Does the Reputation of Independent Non-executive Directors Matter: Evidence from Hong Kong[*]

Roger King
Department of Finance
Hong Kong University of Science and Technology
Clear Water Bay, Kowloon, Hong Kong
Email: rking@ust.hk
Tel: (852)-2833-3501; Fax: (852)-2827-9779

Winnie Qian Peng
Department of Finance
Hong Kong University of Science and Technology
Clear Water Bay, Kowloon, Hong Kong
Email: pengq@ust.hk
Tel: (852)-2358-1096; Fax: (852)-2358-1749

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Abstract

In response to recent corporate scandals, shareholders and regulators around the world are demanding greater corporate transparency. If indeed, as is often stated, Independent Non-executive Directors (INED) can play an important role in monitoring management and enforcement of transparency, then do INEDs' personal reputations matter? This paper examines shareholders' response to appointments of INEDs in Hong Kong – a society where corporate ownerships are concentrated and personal reputations are highly valued. Our study finds prestigious individuals are positively related to less risky and better performing firms. We also find appointments of prestigious INEDs are associated with smaller IPO underpricing, and that the market reacts positively to the new non-replacement appointments of less-busy prestigious INEDs. However, the market seems to be indifferent to reputation in replacements of INEDs. These results extend the reputation capital literature by providing evidence on the role INEDs in certifying and signaling the quality of firms.

1. Introduction

An active literature has developed examining the influence of Independent Non-executive Directors, INEDs, (we use INEDs and outside independent directors interchangeably) on the performance of publicly listed firms. It has been often stated that INEDs can play an important role in monitoring management actions (Fama, 1980), and provide expert knowledge and business networking useful for management. Mace (1986) claims that board directorship can be a source of prestige and business contact which may induce CEOs to accept outside directorships. Allen and Faulhaber (1989) suggest that the quality of the board of directors, amongst other variable may also signal the quality of the firm. Shivdasani (1993) suggests the number of additional board seats held by the appointee as a measure of an individual director's reputation. Booth and Deli (1996) find monetary rewards and perquisites do not appear to attract highly compensated CEOs to outside directorships. One the other hand, Yermack (2004) suggests that remuneration linked to firm's performance can impact outside directors' incentive and decision to retain their directorship. Fich (2005), using data from Fortune 1000 boards, suggests that CEOs of well-performing firms are more likely to gain outside directorships to signal to the market better future prospects for the appointing firm. Thus, it appears that the reputations of INEDs are related to the "reputations" of the appointing firms and that the decisions of prestigious INEDs to join the boards is related to the firms' quality.

In light of the above, this paper examines empirically the relationship between the reputations of the INEDs and appointing firms' characteristics. The paper first addresses the effect of INEDs' reputations (prestige) in the pricing of initial public offerings (IPOs). Numerous studies have appeared in the past three decades addressing the pricing of IPOs. Of particular interest is the persistent observed phenomenon of IPO underpricing, defined as the negative difference between IPOs' offering price and the closing price of the first day of trading. For instance, Ritter (1984) finds average underpricing of 18.8 percent for approximately 5,000 firms that went public between the years 1960 and 1982 in the United States. Similarly, Ibbotson, Sindelar and Ritter (1988) find that the average first-day IPO return is 16.3%. McGuinness (1992) finds, on average, IPOs (for the years between 1980 and 1990) are underpriced by nearly 18

percent in Hong Kong[1]. For the year 2005, as reported by the South China Morning Post,[2] 72 percent of the fifty-seven new issues on the Main Board in Hong Kong closed above their offering price on the first day of trading. Thus, the underpricing phenomenon transcends major capital markets. The question addressed by many past researchers is why high quality and low risk issuers willingly "leave money on the table" for new investors and whether there are ways to minimize this underpricing effect[3]. Rock (1986) suggests that the underpricing phenomenon is associated with information asymmetry between the informed versus the less informed investors and the perceived risks – greater the perceived risk, the great the underpricing. Balver et al. (1988), Beatty (1989), and Carter and Manaster (1990), theorize that quality issuers attempt to minimize the costly underpricing through the use of reputable intermediates such as underwriters and auditors. Other researchers, Allen and Faulhaber (1989), Grinblatt and Hwang (1989), and Welch (1989) suggest that firms with good future prospects use underpricing to signal quality in which bad quality firms cannot easily mimic. Baron (1982), on the other hand suggests that this underpricing anomaly is due to a principal-agent problem between the underwriters and the issuers. However, none of these studies link the reputation of INEDs to IPO underpricing. In this paper we posit that the appointment of prestigious INEDs should convey quality and thus reduce the IPO underpricing because uninformed investors presume prestigious INEDs are better informed of the future prospect of the issuers and, perhaps more importantly, have their own reputation to protect. This concept is similar to the notion of reputation signaling developed by Klein and Leffler (1981) where they demonstrate that a non-salvageable capital expenditure can serve as an effective bond to guarantee the quality of a firm's product.

We also examine market's reaction to appointments and resignations of prestigious INEDs. Past studies addressing this issue are inconclusive. Rosenstein and Wyatt (1990), using NYSE and the American Stock Exchange data for the years 1981 to 1985,

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[1] In Hong Kong, the offering price is determined between the issuer and its underwriter following the IPO book-building process. This implies there is no fixed pricing for the offered share shares prior to the book-building discovery phase. Instead the issuer will provide an indicative price band to establish the ultimate price. Once the price of the offer is fixed, the number of shares allocated to investors is determined at the sole discretion of the issuer in consultation with the underwriter. Furthermore, all IPOs are done on a non-committed basis.
[2] December 30, 2005
[3] Ljungqvist (2005) provides a good summary of the past IPO underpricing literature

report a positive cumulative abnormal return (CAR) around the appointment of prestigious outside directors to corporate boards. However, Fich and Shivdasani (2004) find the market reacts negatively to the appointment of INEDs that have more than three existing directorships. Shivdasani and Yermack (1999) find that outgoing directors are more likely to be replaced by directors with similar characteristics – for instance, prestige replaced by prestige, CEOs replaced by CEOs.

In this paper we test the market's reaction by thoroughly documenting the attributes of INEDs based on hand collected data from Hong Kong. The question is why Hong Kong? Hong Kong is ideally suited for this study for five reasons. First, even though Hong Kong, until June 30, 1997, was a British colony for nearly one hundred and fifty years, its basic cultural philosophy follows the traditional Chinese Confucian values where personal reputation and relationships are fundamental to all aspects of commercial and social intercourse[4]. Bond and King (1985) and Bond (1996) conclude that the value of power, wealth and personal reputation are key elements of the Chinese social fibre. This is particularly important in Hong Kong where nearly 70 percent of the listed firms are family-controlled. Second, Hong Kong's legal system offers considerable investor rights protection to insure a reasonably efficient market. LaPorta et al. (1998) find countries with strong legal investor protections have better developed capital markets[5]. Third, the Hong Kong stock exchanges are globally recognized (ranked 4th by equity fund raised for the year 2005 and ranked 9th by market capitalization)[6]. Four, to induce greater corporate transparency for Main Board listed firms, the Security Exchange of Hong Kong, SEHK, has mandated that all listed firms, after March 31, 2004, must have at least three INEDs serving on their boards and at least one with accounting or related financial management expertise[7] as a member of the Audit Sub-Committee of the Board. One year prior to this new requirement, 72.4 percent of the listed firms had two or less INEDs. Thus, this change in listing requirement offers a natural setting in which to examine the relationship between the qualities and reputation of newly appointed INEDs

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[4] There are many other cultures in Asia and Europe where personal reputation and relationships are highly valued.

[5] LaPorta et al. (1998) rank Hong Kong, Singapore and Pakistan the highest amongst the 14 countries in the Asia Pacific Region.

[6] Statistics are as of September 30th 2005, South China Morning Post, December 2, 2005, B2.

[7] The Exchange expects the person to have, through experience as a public accountant or auditor or as a Chief Financial Officer, controller or principal accounting officer of a public firm or through performance of similar functions, experience with internal controls and in preparing or auditing comparable financial statements or experience reviewing or analyzing audited financial statements of public firms.

and firms' performance. Finally, there are a number of other important capital markets that have many, if not all, of the characteristics of Hong Kong.

Our study shows that prestigious individuals are more likely to accept invitations from firms that are perceived to be less risky. We find that having prestigious INEDs at IPO reduces underpricing which is consistent with notion advanced by Allen and Faulhaber (1989) and Fich (2005) that prestigious INEDs can convey the quality of the appointing firm. This is particularly interesting because prior studies suggest the reputation of intermediaries, such as auditors and underwriters, at least for Hong Kong, is irrelevant and insignificantly related to IPO underpricing (McGuinness (1992) and Ng et al. (1994)). We also find that the market reacts positively to new appointments of less-busy INEDs to fulfill the new requirements of the Security Exchange of Hong Kong. Finally, the empirical results show that, contrary to previous studies based on U. S. firms (Fich and Shivdasani (2004)), the Hong Kong market is insensitive to the unexpected resignation of prestigious INEDs.

The rest of this paper is organized as follows. In Section 2, we discuss the key hypotheses. Section 3 presents our methodology, data and variables. Empirical results are shown in section 4. Conclusions and limitations are discussed in Section 5.

2. Main Hypotheses

2.1. INEDs and IPO Underpricing

We examine the reputation effect for prestigious INEDs to join the firms during the period of IPO "window dressing" process. This concept is similar to prior IPO underpricing "endorsement or certification" studies which suggest that by selecting prestigious auditors and underwriters, the IPO underpricing is reduced (Beatty and Ritter (1986), Beatty (1989), Carter and Manaster (1990), Ng et al. (1994) and Michaely and Shaw (1995)). Thus our first hypothesis is that there is a negative relationship between the prestige of individuals appointed as INEDs and perceived risk of firms. Prior studies suggest six relevant measures for risk: leverage ratio and ROA (e.g., Michaely and Shaw, 1995), firm size (e.g., Ritter, 1984), underwriter reputation and auditor reputation (e.g.,

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Beatty, 1989, and Michaely and Shaw, 1994) and after market standard deviation (Beatty, 1989). A higher leverage ratio (total debt over total assets) and a lower return on asset, ROA, (net income over total assets) are associated with riskier firms. Larger IPOs (measured by the total capital raised at IPO) are perceived as less risky. It is important to note the effects of risk/cost to investors, INEDs and issuers are different. Investors are concerned with the loss of their investments whereas INEDs are concerned with the loss of their reputation. For the issuers, their cost is the "money that is left on the table". Thus, if one assumes, *ceteris paribus*, that firms always prefer to invite more prestigious INEDs, we deduce that prestigious individuals are more likely to accept invitations to join corporate boards at IPO if the inviting firm is perceived to be less risky. This notion of mutual choice is consistent to the concept recently advanced by Fernando et al. (2005) who develop an equilibrium model of mutual choice between issuing firms and underwriters. Therefore,

H1a: There is a negative relationship between the prestige of individuals appointed as INEDs at the time of IPO and the perceived risk of firms.

