STEP BY STEP

Corporate Governance Models in China

The experience of the International Finance Corporation
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The International Finance Corporation, the private sector arm of the World Bank Group, promotes sustainable investment in developing countries, helping to reduce poverty and improve people’s lives. IFC finances private sector investments in the developing world, mobilizes capital in the international financial markets, helps clients improve social and environmental sustainability, and provides technical assistance and advice to governments and businesses.

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ON THE COVER: Photos at and around IFC industrial and financial sector projects in China. Photos by Greg Girard.
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Across the globe corporate governance has risen to the top of the agenda for corporate executives and investors. From recent scandals in Europe and America, to long-standing concerns about closely held or state-dominated firms in Asia, the topic continues to attract much media attention.

In China, there is a popular notion that private entrepreneurs have a deep rooted bias against transparency and are unwilling to accept global best practices. Often when Chinese companies are exposed to initial scrutiny from new partners or financiers, they are found woefully unprepared. And reports about misuse of shareholder funds and disputes among business partners further reinforces the image of poor governance among Chinese companies.

But weak corporate governance practices are at odds with the fact that Chinese businessmen are setting their sights high. They seek not just domestic leadership for their businesses for a few years, but to establish global giants for the next generation. In the process, entrepreneurs and managers want to learn more about international norms and standards. While they may not have the experience or in-house resources to adopt them alone, they have enormous appetite for absorbing the lessons of success in international markets. IFC experience in China indicates that a growing number of Chinese managers and entrepreneurs have a willingness and desire to improve corporate governance. But too often they don’t know where to start.
IFC has been positioning itself to respond to the growing needs among Chinese entrepreneurs to adopt better practices of corporate governance. Today, establishing better practices at our client companies is an integral part of our strategy for working with Chinese companies. It is a strategy that is borne out of both business necessity as well as our desire to contribute to sustainable private sector development in China.

The International Finance Corporation—the private sector arm of the World Bank Group—has contributed to change in China over the past two decades by providing loans, equity, risk management, and technical advice to private companies and regulators. We invest in projects across the full spectrum of the economy, from banks and infrastructure projects to hospitals and schools. We have a special technical assistance facility based in Chengdu that serves entrepreneurs and smaller businesses.

Our cumulative investments in China since 1985 are approaching $2 billion in over 80 companies. IFC’s outstanding Chinese portfolio as of June 2004 was $779 million, after making about $400 million in new investment during the preceding 12 months.

We see the biggest investment opportunities in China with domestic private companies. These businesses are driving the rapid growth of the economy as they strive to expand and become more sophisticated. As they do so, their governance structures need to meet higher standards.

Today we are more confident about our own ability to work with local companies and contribute to private sector development because of our ability to encourage better corporate governance. Our approach works best with Chinese companies seeking a partner who can help them strive for a higher standard. We also recognize that some of our partnerships will stumble or fail to deliver on their promise. Yet we have confidence that the rewards and competition of the global marketplace will drive Chinese companies to seek higher standards.

This study provides the background and some details of how IFC approaches corporate governance today, and how IFC has worked with companies to ensure that we are adding value to their businesses by doing so. I hope that our existing and prospective clients, other businesses, opinion leaders, journalists, and IFC’s staff can learn from this experience. And I hope that this report contributes to the further development of good practices in corporate governance in China.
The IFC Framework

**Toward Better Practices in China**

In the 1990’s, the International Finance Corporation sought opportunities to expand development through the private sector in China. Sichuan-based Plantation Timber Products aimed to be a leader in the local wood products market. PTP’s business model was based on competitive pricing, international quality, local production, and excellent customer service. IFC provided technical assistance and support that helped the company achieve its goal of being a leader in sustainable business practices. IFC also encouraged PTP to establish strong corporate governance as its business expanded, including the adoption of financial accounting systems that allowed directors and shareholders to properly evaluate the company’s performance.

Compliance was not always easy and the value of the higher standards was not always clear to the company’s local management when new practices were being adopted. Yet, years later when the company’s founders were ready to seek new shareholders, their efforts were rewarded. The company was viewed differently by the international investment community from most other Chinese greenfield companies, or startups. A track record with International Accounting Standards-based audited financial statements and a management with clear accountability to its board of directors impressed both the bankers preparing the company for sale and ultimately its new buyers.

