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A One-Size-Fits-All Approach to Corporate Governance Codes and Compliance by Smaller Listed Firms: An Examination of Companies Listed in Hong Kong and Singapore

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Abstract

This article examines the impact of a one-size-fits-all corporate governance code on smaller listed firms, which should have fewer resources to hire more qualified independent directors for their boards and board committees. After examining data from a sample of companies listed in Hong Kong and Singapore, we find some limited support for these resources-based arguments. While smaller firms do not necessarily have a lower proportion of board members who are independent directors, some evidence suggests that smaller firms do pay less to independent directors and that these directors have to serve on multiple board committees. Although many larger firms also share the problem of overloading their independent directors, the ability to find and attract good candidates certainly differs with the availability of resources. Therefore, this article suggests that policymakers rethink the merit of raising board independence standards and increasing board committee requirements, and find ways to assist smaller firms to hire good (and less expensive) independent directors.

I. Introduction

Should corporate governance rules for listed companies in a stock market be “one-size-fits-all”? In other words, should the same rules apply to firms of all sizes, industries, ownership, business models or other characteristics? When people talk about corporate governance, they often focus on larger corporations, which hold a significant proportion of market capitalization, with more shareholders and more economic significance in the market and economy. The impact of any governance failure or scandal will be more pronounced in larger corporations with more shareholders, as it may affect more investors or have a larger effect on the market as a whole.

However, most companies in a stock exchange are not large corporations. For example, daily data released by NASDAQ¹ of the 3,249 observations on October 17, 2017 showed that 2,004 firms (61.68%) had market capitalization lower than US\$500 million. In contrast, 414 firms (about 12.74%) had market capitalization over US\$3 billion on the same day. The disparity in power between larger and smaller firms is obvious. In Asian markets, for example, the benchmark Hang Seng Large-Cap Index includes firms that cover the top 80% of the total market capitalization.² In contrast, smaller firms form the majority of the market measured by number of firms. As on 17 January 2018, the Hang Seng Large-Cap Index contains merely a total of 106 firms³ out of a total of 1,802 firms listed in the Mainboard of the Stock Exchange of Hong Kong.⁴

Despite their number in the market, smaller firms receive far less attention. Although they are relatively small, “small firms are the most dynamic, innovative and risk-taking sector of the economy in most developed countries...”⁵ As Huse noted, “[t]he board[s] of directors in small firms have had little attention.”⁶ Another author argued that the Sarbanes-Oxley Act in the U.S. “ignores the special needs and concerns of small publicly held companies in the economy...”⁷ Similarly, Hertig noted that “it seems at least plausible that submitting smaller firms to governance principles designed for larger firms will prove inefficient.”⁸ The then chairman and chief executive office of former American Stock Exchange testified that the Sarbanes-Oxley Act “made it extremely difficult for smaller companies to compete in this regulatory environment”

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¹ The daily data was extracted from the NASDAQ website, in <http://www.nasdaq.com/screening/companies-by-industry.aspx?exchange=NASDAQ&sortname=marketcap&sorttype=1> (last visited November 30, 2017).

² See Selection Criteria of Hang Seng Composite Size Indexes, in <https://www.hsi.com.hk/HSI-Net/HSI-Net> (last visited November 30, 2017).

³ See Constituents of Hang Seng Composite LargeCap Index, in <http://www.hsi.com.hk/HSI-Net/HSI-Net> (last visited January 18, 2018).

⁴ Hong Kong Exchange, Market Highlights, in <https://www.hkex.com.hk/eng/csm/highlight.htm> (last visited January 18, 2018).

⁵ Christina Atanasova et al., *The corporate governance and financing of small-cap firms in Canada*, 42 *MANAGERIAL FINANCE* 244, 244 (2016).

⁶ Morten Huse, *Board Composition in Small Enterprises*, 2 *ENTREPRENEURSHIP & REGIONAL DEVELOPMENT* 363, 371 (1990).

⁷ Joseph A. Castelluccio, *Sarbanes-Oxley and small business: Section 404 and the case for a small business exemption*, 71 *BROOKLYN L. REV.* 429, 431–432 (2005).

⁸ Gerard Hertig, *On-Going Board Reforms: One Size Fits All and Regulatory Capture*, ECGI Law Working Paper No. 25/2005, at 9, in https://papers.ssrn.com/sol3/papers.cfm?abstract_id=676417 (last visited December 11, 2017).

with the Act making “no distinction between a billion-dollar large-cap company and a \$75-million small-cap one.”⁹

One common argument for smaller firms complying with corporate governance codes is based on lack of financial or human resources, which influences the quality of corporate governance. While enhancing board independence is at the core of a corporate governance regime, it could be expensive for smaller firms to hire a sufficient number of candidates who are not only independent from management and controlling shareholders, but who also possess adequate competence and expertise. If this is the case, a one-size-fits-all approach may not actually improve the corporate governance of smaller firms if they only aim to satisfy minimum requirements or to comply “on paper.” In contrast, one might argue that in markets where corporate governance codes are “comply or explain” in nature, there is some leeway for smaller firms to comply (or otherwise explain their lack of compliance). In addition, if we take corporate governance standards as minimum requirements, the same rules should apply to all kinds of companies regardless of size, as a matter of equal treatment.

It is not that there is no example of differential treatment. Policymakers sometimes identify certain industries as having higher corporate governance requirements. For example, banks or insurers are often subject to higher corporate governance standards. In Singapore, the Insurance (Corporate Governance) Regulations 2013 impose a requirement for large insurers to have at least a majority of directors who are independent from a management business relationship with the insurer if a single substantial shareholder holds 50% or more of the share capital or voting power.¹⁰ Thus, differential treatment in corporate governance standards does exist.

There are also examples of differential treatment based on the size of a firm. In the U.S., the New York Stock Exchange (NYSE) exempts a firm having a majority controlling owner from some corporate governance requirements (such as having the majority the board being independent directors).¹¹ The NYSE also exempts a “smaller reporting company” (as defined by

⁹ Neal Wokloff, *Sarbanes-Oxley Is a Curse for Small-Cap Companies*, Wall Street Journal, Aug. 15, 2005, p. A.13.

¹⁰ Insurance (Corporate Governance) Regulations 2013 (No. S 197) reg. 7(2) (Singapore).

¹¹ New York Stock Exchange Listed Company Manual rule 303A.00 and 303A.01, in <http://wallstreet.cch.com/LCM/> (last visited December 12, 2017).

Rule 12b-2 under the Securities and Exchange Act of 1934)¹² from the some requirements regarding independence test.¹³

In the United Kingdom (U.K.), the Corporate Governance Code (UK Code) states that a smaller company (defined as a company falling under the FTSE 350 throughout a year¹⁴) needs only to have at least two independent directors on its board, instead of having at least half of the board (excluding the chairman) being independent.¹⁵ The FTSE 350 is a stock market index weighted by market capitalization for the largest 350 companies listed on the London Stock Exchange. The UK Code also states that the audit committee of a small company must only have at least two independent directors (instead of three).¹⁶ However, in both Hong Kong and Singapore, corporate governance codes remain one-size-fits-all in nature.

The purpose of this article is to examine whether a one-size-fits-all corporate governance code is appropriate, or whether the rules should have more flexibility in terms of design and application, to assess whether there should be different minimum standards for firms with different characteristics. A normative question from a comparative law angle is whether Hong Kong and/or Singapore should follow the UK Code to have some exemptions for smaller firms. Alternatively, if a one-size-fits-all corporate governance is working well, one may also challenge whether any exemption for smaller firms is necessary. To evaluate the appropriateness of a one-size-fits-all code, we must first understand how companies comply with corporate governance rules.

However, we do not have a direct measure of compliance costs borne by listed companies, as regulators and exchanges in both markets did not publish any regulatory impact analysis and potential costs in consultation or policy papers before or after revisions of corporate governance rules. Instead, this article will explore the corporate governance practices of listed firms in Hong Kong and Singapore, the two leading international financial centers in the Asia Pacific region, to

¹² In general, a smaller reporting company means “an issuer that is not an investment company, an asset-backed issuer (as defined in §229.1101 of this chapter), or a majority-owned subsidiary of a parent that is not a smaller reporting company” with a public float of less than US\$ 75 million. 17 C.F.R. 240.12b-1.