As an extension of the above hypothesis, we posit that firms will seek prestigious individuals to join their boards as INEDs to convey quality of their firms and to reduce the costly IPO underpricing phenomenon to the issuing firms. Specifically, firms with more prestigious INEDs are likely to have lower IPO underpricing than firms with less prestigious INEDs[8].

H1b: The appointment of prestigious INEDs signal firm quality and thereby reduce underpricing of IPOs.

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[8] One might argue that in order to reduce legal liabilities, a reputable INED would want to "leave more money on the table" for IPO investors (a bigger underpricing). This argument is similar to Dye's (1993) findings that prestigious auditors are more vulnerable to lawsuits. We would argue that this situation is unlikely in Hong Kong for two reasons. First, Hong Kong is still considered a non-litigious society. This is demonstrated by the fact that close to a third of Hong Kong listed firms do not carry Directors and Officers Liability Insurance. Second, it is doubtful that INEDs are involved or can influence the IPO offering price. If they are truly concern with potential lawsuits due to mispricing, they simply would refuse the appointment.

2.2. INED (non-replacement) Appointment After 2003

This section links the reputation of newly appointed INEDs to the quality of listed firms and market reaction to the appointment. Beginning with April 1, 2004, all Hong Kong Main Board listed firms are required to have at least three INEDs and the Audit Sub-Committee must be composed of entirely of INEDs, with at least one with financial qualification. This change in regulation provides a natural setting for our study. Our sample period begins with January 1st, 2003, since this approximates the date that the Stock Exchange of Hong Kong, SEHK, announced its intention to increase the minimum number of INEDs to three and began to seek opinions from listed firms.

Similar to our hypothesis *H1a*, we first posit that prestigious individuals are positively related to less risky and better performing listed firms. Unlike IPO firms, these firms have an operating history which potential INEDs and investors can view to determine the quality of appointing firms. If we again assume firms always prefer to appoint the highest quality individual as their INEDs, then we deduce that prestigious individuals, who have their own reputations to uphold, are more likely to accept invitations to join boards of firms that have better past performance and lower risk. Past performances and risks are measured by ROA, frequency of qualified opinion statements and change of auditors (see Appendix). Hence,

H2a: Better performing and less risky publicly listed firms (seasoned stocks) are positively related to prestigious INEDs.

Rosenstein and Wyatt (1990) show that there is a positive cumulative abnormal return (CAR) upon the appointment of prestigious individuals as INEDs. However, Fich and Shivdasani (2004) find the market reacts negatively to appointment of quality CEOs when they already hold two external directorships. They termed these CEOs as "busy" directors. Therefore, we assert that:

H2b: The market reacts positively whenever prestigious non-busy individuals are appointed to the board.

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2.3. INED Replacement

Finally we examine the announcement effect of INED replacements[9]. Thus, our third proposition is that whenever there are unexpected resignations of prestigious INEDs, the market will react negatively if INEDs are replaced by less prestigious individuals, since the resigned prestigious INEDs, who generally support policies of controlling shareholders' management philosophy and policies, will resign if their own reputation is at stake[10]. However, when a less prestigious INED is replaced by a prestigious INED, the market reacts positively since the prestigious INEDs convey quality of the firm and enhance the confidence of the investors.

H3: The market reacts negatively (positively) when a prestigious (less prestigious) INED resigns prematurely from the firm and is replaced by a less (more) prestigious INED.

3. Methodology, data and variables

3.1. Ranking Methodology and Sample Selection

INED Reputation Ranking:

Similar to auditor and underwriter reputation ranking schemes used by past researchers for IPO underpricing studies, we develop an INED reputation ranking scheme which we describe below. INED data (first name, last name, job titles, name of the firm, appointment day, resignation day, etc) is collected from firms' prospectuses, "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's[11] website (www.webb-site.com.hk). We then abstract from our constructed

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[9] Replacement is defined as resignation of an INED (prior to the expiration of his term) and the appointment of another INED on the same day.

[10] The Listing Committee of HKSE may impose disciplinary procedures against INEDs which include private reprimand, public statement involving criticism and issuance of public censures. They may also state publicly that in the Exchange's opinion that the retention of office by the director is prejudicial to the interest of investors.

[11] David M. Webb is currently a non-executive director of Hong Kong Exchanges and Clearing Limited, a retired investment banker, a private investor and a provider of independent commentary on corporate and economic governance, business, finance, investment and regulatory affairs in Hong Kong.

INED database names of all current 2,411 INEDs (61.4% of the total number), and past 1,515 INEDs (38.6% of the total number), totaling 3,926 INEDs, of all Main Board listed firms of the Hong Kong Stock Exchange as of December 31, 2005.

Of 3,926 INEDs, there are a total of 148 different position descriptions or job titles. From this job title list[12], we consolidated the various position descriptions to 14 titles and assigned weight factors to each (see Table 1). The weight factor assignments are somewhat arbitrary but justifiable as not all job titles carried the same importance and prestige. For instance, Fich (2005) identify CEOs as better value-enhancing outsider directors than others.

<Insert Table 1>

We adjust the weight factors for firm size based on the firm's market capitalization, MarCap, using the closing price as of December 31, 2005. LargeCap, MidCap and SmallCap are defined as firms with a MarCap equal to or greater than US$1 billion; equal to or greater than US$ 200 million and less than US$200 million, respectively. We assign a weight factor of 3, 2 and 1 to LargeCap, MidCap and SmallCap, respectively. Furthermore, we differentiate currently held positions from past or retired positions by assigning a discount of 50% to past or retired positions. The scoring formula is defined as:

$$Score_i = \sum_j (Marcap_{ij} \times Title_{ij} \times Status_{ij}) \tag{1.1}$$

and

Tier = 1, when Score >11;

Tier = 2, when 3 < Score ≦11;

Tier = 3, when Score ≦3

where:

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[12] Hong Kong firms use both American and English titles for their executives - CEO (American) vs. CE or Managing Director (English) and CFO (American) vs. Finance Director (English). Often seen titles such as President and CEO tend to be redundant. American oriented firms tend not to use the title Executive Director as an indication of seniority. Director in the English context implies a member of the board. However, the title Director in the American context signifies a position below that of Vice President. An example would be Director of Sales.

Individual i holds j different titles in different firms

Marcap (market capitalization) = 3 for large cap, 2 for mid-cap and 1 for small-cap firms

Title (job description) = 5 to 1 based on the weight factors

Status = 1 for active and 0.5 for retired

The results of this scoring scheme are summarized as follows. The individual score ranged from a high of 118.5 to a low 0.5 with a mean of 6.00, median of 3.00 and a standard deviation of 7.23. There are a total of 509 (12.7%) individuals with a score of 11.0 or better. The next 1,194 (29.8%) individuals scored better than 3.0, with the rest, 2,306 (57.5%), scoring 3.0 or less. We rank the top 509 INEDs as being the most prestigious or Tier-1. We designate the next group of 1,194 INEDs as Tier-2 INEDs with the rest as being the least prestigious or Tier-3. One may argue this ranking assignment is very arbitrary; however, by varying the weight factors for the various job titles, our subgroup results were consistent. Separately, we also determined that the most important determining factor for INED *score* is the number of directorships held followed by positions (titles other than INED) held. It is interesting to note the individual with the highest score (118.5) is the Chairman and CEO of a family-controlled, locally owned, financial institution who sits on more than 30 boards (local and overseas). One must question the effectiveness of this individual at board meetings. The directorship league for Hong Kong listed firms (Main Board and Growth Enterprise Market Board, GEM) as of December 31, 2005, is shown in Table 2. Fich and Shivdasani (2004), find that busy outside directors (more than three directorships) are associated with weak corporate governance based on a sample of U.S. industrial firms from 1989 to 1995. Moreover, they find that appointments of busy directors are unrelated to firm performance but such directors are more likely to depart boards following poor firm performance - a possible indication of reputation as motives for the individual, Shivdasani (1993).

<Insert Table 2>

Auditor Reputation Ranking:

To rank the audit firm's reputation, we adopt a three tier scheme similar to Michaely and Shaw (1995). We assign the Big-Four (previously the Big-Eight) to Tier-1 (most prestigious) auditors. To differentiate the Tier-2 auditors from the Tier-3 (least prestigious) auditors, we asked 10 Hong Kong accounting professionals to segregate all IPO auditors, other than the Big-Four, into two distinct groups according to their perceived market reputations. We also calculate the auditors' reputation ranking using the number of IPO clients and total funds raised. We assume more prestigious INEDs are more likely to choose a firm with a higher ranked auditor. It is, however, interesting to note that in Hong Kong the Big-Four auditing firms dominated most of the new listings – 92.5 percent by clients and 99.5 by funds raised (see Table 3). Thus, any empirical study involving reputation of auditors at IPO for Hong Kong is not meaningful as virtually all issuers use only top tier auditors.

<Insert Table 3>

Underwriter Reputation Ranking:

Carter and Manaster (1990) create a hierarchy of underwriters' reputation by assigning each underwriter a score based on their respective positions on the announcement "tombstone" for each public issue offering. Our method, simpler and we believe equally effective, is based on the number of IPO clients and the amount of total funds raised. There are a total of 76 separate lead underwriters involved in 348 new issues between the years 1998 and 2005. The underwriters are separately ranked according to the number of lead positions and according to the amount of funds raised. The two rankings are then combined to establish a score. For instance, Goldman Sachs is ranked 3 for the number of lead positions and also ranked 3 for the amount of funds raised giving Goldman Sachs a combined score of 6. The subgroup with the lowest score is designated Tier-1 (highest reputation) and the subgroup with the highest score designated as Tier-3. The final reputation ranking is shown in Table 4. We assume more prestigious INEDs are more likely to choose firms with higher ranked underwriters.

<Insert Table 4>

Stock Performance Data:

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The stock performance (daily stock price, stock return, market capitalization, etc) is extracted from Datastream database. The accounting information (total assets, total debt, and net income) is collected from firms' prospectuses or Worldscope database. Other variables are discussed in the following three sections separately.

Table 5 summarizes the industry distribution by firm and by INED for each part of our study.

<Insert Table 5>

3.2. INEDs and IPO Underpricing

Our sample consists of 162 firms with initial public offering on the Main Board of Hong Kong Stock Exchange from January 1, 1999 to December 31, 2005, and 339 INEDs who joined these firms less than one year prior to IPO. The IPO information (offering price, total amount of capital to be raised, name of the underwriter and the name of the auditor) as well as the accounting information at the time of IPO are collected from the firms' prospectuses and SEHK website.