“Certainly the transparency we’ve established in the company made us far more attractive. Investors knew we were prudent and responsible and had ethical business practices,” said a senior company executive after PTP’s sale to a multinational company.

IFC’s experience working with Plantation Timber Products and other companies and financial institutions in China has helped us foster better corporate governance practices in promoting a stronger private sector. While good practices are important, in China they have also provided a means for improving investor confidence, enhancing corporate performance, and increasing access to capital. This publication highlights some of our experiences and what we have learned in the process.
Why Corporate Governance?

Corporate governance refers to structures and processes for directing and controlling companies. Collectively, these constitute a set of rules that govern the relationships among management, company shareholders, and other stakeholders including consumers, creditors, employees, the general public, neighboring people and suppliers. The rules of corporate governance aim to ensure that managers act in the best interests of their shareholders rather than simply acting in their own interests or those of a majority shareholder.

Good corporate governance can provide companies in emerging markets better access to outside capital by making them more attractive targets for portfolio investment. Some companies attempt to improve their governance practices for that reason alone. For example, CalPERS, the California state employee pension fund that is the largest in the United States, has kept its money out of China in part because poor transparency hinders its ability to monitor investments. Good corporate governance also increases capital inflows from domestic investors. For growing companies seeking to diversify their investor base, governance can become a point of competitive differentiation that enhances their capacity to tap a wide array of financing sources.

Business Case for Better Practices

Promoting good corporate governance in China is a good business approach for IFC. Our partnerships with Chinese companies involve risks that must be carefully managed. IFC faces investment risk, or the possibility that borrowers will default on loans or manage their company in a way that undermines the value of IFC’s equity. As a commercial investor and one that aims to encourage other investors to follow our lead, a default would undermine our mission.

Increasingly investors and lenders face reputational risk, or the possibility that companies they support might engage in practices that tarnish a sponsor’s or international bank’s reputation. Such risk is especially pronounced in situations where many stakeholders are exposed to poor performance or lax controls, such as at deposit-taking institutions. At banks, abuses in governance could cost public depositors their life savings. IFC has a role to play in encouraging practices that protect all stakeholders.

IFC also focuses on governance because we put a priority on developing capital markets. Poor governance undermines the integrity of publicly traded securities and discourages the use of public markets to allocate savings efficiently. Without efficient markets, savings will not flow to areas where they can be used to build profitable companies that provide needed goods and services.

Finally, IFC promotes sustainable business—that is, helping clients balance profits with a broader concern for people and the environment. IFC has led the way in integrating corporate governance into all phases of the investment process simply because well-run, transparent companies are much more likely to be profitable in the long term.
Creating Value for Clients

IFC is the private sector arm of the World Bank Group that invests in private companies in developing countries. But IFC’s work in corporate governance in China is one example of the additional value IFC provides for private sector clients beyond capital.

IFC has advised industry regulators on how private companies are typically governed in more developed economies, and when appropriate offers models on which evolving regulatory systems can be based. IFC has an ongoing dialogue with regulators to communicate to them our experience on the company level and suggest how that might be helpful in developing policies. In some instances IFC experts comment on proposed regulations and have held workshops on international best regulatory practices.

IFC works with individual companies to improve transparency, disclosure, and treatment of minority shareholders, usually in the context of our investment activity. When we take an equity stake in a company, we often recommend experienced directors who can function as advocates for improved governance. While this may seem like a small step, an internationally trained director can become a lightning rod for change on a Chinese board of directors that previously has been made up of management and state shareholders representatives. They offer specific, constructive suggestions on board operations. We work with companies to develop a plan for restructuring or expanding their boards to include audit and compensation committees that improve accountability and ensure that executive and staff pay is linked to performance. In other cases, IFC has recommended changes to a company’s articles of association to enhance the rights of minority shareholders or other stakeholders.

To be sustainable, IFC’s contribution to the process must be a portion of a broader partnership. IFC can contribute international consultants or staff expertise that can help localize well established international practices to align them with prevailing business practices. The partnership also involves helping companies conduct more effective shareholder meetings. IFC always requires investee companies to adopt international accounting standards, and to disclose financial information at regular, frequent intervals.