¹³ New York Stock Exchange Listed Company Manual rule 303A.00 and 303A.02(a), in <http://wallstreet.cch.com/LCM/> (last visited December 12, 2017).

¹⁴ Financial Reporting Council, The UK Corporate Governance Code, at 11 (note 6), in <https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf> (last visited November 30, 2017). (UK Code)

¹⁵ UK Code B.1.2.

¹⁶ UK Code C.3.1.

examine the impact of corporate governance codes on smaller firms in terms of compliance records and remuneration.

For simplicity, this article will focus on whether the size of a listed company makes any difference in terms of compliance with corporate governance codes, although we recognize that other firm characteristics, such as industry and nature of the firm or controlling owners (e.g., state or financial institutions), may affect how firms comply with corporate governance codes. The results will offer us valuable insights on how corporate governance rules might affect smaller players, and their potential consequences for shareholders and other market participants.

The remainder of this article is structured as follows. Part II explores current corporate governance regimes in Hong Kong and Singapore, and the pros and cons of the one-size-fits-all approach to corporate governance. Part III introduces data collected from Hong Kong and Singapore to demonstrate how smaller listed firms comply with corporate governance codes, in contrast with larger firms. Part IV provides some policy reflections and Part V concludes the article.

II. A One-Size-Fits-All Approach to Corporate Governance of Listed Firms

This section first gives the background of the one-size-fits-all approach adopted in Singapore and Hong Kong. We then present two contrasting arguments on how these rules may affect small or medium listed firms in the market.

A. Corporate Governance Regimes in Singapore and Hong Kong in a Nutshell

This section briefly introduces the corporate governance regimes in Hong Kong and Singapore. In general, both markets follow the Anglo-American model of corporate governance, particularly the U.K.'s 1993 Cadbury Report.¹⁷ In Hong Kong, the Stock Exchange of Hong

¹⁷ For the background of the Cadbury Report and its impact on corporate governance reforms in other countries, see generally Cally Jordan, *Cadbury Twenty Years On*, 58 VILL. L. REV. 1 (2013).

Kong (SEHK) required a minimum of two independent directors on a board in 1993,¹⁸ before raising the requirement to three in 2004.¹⁹ The first version of the Code on Corporate Governance Practices was published in 2005²⁰ before a major revision after the global financial crisis, resulting in the Code on Corporate Governance Practices 2012.²¹ In Singapore, the Monetary Authority of Singapore, the financial regulator, issued the first edition of the Code of Corporate Governance in 2001, which was amended in 2005 and 2012.²² This section will quickly summarize the key regimes contained in the corporate governance codes in Singapore and Hong Kong as they stand in 2017.

Overall, the most essential regime is the independence of a board. In both markets, policymakers recognize that a company should have an effective board to lead and control the company.²³ Companies should have a strong and independent board that can exercise objective judgment on corporate affairs with a balance of skill and experience.²⁴ For this purpose, Singapore requires a minimum of one-third of a board to be independent.²⁵ This threshold is raised to at least half of the board under certain situations, e.g., when the chairman and chief executive officer (CEO) are the same person or close family members or when the chairman is also part of the management team or otherwise not independent.²⁶ In Hong Kong, although the Code of Corporate Governance Practices only makes the minimum one-third threshold “recommended best practice”,²⁷ the same requirement also appears in the exchange rules,²⁸ which are mandatory in nature.

¹⁸ Hong Kong Exchange, Note to subscribers for the amendments to the rules governing the listing of securities (the “Listing Rules”): Update No. 80 (31 March 2004), in http://www.hkex.com.hk/Listing/Rules-and-Guidance/Listing-Rules-Contingency/Amendments-to-Main-Board-Listing-Rules/2004/Update-No-80?sc_lang=en (last visited November 30, 2017).

¹⁹ Hong Kong Exchange, Mainboard Listing Rules, rule 3.10.

²⁰ Hong Kong Exchange and Clearing Ltd, Consultation Paper on the Review of the Code on Corporate Governance Practices and Associated Listing Rules at para. 22, in <https://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010124.pdf> (last visited November 30, 2017).

²¹ Hong Kong Exchange, Mainboard Listing Rules, Appendix 14. (HK Code)

²² Monetary Authority of Singapore, Code of Corporate Governance, in <http://www.mas.gov.sg/regulations-and-financial-stability/regulatory-and-supervisory-framework/corporate-governance/corporate-governance-of-listed-companies/code-of-corporate-governance.aspx> (last visited November 30, 2017). (Singapore Code)

²³ Singapore Code Principle 1; HK Code A.1.

²⁴ Singapore Code Principle 2; HK Code A.3.

²⁵ Singapore Code Guideline 2.1.

²⁶ Singapore Code Guidelines 2.2.

²⁷ HK Code A.3.2.

²⁸ Hong Kong Exchange, Mainboard Listing Rules, rule 3.10A.

In terms of the definition of independence for board members, Singapore generally defines independence as having no relationship with the company (and related companies) or with more than 10% of shareholders and officers (including directors and senior executives).²⁹ However, this definition of independence and list of relationships are not absolute. Whether a candidate qualifies as an independent director is determined by the nomination committee, which should consist of mostly independent directors.³⁰

Hong Kong's definition of independence is similar. A candidate may lose independence if he has over 1% of issued shares or has received an interest in securities issued by the company as a gift in addition to other connections arising from employment, common business interests or family relationships.³¹ A listed company must demonstrate to the exchange how a candidate is independent.³² Like in Singapore, the nomination committee is responsible for assessing whether a candidate is independent.³³

To support the board independence regime, both Hong Kong and Singapore clarify the role of the chairman of the board. Ideally, the positions of chairman and CEO should not be occupied by the same person.³⁴ The chairman is the leader of the board and ensures the board's effectiveness, while the CEO is the chief of the management team.³⁵ Thus, it is best to separate the roles of the chairman and CEO with different persons.

Both markets require listed firms to establish subcommittees at the board level. The most important is the audit committee, whose responsibility is to make recommendations regarding the firm's external auditor (including appointment, removal and remuneration) and review the company's financial condition, reporting, and internal control system.³⁶ The audit committee may also be responsible for the firm's whistle-blowing policy.³⁷ In Singapore, the audit committee should comprise mostly independent directors with a minimum of three members,³⁸

²⁹ Singapore Code Guidelines 2.3.

³⁰ *Id.*

³¹ Hong Kong Exchange, Mainboard Listing Rules, rule 3.13.

³² Hong Kong Exchange, Mainboard Listing Rules, rule 3.14.

³³ HK Code A.4.5(c).

³⁴ Singapore Code Guidelines 3.1; HK Code A.2.1.

³⁵ Singapore Code Guidelines 3.2; HK Code A.2.4.

³⁶ Singapore Code Guidelines 12.4; HK Code C3.3.

³⁷ Singapore Code Guidelines 12.7.

³⁸ Singapore Code Guidelines 12.1.

and in Hong Kong the SEHK requires the audit committee to be comprised of non-executive directors only.³⁹

Apart from audit committees, both markets require remuneration and nomination (or nominating) committees, both of which should comprise mostly independent directors.⁴⁰ The remuneration committee is responsible for reviewing the company's procedure and policy for remunerating executives and directors.⁴¹ In Hong Kong, a significant proportion of executive directors' compensation should be linked to corporate and individual performance.⁴² In contrast, in Singapore, the regulator makes it clear that the level and structure of remuneration should be aligned with the long-term interests and risk policy of the firm, to motivate good stewardship and successful management of the company.⁴³ Details of executives' remuneration should be disclosed in company annual reports.⁴⁴ The nomination committee is in charge of making recommendations to the board regarding the company's succession plan, evaluating the board's performance, and appointing and training directors.⁴⁵

In sum, both Hong Kong and Singapore follow the Anglo-American model of corporate governance and place great emphasis on board independence and the role of board committees in monitoring and management. There are two features worth noting. First, both markets have improved corporate governance on an incremental basis with revisions made over time. Second, both markets have also adopted minimum corporate governance standards without differentiating between different kinds of firms. All firms, regardless of size, industry or other characteristics, are expected to comply with the same standards.