The underpricing of an IPO issue is calculated as the return on the first day of trading (relative to the offering price):

$$Rt_1 = \frac{P_{i1}}{P_{i0}} - 1 \qquad\qquad (1.2)$$

where:

Rt_1 = the return (underpricing) of the IPOs on the first trading day

P_{i1} = the closing price of stock i on the first day

P_{i0} = the offering price of stock i.

We also adjust the return for the market effect:

$$AdjRt_1 = \frac{P_{i1}}{P_{i0}} - (R_{i,m1} + 1) \qquad\qquad (1.3)$$

where:

$AdjRt_1$ = the market-adjusted return (underpricing) of IPOs on the first trading day

$R_{i,m1}$ = the market return on the first trading day of the new issue i.

Other variables used to test our hypotheses *H1a* and *H2b* are explained as follows:

Mscore is the average score of all INEDs in the same firm before IPO and is use to proxy the reputation of all INEDs. This firm-level approach reduces the potential bias resulting from having a single very prestigious INED dominating the study results. However, for robustness checks, we also use the highest score among the INEDs for the same firm. The results, not shown in this paper, are similar and consistent.

Total Assets[13] is used to control for firms' size and proxy for risk. Larger firms are considered to have lower risk. We use Log of the total assets in our regressions. We expect larger firms are positively related to higher *Mscore*.

Leverage is calculated as total debt over total assets. Firms with higher leverage are considered to have higher risk. We expect higher leverages are negatively correlated with *Mscore*.

ROA is calculated as net income before extraordinary items over total assets. It is a proxy for firm's performance as well as bankruptcy risk. We expect ROA is positively correlated with *Mscore*.

SD is the standard deviation of daily returns for days 2-11 after the first trading day, which is used as an ex post proxy to control for ex ante uncertainty for our sample. We expect SD is negatively correlated with *Mscore*.

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[13] Instead of using *Total Assets* in the IPO session, we also tried *Capital*, a measurement of the offering size (the total funds raised by the IPO). Statistically there's no difference in analysis results.

Market return is the market return in the period between offering and listing.

F-Busy is a dummy variable which equals 1 when at least one INED is a busy INED in the firm, 0 otherwise. Busy INED is a INED who holds at least three directorship (executive or non-executive) positions at the same time.

H/Red is a dummy variable which equals 1 when the firms are either H-share or Red-Chip firm, 0 otherwise[14].

Table 6 presents the descriptive summary of all defined variables. It also shows the results for test-of-differences between firms with Tier-3 and Tier-1 INEDs. There are 39 firms in the Tier-3 Group, 59 firms in the Tier-2 Group, and 64 firms in the Tier-1 Group[15]. Our results indicate that Tier-1 Group firms are significantly larger, with higher ROAs, affiliated with more prestigious underwriters, are more likely to be H-share or Red chip firms, with larger offering sizes, lower SD and less underpricing level. Tier-3 Group also exhibit higher leverage and lower past market return than Tier-1 Group but the difference is statistically insignificant. Table 7 presents the correlation matrix for the variables used in our underpricing analysis.

<Insert Tables 1.6 and 1.7>

3.3. INED (non-replacement) Appointment After 2003

The sample consists of 976 announcements of INED appointments (without replacement) for the period of January 1, 2003 to December 31, 2005. The announcement information is collected from the "Change in Directorships" section of the Hong Kong Stock Exchange website and from David Webb's website. The accounting information (total assets, leverage, ROA at the beginning of appointment year) is extracted from Worldscope database.

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[14] H-shares describe firms listed on SEHK's Main Board with legal domicile in the People's Republic of China, PRC. Red-chip shares are firms listed on SEHK's Main Board that are controlled by PRC entities but their legal domiciles are outside of PRC.
[15] Firms with a Mscore greater than 11 are designated as Tier-1 Group firms and those with a Mscore of 3 or less are designated as Tier-3 Group firms

We use standard event study methodology to calculate the cumulative abnormal returns for the periods around the announcement date of INED appointment.

The ex post abnormal returns (AR_{it}) are calculated as:

$$AR_{it} = R_{it} - (\hat{\alpha}_i + \hat{\beta}_i R_{mt})$$

(1.4)

where R_{it} and R_{mt} are the daily return of the firm associated with announcement i at time t and the daily market index return at time t, respectively. [16] The cumulative abnormal return (CAR_i) between any two dates T_1 and T_2 is calculated as:

$$CAR_i(T_1, T_2) = \sum_{t=T_1}^{T_2} AR_{it}$$

(1.5)

In addition to the accounting variables discussed in the previous section, we define three variables to indicate the firms' previous quality and other attributes of the newly appointed INEDs.

Qualified is a dummy variable that equals 1 when the firm received at least one qualified opinion statement during the past three years prior to the new appointment, 0 otherwise. We expect a negative effect on CARs when *Qualified* is 1.

Board Size is the total number of the existing directors on the board - including executive and non-executive chairman and vice chairman, executive and non-executive directors, directors, and INEDs but excluding alternate directors. *Board Size* can be a proxy for firm size.

Number of INEDs is the number of INEDs on the board prior to the new appointment of the INED.

Required is a dummy variable which equals 1 when the INED is appointed to fulfill the stock exchange's requirement of having at least three INEDs or at least one qualified

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[16] To estimate the specific parameters in an ordinary least squares regression of α and β, we use 200 daily returns beginning with day -220 and ending with -21 relative to the announcement date.

member in Audit Committee, and 0 otherwise. We expect the market reaction is stronger when *Required* is 1.

CEO is a dummy variable which equals 1 when the INED is at the same the CEO, chairman or president of other firm, 0 otherwise. As *CEO* conveys higher quality and reputation, Fich (2005), we thus expect the CARs will be higher when a *CEO* is appointed.

Busy INED is a dummy variable which equals to 1 when the individual holds at least three directorship (executive or non-executive) positions at the same time before the new INED appointment, and 0 otherwise. Similar to Fich and Shivdasani (2004), we expect busy INEDs will cause a negative market reaction since the market believes they are too busy to take the responsibility as an INED.

Panel A of Table 8 presents descriptive statistics for the full sample. Tier-1 shows significantly higher ROA, lower leverage, larger board size, and more INEDs than the Tier-3. The results also show that Tier-1 has more CEOs and busy INEDs. However, all CARs lose their significance, which is further analyzed in the Empirical Results section. Panel B provides the distributions of the types of INEDs for each tier. Table 9 provides the correlation matrix of all variables used in our CAR analysis.

<Inset Tables 1.8 and 1.9>

3.4. INED Replacement

Our sample consists of 337 announcements (other than AGM) of INED replacements from Main Board listed firms between April 1, 1999 and December 31, 2005. The sources of the announcements data as well as the method of calculation for CARs are the same as those in the previous section.

Table 10 shows the statistics of the variables by groups. Group ij means the Tier-i INED is replaced by the Tier-j INED. For example, when the Tier-1 INED is replaced by the Tier-3 INED (higher prestige INED is replaced by a lower prestige INED), the event is designated as Group 13. There are 9 different sub-groups. As above, the table

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includes the accounting variables (*Assets*, *ROA*, *Leverage* and *Qualified*), the board-related variables (*Board size*, *Number of INEDs*, INED *Scores* and number of *Busy INEDs* for both appointed and resigned INED), and the CARs. We find firms with replacements between higher Tier INEDs' show larger *Assets*, higher *ROA* and more *Busy INEDs*. However, there's no clear trend for other variables. Further tests will be done in the Empirical Results section below.

<Insert Table 10>

4. Empirical Results

4.1. INEDs and IPO Underpricing

We first examine INEDs' decisions to join boards. As posited by our hypothesis *H1a*, prestigious individuals are more likely to accept board appointments if the inviting firm is perceived to be less risky. The following is our regression model:

$$
\begin{aligned}
MScore = \alpha &+ \beta_1 LogAssets + \beta_2 ROA + \beta_3 Leverage + \beta_4 Underwriter\ rank \\
&+ \beta_5 Auditor\ rank + \beta_6 H / Red + Year\ and\ industry\ dummies + \varepsilon
\end{aligned}
\tag{1.6}
$$

Similar to Michaely and Shaw (1995), we proxy for risk using a) firm size (*LogAssets*), b) level of debt (*Leverage*) and c) return on asset (*ROA*). Regression I of Table 11 reports our regression results. *LogAssets* is significantly positive at the 1 percent level, suggesting prospective prestigious INEDs are more likely to be attracted to large firms. *Leverage* is significantly negative at 1 percent level, which again shows prospective prestigious INEDs are positively correlated to firms with less debt. Prestigious individuals positively correlated to firms' performance as *ROA* is significantly positive at the 10 percent level. Our results also indicate that the reputation of underwriters and the auditors show no significant effect on INEDs decisions to accept directorships. As the mean values for underwriters' ranking and auditors' ranking in our sample are 1.5 and 1.1, respectively, indicating that virtually all firms have already chosen prestigious underwriters and auditors at IPO. Our finding is consistent with the findings of McGuinnes (1992) and Ng et al. (1994) and could explain why these two risk proxies

lose their significance. Furthermore, our results indicate the coefficient of the control variable *H/Red* is positive but not significant. Our results are consistent with our hypothesis *H1a* that prospective prestigious INEDs are positively related to firms which are larger with lower debt leverage and better performance. From these results, we deduce that prestigious individuals are more likely to accept directorships from better performing and less risky firms.

<Insert Table 11>

We next examine how the reputation of the INEDs can influence the IPO underpricing level. Our regression model is as follow:

$$
\begin{aligned}
R_{t0} = {} & \alpha + \beta_1 Mscore + \beta_2 SD + \beta_3 Market\ Return + \beta_4 Busy + \beta_5 LogAssets \\
& + \beta_6 ROA + \beta_7 Leverage + \beta_8 Underwriter\ rank + \beta_9 Auditor\ rank \\
& + \beta_{10} H/Red + \beta_{11} Mscore*Busy + Year\ and\ industry\ dummies + \varepsilon
\end{aligned} \tag{1.7}
$$

The results are reported under Regression II of Table 11. As expected, the coefficient of *Mscore* is statistically significant negative at the 5 percent level, which suggests that the appointment of prestigious INEDs can reduce the IPO underpricing level. *SD* is statistically significant positive at the 1 percent level, indicating that the IPO under pricing is positively related to the IPO firm's ex ante uncertainty, and *Market Return* is significant positive at the 5 percent level. However, other variables are not statistically significant at conventional levels. To test the robustness of our regression, we substitute the dependent variable R_{t0} with $AdjR_{t0}$, the market adjusted underpricing level. The results, shown in Regression III of Table 11, remain much the same as Regression II. *Mscore* shows a negative at the 5 percent level and *SD* is positive at the 1 percent level, but again other variables remain insignificant. To test the busy INED effect, we add an interaction term of *F-Busy*Mscore* in Regression IV. The results are, however, not much affected, which suggests the busy INED has little effect on IPO underpricing level. Therefore, we conclude that Hypothesis *H1b* is supported.