“Many client companies don’t set up a proper corporate governance system until they’re about to go public,” observes Mike Lubrano, head of IFC’s Corporate Governance Unit. “We now try to encourage them to do it earlier by convincing them they’ll create more value. Investors are willing to pay more for shares at an initial public offering or in the aftermarket for companies that can show they’ve had two years or more experience with an audit committee.”

Often, however, companies that approach IFC are seeking to enhance their standing by associating with an internationally recognized financial institution. Credibility, rather than credit, is the first item on their agenda. To fulfill our role in this type of partnership, IFC must be demanding. Because partnering with IFC sends a positive signal to the market, we must require best accounting procedures, as well as international environmental and social business practices. Our experience indicates companies that are receptive to good corporate governance practices and improved accountability are also likely to be good corporate citizens across the board (see box on page 13).
Challenges and Opportunities in China

Corporate governance is a new concept in China and most managers and boards remain unaware of basic governance procedures, often confusing governance with general management. As a consequence, bridging the gap between rhetoric and reality is required.

The private sector has clearly become the engine of growth, seemingly offering enormous investment opportunities. But the structures in place at private companies are often immature, reflecting the newness of the private sector.

“Most small and mid-sized enterprises in China are run informally,” commented one IFC staff member who advises smaller businesses. “They’re family-owned, they don’t have checks and balances, and their financial reporting is not transparent.”

The state-owned enterprises that are diversifying ownership on their way to becoming private enterprises suffer from a different set of governance problems. When these companies take on private ownership, they carry the legacy of the state-dominated decision making regime. They often have complex and opaque corporate ownership structures, overlapping new and traditional bodies of corporate control, and reporting practices that are focused on satisfying the information requirements of the authorities rather than the needs of investors.

Today most Chinese companies tend to be compliance-oriented: They want to know what they must do to meet the letter of the law, but are not inclined to go beyond those basic requirements. This situation offers IFC an opportunity to demonstrate the value of corporate governance when it invests in its partner companies.

Another challenge at this stage of the game is that China’s business culture is largely relationship-driven and built on a desire to avoid conflict. These two traits lead to an emphasis on informality and being discreet that can often be perceived by outside investors as insufficiently transparent. Yet trying to impose formal structures on an organization that has traditionally done business in a certain way can lead to an insurmountable culture clash. When IFC first suggests changes in governance practices, companies sometimes interpret the suggestion as indicating a lack of trust in the company’s management. Handled insensitively, such a development could adversely affect the relationship with that client company.

A more hospitable environment for corporate governance will not be created overnight. Yet the enormous transfer of assets from the state to the private sector, for example, is creating a new breed of private enterprises. With grand ambitions for growth, many entrepreneurs realize they can no longer rely simply on friends, family, and internal cash flow to finance their visions. This development offers opportunities for creating more transparent corporate structures in local companies, thereby setting a powerful precedent for others to emulate. By creating real-world examples of transparency and world-class governance at local companies, IFC brings about a powerful demonstration effect showing a new model of transparent, equitable, and communicative Chinese enterprises that prosper and thrive.

For enterprises that support this broader vision of what business in China can be, IFC’s work offers a blueprint for making that vision real. In so doing, it also contributes to the country’s smooth transition to a market economy. The following chapters examine ways in which IFC works with regulators and private companies in the industrial and financial sectors to make good corporate governance a reality.
IFC’s Approach to Corporate Governance

Adding Value The aim of IFC’s activities in corporate governance is to add value to client companies. This is achieved by developing a collaborative relationship with investee companies and working with them to improve their governance.

Prioritizing Corporate Governance The first task for IFC investment staff when examining the corporate governance of a potential investee company is to identify whether governance will be a priority for IFC’s engagement with the client. Priority is given to improving an investee company’s governance when the client’s practices present a special risk for IFC’s investment or an exceptional opportunity to improve the client’s governance.