Thus, both Hong Kong and Singapore have created one-size-fits-all corporate governance codes. Interestingly, policymakers in both markets did not follow the U.K.'s approach to differentiate the application of some provisions in corporate governance codes to smaller firms, although both markets generally transplanted regimes from the U.K. In Hong Kong, SEHK has recognized that a smaller percentage of medium-cap or small-cap issuers fully complied with the

³⁹ Hong Kong Exchange, Mainboard Listing Rules, rule 3.21.

⁴⁰ Singapore Code Guidelines 4.1 and 7.1; HK Code A.4.4 and B.1.1.

⁴¹ Singapore Code Guidelines 7.2; HK Code B.1.3.

⁴² HK Code B.1.6.

⁴³ Singapore Code Principle 8.

⁴⁴ Singapore Code Guidelines 9.1; HK Code B.1.7.

⁴⁵ Singapore Code Guidelines 4.2; HK Code A.4.5.

Code of Corporate Governance Practices.⁴⁶ Many smaller companies did not have a corporate governance committee.⁴⁷ In the 2010 consultation paper, the exchange also recognized that the same standard (the one-third threshold) is potentially costly, and some may argue that it should not apply to both large and small issuers.⁴⁸ Some respondents suggested that SEHK considers “the cost implications of the proposal for issuers with smaller market capitalizations.”⁴⁹ Nonetheless, the exchange did not implement different rules for smaller firms in the end.

In Singapore, none of the consultation papers leading up to the Code of Corporate Governance in 2001 or the revisions of the code in 2005 and 2012 examined whether provisions in the code were appropriate for smaller firms. In 2001, most discussion related to small businesses was about rules for private companies.⁵⁰ During the later rounds of consultation on the reform of the corporate governance code, there was no discussion of its application to smaller firms.

B. Pros and Cons of the One-Size-Fits-All Approach

Is the one-size-fits-all approach good or bad for smaller firms? There are reasons that uniform corporate governance standards are preferable. First, the agency problem exists where there is a separation of ownership from control.⁵¹ This should not change whether a firm is large or small. Larger corporations may have more shareholders, but the degrees of concentration of ownership do not necessarily differ. As long as there are minority shareholders, there is a need for corporate governance—this should not change merely because a firm is smaller. In addition, there is no particular reason or proof showing that controlling shareholders or managers of smaller firms are less likely to tunnel, which generally means activities to ‘transfer of assets and profits out of firms for the benefit of those who control them’.⁵²

Second, corporate governance standards are often laid down as minimum standards (e.g., a minimum one-third of a board being independent directors). Unless the law requires a super-

⁴⁶ Hong Kong Exchange, *supra* note 20, at para. 22.

⁴⁷ *Id.*, at para. 136.

⁴⁸ *Id.*, at para. 71.

⁴⁹ *Id.*, at para. 116.

⁵⁰ REPORT OF THE COMPANY LEGISLATION AND REGULATORY FRAMEWORK COMMITTEE (2001), paras. 3.1-3.10.

⁵¹ See generally Michael C. Jensen and William H. Meckling, *Theory of the firm: Managerial behavior, agency costs and ownership structure*, 3 JOURNAL OF FINANCIAL ECONOMICS 305 (1976).

⁵² S Johnson et al., *Tunnelling*, 90 AMERICAN ECONOMIC REVIEW 22, 22 (2000).

majority of a board to be independent, or a very high standard (e.g., hypothetically, an audit committee with five members all with accounting or financial expertise), minimum standards should not cause hardship in terms of compliance for smaller firms, as they represent the minimum requirements that market participants are expected to have. A firm may voluntarily choose to have more independent directors at its own cost. Exchange or trade associations might help smaller firms find independent directors by having a register of potential candidates, such as the one operated by the Australian Institute of Corporate Directors.⁵³

Third, in places where corporate governance codes are “comply or explain” in nature, a firm may disclose the reasons behind any failure to comply with a standard and let the market decide. In a way, the “comply or explain” principle has been seen as “a practical means of establishing a single code of corporate governance whilst avoiding an inflexible ‘one size fits all’ approach.”⁵⁴ Considering the flexible approach, minimum corporate governance standards should not generate excessive burden on these firms if they can properly explain their noncompliance.

Fourth, it is easier for market participants to compare and regulators to supervise compliance if there is a uniform benchmark to measure companies. If the law imposes a lower standard for smaller firms (e.g., 20% of the board being independent instead of one-third), policymakers need to first decide how to define large and/or small firms (depending on how the law is drafted). As a company’s fortune may fluctuate, there could be difficulties in continuous monitoring and classification of a firm, thereby increasing regulatory and enforcement costs. Doing also might also raise the chance of regulatory arbitrage.

Fifth, one might also argue for a one-size-fits-all approach on the ground of equality. Having differential treatment in favor of smaller firms might penalize those who happen to become more successful (and henceforth becoming larger). If a firm really prefers to evade corporate governance requirements, it may choose to go private. Since corporate governance codes apply mainly to listed companies in stock exchanges (at least in the cases of Hong Kong and Singapore), there seems to be no need to have further differential treatment provided that

⁵³ Mak Yuen Teen, *Improving the implementation of corporate governance practices in Singapore* (2007), at 46, in http://www.mas.gov.sg/~media/resource/news_room/press_releases/2007/CG_Study_Complete_Report_260607.pdf (last visited December 1, 2017).

⁵⁴ David Seidl et al., *Applying the “comply-or-explain” principle: discursive legitimacy tactics with regard to codes of corporate governance*, 17 *JOURNAL OF MANAGEMENT & GOVERNANCE* 791, 792 (2013).

even small listed firms are larger than most other firms if we examine the whole spectrum of business entities in a market.

Last, there are some arguments that better corporate governance may benefit smaller companies. For example, Brunninge argued that for closely held small or medium enterprises, a change of board composition by introducing more outside directors might facilitate more strategic changes.⁵⁵ Minichilli suggested that board diversity is important during a crisis and independent directors may provide the CEO and the firm better access to a more diverse pool of competence and experience.⁵⁶ Switzer argued that small-caps firm that were subject to Sarbanes-Oxley Act experienced an incremental increase in market valuation by comparing firms that are subject to the Act and those that are not.⁵⁷

There are also contrary views against a one-size-fits-all approach to corporate governance. First, good corporate governance comes with costs. If we accept that hiring good and qualified people tends to cost more money (including remuneration, cost for directors' insurance, and other benefits), it disadvantages smaller firms compared with their larger counterparts, who are presumed to have more financial resources for such expenditure. In other words, smaller firms could face resource constraints that limit their choices.⁵⁸

In the U.S., some argue that the Sarbanes-Oxley Act imposed disproportionately high compliance costs on smaller firms.⁵⁹ The cost of registration alone could range from US\$200,000 to \$500,000 as reported in a paper published in 2005.⁶⁰ Another survey showed that the projected expenditures to comply with the Sarbanes-Oxley Act was US\$2.9 million per company for companies with annual revenue over US\$5 million, compared with a projection of US\$222,200

⁵⁵ Brunninge et al., *Corporate governance and strategic change in SMEs: The effects of ownership, board composition and top management team*, 29 *SMALL BUSINESS ECONOMICS* 295, 304 (2007).

⁵⁶ Alessandro Minichilli & Cathrine Hansen, *The Board Advisory Tasks in Small Firms and the Event of Crises*, 11 *JOURNAL OF MANAGEMENT GOVERNANCE* 5, 19 (2007).

⁵⁷ See generally Lorne N. Switzer, *Corporate governance, Sarbanes-Oxley, and small-cap firm performance*, 47 *QUARTERLY REVIEW OF ECONOMICS AND FINANCE* 651 (2007).

⁵⁸ See generally Irene M. Gordon et al., *Corporate governance in publicly traded small firms: A study of Canadian venture exchange companies*, 55 *BUSINESS HORIZONS* 583 (2012) (suggesting that smaller firms might face resource constraints on choices after studying some publicly traded smaller firms listed in Canada).