4.2. INED (non-replacement) Appointment After 2003

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As shown in Panel A of Table 8, the full-sample t-test for all CARs show no significant differences between appointments of Tier-3 (least prestigious) and Tier-1 (most prestigious) INEDs. At first glance these results appear to be surprising and counter-intuitive. I therefore posit that the unexpected results might be due to other attributes of the newly appointed INEDs. According to Fich and Shivdasani (2004), the market reacts negatively to the appointments of prestigious, but busy, INEDs. We also posit that the market reacts positively to new INEDs appointed to fulfill the SEHK Listing Committee's mandate of having at least three INEDs or at least one qualified member on the Audit Committee, because these appointments increase the transparency and the perception of quality for the appointing firms. However, once the mandate requirement has been fulfilled, the market is less concerned with subsequent new INEDs appointments.

To test these propositions, we select only those newly appointed INEDs that hold less than three directorships before their new appointment and are fulfilling the Listing Committee's mandate and analyze the market's reaction for various CARs. The sample subset yields 393 INEDs, which is 40.3% of the full sample. The resultant CAR statistics and the t-test for our sub-sample are shown in Table 12. The t-values of the difference between Tier-3 (least prestigious) and Tier-1 (most prestigious) for all CARs are negative and significant at the 1 percent level. The t-values of the difference between Tier 2 and Tier 1 show similar results to Tier-3 and Tier-1. However, the t-value of the difference between Tier-3 and Tier-2 is significantly negative only for CAR(-3,3); other CARs lose their significance. These results suggest our hypothesis *H2b* is supported for *Required* and non-busy INEDs.

<Insert Table 12>

Next, we perform regression analysis to further verify our hypotheses *H2a* and *H2b*. The two regression models are shown as follows:

$$Score = \alpha + \beta_1 LogAssets + \beta_2 ROA + \beta_3 Leverage + \beta_4 Qualified$$
$$+ \beta_5 H/Red + \beta_6 Board\ size + \beta_7 Number\ of\ INEDs + \beta_8 Required \qquad (1.8)$$
$$+ Year\ and\ industry\ dummies + \varepsilon$$

$$CAR(-5,5) = \alpha + \beta_1 Score + \beta_2 LogAssets + \beta_3 ROA + \beta_4 Leverage + \beta_5 Qualified$$
$$+ \beta_6 H/Red + \beta_7 Board\ size + \beta_8 Number\ of\ INEDs + \beta_9 Required$$
$$+ \beta_{10} Busy\ INED + \beta_{11} CEO + \beta_{12} Required*Score + \beta_{13} CEO*Score \qquad (1.9)$$
$$+ \beta_{14} Busy\ INED*Score + Year\ and\ industry\ dummies + \varepsilon$$

Table 13 reports our regression results. Regression I includes only the key independent variables. Similar to our findings from regression (1.6), *LogAssets* is significantly positive at the 5 percent level and *Leverage* is significantly negative at the 10 percent level. *ROA* and *Qualified*, the two proxies for past performance and quality, are significantly positive and negative at the 5 percent level. The results again show that prestigious INEDs (with higher scores) accept directorship appointments from larger, lower leveraged and better past performance firms. With the introduction of control variables in Regression II, the key variables remain significant. Among the control variables, *Board Size* and *H/Red* are significantly positive at 1 percent level. As Table 9 shows, *Board Size* can be another proxy for firm size (*Total Assets*). Moreover, H-share and red chip firms appear to have more prestigious INEDs. One possible explanation is that H-share firms and red chip firms are perceived to be more prestigious by INEDs because these firms tend to be large State-owned Enterprises from China. I, therefore, conclude that Hypothesis *H2a* is supported since both regressions suggest prestigious INEDs prefer less risky firms.

<Insert Table 13>

Regressions III and IV examine the market reaction on announcement day. In Regression III, again *LogAssets* and *Board Size* are significantly at the 5 and 1 percent, respectively. *Score* is also positively correlated with CAR(-5,5) at the 10 percent level. *Required* INEDs shows a positive relation with CAR(-5,5), while *Busy* INEDs shows a negative relation, both at the 10 percent level. *Number of INED* and the dummy variable *CEO* have no significant effect. Regression IV replaces *Required*, *Busy* INEDs and *CEO* with their interactions with *Score*. Although *Score* and *CEO*Score* is not significant, the coefficients of *Require*Score* and *Busy INED*Score* show a stronger effect on the market reaction, both at the 1 percent level. Furthermore, Regression III and IV results show the market reaction is positive when *Required* INEDs are appointed and is negative when *Busy* INEDs are appointed which supports our hypothesis *H2b*.

4.3. INED Replacement

Table 14 shows some selected tests-of-differences between different groups. Unfortunately, we find no statistically significant differences in market reactions when lower prestige INEDs are replaced by higher INEDs or when higher prestige INEDs are replaced by the lower prestige INEDs. The exceptions are Group23-Group22, Group22-Group21 and Group12-Group11, but our findings are not robust. To test the Busy INED theory, we calculate the t-values for the same groups in Table 14 without busy INEDs again (which excludes 166 of the replacements in total) but still find no significant differences. Considering nearly half of our sample is related to busy INEDs, instead of deleting them, we next calculate the t-values between the busy INEDs and the non-busy INEDs in each of the groups in Table 10, again there are no significant differences. The results are not shown in the paper.[17]

Thus, our study of the announcement effect of INED replacement yields no result, and we conclude that our hypothesis *H3* is not supported.

<Insert Table 14>

5. Conclusions and limitations

The effects of the Sarbanes-Oxley, a US law passed in 2002 to strengthen corporate transparency and restore investor confidence, have been far reaching. Past research suggests that INEDs can play an important role in monitoring management and making financial decisions, Fama (1980). However, there is now considerable debate on the true effectiveness of INEDs in their role in monitoring the actions of management and whether investors view INEDs as value enhancing for the appointing firms. Our study examines the contribution of prestigious INEDs for listed firms at IPO and subsequent times.

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[17] Please contact the authors for the results if interested.

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Our finding supports the notion that prestigious individuals are more likely to accept directorships, at IPO and operating listed firms, only if the inviting firm is perceived to be high quality and less risky. Our data shows that, of the current active (2,537) Hong Kong INEDs, 296 (11.7 percent) hold 3 or more (excluding executive, overseas and NGO) directorships (see Table 2 for details). One may deduce that some individuals, do in fact, accept or seek directorships to enhance their own personal prestige and extend their business network as suggested by Mace (1986). Contrary to subsequent appointments for seasoned firms, the market is indifferent to the appointment of busy INEDs at the time of IPO. This finding also is consistent with Bond's (1991) observation that "name dropping, eagerness to associate with the rich and famous, use of external status symbols, lavish gift giving, and use of titles" are deeply ingrained in the Chinese culture. Our study, due to insufficient compensation data at this time[18], is unable to confirm whether monetary rewards and perquisites are significant inducements for individuals to accept directorships (Booth and Deli (1996) and Yermack (2004)).

It is also interesting to note that our empirical results support the notions that the appointment of prestigious INEDs is associated with smaller IPO underpricing and that the market reacts positively to new appointments of non-busy prestigious INEDs. However, our third hypothesis, *H3*, is not supported from the empirical results. It seems that Hong Kong shareholders and investors are indifferent to the reputation of INEDs that replace other INEDs. At first glance, these results appear to be contradictory. One possible explanation is that at IPO prestigious INEDs convey the image of quality for the appointing firm when *ex ante* uncertainly, as defined by Beatty and Ritter (1986), is greatest. Similarly, at mandate fulfillment time, the market may infer that these firms will be more transparent. However, at times of subsequent appointments and resignations, this *ex ante* uncertainly may be lower. Another possible explanation is that investors do not believe that Hong Kong INEDs are good monitors of management's actions, especially in settings where firms' ownership structures are highly concentrated (family or State-owned Enterprises) and invitations for directorships are usually extended to individuals based on personal relationships. Therefore a possible limitation of our study is the issue whether INEDs in Hong Kong, where the business and social

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[18] The SEHK mandated that all Main Board listed firms to identify monetary compensations of all INEDs in their 2005 Annual Report.

communities are close-knit and intertwined, can be truly independent. This begs the question as to whether the presence of INEDs really produces greater transparency and better governance. Also, one may want to ask whether the SEHK Listing Committee's 2004 mandate of requiring all listed firms to have at least three INEDs really necessary or effective. A possible shortcoming for event studies of appointments and resignations of INEDs is that the announcements are not well publicized to the general investment community. This may account for the lack of robustness of our results for new appointments as well the lack of support for our resignation studies.

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Table 1 Weight factors assigned for various job titles

Of 3,926 current and past INEDs for Main Board listed firms as of December 31, 2005, there are a total of 148 (executive and non-executive) different position descriptions or job titles held by these INEDs in other firms. From this job title list, we consolidated the various position descriptions to 14 titles and assigned weight factors to each. The weight factors assignments are somewhat arbitrary but justifiable as not all job titles carried the same importance and prestige.

Positions or job titles	Wt. factor
Chairman, CEO or Managing Director	5
Non-chairman CEO or Managing Director	4
Non-director CEO or Managing Director	4
Deputy Chairman, CEO or Managing Directors	4
Acting Chairman, CEO, President or Managing Directors	3
CFO and Executive Director	3
COO	3
INEDs	3
Alternate INEDs	2
Executive Directors	2
CFO, General Manager and Executive Vice President	2
Honorary Chairman	2
Vice Chairman	2
Alternate Executive Directors	1

Table 2 Directorship league table

Directorship league table for Hong Kong listed firms (Main Board and Growth Enterprise Market Board, GEM) as of March 26, 2006

No. of Directorships held	No. of individuals	Percentage of total
16	1	0.04%
14	1	0.04%
11	2	0.08%
10	2	0.08%
8	4	0.16%
7	10	0.39%
6	12	0.47%
5	30	1.18%
4	38	1.49%
3	95	3.73%
2	288	11.29%
1	2,067	81.06%
	2,550	100.00%

Source: David M. Webb

Table 3 Auditor Rankings

The Big-Four (previously the Big-Eight auditing firms) are assigned to Tier-1 (most prestigious) auditors. To differentiate the Tier-2 auditors from the Tier-3 (least prestigious) auditors, 10 Hong Kong accounting professional segregate all IPO auditors, other than the Big-Fours, into two distinct groups according to their perceived market reputation. Each auditor is assigned a unique score – lowest score being the most prestigious. Auditor reputation is also ranked according to the number of their IPO clients and total funds raised. Again each auditor is assigned a unique score – lowest score being the most prestigious. The two scores are added to give the final score. It is interesting to note that in Hong Kong the Big-Four auditing firms dominated most the new listings – 92.5 percent by clients and 99.5 by funds raised (see Table 2).