Risk One type of risk is investment risk, where the returns on IFC’s investment are jeopardized by poor performance (in the extreme case, corporate failure) or mistreatment of IFC and other investors. Another type is reputational risk, where although IFC’s own investment is protected, corporate governance abuses threaten other shareholders and stakeholders in the company or even undermine the integrity of local capital markets.

Opportunity First, the client company’s commitment to achieving good corporate governance is fundamental, which is why this is the first of the four key areas in which IFC evaluates the governance of companies. If governance improvements are imposed by IFC on an unwilling client, then any corporate governance improvement program is likely to be little more than an artificial compliance exercise. The second aspect of opportunity is that some countries and markets have moved further than others in carrying out legal and regulatory reforms that encourage good corporate governance. In these countries and markets, IFC’s crucial contribution is to give meaning to these reforms by implementing improved governance practices at the company-level.

Six Steps IFC’s corporate governance methodology uses a step-by-step process. This introduces the client to IFC’s approach to corporate governance, the investment staff then reviews the client’s governance practices and, where necessary, IFC develops a corporate governance improvement program with the client.

Step 1: First Impressions
Step 2: Client Self-Assessment
Step 3: Corporate Governance Review
Step 4: Corporate Governance Improvement Program
Step 5: Documentation and Implementation
Step 6: Supervision
Assessing Chinese Companies

In seeking to evaluate corporate governance practices at Chinese companies, IFC seeks information in four broad areas.

Commitment to Good Corporate Governance
- Ownership structure
- Governance structure
- Major transactions and material events
- Organic documents
- Policies relating to corporate governance
- Corporate events calendar
- Company corporate governance code
- Country corporate governance code
- Compliance responsibility
- Shareholders agreements
- Succession
- Foreign listings of shares

Transparency and Disclosure
- Information dissemination
- Internal audit and internal controls
- External audit and external auditors
- Fair disclosure
- Financial statements
- Shareholders agreements
- Disclosure of major transactions and material events
- Regulatory and self-regulatory review
- Responses to information requests
- Meetings with securities analysts

Structure and Functioning of the Board of Directors
- Establishment of a board of directors
- Board policies
- Agenda and minutes
- Current board membership
- Composition of the board
- Independent board members
- Skill mix
- Functioning of the board
- The board and management team
- Audit and other standing committees
- Conflicts of interest and related party transactions
- Board evaluation
- Corporate secretary (secretary of the board)
- Supervisory board (inspection committee)

Treatment of Minority Shareholders
- Ultimate beneficial ownership
- Shareholders meetings
- Attendance and results of shareholders meetings
- Related party transactions
- Changes of control
- Minority shareholder nomination of board members
- Other minority shareholder rights
- History of shareholder relations
- Differentiated classes of shares
IFC’s activities span China. Among its more than 80 projects financed over two decades, IFC has provided investment and technical assistance for large and small businesses in Sichuan, supported financial institutions and heavy manufacturing in Fujian, financed toll roads in Zhejiang, and encouraged pork farming in Jilin. It has provided equity and loans to formerly state-owned companies as well as newly emerging private sector companies. Even so, Chinese enterprises across sectors and regions lack a tradition of private control and diverse shareholdings, and the emergence of a rapidly growing private sector has only recently created the demand for establishing these corporate customs.

Even companies that strive to develop professional practices and respect minority shareholders often fall short of international best practices. Without traditions deeply embedded in the marketplace, there are few places for managers to turn for guidance on improving practices. IFC has been able to fill that gap with some companies it works with in China.

**Improving Governance at Industrial Corporations**

**Plantation Timber Products**

China’s rapidly growing economy and the recent liberalization of government housing policies offer opportunities for Chinese to own homes for the first time. This trend has fueled a residential construction boom and created strong demand for housing materials such as wood flooring. Until recently, China met that demand by importing medium-density wood-based floor paneling or using local products of low quality.

Sichuan-based Plantation Timber Products entered the market in the mid-1990s, aiming to be a leader in the local market. PTP’s business model was based on competitive pricing, international quality, local production, and excellent customer service. It delivered through a new operations site in Leshan, a small city about one hour outside of the provincial capital of Chendgu. IFC initially provided a loan financing package of $38 million to help PTP to set up a state-of-the-art timber processing plant with equipment imported from the United States and Europe. The company’s plantation base lay within a 100-kilometer radius of the factory, making it easy for local farmers to transport raw lumber to the site. Based on the success of the Leshan factory, PTP established a second one in Hubei Province, for which IFC also provided financing. IFC made equity investments in the businesses.

