A PARTNERSHIP TO IMPROVE CORPORATE GOVERNANCE BETWEEN CHINA AND THE UK

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EXECUTIVE SUMMARY

Good corporate governance brings a number of benefits to a company, not least the access to funds and potential growth potential. Good corporate governance improves shareholder confidence in companies and is fundamental to the proper functioning of capital markets. Corporate governance relies on facilitating and encouraging transparency and accountability. Shareholders expect companies to be properly governed, and so corporate governance is primarily concerned with the way in which companies are controlled and directed. Our initial focus has been on the UK markets, but we believe it is also vital for China to improve actual and perceived governance of its domestically listed entities as well. This is in order to give individual Chinese investors greater confidence in investing, and to support the development of institutional investment in China, such as the mutual fund/investment fund/hedge fund activities undertaken by UK based international investment firms including Aberdeen Asset Management, Fidelity, Schroeder’s and Henderson. Consequently, there are substantial benefits to China in improving corporate governance issues and it is not merely a UK problem needing a UK solution.

Overview

The main objective of this study is to consider what can be done to create two-way trust between investors and Chinese companies, so that good corporate governance becomes associated with China and in turn:

- leads to increasing use of the UK Markets as a listing option
- underpins growth in international fund investment into Chinese companies
- improves China’s standing in the international corporate arena

In order to achieve this, we have considered the differences between the UK and Chinese legal systems in respect of corporate governance standards and legal remedies for investors, and will point out areas for further study and recommendations for improvement. It is generally accepted in the investment community that quality governance of a company increases...
investors’ willingness to invest and ultimately increases the company’s valuation. This belief supports the argument that good governance benefits both investors (by reducing uncertainty and perceived risk) and the management of a company (by increasing the company’s value). Specifically on AIM, our research suggests that it is likely that a number of the Chinese companies that listed on the UK Markets were not appropriate for listing in the first place. Compared to Hong Kong, the UK has probably not set a high enough bar in allowing companies to list on its markets and, given that Chinese companies are very familiar with having to clear onerous hurdles to list on their domestic exchanges, strengthening the listing requirements in London would likely not impact Chinese companies significantly and could greatly help in avoiding further failures.

Developing this theme further and after discussion with City professionals, the merits of London in a post Brexit era should be exploited, as the London capital markets can give access to a China acquisition currency. Currently, when Chinese companies acquire businesses overseas, they are largely funded by cash, which as demonstrated in 2016, has had a major impact in reducing the Chinese foreign currency reserves. However, if a Chinese company could list in London, then any acquisitions could either be funded by shares or by the issuance of shares for cash. If such a route were to be adopted, the benefit to China would be enormous as immediately, they would have a presence on one of the world’s leading stock exchanges (excluding Shanghai and Hong Kong) which in turn would create a higher scrutiny from Beijing and by definition lead to a greater transparency in their governance. Such an initiative would assist China in enhancing its international governance reputation, which could set a standard for other companies to follow. Furthermore, a London listing would provide an endorsement to China as a whole and possibly create an improvement to the country’s international corporate governance rankings.

The management of Chinese companies need to accept that if they wish to access capital from the international public markets, they will effectively have to surrender ultimate control of the business to their board of directors. Whilst they can be represented on the board, they will not have the same degree of control as they enjoyed prior to listing. If they are not willing to accept these new arrangements, then the company should not be admitted to the markets. It is important for Chinese companies to recognise that this is the price which is paid in exchange for access to third party capital. Chinese companies which go public whilst following these new standards will, by implication, have accepted a stronger corporate governance framework and these changes will, in time, start to improve the investment sentiment towards Chinese companies.

In order to make our findings a reality, we have concluded that the following corporate governance areas should be targeted for further study:
1. developing a draft code of corporate governance standards to be adopted by Chinese listed companies in the UK;
2. implementing an 18-24 month pilot programme together with a Chinese partner(s) to assist specific companies which may wish to list overseas;
3. creating a ‘best practice’ guidance paper by creating a China/UK centre for corporate governance excellence;
4. procuring the adoption of a dispute resolution process for foreign investors in China;
5. engaging with Regularity Authorities in China to improve supervision of their domestic companies listened overseas
6. developing a series of workshops/seminars/exchanges/dialogues and forums;
7. Create an ongoing PR/marketing campaign to demonstrate that initiatives are taking place and that improvements are being achieved; consider creating the Corporate Governance Awards;
8. reviewing Hong Kong’s approach to corporate governance to see what can be extrapolated and applied in the UK;
9. creating a governance momentum by completing pilot projects between the various parties to demonstrate that governance can and is improving;
10. examining the possibility of establishing an on-going independent assessment of corporate governance; and
11. developing model solutions for companies which have already delisted from London based exchanges and where the shareholders are now disenfranchised.

The perception of corporate governance in China is that the standards imposed domestically do not meet international principles. With the recent report from the Asian Corporate Governance Association, and the lack of any initiatives from within China to change these perceptions and standards, outside investors have an impression that China is a market which is unwilling to improve. We believe that by working together, both China and the UK can change this perception, and create a beacon of corporate governance excellence which can be offered up as example for other Chinese companies looking to raise equity capital internationally.

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