⁵⁹ Anita Anand, *Voluntary corporate governance, proportionate regulation, and small firms: Evidence from venture issuers*, note 1, in <https://corp.gov.law.harvard.edu/2017/04/10/voluntary-corporate-governance-proportionate-regulation-and-small-firms-evidence-from-venture-issuers/#1> (last visited November 30, 2017).

⁶⁰ Castelluccio, *supra* note 7, 445 (2005).

by companies with annual revenues under US\$25 million,⁶¹ showing that the magnitude of impact (as a proportion of revenue) on smaller firms is bigger than larger ones.⁶² Another report in 2008 estimated that the average cost of compliance with Sarbanes-Oxley Act for companies with under US\$1 billion in annual revenue has increased more than US\$1.7 million to US\$2.8 million since 2001.⁶³ It is also costly to prepare a report assessing a firm's internal control system.⁶⁴ Even in Singapore, one report suggests that smaller companies might comply with the code in form rather than in substance, though there is no further empirical evidence provided⁶⁵

Second, unless a smaller firm has a well-known brand, it may not have a sufficient reputation to attract good candidates. This in turn may affect the quality and expertise of board members. Eisenberg et al. argued that “[o]utside directors thus bear a reputation cost if projects fail and the firm encounters financial difficulties, [in] which their share of the gains is limited.”⁶⁶ This is based on an assumption that independent directors of smaller firms own only negligible equity stakes in the firms.⁶⁷ This may also mean that independent directors have a bias against projects that increase the probability of bankruptcy.⁶⁸ In the end, board independence regime might not benefit shareholders of smaller firms.

Third, if a smaller firm can only hire the required number of independent directors to meet the minimum regulatory requirement, the same independent directors might be required to be a member of all relevant committees (including audit, remuneration and nomination committees). If this is the case, it increases the workload and responsibility of the independent directors, compared with in a larger firm, which should be able to afford to have more independent directors on the board and to have more variety of expertise. This in turn could reduce the chance of a smaller firm hiring a highly qualified candidate if the person is conscious of responsibility and potential liability.

⁶¹ Roberta Romano, *The Sarbanes-Oxley Act and the making of quack corporate governance*, 114 YALE LAW JOURNAL 1529, 1587 (2005).

⁶² *Id.*, at 1588.

⁶³ Nikki Swartz, *SOX Costs Sock Small Firms*, 42(2) INTERNATIONAL MANAGEMENT JOURNAL 14 (2008).

⁶⁴ Sarbanes-Oxley Act, Pub. L. 107-204, s 404; Castelluccio, *supra* note 7, at 457.

⁶⁵ Mak, *supra* note 53, at 23.

⁶⁶ Theodore Eisenberg et al., *Larger board size and decreasing firm value in small firms*, 48 JOURNAL OF FINANCIAL ECONOMICS 1 35, 37-38 (1998).

⁶⁷ *Id.*, at 37.

⁶⁸ *Id.*, at 38.

Fourth, if a smaller firm is a family-owned business with a controlling shareholder, the company might have a certain degree of closeness among the controllers and management. In such a situation, independent directors may not be as effective if they cannot acquire information from the insiders. If an independent director comes from a small network of controlling shareholders of a small firm, this could further undermine the board's effectiveness, as the director might not be truly "independent."

In extreme situations, high compliance costs might prevent smaller firms from going public. As Holmstrom and Kaplan argued,

"[B]ecause some of the additional costs of comply[ing] with [the Sarbanes-Oxley Act] are fixed rather than variable, the effects will be more negative for smaller companies than for larger ones. At the margin, this may lead some public companies to go private and deter some private companies from going public."⁶⁹

There has been some empirical evidence of this effect. Chhaochharia et al. found that small firms that are less compliant earn negative abnormal returns, suggesting that some provisions might be detrimental to small firms.⁷⁰ Eisenberg et al. found a negative correlation between board size and profitability in small and mid-size Finnish firms.⁷¹ Gordon et al. found that larger firms have better corporate governance practices and larger board sizes than smaller firms in a sample of over 700 companies listed in Toronto.⁷² Further, in a study of Norwegian companies published in 1990, Huse found that board composition in small firms is a function of company size and ownership structure and varies with industry.⁷³ If smaller firms have smaller boards, independent directors may be less likely to resist the influence of executive officers.⁷⁴

Last, even if a corporate governance code is "comply or explain" in nature, there could be some standardization effect to the point that smaller firms are still expected to comply by investors market analysts.⁷⁵ Therefore, smaller firms may still be compelled to comply with rules that may not be optimal for them.

⁶⁹ Bengt Holmstrom and Steven Kaplan, *The state of U.S. corporate governance: What's right and what's wrong?* 15 JOURNAL OF APPLIED CORPORATE FINANCE 8, 17 (2003).

⁷⁰ Vidhi Chhaochharia and Yaniv Grinstein, *Corporate governance and firm value: The impact of the 2002 governance rules*, 62 JOURNAL OF FINANCE 1789, 1813-1814 (2007).

⁷¹ Eisenberg, *supra* note 66, at 53.

⁷² Gordon, *supra* note 58, at 589.

⁷³ Huse, *supra* note 6, at 372.

⁷⁴ Eisenberg, *supra* note 66, at 37.

⁷⁵ Hertig, *supra* note 8, at 10.

In sum, there are arguments that support or oppose the application of a one-size-fits-all corporate governance code. In relation to smaller firms, the key opposition is based on restraint of resources that smaller firms might face. On a grander level, it is also arguable whether or not a one-size-fits-all corporate governance practice based on the Anglo-Saxon model is suitable in the global context.⁷⁶ Another paper argues that there could be multiple governance paths leading to high firm performance, but these practices do not always belong to the same national governance tradition.⁷⁷ However, this is beyond the scope of this article. To better evaluate the impact of a one-size-fits-all approach of corporate governance to smaller firms, we must first acquire a better idea on how firms comply with corporate governance codes. For this purpose, the next part will use data to examine whether the resources-based arguments still stand with empirical evidence collected in Hong Kong and Singapore. Before then, there is a preliminary question: who to define firm size?

C. Defining Firm Size

Our question is this: which argument better reflects the state of compliance by smaller firms? Before we illustrate our data in Part III, we must define “smaller firms.” The easiest reference is the definition of small and medium-sized enterprises (SMEs). However, we must note that smaller listed corporations are probably larger than most unlisted SMEs.

The definition of an SME varies by country. The Organization for Economic Cooperation and Development (OECD) generally defines SMEs as “non-subsidary, independent firms which employ fewer than a given number of employees [which may vary across countries].”⁷⁸ The OECD also recognizes that some jurisdictions use the size of financial assets as benchmarks. In the U.S., the definition of an SME may vary by industry, pursuant to standards laid down by the North American Industry Classification System or the U.S. Small Business Administration (SBA). Pursuant to the SBA standards, the size standards for small businesses depend on either

⁷⁶ See generally Marlene Davies and Bernadette Schlitzer, *The impracticality of an international “one size fits all” corporate governance code of best practice*, 23 *MANAGERIAL AUDITING JOURNAL* 2 532–544 (finding that the Anglo-Saxon model is not necessarily the right approach from a global perspective); Ann-Marie Anderson & Parveen P. Gupta, *Corporate governance: Does one size fit all?* 24 *JOURNAL OF CORPORATE ACCOUNTING & FINANCE* 51–64 (2013) (arguing that mandating corporate governance practices based on the Anglo-Saxon model may lead to sub-optimal firm performance).

⁷⁷ See generally Roberto Garcia-Castro et al., *Bundles of firm corporate governance practices: A fuzzy set analysis*, 21 *CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW* 390 (2013).

⁷⁸ O.E.C.D., <https://stats.oecd.org/glossary/detail.asp?ID=3123> (last visited December 1, 2017).

the average annual receipts or the average number of employees of a firm, varying by industry and subsector. For example, the size standard for timber tract operations is US\$11 million, but for the logging sector the standard is 500 employees.⁷⁹ The European Commission defines SMEs as enterprises “which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million and/or an annual balance sheet total not exceeding EUR 43 million.”⁸⁰ In Asia, taking Singapore as an example, a firm would qualify as an SME if either its annual turnover is no more than S\$100 million (about US\$71 million) or it has no more than 200 workers.⁸¹ In sum, the definition of SMEs usually includes either the number of employees or the size of a firm (by asset or by revenue), or both, as benchmarks, although the actual standards vary by country.