IFC encouraged PTP to establish strong corporate governance and other good practices (see page 13) as its business expanded. The first step was to bring in a major accounting company to ensure PTP’s financial accounting systems were consistent with international standards. This allowed directors and shareholders to properly evaluate the company’s performance and provided an independent assessment
of the accuracy of its financial records. “Having someone come in and to help design and double-check our systems was very useful,” said former CEO Daniel Spitzer. “It helped us to anticipate a number of issues.”

IFC encouraged transparent management accountability. “We carefully evaluated all our business activities against criteria IFC had given us, to ensure they were above reproach,” Spitzer said. “We also used those criteria as basis for in-house training on business ethics and internal reporting.”

The additional work required to meet the new standards was worth the effort: When the company’s founders were ready to seek new shareholders, they were gratified that their operations were viewed differently by the international investment community from most other Chinese-based companies. After establishing good accounting practices, a track record in audited financial statements, and a governance regime that included independent directors, the company found international investment banks eager to represent it.

In July 2004, PTP was sold to Carter Holt Harvey, the fourth-largest paper products company in Australasia and which was seeking to establish a presence in the Chinese market. “They looked at us in terms of our management...”

**A Proxy for Good Management**

Often companies willing to strive for high standards in corporate governance are also open to adopting best practices and modern management techniques in other areas of their businesses. Plantation Timber Products is a good example. IFC was able to support such efforts in several areas, helping improve the developmental impact of the company while increasing the value of the business.

**Information technology.** Because PTP had a diverse base of Chinese and overseas customers, IFC encouraged the company to buy and install enterprise resource planning, or ERP, software. Linking information about ordering, purchasing, finance, and production, the ERP system formed a data network that connected the Leshan and Hubei operations plus six branch offices and numerous outlets and warehouses. It also allowed managers to effectively oversee inventory levels and enabled the company to respond more quickly to changes in customer demand.

**Environmental health and safety.** IFC worked with PTP to establish guidelines for evaluating EHS performance—days lost to injury and other data that helped the company conform to international standards. These issues were addressed at the corporate level and integrated into the company’s overall business functions. Partly as a result, PTP became the first Chinese company in the timber industry to achieve ISO 14000 certification for management excellence.

**Environmental protection.** Working in an environmentally sensitive industry that makes use of natural resources, PTP recognized its responsibility to minimize waste and protect its timber plantations—operating in an environmentally friendly and sustainable manner. Efforts included minimizing risks stemming from fiber dust emissions, wastewater discharge, formaldehyde emissions, and noise levels.
governance and good reporting,” said Spitzer. “Certainly the transparency we’ve established in the company made us far more attractive. In the due diligence phase before we were acquired, we had 30 people on the buyer’s team reviewing our different financial and operational issues. All those areas had already been covered in IFC reports.” After the due diligence, Carter Holt Harvey determined PTP complied with their requirements and the deal went forward.

“I’m sure our reputation as an IFC client and partner helped us in the eyes of the buyer,” Spitzer concluded. “Investors knew we were prudent and responsible and had ethical business practices. They also knew we’d be able to work effectively with international management systems. IFC was undoubtedly a very important reference for us.”

The city of Leshan and its outlying areas also benefitted from PTP’s success. Among the plantation workers were local Sichuanese who had been laid off from state-owned enterprises. Farmers who had sown low-margin crops began to plant fast-growing varieties of wood on hillsides requiring less intensive cultivation, such as eucalyptus and pine. Transport of timber products indirectly provided employment in trucking, loading, logistics, rail, and even shipping. Local furniture companies were able to expand product lines and upgrade the quality of their goods, attracting new business that elevated overall production levels and created new jobs. The company’s collaboration with IFC has been so successful that it has led other local companies to approach IFC for guidance, creating new client relationships for the organization.