Auditor Name	clients	client %	Total HK$ Raised	Fund Raised %	Ranking by clients	Ranking by fund raised	Ranked by score	Ranking by Professional
Arthur Andersen & Co	26		62,810,734,407		5	3	8	1
Deloitte Touche Tohmatsu	79		45,244,429,270		3	5	8	1
Ernst & Young	93		62,072,958,962		1	4	5	1
KPMG	35		169,463,895,900		4	2	6	1
PricewaterhouseCoopers	88		172,181,308,591		2	1	3	1
Tier-1 summary	321	92.50%	511,773,327,130	99.50%				
Grant Thornton	3		291,440,000		9	9	18	2
HLB Hodgson Impey Cheng	5		196,900,000		6	10	16	2
Moores Rowland	2		180,288,960		11	11	22	2
RSM Nelson Wheeler	5		639,500,000		7	6	13	2
Tier-2 summary	15	4.30%	1,308,128,960	0.30%				
BDO McCabe Lo & Co / PCP CPA Ltd	1		55,000,000		12	13	25	2
CCIF CPA Limited	2		454,675,000		10	7	17	3
Charles Chan, Ip & Fung CPA Ltd	4		321,240,000		8	8	16	3
HLM & Co	1		126,360,000		13	12	25	3
Horwath Hong Kong CPA Ltd	1		na		14	16	30	3
KLL Associates CPA Ltd	1		50,000,000		15	14	29	3
PKF	1		22,000,000		16	15	31	2
Tier-3 summary	11	3.20%	1,029,275,000	0.20%				
Total	347	100.00%	514,110,731,090	100.00%				

Source of data: Hong Kong Stock Exchange

Table 4 Underwriter Rankings

Method is based on the number of IPO clients and the amount of total funds raised. There are a total of 76 separate lead underwriters involved in 348 new issues between the years 1998 to 2005. The underwriters are separately ranked first according to the number of leads and then according to the amount of funds raised. The two rankings are then combined to establish a score. For instance, Goldman Sachs is ranked 3 for the number of lead positions and also ranked 3 for the amount of funds raised giving Goldman Sachs a combined score of 6. The subgroup with the lowest score is designated Tier-1 (highest reputation) and the subgroup with the highest score designated as Tier-3.

Panel A - Tier -1 Underwriters

Rank	Underwriter	# of clients	Total HK$ Raised	Score
1	Goldman Sachs (Asia) L.L.C.	13	55,028,607,475	6
2	BNP Paribas Peregrine Capital Ltd	15	23,071,257,090	8
3	Morgan Stanley Dean Witter Asia Ltd	11	88,667,218,840	10
4	The Hongkong and Shanghai Banking Corporation Ltd	12	18,721,041,574	11
5	DBS Asia Capital Ltd	19	2,865,966,000	13
6	BOCI Asia Ltd	10	53,510,149,560	14
7	China International Capital Corporation (Hong Kong) Ltd	9	182,370,640,740	14
8	CLSA Ltd	8	7,024,929,680	24
9	Credit Suisse First Boston (Hong Kong) Ltd	6	28,634,307,590	26
10	ICEA Capital Ltd	8	2,641,500,000	29
11	Merrill Lynch Far East Ltd	5	9,395,615,000	31
12	Tai Fook Capital Ltd	12	1,061,660,000	31
13	First Shanghai Capital Ltd	10	1,231,451,120	33
14	Sun Hung Kai International Ltd	12	937,692,500	34
15	Oriental Patron Asia Ltd	12	900,040,000	37
16	China Everbright Capital Ltd	5	2,169,895,200	38
17	Citigroup Global Markets Asia Ltd	3	3,402,407,500	44
18	Deloitte & Touche Corporate Finance Ltd	5	1,299,690,000	44
19	Kingston Corporate Finance Ltd	11	648,572,560	44
20	Cazenove Asia Ltd	4	2,148,200,000	46
21	CSC Asia Ltd	10	686,375,000	46
22	Yuanta Securities (Hong Kong) Co Ltd	9	802,325,000	46
23	Kingsway Capital Ltd	5	1,241,913,000	47
24	ABN AMRO Rothschild	2	2,884,038,631	53
25	Anglo Chinese Corporate Finance Ltd	8	538,862,000	55
		224	491,884,356,060	

Source of data: Hong Kong Stock Exchange

Table 4 (continued)

Panel B – Tier-2 Underwriters

Rank	Underwriter	# of clients	Total HK$ Raised	Score
26	Core Pacific - Yamaichi Capital Ltd	5	929,600,000	56
27	Goldbond Capital (Asia) Ltd	5	829,150,000	59
28	South China Capital Ltd	8	427,552,500	60
29	UBS AG	2	1,997,549,750	60
30	Dao Heng Securities Ltd	8	393,500,000	62
31	Polaris Securities (Hong Kong) Ltd	3	952,522,000	62
32	Lippo Securities Ltd	6	440,600,000	63
33	Guotai Junan Capital Ltd	4	771,630,000	65
34	JS Cresvale Capital Ltd	5	547,588,160	66
35	Somerley Ltd	7	362,050,000	66
36	JP Morgan Securities Asia Ltd	2	1,214,706,500	67
37	Bear Steans Asia Ltd / ABN AMRO Rothschild	1	2,072,360,000	71
38	CAF Securities Company Ltd	3	579,300,000	72
39	Citic Capital Markets Ltd	1	1,328,250,000	74
40	Salomon Smith Barney Hong Kong Ltd	1	1,287,984,600	77
41	UOB Asia (Hong Kong) Ltd	5	242,050,000	80
42	ING Barings Asia Ltd/ ICEA Capital Ltd	1	1,138,500,000	82
43	Jardine Fleming Securities Ltd	1	1,094,290,000	84
44	Kim Eng Capital (Hong Kong) Ltd	4	236,150,000	84
45	TIS Securities (HK) Ltd	3	326,060,000	84
46	Pacific Challenge Capital Ltd	3	192,800,000	91
47	Baron Capital Ltd	3	177,800,000	93
48	VC Capital Ltd	2	304,606,500	93
49	Yu Ming Investment Management Ltd	3	170,000,000	96
50	Celestial Capital Ltd	2	193,380,000	98
51	Hantec Capital Ltd	3	160,400,000	98
		88	18,370,380,010	

Table 4 (continued)

Panel C – Tier-3 Underwriters

Rank	Underwriter	# of clients	Total HK$ Raised	Score
52	Nomura International (Hong Kong) Ltd	1	528,990,480	99
53	CCB International Capital Ltd / Access Capital Ltd	1	526,400,000	101
54	Asia Financial Capital Ltd	2	176,362,500	102
55	Ernst & Young Corporate Finance Ltd	1	378,513,440	106
56	Upbest Securities Co. Ltd	2	152,754,000	106
57	CEF Capital Ltd	2	150,000,000	108
58	SinoPac Securities (Asia) Ltd	1	364,000,000	108
59	Rexcapital (Hong Kong) Ltd	2	122,000,000	110
60	Credit Agricole Indosuez	1	293,250,000	113
61	First Asia Finance Group Ltd	2	105,000,000	114
62	AMS Corporate Finance Ltd	2	75,000,000	121
63	Shenyin Wanguo Capital (HK) Ltd	2	61,000,000	123
64	Daiwa Securities SMBC Hong Kong Ltd	1	117,669,600	126
65	Platinum Securities Co Ltd	2	50,000,000	127
66	Worldsec Corporate Finance Ltd	1	116,100,000	128
67	MasterLink Securities (Hong Kong) Corporation Ltd	1	98,175,000	131
68	Tanrich Capital Ltd	1	97,440,000	133
69	Barits Securities (Hong Kong) Ltd	1	94,000,000	135
70	Quam Capital Ltd / Altus Capital Ltd	1	89,975,000	137
71	KE Capital (Hong Kong) Ltd / Altus Capital Ltd	1	81,000,000	139
72	Asian Capital (Corporate Finance) Ltd	1	60,000,000	143
73	Partners Capital International Ltd	1	55,000,000	145
74	Emperor Capital Ltd	1	50,000,000	148
75	New Japan Securities International (H.K.) Ltd	1	13,365,000	150
76	N M Rothschild & Sons (HK) Ltd	1	na	152
		33	3,855,995,020	

Table 5 Industry Distributions by firms and by INEDs

The industry information for each firm is from the Datastream database. Code is the industry code. Name is the industry name.

Code	Name	IPO		Appointment		Replacement		Code	Name	IPO		Appointment		Replacement	
		firm	INED	firm	INED	firm	INED			firm	INED	firm	INED	firm	INED
30	Building Mat.& Fix.	3	9	13	18	7	9	77	Investment Companies	13	23	24	43	15	21
31	Gas Distribution	1	1	4	6	2	2	79	Tobacco	0	0	1	1	1	1
32	Industrial Supplier	0	0	3	4	1	1	80	Hotels	0	0	16	26	8	11
33	Specialty Chemicals	2	4	9	15	5	7	82	Paper	2	4	5	7	1	1
34	Computer Hardware	5	10	16	29	7	8	84	Publishing	2	6	6	10	4	4
35	Farming & Fishing	0	0	3	12	2	5	85	Home Improvement	0	0	1	2	1	2
36	Home Construction	0	0	4	10	3	4	86	Business Support Sv	6	11	9	18	7	9
37	Electrical Equipment	8	20	14	27	6	7	87	Broadline Retailers	1	3	5	5	1	1
38	Forestry	0	0	0	0	1	1	88	Food Retail	0	0	0	0	1	1
39	Heavy Construction	3	5	14	22	4	4	90	Specialty Retailers	3	4	9	13	3	4
40	Delivery Services	0	0	1	1	1	1	92	Commodity Chemicals	1	3	1	1	1	1
41	Media Agencies	1	3	3	4	1	1	93	Aluminum	0	0	1	1	1	1
42	Consumer Finance	0	0	1	1	0	0	94	Travel & Tourism	2	4	7	10	2	2
43	Industrial Machinery	7	14	16	21	4	5	95	Pharmaceuticals	7	14	11	13	8	11
45	Healthcare Provider	1	1	2	2	2	2	99	Marine Transportation	3	3	5	7	3	4
48	Personal Products	3	5	3	3	1	1	101	Divers. Industrials	2	4	15	22	8	8
50	Exploration & Prod.	1	1	3	4	1	1	102	Banks	1	3	7	14	0	0
52	Pipelines	0	0	2	2	2	2	103	Medical Supplies	1	1	4	7	2	2
53	Tires	0	0	1	2	1	1	107	Prop. & Casualty	0	0	1	1	0	0
54	Nonferrous Metals	0	0	2	2	1	2	111	Investment Services	2	2	19	33	11	13
55	Recreational Service	0	0	1	1	1	3	112	Real Estate Hold	3	5	78	135	33	40
56	Steel	2	6	7	11	3	4	113	Specialty Finance	2	3	15	28	4	6

