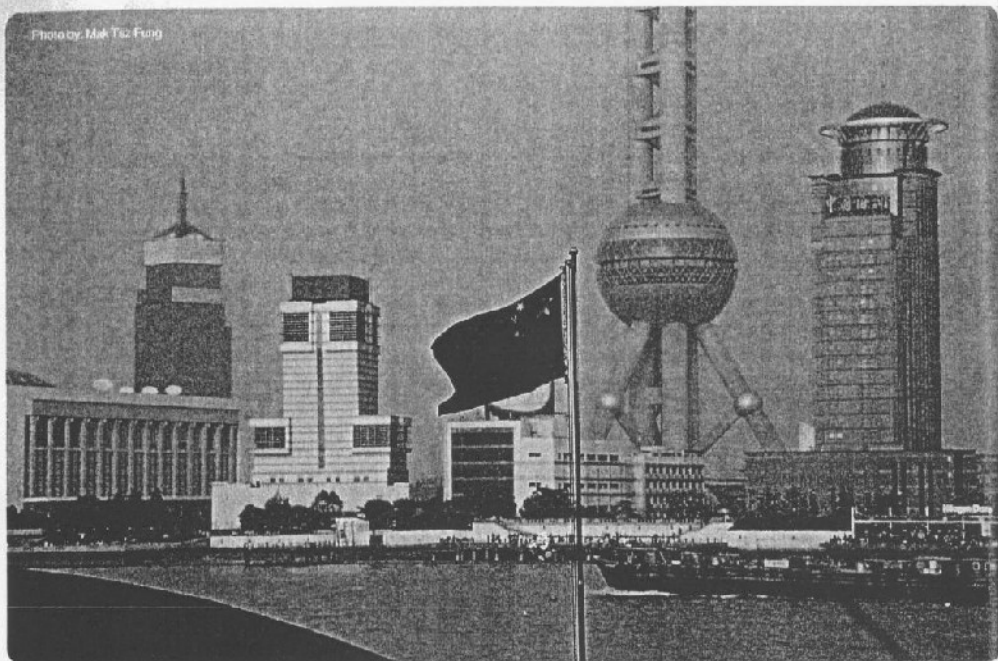


Corporate Governance - China's Long March



Corporate scandals in the US led to a review of corporate governance rules in many jurisdictions across the globe. With its policy of economic liberalisation and its increasing attractiveness to foreign investors, the way Mainland China regulates its listed firms has come in for scrutiny. *Hong Kong Securities* talks to two academics on their view of the country's progress to improve the level of corporate governance among Chinese enterprises.

With the world's capital markets coming to the end of a period of self reflection and change brought on by the corporate collapses in the US, the way corporate governance is regulated and managed is coming in for increased scrutiny.

China has enjoyed a long period of unrestrained investment by foreigners as the country prepares for entry into the World Trade Organisation (WTO) and as a result of a

liberalisation of the country's economic policy.

However, like many other countries, China has its own problems with corporate governance standards, fraud and corruption.

Taking a view from both sides of the one country, two systems divide, an academic from Mainland China and one from the Hong Kong Special Administrative Region discuss their

own personal view on the development and current state of China's level of corporate governance.



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The level of corporate governance in Mainland China is very low. Many surveys rank China as having one of the lowest levels of corporate governance in the region.

However, the country has been quick to adopt many new rules and regulations that pave the way for a marked improvement.

Mainland China's move towards better levels of corporate governance is being hampered by the poor infrastructure that exists as a result of political, social and legal issues.

On the plus side, because the country lacks the historical institutions, rules and regulations of other better developed markets, Mainland China is not impeded by having to demolish archaic systems that in some cases owe more to tradition than common sense. This enables the authorities to build a regulatory framework from scratch that could rival that of other jurisdictions. Mainland China can therefore attempt to guard against making the same mistakes made by some regulators in other countries.

Private Ownership Recognised

Until very recently, Mainland China's political ideology prevented private ownership of property. The rules were amended earlier this year, which signaled a giant step forward in the development of the country's corporate governance standards.

By allowing private ownership and the further reduction of state-owned shares, the state has provided individuals with an incentive to work hard and achieve results through transparency and accountability rather than questionable transactions and corruption.

Hurdles

A lack of legal precedence is also hampering

the development of the country's corporate governance structure.

The authorities not only have trouble enforcing the rules, but it is not easy to hold individuals liable. Currently in Mainland China there is no class action and firms cannot be sued directly. Disgruntled investors have to take their case to the China Securities Regulatory Commission (CSRC), which then decides if the company or individuals have a case to answer.

This apparent inability to provide compensation for loss through poor corporate governance is very frustrating for investors.

Because the executive labour markets are not yet mature, there is currently little corporate incentive (such as stock options) for executives to abide by the rules through hard work. Questions also need to be raised over the independence of many of the country's lawyers, fund managers, accountants and analysts.

All of the above adds up to present the country with a huge challenge when it comes to improving its levels of corporate governance.

Way Forward

What I am advocating is a proactive approach by Chinese companies. It may take some time, but I believe that companies should take the lead and begin by improving their own internal controls.

Every firm should promote a culture of integrity, transparency, accountability and social responsibility that everybody can then work hard to improve and be rewarded for doing so.

The improvement in the macro-environment, institutions, markets, rules and regulations are very important, but that does not mean the microenvironment within the firm should be ignored.

China is doing a lot but it still has a long way to go and I believe that companies should not wait for the authorities to improve the environments and institutions before they take their own government initiatives.

In joining the WTO, the country has fostered an environment that is conducive to improving corporate governance. Mainland China has to show the whole world that it is capable of improving its standards and in return, the international community will have the confidence to invest much more.