How can we differentiate between large and smaller firms in the case of listed companies? Drawing from the definitions of SMEs, we may consider using assets, revenue or number of employees as benchmarks. The former two factors could be acquired from public databases or financial statements. However, listed companies do not always report their numbers of employees, so we have only limited information for this factor.

Another benchmark is market capitalization, which generally refers to the total market value of company shares, illustrating the market’s perception of the company’s value. The market generally classifies firms into large-cap, medium-cap, small-cap or even micro- or nano-cap companies, depending on the figures of their market capitalization. Nonetheless, there is no universal standard for classifying market capitalization. For example, NASDAQ defines “large-cap” as “a stock with high level of market capitalization, usually at least \$5 billion market value,”⁸² while it defines a mid-cap firm as a firm with capitalization between \$1 billion and \$5 billion.⁸³ In Hong Kong, the Hong Kong Exchange defines a company as large-cap if its market

⁷⁹ U.S. Small Business Administration, Table of Small Business Size Standards Matched to North American Industry Classification System Codes, at 1 and 3, https://www.sba.gov/sites/default/files/files/Size_Standards_Table_2017.pdf (last visited December 1, 2017).

⁸⁰ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, 2003/361/EC, article 2(1).

⁸¹ SPRING Singapore, *Factsheet on New SME Definition*, in https://www.spring.gov.sg/NewsEvents/PR/Documents/Fact_Sheet_on_New_SME_Definition.pdf (last visited December 1, 2017).

⁸² Nasdaq, Financial Glossary (Large cap) in <http://www.nasdaq.com/investing/glossary/l/large-cap> (last visited December 1, 2017).

⁸³ Nasdaq, Financial Glossary (Mid cap) in <http://www.nasdaq.com/investing/glossary/m/mid-cap> (last visited December 1, 2017).

capitalization is at least HK\$1,000 million (about US\$130 million) or more, with the threshold for mid-cap between HK\$400 million (about US\$52 million) and HK\$1,000 million, and companies below HK\$400 million small-cap.⁸⁴

This article will mainly adopt total assets and market capitalization as benchmarks. The value of total assets of a company refers to the left side of the firm's balance sheet and is a raw indicator of how large a company is. For simplicity, this article uses the end of fiscal year as the cut-off day for the value of total assets (as reported in financial statements) and market capitalization. For clarification, this article does not propose to use annual revenue as a benchmark to define smaller firms. This is in part because some companies suffer losses in some years, and therefore there could be negative annual revenue figures.

From our total sample of 354 firms and 2,499 firm-year observations, the mean of market capitalization converted to US dollars⁸⁵ at the end of each fiscal year is US\$1,913.5 million (US\$2,340.6 million in Hong Kong and US\$846.7 million in Singapore). The difference in values between Hong Kong and Singapore is consistent with the size of each market.⁸⁶ In addition, the data are highly skewed. In aggregate, the highest observation of end-of-year market capitalization is US\$139.84 billion, in contrast with US\$0.53 million in the smallest case. This shows how great the divide is.

In terms of total assets by end of fiscal year for each firm, we find a similar pattern, with the mean of observations of total assets US\$6,175.6 million (largest US\$873.72 billion and smallest merely US\$0.18 million). Between Hong Kong and Singapore, the results are also consistent with market capitalization; Hong Kong is larger in means of total assets (US\$7,380.4 million vs US\$3121.2 million) and total revenue (US\$2,872.8 million vs US\$1,183.1 million), with the difference in means significant at the 1% level for both measures. This could be a result

⁸⁴ Hong Kong Exchange, *Analysis of Corporate Governance Practices Disclosure in 2009 Annual Report*, at 5, in http://www.hkexnews.hk/reports/corpgovpract/Documents/CG_Practices_2010_e.pdf (last visited December 1, 2017).

⁸⁵ This research converts all financial and RPT data into USD by calculating the annual average of the exchange rate between USD and the reporting currency based on the daily exchange rate reported by the Board of Governors of the Federal Reserve System. See the Federal Reserve website: <https://www.federalreserve.gov/releases/h10/Hist/> (last visited December 1, 2017).

⁸⁶ According to the World Bank, the total market capitalization of listed companies in 2016 was US\$3,193.235 billion in Hong Kong and US\$640.428 billion in Singapore. World Bank, *Market capitalization of listed domestic companies (current US\$)* in <https://data.worldbank.org/indicator/CM.MKT.LCAP.CD> (last visited December 1, 2017).

of the gigantic Chinese firms listed in Hong Kong, as there are no Chinese firms in our Singapore sample. In only our Hong Kong sample, the mean of Chinese firms (US\$7955.7 million) is nearly five times larger than the mean of other firms (US\$1652.0 million), with the difference in means statistically significant at the 1% level.

The next issue is how to classify firms into different categories by size. In the U.K., the Corporate Governance Code defines a “smaller company” as “one that is below the FTSE 350 throughout the year immediately prior to the reporting year.”⁸⁷ This means that the UK code defines a smaller company as a company that is not one of the largest 350 companies by market capitalization.

As our main purpose is to distinguish small companies from their larger counterparts in order to observe characteristics and compliance records, this article will classify firms into two groups by market capitalization: larger firms and smaller firms for some analysis. To avoid having an arbitrary dividing line, this article uses US\$150 million (inclusive) as the dividing line, as it is around the median of all of our observations and close to the criteria of SEHK’s definition for large-caps.⁸⁸ As each of the sampled firms has observations for 7 years (if there is no missing value), we treat a firm as a “smaller firm” if the average of its market capitalization for all 7 years is below US\$150 million. This approach ensures that we can analyze our data at the firm level, since a firm’s market capitalization may fluctuate above or below the threshold at times, depending on market movement. As the effect of corporate governance and company performance should be continuous, this approach is more suitable than classifying each firm-year observation separately. This classification leaves us with two groups of companies that this article will adopt for further analysis: larger companies (1,220 observations) and smaller companies (1,190 observations).⁸⁹ If we classify them into the different markets, about 42.07% of observations in Hong Kong belong to the category of smaller companies, and it is 67.63% in Singapore.

Before we move on, we entertain a question regarding the connection between ownership and firm size. A two-sample t-test shows that smaller firms (as a group) have a lower mean of

⁸⁷ UK Code B.1.2 and Note 6.

⁸⁸ *Supra* note 84.

⁸⁹ There are 89 observations of missing values due to inability to find end-of-year figures for market capitalization from public information or subscription-based databases.

highest beneficial stakes than larger companies if we combine both markets (mean = 43.35% for smaller firms and 46.68% for larger firms, $p < 0.001$), or in the Singapore market only (mean = 39.27% for smaller firms and 45.80% for larger firms, $p < 0.001$), but not for Hong Kong alone, although the differences in means are not very large. Moreover, we find that smaller firms are less likely to have 30% controlling ownership in both markets ($\chi^2 = 27.16, p < 0.001$), for Hong Kong ($\chi^2 = 10.98, p = 0.001$) and for Singapore ($\chi^2 = 7.31, p = 0.007$). Combining both markets, 68.16% of smaller firms have a 30% controlling owner, in contrast to 77.61% for larger firms. In Hong Kong, it is 71.65% for smaller firms and 78.59% for larger firms. In Singapore, it is 62.69% for smaller firms and 73.18% for larger firms.

In addition, it is clear that state-owned enterprises (SOEs) (notably those from China) are far larger than other businesses on average. In Hong Kong, the average market capitalization at the end of 7 fiscal years is about US\$8151.8 million for SOEs and US\$1118.7 million for others. The figures in Singapore are US\$3,801.3 million for SOEs and US\$702.8 million for others. In contrast, very few smaller firms in our dataset are SOEs. Overall, less than 5% of smaller firms are SOEs, in contrast with 22.79% of larger firms. Therefore, smaller firms have far less implications from state ownership. In sum, our data show that smaller firms do not necessarily have a higher degree of concentration of ownership. As state ownership is probably not a significant factor for smaller firms, the main corporate governance issues for smaller firms are from family or a single controlling shareholder.