Table 5 (continued)

Code	Name	IPO		Appointment		Replacement		Code	Name	IPO		Appointment		Replacement	
		firm	INED	firm	INED	firm	INED			firm	INED	firm	INED	firm	INED
57	Electronic Equipment	0	0	23	25	7	10	114	Soft Drinks	0	0	1	1	0	0
58	Software	1	3	4	7	1	2	115	Broadcast & Entertain	3	5	8	14	3	4
59	Dur. Household Prod	8	14	20	40	16	22	117	Comm. Vehicles, Trucks	0	0	2	2	0	0
60	Furnishings	1	2	6	14	3	5	119	Gold Mining	0	0	1	3	1	1
61	Toys	1	1	5	6	6	7	120	Food Retail, Wholesale	0	0	1	1	0	0
63	Auto Parts	3	9	4	6	3	3	126	Telecom. Equipment	6	17	8	13	1	1
64	Transport Services	2	6	6	6	1	2	129	Airlines	0	0	1	1	0	0
65	Automobiles	1	2	3	3	1	2	130	Semiconductors	2	6	4	6	0	0
66	Apparel Retailers	3	6	12	17	2	3	134	Bus &Train	0	0	1	1	1	1
67	Brewers	1	1	0	0	1	1	140	Electricity	2	6	4	7	0	0
68	Distillers & Vintner	1	3	1	3	1	1	142	Fixed Line Telecom.	2	5	3	4	1	1
69	Clothing & Accessory	13	25	57	93	13	16	143	Mobile Telecom.	3	7	6	7	4	4
70	Containers & Package	4	8	9	13	3	3	150	Computer Services	2	4	7	11	2	2
71	Food Products	7	17	13	22	5	6	152	Mortgage Finance	0	0	1	4	1	2
72	Restaurants & Bars	3	9	9	15	4	4	153	Footwear	2	4	10	11	5	8
75	Consumer Electronic	3	7	13	21	9	9	155	Recreational Product	0	0	4	5	3	3
									Total	162	339	609	976	269	337

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Table 6 Firm-Level Descriptive Statistics of IPO Study

The sample consists of 162 IPOs on the Hong Kong Exchange between 1999 and 2005. INED information is collected from firms' prospectuses, "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). Accounting information is from firms' prospectuses. The stock information is from Datastream database. Mscore is the average score of the INEDs in the same firm before IPO. Assets is the firm's total assets before IPO. Leverage is calculated as total debt over total assets. ROA is calculated as net income before extraordinary items over total assets. H/Red is a dummy variable which equals 1 when the firms are either H-share firm or Red Chip firm, 0 otherwise. SD is the standard deviation of daily returns for days 2-11 after the first trading day. Market return is the market return in the period between offering and listing. F-Busy is a dummy variable which equals to 1 when there is at least one INED is busy INED in the firm, 0 otherwise. Auditor rank and underwriter rank are described in Table 2 and Table 3. R_{t1} is the underpricing level of the first trading day. $AdjR_{t1}$ is the market adjusted underpricing level of the first trading day. R_{t10} is the underpricing level till the 10th trading day. R_{t30} is the underpricing level till the 30th trading day. R_{t60} is the underpricing level till the 60th trading day. T-test is applied. *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively.

Variables	All n=162		Tier-3 Group INEDs n=39 (70 INEDs)		Tier-2 Group INEDs n=59 (92 INEDs)		Tier-1 Group INEDs n=64 (177 INEDs)		Test of Differences Tier3-Tier1
	mean	median	mean	median	mean	median	mean	median	t-value
Mscore	12.76	6.29	2.34	2.50	5.85	5.83	25.48	21.00	-9.631***
Assets	3,684,994	298,106	302,653	193,222	671,334	256,125	8,524,327	489,097	-2.025**
leverage	0.192	0.133	0.166	0.112	0.180	0.137	0.218	0.158	-1.201
ROA	0.146	0.152	0.086	0.110	0.176	0.179	0.152	0.152	-2.013**
Underwriter rank	1.500	1.000	1.667	1.000	1.441	1.000	1.453	1.000	1.517
Auditor rank	1.099	1.000	1.205	1.000	1.119	1.000	1.016	1.000	2.567*
H/Red	0.093	0.000	0.000	0.000	0.068	0.000	0.172	0.000	-2.817***
SD	0.037	0.030	0.045	0.039	0.040	0.031	0.029	0.025	3.270***
Market return	0.002	0.004	0.011	0.008	-0.001	0.006	-0.001	-0.003	1.420
F-Busy	0.525	1.000	0.026	0.000	0.441	0.000	0.906	1.000	-17.205***
R_{t1}	7.54%	2.58%	16.18%	8.33%	7.05%	3.41%	2.74%	1.18%	3.213***
$AdjR_{t1}$	7.48%	2.65%	15.72%	7.50%	6.96%	3.16%	2.94%	0.64%	3.023***
R_{t10}	7.56%	2.11%	17.09%	10.83%	8.96%	3.00%	0.45%	1.79%	3.102***
R_{t30}	11.42%	3.09%	23.23%	12.50%	13.85%	3.17%	1.99%	1.17%	2.692***
R_{t60}	15.14%	6.25%	32.08%	20.00%	18.30%	6.21%	1.90%	1.53%	2.904***

Table 7 Correlation Matrix for the IPO Study

The sample consists of 162 IPOs on the Hong Kong Exchange between 1999 and 2005. INED information is collected from firms' prospectuses, "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). Accounting information is from firms' prospectuses. The stock information is from Datastream database. Mscore is the average score of the INEDs in the same firm before IPO. Assets is the firm's total assets before IPO. ROA is calculated as net income before extraordinary items over total assets. H/Red is a dummy variable which equals 1 when the firms are either H-share firm or Red Chip firm, 0 otherwise. SD is the standard deviation of daily returns for days 2-11 after the first trading day. Market return is the market return in the period between offering and listing. Busy is a dummy variable which equals to 1 when there is at least one INED is busy INED in the firm, 0 otherwise. Auditor rank and underwriter rank are described in Table 2 and Table 3. R_{t1} is the underpricing level of the first trading day. $AdjR_{t1}$ is the market adjusted underpricing level of the first trading day. R_{t10} is the underpricing level till the 10th trading day. R_{t30} is the underpricing level till the 30th trading day. R_{t60} is the underpricing level till the 60th trading day.

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	Mscore	1.000														
2	Total assets	0.292	1.000													
3	leverage	-0.010	0.109	1.000												
4	ROA	0.065	-0.167	-0.106	1.000											
5	Underwriter rank	0.145	0.153	0.034	0.108	1.000										
6	Unditor rank	0.113	0.053	0.085	-0.074	-0.042	1.000									
7	H/Red	0.259	0.298	0.164	-0.044	0.177	0.080	1.000								
8	SD	-0.225	-0.142	-0.176	-0.062	-0.052	0.045	-0.180	1.000							
9	Market return	0.000	0.089	0.031	-0.162	-0.061	0.147	-0.033	-0.087	1.000						
10	Busy	0.527	0.118	0.099	0.118	0.048	0.079	0.080	-0.258	0.067	1.000					
11	R_{t1}	-0.158	-0.053	-0.044	-0.154	-0.008	0.006	0.020	0.298	0.150	-0.206	1.000				
12	$AdjR_{t1}$	-0.149	-0.051	-0.037	-0.134	-0.004	0.010	0.024	0.307	0.132	-0.202	0.996	1.000			
13	R_{t10}	-0.159	-0.024	0.030	-0.142	-0.043	-0.065	0.032	0.230	0.132	-0.178	0.755	0.749	1.000		
14	R_{t30}	-0.156	-0.015	0.064	-0.071	-0.005	-0.105	-0.025	0.128	0.136	-0.146	0.526	0.517	0.856	1.000	
15	R_{t60}	-0.201	0.011	0.136	-0.095	-0.058	-0.119	-0.014	0.218	0.025	-0.196	0.494	0.492	0.745	0.813	1.000

Table 8 Descriptive Statistics of INED Appointment Study

The sample consists of 976 announcements of INED appointments between 2003 and 2005. INED information is collected from "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). Accounting information is from Worldscope database. The stock information is from Datastream database. Score is the reputation score of the INED before joining the firm. Assets is the firm's total assets before IPO. Leverage is calculated as total debt over total assets. ROA is calculated as net income before extraordinary items over total assets. Board size is total number of the existing directors on the board. Number of INEDs is the number before the new appointment. $CAR(T_1, T_2)$ is the cumulative abnormal return between any two dates T_1 and T_2. Required INED is an INED who is appointed as to fulfill the stock exchange's requirement of having at least three INEDs or at least one qualified member in Audit Committee. Busy INED is an INED who holds at least three INED positions at the same time before the new appointment. T-test is applied. *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively.

Panel A Descriptive Statistics of INED Firm Characteristics

Variables	All n=976		Tier-3 INEDs n=353		Tier-2 INEDs n=307		Tier-1 INEDs n=316		Test of Differences Tier3-Tier1
	mean	median	mean	median	mean	median	mean	median	t-value
Score	10.88	6.00	2.66	3.00	6.89	6.00	23.94	18.00	-25.922***
Assets	26,900,000	658,281	5,331,939	375,951	34,500,000	731,340	43,600,000	1,332,919	-1.385
Leverage	0.240	0.199	0.268	0.213	0.234	0.196	0.214	0.190	3.414***
ROA	-0.035	0.012	-0.070	-0.009	-0.024	0.014	-0.007	0.024	-3.839***
Board size	9.017	8.000	8.153	8.000	9.205	8.000	9.801	8.500	-5.358***
Number of INEDs	2.433	2.000	2.348	2.000	2.440	2.000	2.522	2.000	-1.941*
CAR(-5,5)	-0.138	-0.197	-0.379	-0.297	-0.717	-0.061	0.694	-0.513	-0.973
CAR(-3,3)	0.065	-0.035	0.132	0.012	-0.075	-0.003	0.125	-0.261	0.009
CAR(-2,2)	0.145	-0.179	0.315	-0.175	-0.128	-0.318	0.219	-0.065	0.131
CAR(-1,1)	0.231	-0.144	0.362	-0.210	0.070	-0.096	0.243	-0.062	0.204
CAR(-10,10)	-0.208	-0.569	-0.381	-0.558	-0.635	-0.758	0.399	-0.353	-0.482
CAR(-10,-2)	0.220	-0.338	0.618	-0.365	-0.481	-0.348	0.457	-0.313	0.145
CAR(-1,0)	0.050	-0.183	-0.150	-0.232	0.011	-0.136	0.310	-0.125	-0.921
CAR(0,2)	0.116	-0.228	0.412	-0.166	-0.258	-0.364	0.149	-0.033	0.460
CAR(1,10)	-0.428	-0.212	-0.999	-0.674	-0.154	0.204	-0.058	0.180	-0.489