PTP Manager Cheng Zheng notes that companies often are eager to work with IFC because they want to secure financing. But he cautions that they should not only have a short-term focus. “Management skills, expertise, and creating a culture of transparency are more critical,” he says, “because they confer a greater strategic advantage over time.”
Chengdu Huarong Chemical Company

Huarong Chemical demonstrates how a privately managed company can transform an ailing state enterprise into a profitable business that contributes to the local economy. It also offers a model for how corporate governance improvements can contribute to that process. Huarong was founded in 2000 by one of China’s largest private holding companies, the New Hope Group. It acquired the facilities of the Chengdu Chemical Company, an insolvent state-owned enterprise 40 kilometers west of Chengdu. The factory’s main product, high-purity potassium (KOH) flakes, is used across a range of industrial applications, including alkaline batteries, cosmetics, food additives, and pharmaceutical products. Its secondary product, PVC, is a plastic raw material used in construction, home appliances, autos, and furniture.

To this venture New Hope brought management expertise, working capital, and local market knowledge; IFC provided $3.2 million in equity and $16 million in loans from its own account and with participants. IFC also set forth new guidelines for financial management, corporate governance, and environmental practices. Although New Hope was an experienced local manager of successful businesses, it lacked experience in presenting its plans to a board of directors or using the board effectively to help the company make sound, long-term business decisions.

“IFC set broad rules and suggested big picture issues that needed to be addressed. The rules and details were all worked out by New Hope. This was a partnership,” commented a senior manager. “The principal assistance that IFC provided was in helping management operate the business from the board level down. IFC encouraged management to provide board meetings with a clear agenda and to conduct the meetings in accordance with the agendas.

By building an understanding of what directors need to contribute to the success of the business, management gained a better appreciation for establishing controls and good accounting procedures. To meet the needs of the board Huarong established strict internal systems for reporting and verified its reporting through audits. Unlike some
foreign companies that meet international standards by investing heavily at the outset in outside consultants, Huarong was determined to meet the new requirements as much as possible through internal resources and staff.

The upside to Huarong’s reliance on internal staff, who faced a steep learning curve, was that the management built in-house capacity and skills that helped maintain better reporting even after the systems were implemented. New Hope, the parent company, also benefited by having access to management resources that could contribute to establishing similar practices in subsequent acquisitions of state owned enterprises.

Board-led changes at the company encouraged the development of a compensation system that tied pay to performance. Management abolished the policy that guaranteed lifetime employment and doled out automatic promotions on the basis of seniority. Employee salaries were reformed to link to business unit performance. Employee pay began to fluctuate with production.

Huarong’s board took control of hiring both the general manager and the financial manager. The board gained greater confidence in management’s reporting and created an additional check within the management structure to ensure professional and honest practices at the company.

Board-led reforms combined with investment and improved management helped New Hope transform a failing chemical plant into a highly productive company. Changes went beyond corporate governance, demonstrating the company’s commitment to best practices across the board. The company improved its environmental practices through a new water treatment facility, and focused on better worker safety, helping employee morale and productivity.

After three years in operation, Huarong’s sales tripled to $30 million. By 2003, when the revamped factory lines operated close to capacity, Huarong was manufacturing international-grade KOH and PVC and exporting to or exploring markets such as the United States, Japan, and South Korea.

The company also has contributed greatly to the local economy of Sichuan province, an area hit hard by the ongoing restructuring of China’s state-owned enterprises. It reemployed about one-sixth of the Chengdu Chemical staff when it acquired the plant and continues to serve as a source of employment for laid-off state enterprise workers. Over its brief history,
Huarong has absorbed more laid-off workers than any other company in the area, and has been recognized by the city government for its contribution to supporting the local economy. The company also hires farmers for part-time transport and cleaning work, enabling many to double their farm income.

Chengdu Huarong has performed well and the owners and management feel that the increased accountability from good practices has contributed to its performance. New Hope has expanded its use of international practices in other new investments in state owned enterprises and to some of its other investments.