III. Assessing Smaller Firms' Compliance with Corporate Governance Codes

How can we assess the suitability of corporate governance codes for smaller listed firms? The existing literature states lack of resources and costs as the biggest concerns for smaller firms. If this is the case, we should expect smaller firms to have smaller boards and just enough independent directors to meet the minimum requirement if they choose to comply, resulting in the proportion of independent directors on the board being around or right above the minimum threshold. Moreover, if the resource-based arguments are correct, smaller firms should have fewer resources to hire outside directors, and those independent directors would have heavy

workloads. These factors combined may negatively affect the goals of the corporate governance rules, and support the argument that one size does not fit all.

To this end, this article presents empirical data from a sample of companies listed in Hong Kong and Singapore to see how firms comply with corporate governance standards. We sample 25% of all companies listed on the main boards of both the SEHK and the SGX as of January 1, 2009 (that were still listed at the end of 2015), resulting in a total of 254 companies from the SEHK and 103 from the SGX, with a total of 2,499 firm-year observations, to create panel data for 7 years. We collect a variety of corporate governance data, including board size, number of independent and executive directors, type of chairman, duality of chairman and CEO, number of members on board committees, remuneration paid to directors (where available), names of external auditors and fees paid to auditors, some firm characteristics (e.g., ownership and largest ownership stakes), and financial data for each firm-year observation.

In general, we present data from different analyses for each issue in order to have a complete picture. First, we seek to test any correlation between some corporate governance benchmarks (e.g., board size, board independence, remuneration for independent directors, etc.) and firm size (in terms of the amount of market capitalization or total assets) through a regression model clustered by firms, controlling year fixed effect for our panel dataset.⁹⁰ As we aim to discover evidence rather than draw statistical inferences, this article refrains from adding complexity by controlling more factors in the regression model. Second, this article examines whether firms that we classify as small⁹¹ have certain characteristics (e.g., smaller boards) through two-sample t-tests or *chi*² analysis (where appropriate). We also support with other analytical methods such as Wilcoxon-Mann-Whitney test where appropriate.

Overall, this article attempts to paint a picture of the effect of a one-size-fits-all corporate governance code on smaller listed firms in Hong Kong and Singapore. For clarification, as the spectrum of market capitalization or total assets for our sampled firms is very wide, we use logged figures for financial data and market capitalization for our analysis. On this basis, the

⁹⁰ This article does not present data with fixed effect regression with firm fixed effect. The underlying reason is that firms do not radically change ownership, size or corporate governance practices within 7 years (i.e. 2009 to 2015). As a result, the lack of variance in a number of variables would affect the outcome in fixed regression models with firm fixed effect. As the purpose to identify general patterns rather than to draw statistical inference, this article will present data with regression models clustered by firms and with year fixed effect.

⁹¹ See *supra* Section II.C.

following four sections will offer empirical evidence on the compliance of corporate governance codes by smaller firms. For clarification, due to some missing information, the total number of observations for each benchmark may differ.

A. Corporate Governance Practices and Compliance

This article first examines compliance records of corporate governance, to understand whether firm size may be a factor in shaping corporate governance practices. In terms of board size, the mean of all observations is 8.40 directors (8.97 in Hong Kong and 7.00 in Singapore). Regarding the total number of independent directors (as designated in annual reports), Hong Kong and Singapore are in the same band, with the mean being 3.53 independent board directors in Hong Kong, and 3.38 in Singapore. The size of the audit committee is also comparable between the two markets, with the mean being 3.37 directors in Hong Kong and 3.25 in Singapore. Regarding the proportion of independent directors on the board (i.e., the degree of board independence), with larger board sizes and similar numbers of independent directors, Hong Kong firms naturally have a lower degree of board independence (about 41%) than Singapore firms (48.86%).

In addition, 1,921 of 2,427 observations (79.15%) with this information have the chairman as an executive director (84.65% in Hong Kong and 66.06% in Singapore). In contrast, only about 21.04% of observations in Singapore and barely 2.33% in Hong Kong have the chairman as an independent director. In terms of chairman–CEO duality (i.e., the chairman also being the CEO), 33.38% of observations in Singapore and 26.46% in Hong Kong (28.46% aggregated) have chairman–CEO duality. Therefore, separating the roles of chairman and CEO or having an independent chairman is not overwhelmingly common, despite the recommendations of corporate governance codes in both markets.⁹² This is a contrast to compliance with the minimum board independence requirement.

How do smaller firms comply with corporate governance codes in comparison with larger firms? First, we find that board size positively correlates with market capitalization ($p < 0.001$) or total assets ($p < 0.001$) if we use the combined data. We can replicate the positive correlation in both Hong Kong and Singapore for both market capitalization and total assets ($p < 0.001$ in all

⁹² See, for example, David J. Denis and Atulya Sarin, *Ownership and board structures in publicly traded corporations*, 52 JOURNAL OF FINANCIAL ECONOMICS 187, 195 (1999).

cases). In addition, we also a positive correlation between the number of independent directors on the board and market capitalization or total assets no matter for combined data or for each market separately ($p < 0.001$ in all cases).

Combining the two factors, we identify a negative correlation between the degree of board independence and market capitalization ($p = 0.003$) for the combined data and in Hong Kong ($p < 0.001$), but in Singapore, the correlation is only significant at 10% level ($p = 0.059$). Moreover, we identify negative correlation between the degree of board independence and total assets for combined data and in Hong Kong ($p < 0.001$ in both cases), but there is no statistically significant correlation between the two variables in Singapore. The results suggest that in Hong Kong at least, larger firms are likely to have a lower proportion of independent directors on the board, though they might have more board members and independent directors. In Singapore, larger firms might also have more board members and independent directors, but the degree of board independence does not seem to differ judging by firm size.

We can support the findings with other analytical methods. Through two-sample t-tests, we find that smaller firms have smaller board sizes (7.22 vs 9.54, $p < 0.001$) and fewer independent directors (3.14 vs 3.82, $p < 0.001$) based on the combined data, although smaller firms have a higher mean of degree of board independence (45.39% vs 41.36%, $p < 0.001$). We reach the same conclusion if we analyze each market separately. However, we note that the actual differences in means is not particularly great. Therefore, we have some mixed evidence on the correlation between firm size and the degree of board independence.

Second, regarding the nature of the chairman, we find that a supermajority of observations (1,450 out of 1,713, 84.6%) in Hong Kong and about two thirds of observations in Singapore (471 out of 713, 66.06%) have executive chairman, contrary to recommendations by corporate governance codes in either market. We find that the amount of market capitalization or total assets cannot predict the odds of a firm having an executive chairman for the combined data or the Hong Kong only data. However, if we analyze the Singapore sample alone, we find that firms with bigger market capitalization (odds ratio = 0.735, $p = 0.003$) or total assets (odds ratio = 0.757, $p = 0.01$) are less likely to have an executive chairman. If we classify firms into two groups—smaller and larger firms—the results also show that smaller firms tend to be more likely to have an executive chairman in Singapore ($chi^2 = 28.48$, $p < 0.001$) but this is not true for the

combined data or Hong Kong only data. In addition, applying Wilcoxon-Mann-Whitney ranksum test also shows that in Singapore, those companies with executive chairman have lower market capitalization or total assets ($p < 0.001$ in both cases).

Third, regarding chairman-CEO duality, the sample shows that about 26.46% of observations in Hong Kong (468 out of 1,769) and 33.38% in Singapore (240 out of 719) have chairman-CEO duality. In Singapore, firms with larger market capitalization (coefficient = -282, $p = 0.01$) or total assets (coefficient = -0.237, $p = 0.053$) are less likely to have chairman-CEO duality. However, we find no statistically significant relationship between firm size and the odds of chairman-CEO duality for the combined data or the Hong Kong only data. If we classify firms into “smaller” and “larger” groups, we find that smaller firms are more likely to have chairman-CEO duality for the combined data ($\chi^2 = 4.64$, $p = 0.03$) but this is not the case if we analyze each market individually ($p = 0.48$ for Hong Kong and $p = 0.12$ for Singapore). Applying Wilcoxon-Mann-Whitney ranksum test, the data shows that in Singapore (but not in Hong Kong) firms with chairman-CEO duality have lower market capitalization or total assets ($p < 0.001$ in both cases).