Table 8 (continued):

Panel B Descriptive Statistics of INED Types								
Type	All		Tier-3 INEDs		Tier-2 INEDs		Tier-1 INEDs	
	Number	Percentage	Number	Percentage	Number	Percentage	Number	Percentage
INED whose firm receives qualified statements	240	24.59%	116	32.86%	68	22.15%	56	17.72%
Required INED	542	55.53%	211	59.77%	173	56.35%	158	50.00%
INED in H or Red Share firm	81	8.30%	16	4.53%	24	7.82%	41	12.97%
INED who's also CEO of other firm	40	4.10%	0	0.00%	9	2.93%	31	9.81%
Busy INED	288	29.51%	11	3.12%	39	12.70%	238	75.32%

Table 9 Correlations Matrices for the INED Appointment Study

The sample consists of 976 announcements of INED appointments between 2003 and 2005. INED information is collected from "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). Accounting information is from Worldscope database. The stock information is from Datastream database. Score is the reputation score of the INED before joining the firm. Assets is the firm's total assets before IPO. Leverage is calculated as total debt over total assets. ROA is calculated as net income before extraordinary items over total assets. H/Red is a dummy variable which equals to 1 when the firms are either H-share firm or Red-chip firm, 0 otherwise. Board size is total number of the existing directors in the board. Number of INEDs is the number before the new appointment. CAR(-5, 5) is the cumulative abnormal return between any two dates *-5* and *5*. Qualified is a dummy variable which equals to 1 when the firm received at least one qualified statement during the past three years before the new appointment, 0 otherwise. Required is a dummy variable which equals to 1 when the INED is appointed as to fulfill the stock exchange's requirement of having at least three INEDs or at least one qualified member in Audit Committee, 0 otherwise. CEO is a dummy variable which equals to 1 when the INED is at the same the CEO or chairman or president of other firm, 0 otherwise. Busy INED is a dummy variable which equals to 1 when the individual holds at least three INED positions at the same time before the new appointment, 0 otherwise.

		1	2	3	4	5	6	7	8	9	10	11	12
1	*Score*	1.000											
2	*CAR(-5,5)*	0.019	1.000										
3	*Total asset*	0.078	0.001	1.000									
4	*Leverage*	-0.093	-0.010	-0.001	1.000								
5	*ROA*	0.116	0.034	0.016	-0.150	1.000							
6	*Qualified*	-0.122	0.010	-0.035	0.222	-0.382	1.000						
7	*Required*	-0.076	0.068	-0.060	-0.003	0.033	0.046	1.000					
8	*H/Red*	0.129	0.015	0.004	-0.017	0.064	-0.065	-0.075	1.000				
9	*Board size*	0.185	-0.086	0.217	-0.060	-0.010	-0.032	-0.202	0.156	1.000			
10	*Number of INEDs*	0.061	-0.035	0.526	-0.040	-0.011	0.004	-0.286	-0.005	0.432	1.000		
11	*CEO*	0.176	-0.022	0.108	-0.046	-0.009	-0.049	-0.020	0.035	0.079	0.094	1.000	
12	*Busy INED*	0.576	-0.028	-0.030	-0.079	0.042	-0.064	-0.049	0.050	0.032	-0.008	0.021	1.000

Table 10 Descriptive Statistics of INED Replacement Study

The sample consists of 337 announcements of INED replacements between 1999 and 2005. INED information is collected from "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). Accounting information is from Worldscope database. The stock information is from Datastream database. Group ij means the Tier-i INED is replaced by the Tier-j INED. Score_appointed is the reputation score of the appointed INED before joining the firm. Score_resigned is the reputation score of the resigned INED. Assets is the firm's total assets before IPO. Leverage is calculated as total debt over total assets. ROA is calculated as net income before extraordinary items over total assets. Qualified is a dummy variable which equals to 1 when the firm received at least one qualified statement during the past three years before the new appointment, 0 otherwise. Board size is total number of the existing directors in the board. Number of INEDs is the number before the replacement. Busy_appointed is the busy INED who's appointed. Busy_resigned is the busy INED who resigned. Busy_same is both appointed INED and resigned INED are busy INEDs. CAR(T_1, T_2) is the cumulative abnormal return between any two dates T_1 and T_2. T-test is applied. *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively. All the statistics are the means of the variables, except for Busy-appointed and Busy_resigned, which are the number of busy INEDs in each group.

Event window	All n=337	Group33 n=68	Group32 n=34	Group31 n=38	Group23 n=33	Group22 n=29	Group21 n=20	Group13 n=30	Group12 n=38	Group11 n=47
Score_appointed	10.49	2.74	6.22	19.62	2.76	6.79	24.88	2.55	7.13	26.77
Score_resigned	12.04	1.79	2.06	1.93	5.88	6.1	6.18	24.97	29.59	30.31
Assets	5,077,355	346,782	1,934,181	1,087,244	5,837,193	11,300,000	1,189,234	2,630,313	3,912,059	16,600,000
Leverage	0.188	0.154	0.181	0.216	0.225	0.223	0.191	0.209	0.17	0.17
ROA	-0.043	-0.102	-0.062	-0.067	-0.045	0.004	-0.055	-0.076	0.014	0.026
Qualified	0.326	0.324	0.265	0.395	0.394	0.379	0.5	0.5	0.105	0.234
Board size	8.804	8.971	8.5	8.784	7.667	8.345	7.95	9.467	8.184	10.319
Number of INEDs	2.586	2.632	2.794	2.486	2.606	2.483	2.25	2.5	2.632	2.66
Busy_appointed	96	0	5	29	0	4	16	1	6	35
Busy_resigned	109	0	0	0	5	4	5	26	32	37
Busy_same	39	0	0	0	0	1	4	1	5	28
CAR(-5,5)	0.294	-0.32	-1.123	-1.783	0.671	-0.938	1.15	-0.091	4.336	0.996
CAR(-3,3)	-0.425	-0.988	-1.023	-1.673	1.376	-3.655	-0.245	0.318	2.142	-0.068
CAR(-2,2)	-0.558	-0.648	-1.685	-0.521	-0.435	-4.081	-0.026	-0.16	2.189	-0.254
CAR(-1,1)	0.039	0.186	-0.598	-0.371	-0.298	-2.271	0.198	1.11	1.492	0.357
CAR(-10,10)	0.891	2.043	-1.042	-5.201	-2.194	3.265	1.728	-1.153	9.633	0.132
CAR(-10,-2)	0.253	2.689	-0.857	-2.194	-3.359	1.059	0.842	0.543	2.419	-0.641
CAR(-1,0)	-0.152	-0.364	-0.201	-0.337	0.385	-1.696	0.271	-0.066	-0.133	0.668
CAR(0,2)	-0.058	-0.421	-1.297	-0.148	1.253	-2.261	0.947	0.183	1.893	-0.28
CAR(1,10)	0.639	-0.645	-0.185	-3.008	1.165	2.206	0.887	-1.695	7.214	0.773

Table 11 Regressions for the IPO Study

The sample consists of 162 IPOs on the Hong Kong Exchange between 1999 and 2005. INED information is collected from firms' prospectuses, "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). Accounting information is from firms' prospectuses. The stock information is from Datastream database. Mscore is the average score of the INEDs in the same firm before IPO. LogAssets is the log of firm's total assets before IPO. Leverage is calculated as total debt over total assets. ROA is calculated as net income before extraordinary items over total assets. SD is the standard deviation of daily returns for days 2-11 after the first trading day. Market return is the market return in the period between offering and listing. F-Busy is a dummy variable which equals to 1 when there is at least one INED is busy INED in the firm, 0 otherwise. H/Red is a dummy variable which equals 1 when the firms are either H-share firm or Red Chip firm, 0 otherwise. Auditor rank and underwriter rank are described in Table 2 and Table 3. R_{t1} is the underpricing level of the first trading day. $AdjR_{t1}$ is the market adjusted underpricing level of the first trading day. R_{t10} is the underpricing level till the 10th trading day. T-test is applied. *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively.

n=162	Dependent variables							
Independent variables	I.Mscore		II. R_{t0}		III. $AdjR_{t0}$		IV. R_{t0}	
	Coef.	t-value	Coef.	t-value	Coef.	t-value	Coef.	t-value
Intercept	-42.867	-3.590***	-0.016	-0.070	-0.026	-0.120	-0.017	-0.080
Mscore			-0.060	-2.330**	-0.056	-2.160**	-0.062	-1.630*
LogAssets	9.328	5.320***	0.031	0.800	0.028	0.720	0.031	0.800
Leverage	-13.653	-2.580***	-0.044	-0.520	-0.030	-0.350	-0.044	-0.520
ROA	11.500	1.710*	-0.124	-1.110	-0.096	-0.860	-0.123	-1.090
SD			2.126	3.460***	2.222	3.610***	2.124	3.440***
Market return			0.732	1.970**	0.667	1.790*	0.729	1.920*
F-Busy			0.029	0.870	0.027	0.790	0.027	0.580
F-Busy*Mscore							0.002	0.060
Underwriter rank	-0.434	-0.280	0.003	0.120	0.004	0.150	0.003	0.110
Auditor rank	1.686	0.560	-0.013	-0.260	-0.010	-0.200	-0.012	-0.250
H/Red	4.272	1.120	0.079	1.310	0.081	1.350	0.079	1.300
Year dummies								
Industry dummies								
R-squared	0.237		0.176		0.169		0.177	

Table 12 Cumulative Abnormal Returns (CAR, %) for Firms Around the Announcement of INED Appointment- Only Including Required INEDs and Excluding Busy INEDs

The sub sample consists of 393 announcements of INED appointment between 2003 and 2005. INED information is collected from firms' prospectuses, "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). The stock information is from Datastream database. $CAR(T_1, T_2)$ is the cumulative abnormal return between any two dates T_1 and T_2. T-test is applied. *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively.