“In the past, we’d had some experience restructuring state-owned enterprises but Huarong was a bigger project,” says New Hope Chairman Liu Yonghao. We felt we needed help with management and guidance on attaining international standards. We also felt that IFC could help introduce New Hope to more international players.” Today, he says, IFC is instrumental in helping New Hope enter new industries such as natural gas, in markets such as Shenzhen where the group has never operated before. “By working with IFC,” says Liu, “we have learned what to consider when working with an international partner. We need to form more detailed business plans, and to comply with international standards.”

The legacy of a state dominated economy has provided few rules or guidelines to support businesses that are accountable and transparent to private shareholders. Therefore IFC can best fulfill its role of promoting private sector development by encouraging good practices and creating demonstration companies. To do this effectively, IFC needs to make the case for undertaking often difficult changes to the corporate culture among our clients. IFC tries hard to test investees for commitment at the start of each engagement. “We have to agree with companies at the outset that there’s a value to what we’re doing,” says IFC’s East Asia and the Pacific Associate Director, Karin Finkelston. “Everyone seems to think our name can be helpful. But there’s a lot of work involved in getting our name attached to the company.”

Each investment poses risks that must be managed and minimized to ensure the value of IFC’s participation in a
particular project and to the project sponsors involved. As a result, IFC requires potential clients to demonstrate a willingness to move toward internationally recognized practices that support better governance. “Changes don’t happen overnight,” observes Ms. Finkelston. “You have to identify the place where changes are needed, prioritize those changes, and then make the transition gradually. You’re really looking for a cultural change within the organization. It takes time.”

While IFC has had some notable successes in encouraging better governance practices, not all projects turn out as expected. Experience indicates that this occurs because a client has underestimated the degree of commitment required to overhaul its corporate governance regime. Local managers may resist better practices even after they weigh the advantages because of factors that undermine the traditional business case. The company may like the concept of better governance, but improving governance requires enormous commitment. A few companies have found, either before or after IFC has committed to investing, that they are unwilling or unable to do what it takes to make the necessary changes. IFC builds in exit levers that enforce standards.

In China today, legal reform and consistent application of regulation create dilemmas for businesses. Managers may resist internationally accepted practices simply because the local policy or regulatory enforcement environment drives them out of the market if they try to pioneer greater transparency and accountability.

IFC experienced such a case with a company located in a remote interior city of China—an area where private entrepreneurship was lacking and joblessness was on the rise. IFC began working with an industrial company that had a wide range of sustainable business issues to address. When IFC began speaking with the company, it was dumping thousands of tons of largely untreated waste into local rivers each day and had only a frail grasp of worker safety issues. Management needed to take control of the issues and given the potential risk it faced on pollution and safety issues the company was an excellent candidate for corporate governance reform.
Corporate Governance at IFC Projects

Governance for Small Businesses

China Project Development Facility is an IFC-managed multi-donor facility that supports small- and medium-sized enterprises in Sichuan province, in the west of China. It has developed a corporate governance program, funded by the Canadian and Italian governments, to support good practices at smaller companies. In China many enterprises, especially domestically listed companies, don’t yet recognize the benefits of good governance practices. By working with companies to bring about specific improvements in shareholders meetings, board of directors and management team, the program aims to increase investor confidence in small enterprises.

"While investors are relying on the central government to issue new laws to regulate listed firms, we can also do a lot of things to help those small and medium enterprises that do not know where to go to improve their corporate governance," said CPDF General Manager Mario Fischel.

The program offers advisory services to these companies to help them set up the board of directors and teach them how to organize shareholder meetings. It provides templates that assist in preparing company documents. It also delivers training courses to local accounting firms to help them work with the SMEs to prepare audit reports in accordance with international and domestic standards.

The program’s first agreements to provide support were made with Jinjiang Foaming Materials, Guanglin Electrical Appliance, and Mainland Hope Group. Firms received tailored technical assistance and support for step-by-step improvement of their corporate governance structure and practices. Support included provision of specific training and orientation session for the board of directors and management; review of corporate documents and internal decision making processes; organization restructuring; preparation and implementation of shareholders’ meeting; and advice on addressing specific corporate governance concerns. IFC hopes to use the relationships to facilitate access to finance through close cooperation with financial institutions, demonstrating to other small firms the benefits of adopting good practices.