In sum, the data shows some evidence suggesting that smaller firms tend to have a smaller board with a fewer number of independent directors, though they do not necessarily have a lower proportion of independent directors. In addition, the data also shows that smaller firms seem to be more likely to have executive chairmen in both markets and chairman-CEO duality in Singapore only. A further question may be the characteristics of those who serve as independent directors. This is subject to further studies in the future, as this research has not acquired data on personal characteristics of independent directors in our sample companies.

B. Board Committees

The next issue is the size of board committees and compliance by smaller firms. These aspects should shed some light on the potential workload and responsibility of independent directors in smaller firms.

In general, companies in both Hong Kong and Singapore require at least three different committees: audit, remuneration and nomination committees.⁹³ If we combine both markets, the

⁹³ See section II.A.

mean size of an audit committee is about 3.34 directors (median = 3) with the maximum observation of 7 directors in the committee and the minimum 2. In fact, most companies have 3-5 audit committee members, covering a range from the 1st to the 99th percentile. The mean size of both remuneration and nomination committees is about 3.5 members per observation, with a median of 3. However, in the case of nomination committees, some companies listed in Hong Kong have only recently set up their nomination committees. If we only count observations with a nomination committee, the mean size is 3.66 members with a median of 3. If we analyze each market separately, the mean and median are similar to the combined data, with the mean and median size of each board committee being between 3 and 4 members.

How do smaller firms fare in terms of board committees? For simplicity, this article reports only data on audit committees, which serve the important function of reviewing financial accounts and related party transactions. We find that firm size does not correlate with the number of members of an audit committee, except in the Singapore only data, where market capitalization has a positive correlation ($p = 0.02$).

If we apply two-sample t-tests by classifying firms into two groups, we find that smaller firms tend to have smaller audit committees ($p < 0.001$ for all cases). If we combine all observations, the mean size of an audit committee is 3.20 members in smaller firms, and 3.47 for larger firms, with a statistically significant difference in means (mean = 3.23 for smaller firms and mean = 3.42 for larger firms, $p < 0.001$). The same holds true if we analyze Hong Kong and Singapore separately ($p < 0.001$ in both cases). Considering that there is little variance in the size of the audit committee, the actual difference between larger and smaller firms is too small to be meaningful.

A further point is the workload of independent directors in board committees. Our dataset does not record the number of committee memberships held by each director. Hence, we do not have a direct measure of the workload of independent directors regarding board committee work. This article thus proposes an indirect measure for workload, by calculating the ratio between the total seats of the three board committees (audit, remuneration and nomination committees⁹⁴) divided by the total number of independent directors in a certain firm-year observation. As the corporate governance codes in either market generally expect more than half of these committee

⁹⁴ We treat the value as 0 if a firm does not have a remuneration or nomination committee in a certain year.

members to be independent directors, the higher the ratio, the more likely it is that independent directors have multiple board committee memberships and hence greater workloads and responsibility.

In general, the overall mean of the ratio between total board committee seats and number of independent directors is 3.01 (median = 3) if we combine both markets. If we analyze each market separately, the mean is 2.93 in Hong Kong and 3.22 in Singapore (median = 3 in both markets). This means that on average the total number of seats in board committees is three times the total number of independent directors. Considering that our sample companies have a mean of about 3.5 independent directors, it is likely that independent directors are required to serve on two or often all three board committees.

Is there any difference between larger and smaller firms? We find that the ratio negatively correlates with market capitalization or total assets in Singapore ($p < 0.001$) in both cases and with total assets only in Hong Kong ($p = 0.01$). If we apply two-sample t-tests to examine the means of the ratio between the groups of larger and smaller firms, we can repeat the same result with the means of the ratio for smaller firms being statistically significantly higher than those for larger firms for combined data (mean = 3.10 for smaller firms and 2.94 for larger firms, $p < 0.001$) and in Singapore (mean = 3.37 for smaller firms and 2.88 for larger firms, $p < 0.001$), although not in Hong Kong. Thus, we have limited evidence that smaller firms tend to have a higher ratio between the total number of board committees and independent directors. However, as the ratio is closer to three in both markets, it is perhaps a general problem where independent directors are required to serve on multiple (if not all) board committees regardless of the size of the firm.

C. Remuneration of Directors

Another angle is to examine directors' remuneration, which represents the direct costs of complying with corporate governance codes. This also represents an indirect way to measure compliance costs. However, there were some difficulties in acquiring data on remuneration of directors in our sample, as there is no known database providing Asian data for analysis. Annual reports (including corporate governance reports) sometimes do not offer exact figures. This study acquires remuneration data from financial statements from two sources: key management remuneration listed under the disclosure of relation party transactions and emolument of board of

directors. Nevertheless, there is a considerable number of missing values that might hinder inferential analysis. We have only 1,998 observations (out of 2,499) for key management compensation disclosed in the section of related party transactions in the notes to financial statements, and 2,351 observations for aggregate directors' compensation disclosed in other parts of financial statements, including only 1,649 observations for remuneration of executive directors and only 1,285 observations for independent directors. Thus, there is a limit on the power of the data. On this basis, this article provides a descriptive account of the data on directors' remuneration, notably for independent directors.

First, a general question is whether smaller firms tend to pay directors less. Combining both markets, a regression analysis shows that the amount of total remuneration paid to directors positively correlates with firm size ($p < 0.001$ for both market capitalization and total assets). We can replicate the correlation if we analyze each market separately ($p < 0.001$ in all cases). Thus, there are evidence showing that smaller firms generally pay their directors less.

Second, what about remuneration paid to independent directors? From our limited data, we identify a similar pattern whereby smaller firms pay less to independent directors (mean = US\$0.09 million for smaller firms and US\$0.24 million for larger firms, $p < 0.001$) if we test the differences in means between smaller and larger firms. A regression analysis shows that the amount of market capitalization or total assets positively correlates with the amount of remuneration to independent directors ($p < 0.001$ in both cases) for the combined data or in Hong Kong only. This is supported by the data showing that the means of total remuneration to directors and total remuneration to independent directors are both higher for larger firms than smaller firms ($p < 0.001$ in both cases) if we analyze the means of the combined data. However, for Singapore, there are too many missing values, resulting in a very small sample size of about 30 observations only. This prevents us from making a judgment for the Singapore sample.

Thus, our limited data show that smaller firms might pay less to independent directors (and the whole board generally) if we combine data from the two markets. This generally reflects the size of the firm and financial resources. However, this conclusion is not very robust due to the significant amount of missing data.

D. Smaller Firms and Auditing

How do smaller firms and larger firms differ in terms of auditing? If smaller firms tend to have fewer resources, one may argue that they are less likely to hire more reputable auditing firms. If this is the case, it may reduce the quality of their audits and therefore their corporate governance. Commonly in finance studies, one benchmark is whether the auditing firm is one of the Big 4 in the industry.⁹⁵

Our dataset lends some support to the above assertion. From the 2,407 observations where we can clearly identify the auditing firm, we find that larger firms are more likely to hire one of the Big 4 ($chi^2 = 215.16, p < 0.001$). For larger firms, 82.27% of observations were audited by one of the Big 4 auditing firms, while only 54.50% were for smaller firms. There is also a consistent pattern if we analyze Hong Kong and Singapore separately. In Hong Kong, the proportion of firms hiring one of the Big 4 is 82.81% for larger firms and 57.87% for smaller firms ($chi^2 = 130.19, p < 0.001$), and in Singapore it is 79.82% for larger firms and 49.25% for smaller firms ($chi^2 = 58.3, p < 0.001$). If we apply the Wilcoxon-Mann-Whitney ranksum test, we also find that in both Hong Kong and Singapore, firms that hire one of the Big 4 as the auditor are generally larger in size in terms of market capitalization or total assets for both Hong Kong and Singapore ($p < 0.001$). Therefore, we have some evidence showing that smaller firms are less likely to hire one of the Big 4 auditing firms as their external auditor.