Variables	All n=393		Tier-3 INEDs n=201		Tier-2 INEDs n=150		Tier-1 INEDs n=42		Test of Differences		
									Tier3-Tier1	Tier2-Tier1	Tier3-Tier2
	mean	median	mean	median	mean	median	mean	median	t-value	t-value	t-value
CAR(-5,5)	0.346	-0.150	-1.618	-0.517	-0.206	-0.040	11.720	3.627	-5.120***	-4.003***	-1.011
CAR(-3,3)	-0.066	-0.137	-1.727	-0.333	0.311	-0.048	6.536	1.786	-4.625***	-3.778***	-1.973**
CAR(-2,2)	-0.249	-0.235	-1.198	-0.295	-0.190	-0.617	4.086	1.385	-3.592***	-3.053***	-1.159
CAR(-1,1)	-0.045	-0.293	-0.533	-0.386	-0.213	-0.254	2.887	0.319	-2.828***	-2.415**	-0.448
CAR(-10,10)	0.087	-0.950	-0.753	-0.170	-1.635	-1.957	10.259	3.241	-2.590***	-2.969***	0.341
CAR(-10,-2)	0.096	-0.444	0.526	-0.412	-1.490	-1.115	3.701	0.997	-1.005	-2.649***	1.104
CAR(-1,0)	-0.091	-0.214	-0.709	-0.315	0.094	-0.202	2.211	0.269	-3.209***	-1.929*	-1.373
CAR(0,2)	0.069	-0.302	-0.247	-0.225	-0.013	-0.452	1.869	0.189	-1.780*	-1.585	-0.331
CAR(1,10)	-0.009	-0.256	-1.279	-0.710	-0.145	-0.471	6.557	1.691	-1.971**	-1.656*	-0.205

Table 13 Regressions for the INED Appointment Study

The sample consists of 976 announcements of INED appointments between 2003 and 2005. INED information is collected from "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). Accounting information is from Worldscope database. The stock information is from Datastream database. Score is the reputation score of the INED before joining the firm. Assets is the firm's total assets before IPO. Leverage is calculated as total debt over total assets. ROA is calculated as net income before extraordinary items over total assets. H/Red is a dummy variable which equals to 1 when the firms are either H-share firm or Red-chip firm, 0 otherwise. Board size is total number of the existing directors in the board. Number of INEDs is the number before the new appointment. CAR(-5, 5) is the cumulative abnormal return between any two dates *-5* and *5*. Qualified is a dummy variable which equals to 1 when the firm received at least one qualified statement during the past three years before the new appointment, 0 otherwise. Required is a dummy variable which equals to 1 when the INED is appointed as to fulfill the stock exchange's requirement of having at least three INEDs or at least one qualified member in Audit Committee, 0 otherwise. CEO is a dummy variable which equals to 1 when the INED is at the same the CEO or chairman or president of other firm, 0 otherwise. Busy INED is a dummy variable which equals to 1 when the individual holds at least three INED positions at the same time before the new appointment, 0 otherwise. T-test is applied. *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively.

n=976	Dependent variables							
Independent variables	I. Score		II. Score		III. CAR(-5,5)		IV. CAR(-5,5)	
	Coef.	t-value	Coef.	t-value	Coef.	t-value	Coef.	t-value
Intercept	12.447	19.200***	9.650	6.360***	-0.075	-1.780*	-0.073	-1.830*
LogAssets	0.022	2.290**	0.020	1.790*	0.016	2.240**	0.016	2.180**
Leverage	-4.045	-1.940*	-3.636	-1.770*	-0.013	-0.550	-0.012	-0.520
ROA	4.693	2.150**	4.880	2.270**	0.009	0.350	0.005	0.190
Qualified	-2.262	-2.130**	-1.871	-1.790*	0.012	1.020	0.012	0.980
Score					0.001	1.840*	0.001	0.590
H/Red			3.975	2.710***	0.009	0.510	0.008	0.490
Board size			0.496	4.700***	-0.004	-3.130***	-0.004	-2.980***
Number of INEDs			-0.644	-1.490	0.002	0.400	0.002	0.390
Required			-1.222	-1.440	0.018	1.820*		
Busy INED					-0.021	-1.680*		
CEO					-0.021	-0.900		
*Require*Score*							0.002	4.220***
*Busy INED*Score*							-0.002	-2.940***
*CEO*Score*							-0.001	-0.540
Year dummies	√		√		√		√	
Industry dummies	√		√		√		√	
R-squared	0.030		0.070		0.023		0.040	

Table 14 Test of Differences in Mean of Cumulative Abnormal Returns (CAR, %) for Firms Around the Announcement of INED Replacements

The sample consists of 337 announcements of INED replacement between 1999 and 2005. INED information is collected from firms' prospectuses, "Change in Directorships" section of the SEHK website (www.sehk.com.hk) and from David Webb's website (www.webb-site.com.hk). The stock information is from Datastream database. $CAR(T_1, T_2)$ is the cumulative abnormal return between any two dates T_1 and T_2. Group ij means the Tier-i INED is replaced by the Tier-j INED. T-test is applied. *, **, and *** denote significance at the 10, 5, and 1 percent levels, respectively.

Event window	Group33-Group32	Group11-Group13	Group23-Group22	Group22-Group21	Group12-Group11	Group33-Group31	Group32-Group23	Group31-Group13	Group21-Group12
CAR(-5,5)	0.214	0.238	0.384	-0.521	0.758	0.481	-0.380	-0.687	-0.762
CAR(-3,3)	0.014	-0.172	1.230	-1.008	1.069	0.297	-0.617	-0.761	-0.817
CAR(-2,2)	0.493	-0.051	1.780*	-1.781*	1.376	-0.063	-0.579	-0.160	-0.868
CAR(-1,1)	0.535	-0.572	1.817*	-1.375	0.860	0.423	-0.211	-1.031	-0.663
CAR(-10,10)	0.443	0.271	-1.165	0.264	1.840*	1.194	0.188	-1.003	-1.165
CAR(-10,-2)	0.621	-0.535	-1.765*	0.264	1.359	0.950	0.692	-1.023	-0.394
CAR(-1,0)	-0.154	0.827	2.342**	-1.051	-1.043	-0.025	-0.656	-1.023	0.255
CAR(0,2)	0.505	-0.280	1.577	-1.464	1.220	-0.180	-1.166	-0.193	-0.396
CAR(1,10)	-0.084	0.468	-0.611	0.740	1.848*	0.810	-0.165	-0.193	-1.499

Appendix

A1. Current directorship

Of the 934 listed firms on the Main Board of the Hong Kong Stock Exchange as of December of 31st 2005, data on INEDs is available for 921 firms. Additionally, of the listed firms, 35 firms have prolonged suspension for various reasons and are not traded. As shown Table A3, 174 (19.0%) firms failed to meet the Listing Rule 3.10 requiring firms to have at least three INEDs. For those firms that failed to meet this requirement must specifically seek an extension, granted at the sole discretion of the Listing Committee of the Hong Kong Stock Exchange.

<Insert Table A1>

A2. Change of auditors statistics

Based on SEHK's website, a total of 69 (7.7%) and 87 (9.2%) Main Board listed firms announced changes in auditors for the years 2004 and 2005 respectively. Furthermore, two firms from each of the years changed auditors twice.

A3. Qualified opinion statements

Between the fiscal years ending April 30, 1999 to April 30, 2005 a total of 182 firms received qualified opinion statements from their auditors.

<Insert Table A2>

Furthermore, of those firms 108 (59.3%) receiving multiple qualified statements. As part of this investigation, we analyze the reputation of the new auditor to those that

are replaced as well as the effects of auditor change on appointments and resignations of INEDs.

It is also interesting to the note that the Tier-1 and Tier-2 auditors issued 68.3 percent and 13.5 percent of the qualified opinion statements, respectively. Contrary to disagreement in audit fees, the most stated reason for change of auditors, the recent frequent issuance of qualified opinion statements by prestigious auditors could explain the reason for the high incidence of auditor changes.

<Insert Table A3>

Table A1 Composition of INED by firms

Of the 934 listed firms on the Main Board of the Hong Kong Stock Exchange as of December of 31st 2005, data on INEDs is available for 921 firms.

Number of INEDs in firm	zero	one	two	three	four	five	six	seven	8 or more	total
Number of firms	8	28	139	576	125	31	8	4	2	921
Percentage of total	0.9%	3.0%	15.1%	62.5%	13.6%	3.4%	0.9%	0.4%	0.2%	100.0%
Mean age of firm	10.5	14.8	13.5	10.3	12.1	13.1	5.6	40	na	12.3

Table A2 Qualified opinion statements

For fiscal years ending April 30, 1999 to April 30, 2005 a total of 182 firms received qualified opinion statements from their auditors.

Frequency of Qual. Opinion Statements	# of firms	Total # of Qual. Opinion Statements
1	76	76
2	48	96
3	31	93
4	17	68
5	10	50
Total	182	383

Source of data: Hong Kong Stock Exchange

Table A3 Frequency of issuance of qualified opinion statements by auditing firms for fiscal ending 4/30/99 to 12/31/05

	Audit Firms	Freq of Issue	Percent	Percent Accum.
1	Deloitte Touche Tohmatsu	108	28.20%	28.20%
2	Ernst & Young	107	27.90%	56.10%
3	PricewaterhouseCoopers	20	5.20%	61.40%
4	RSM Nelson Wheeler	17	4.40%	65.80%
5	Grant Thornton	15	3.90%	69.70%
6	KPMG	15	3.90%	73.60%
7	Moores Rowland Mazars	13	3.40%	77.00%
8	Arthur Andersen	12	3.10%	80.20%
9	CCIF CPA Limited	11	2.90%	83.00%
10	Charles Chan, Ip & Fung CPA Ltd	10	2.60%	85.60%
11	HLB Hodgson Impey Cheng	7	1.80%	87.50%
12	Horwath Hong Kong CPA Ltd	7	1.80%	89.30%
13	Moore Stephens	5	1.30%	90.60%
14	Fan, Mitchell & Co	4	1.00%	91.60%
15	Hodgson Impey Cheng	3	0.80%	92.40%
16	Johnny Chan & Co	3	0.80%	93.20%
17	Lam, Kwok, Kwan & Cheng CPA Ltd	3	0.80%	94.00%
18	Nexia Charles Mar Fan & Co	3	0.80%	94.80%
19	Ting Ho Kwan & Chan	3	0.80%	95.60%
20	Graham H Y Chan & Co	2	0.50%	96.10%
21	HLM & Co.	2	0.50%	96.60%
22	John K H Lo & Co	2	0.50%	97.10%
23	KLL Associates CPA Ltd	2	0.50%	97.70%
24	Albert Lam & Co.	1	0.30%	97.90%
25	Baker Tilly Hong Kong Ltd.	1	0.30%	98.20%
26	BDO International	1	0.30%	98.40%
27	Chu and Chu	1	0.30%	98.70%
28	Ho and Ho & Company	1	0.30%	99.00%
29	Kennic L. H. Lui & Co. Ltd.	1	0.30%	99.20%
30	Li, Lai & Cheung	1	0.30%	99.50%
31	Li, Tang, Chen & Co.	1	0.30%	99.70%
32	Wong Lam Leung & Kwok C.P.A. Limited	1	0.30%	100.00%
		383	100.00%	

Source of data: Hong Kong Stock Exchange