;
 - The percentage of women in senior executive roles and whether the board sets any measurable targets for increasing gender diversity among senior management;
 - Why the board believes the diversity policy is beneficial to the company, that is, an articulation of a compelling business case for gender diversity in the entity as part of the business strategy, and whether there are internal procedures to review the effectiveness of the diversity policy;
 - Initiatives the company has in place (if any) to address diversity in senior executive positions and whether those initiatives are measured and evaluated.

12. <http://www.blackrockinvestments.com.au/content/groups/australiainsite/documents/literature/change-diversity-asx-200.pdf>

APPENDIX 1

HKEx Listing Rule Amendments¹³

MAIN BOARD LISTING RULES

Appendix 14

CORPORATE GOVERNANCE CODE AND CORPORATE GOVERNANCE REPORT

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A.3 Board composition

Principle

The board should have a balance of skills, experience and diversity of perspectives appropriate to the requirements of the issuer's business. It should ensure that changes to its composition can be managed without undue disruption. It should include a balanced composition of executive and non-executive directors (including independent non-executive directors) so that there is a strong independent element on the board, which can effectively exercise independent judgement. Non-executive directors should be of sufficient calibre and number for their views to carry weight.

A.4 Appointments, re-election and removal

Principle

There should be a formal, considered and transparent procedure for the appointment of new directors. There should be plans in place for orderly succession for appointments. All directors should be subject to re-election at regular intervals. An issuer must explain the reasons for the resignation or removal of any director.

Code Provisions

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A.5 Nomination Committee

Principle

In carrying out its responsibilities, the nomination committee should give adequate consideration to the Principles under A.3 and A.4

Code Provisions

...

A.5.6 The nomination committee (or the board) should have a policy concerning diversity of board members, and should disclose the policy or a summary of the policy in the corporate governance report.

Note: Board diversity will differ according to the circumstances of each issuer. Diversity of board members can be achieved through consideration of a number of factors, including but not limited to gender, age, cultural and educational background, or professional experience. Each issuer should take into account its own business model and specific needs, and disclose the rationale for the factors it uses for this purpose.

L. BOARD COMMITTEES

The following information for each of the remuneration committee, nomination committee and audit committee, and corporate governance functions:

- (a) ...
- (d) a summary of the work during the year, including:
 - (i) ...
 - (ii) for the nomination committee, determining the policy for the nomination of directors, performed by the nomination committee or the board of directors (if there is no nomination committee) during the year. The nomination procedures and the process and criteria adopted by the nomination committee or the board of directors (if there is no nomination committee) to select and recommend candidates for directorship during the year. If the nomination committee (or the board) has a policy concerning diversity, this section should also include the board's policy or a summary of the policy on board diversity, including any measurable objectives that it has set for implementing the policy, and progress on achieving those objectives;

(The same amendments will be made to Appendix 15 of the GEM Listing Rules).

13. <http://www.hkex.com.hk/eng/newsconsul/mktoconsul/Documents/cp201209cc.pdf> pages 19-20

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