CHINA CSR

CHINACSR.COM

Study: Chinese Companies Have Inadequate Corporate Governance

September 18, 2007
By Staff

A new study says publicly-traded Chinese companies whose American Depository Shares are traded on the New York Stock Exchange have very poor quality of earnings, inadequate corporate governance standards, and serious accounting related issues.

RateFinancials, a New York-based forensic research firm specializing in early-warning risk avoidance for institutional clients, issued the study's summary in a corporate press release.

The ten largest NYSE-listed Chinese companies by market capitalization received “Poor,” or “Very Poor,” ratings for their accounting, quality of earnings, and governance. The study also found that all ten companies frequently engage in related-party transactions, make strategic decisions that are not adequately disclosed, and pose potential conflicts of interest.

“Investing in publicly traded Chinese companies at the end of the day is a crapshoot that requires blind and unfounded faith that the PRC will ultimately put the best interests of shareholders ahead of political and other considerations,” said Victor Germack, founder and president of RateFinancials. “These companies are government-controlled enterprises masquerading as independent public companies and it is virtually impossible to adequately assess their financial condition given their poor level of disclosures. Given the inherent risks of these companies, it's both surprising and disappointing that they are allowed to trade on the NYSE.”

The average quality of earnings, which determines fifty percent of RateFinancials’ rating, averaged just 7.3 points out of a total of 20 points. PetroChina, the largest market cap in the study, scored three points. China Mobile, though, scored a respectable 15 points.

No Chinese company scored higher than one star, which RateFinancials classifies as very poor corporate governance. Five companies were so poor they received no stars. By comparison, the average corporate governance rating assigned to U.S. companies is around three stars and virtually all have received a minimum one star rating;

In addition, none of the publicly traded Chinese companies file annual proxy statements, so they don't make public certain very detailed information typically available pertaining to related party transactions, governance, and compensation. Although 20-F filings of these companies contain some level of detail, RateFinancials says they don't have to be filed until six months after their year-end, so the information is usually dated.

Finally, RateFinancials says the public filings are typically translated from Chinese and are often so poorly written that they cannot be fully understood and raise some questions.

RateFinancials says Chinese companies listed on the NYSE are exempted from the Exchange’s standard corporate governance requirements because of a loophole provision for corporations who are “foreign private issuers.” These companies are permitted to follow home country practices in lieu of some of the key corporate governance practices required to be followed by U.S. companies listed on the New York Stock Exchange. As a result, their corporate governance practices differ in some major respects from those required to be followed by U.S. companies listed on the New York Stock Exchange.

“If the NYSE is serious about maintaining its superior reputation for governance and the quality of its listed companies, it should close its ‘controlled company’ loophole provision, and urge its foreign issuers to comply with higher corporate governance standards,” Germack said.