Does the finding mean that smaller firms have lower quality audits? Among the smaller firms in both markets that did not hire a Big 4 firm for auditing services, more than 70% hired other large international auditing firms, such as BDO, HLB, Mazars, RSM, Grant Thornton, Baker Tilly, etc. There are indeed cases where smaller firms hired relatively unknown local auditing firms. However, without other evidence, it might be too harsh to accuse them of providing poorer auditing services in comparison with larger firms. Therefore, we find no substantial proof that smaller firms have poorer audit quality based on the audit firms they hire.

E. Summary

In summary, Part III examines the compliance of corporate governance codes in a sample of companies listed in Hong Kong and Singapore. First, we find some evidence showing that

⁹⁵ The Big 4 are PricewaterhouseCoopers, KPMG, Deloitte & Touche, and Ernst & Young.

smaller firms tend to have smaller boards and less independent directors, but we have no robust evidence showing that smaller firms have a lower degree of board independence in terms of the proportion of independent directors. Second, in Singapore only (not in Hong Kong), smaller firms are more likely to have executive chairman and chairman–CEO duality. Third, it seems to be a general problem that independent directors are required to serve on multiple (and sometimes all three) board committees, but there is no strong evidence showing that the situation is worse in smaller firms than in larger ones. Fourth, there is limited evidence that smaller firms pay less remuneration to independent directors than larger firms, as our data are limited by missing values. Last, we find that smaller firms are less likely to use one of the Big 4 auditing firms (raising questions of audit quality), although we cannot say whether smaller firms have higher degrees of concentrated ownership.

IV. Reflection on a One-Size-Fits-All Corporate Governance Code

What do our findings imply regarding a one-size-fits-all approach to corporate governance? As Romano suggests, provisions should enable firms to tailor their internal organization to their specific needs.⁹⁶ The discussion above does to a certain extent support resources-based arguments that a one-size-fits-all approach to corporate governance does not favor smaller listed firms. However, must it mean that Hong Kong or Singapore should have lower standards for smaller firms, like the U.K. does? This article makes the following suggestions.

First, meeting the minimum threshold of one-third of a board being independent directors in both markets, and the minimum number of three independent directors required by the SEHK, does not seem to be difficult for smaller firms, as most seem able to satisfy this requirement. All of the sampled companies in Singapore generally complied with the minimum threshold during the study period, and over 80% of the sampled firms in Hong Kong complied with the minimum threshold in 2009 even before the requirement was enacted in the corporate governance code. The high compliance rate (even before the official implementation of the rule in Hong Kong)

⁹⁶ Romano, *supra* note 61, at 1596.

lends support to a one-size-fits-all approach to impose some common minimum requirements. For this purpose, there seems no strong evidence demanding Hong Kong or Singapore to impose a lower board independence requirement for smaller firms. To push further, perhaps the UK could reconsider merits of having a lower board independence requirement for smaller companies after examining UK data.

However, a bigger question is whether it worth raising minimum board independence thresholds for all companies. For example, the Singapore code now requires firms to have at least half of their boards as independent directors if the chairman is part of the management team.⁹⁷ As the Singapore sample shows that smaller firms are more likely to have an executive chairman, this will mean that many smaller listed firms may have to hire more independent directors if they want to comply with the code.

While hiring more independent directors might reduce some of the burden on serving board committees, it also means that firms must pay more and find good candidates. The former is certainly a financial constraint when smaller firms already pay less to independent directors, while the latter means that the pool of candidates will only get smaller if smaller firms all try to hire more independent directors at the same time. This might be less of a problem in larger countries such as the U.S. or China where there is an abundance of professionals or qualified candidates. However, it might be an issue in smaller markets like Singapore without assessing foreign candidates, who might cost more for smaller firms to hire if those firms do not have many international business connections.

Shrinking board size may be another option to meet the minimum threshold if a firm does not want to, or finds it difficult to, hire more independent directors. There is some evidence from the compliance record of the 2012 code in Hong Kong that reducing board size is a common strategy to meet the minimum one-third threshold.⁹⁸ However, it is unclear whether reducing board size is good or bad, especially when smaller firms already tend to have smaller boards. For example, Coles et al. find that the relationship between firm value and board size may not be

⁹⁷ Singapore Code, Guidelines 3.3.

⁹⁸ Chen et al., *Board Independence as Panacea to Tunneling? An Empirical Study of Related Party Transactions in Hong Kong and Singapore*, at 30, in https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2991423 (last visited December 1, 2017).

linear, so very large or very small boards could both be optimal,⁹⁹ while Yermack shows that smaller boards are more effective.¹⁰⁰ Thus, policymakers should reconsider the merit of one-size-fits-all corporate governance standards for smaller firms, especially when they consider imposing higher standards. Otherwise, policymakers should assist firms to find good candidates that do not demand outstanding payment as compensation.

Second, regarding the nature of chairman and chairman–CEO duality, the relatively low compliance record perhaps shows that chairman–CEO duality is not an overwhelmingly popular idea among companies no matter whether they are big or small. This article suggests that policymakers could consider differentiating between larger and smaller companies. There are arguably more benefits in requiring larger firms to have an independent chairman and/or to separate the roles of chairman and CEO. It is likely that larger firms have many more shareholders and it may be more justifiable for them to have additional safeguards, such as an independent chairman, to ensure the board’s function. Nonetheless, the case may be weaker for smaller firms, which are often run by a family or a single founding owner. In light of the potential burden of hiring more independent directors (let alone designating one of them as the chairman), one may argue for a more flexible approach to respect certain features of family firms or sometimes to preserve the vision of founder of a company.¹⁰¹

Third, this article does not propose exemptions for smaller firms from board committee requirements. However, assuming that there is no particular reason to believe that smaller firms would be willing to pay more to hire better independent directors, policymakers should perhaps do more to address potential concerns about overloading independent directors of smaller firms. This research does not prove that more responsibility (which might be translated into more liability) might mean that smaller firms hire lesser candidates. This is subject to future studies to examine characteristics and expertise of directors hired by listed companies. However, it is perhaps not an unreasonable expectation that an excellent candidate would think about workload

⁹⁹ Jeffrey L. Coles et al., *Boards: Does One Size Fit All?* 87 JOURNAL OF FINANCIAL ECONOMICS 329 (2008) (examining the relationship between firm size and board structure in different kinds of firms).

¹⁰⁰ David Yermack, *Higher market valuation of companies with a small board of directors*, 40 JOURNAL OF FINANCIAL ECONOMICS 185 (1996).

¹⁰¹ See generally Zohar Goshen and Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 360 (arguing that corporate law for publicly traded firms with controlling shareholders should balance the need to secure his/her idiosyncratic vision against the minority’s need for protection).

and potential liability when considering a directorship. If a candidate is excellent, we should also assume that he probably has other full-time business to handle.

To make corporate governance regimes work, we must have good candidates for independent directors. Relaxing certain rules for smaller firms may be one way to reduce compliance costs and assist smaller firms in concentrating their resources on hiring good people. Policymakers should also do more to help match demand and supply. Creating a register or network of suitable candidates for independent directors may be a start. However, it will not address potential concerns around overload and responsibility.

V. Conclusion

In conclusion, this article examines the impact of a one-size-fits-all corporate governance code (as is the case in Hong Kong and Singapore) on smaller listed firms, which are supposed to have fewer resources to hire more qualified independent directors to serve on their boards and board committees. Thus, a one-size-fits-all approach is arguably not suitable for smaller listed firms. After examining data from a sample of companies listed in Hong Kong and Singapore, we find some limited support for the resources-based arguments, though there is no overwhelming evidence suggesting that smaller firms have difficulties meeting the minimum board independence requirements. While smaller firms seem to comply with the minimum one-third threshold quite well, evidence suggests that smaller firms might pay less to their independent directors and these directors are quite likely to be required to serve on multiple board committees. Although many larger firms also share the problem of overloading their independent directors, the ability to find and attract good candidates certainly differs with the availability of resources. Therefore, this article suggests that policymakers should rethink the merit of raising board independence standards to a higher level or board committee requirements and should find ways to assist smaller firms to hire good (and hopefully less expensive) candidates as independent directors in order to strengthen the board independence regime and to achieve the goals of promoting good corporate governance.