An auditor brought in early as part of the company’s developing relationship with IFC discovered irregularities, which IFC discussed with company management. Management was open about shortcomings in its past accounting practices, and agreed all future financial statements would be reviewed according to international accounting standards.

Despite this encouraging start, company management later resisted full financial disclosure, a condition of IFC’s financial support. The company concluded that implementing IFC’s recommendations would create a significantly higher tax burden than it had previously borne. In a market where competitors were not adhering to such practices, management concluded that operating according to IAS would have put the company at a competitive disadvantage. In the end, IFC was forced to sell its stake—a disappointing but necessary step.

We can help those small and medium enterprises that do not know where to go to improve corporate governance.
Providing Intellectual Capital

Corporate governance has been identified by the Chinese government as the core element of the modern enterprise system. Such policy focus reflects the significant progress that China has made in building market institutions and the importance it attaches to changing corporate behavior. To support this policy, IFC’s East Asia and Pacific Department joined with the Private Sector Development Unit, East Asia and Pacific Region of the World Bank to publish Corporate Governance and Enterprise Reform in China: Building the Institutions of Modern Markets. The Development Research Center at the State Council supported and facilitated the study. A draft of the study was presented and discussed at a workshop organized by the World Bank Group and DRC in May 2001 in Beijing.

The study was released the following year at an international conference on corporate governance reform in post-WTO China cosponsored by the World Bank Group, the Development Research Center of the State Council, and the National Accounting Institute. Ningxia University joined the program through the Global Development Learning Network facilities. The conference was attended by more than 400 Chinese and international experts and policy makers in Beijing and more than 70 people in the campus of Ningxia University in Yinchuan, the capital of Ningxia Hui Autonomous Region, connected through the World Bank Global Development Learning Network facilities. Delivering the keynote address at the conference, the World Bank President Mr. Wolfensohn noted that as China begins to implement its commitments to the WTO, the policy focus on corporate governance in China is sending a strong signal that the government is committed to further market reforms.

The study was described the “most comprehensive account of Chinese corporate governance practices available today,” by the China Business Review. “The work clearly delineates the governance problems that China is facing while it builds modern financial institutions and efficient capital markets and explains why the current efforts to clarify the ownership rights of Chinese firms are crucial to the nation’s overall economic reform program.” It makes a large number of recommendations concerning the policy and legal frameworks, procedures, and institutional capacity for improving corporate governance practices in China.

The study was intended to provide those with an interest in the corporate governance practices of Chinese companies with new insights into their status and new ideas for ways to support and participate in their future improvement.

The study reflects the increasing emphasis that IFC and the World Bank place on improving corporate governance practices as part of the overall effort to support the development of the market institutions needed for sustained growth and poverty reduction. In China, the World Bank’s work over the years in support of government reforms in the financial sector, corporate restructuring, accounting, and legal and judicial practices has contributed directly to the development of the institutions of corporate governance.
Sharing Local and International Perspectives

The Global Corporate Governance Forum, co-founded by the World Bank Group and the Organization for Economic Cooperation and Development is an advocate, supporter, and disseminator of high standards and practices of corporate governance in developing and transition economies. It provides a convening venue for the leading players in governance worldwide. Its theme of partnership between the public and private sector is established through a Private Sector Advisory Group, which comprises internationally recognized business leaders serving in an individual capacity, drawn from developing, developed and transition economies. The Private Sector Advisory Group of the Global Corporate Governance Forum, headed by American corporate governance pioneer Ira Millstein, has been a catalyst for improved practices around the world.

In January 2003, PSAG cohosted a conference and held meetings in Shanghai. The group, including representatives of the PSAG Investor Responsibility Task Force, chaired by Peter Clapman of TIAA-CREF, participated in a conference co-hosted by the Forum, the Chinese Securities Commission and the Shanghai Stock Exchange followed by private meetings with Chinese business executives. Javed Hamid, IFC’s director for East Asia & the Pacific, provided an address that offered practical areas for further reform on corporate governance. PSAG offered Chinese businesses a range of industry perspectives from the United States, Europe, and other parts of Asia.

The conference was attended by over two hundred Chinese business leaders. It provided an opportunity to discuss global issues in corporate governance and the remarkable progress made in China in recent years, mostly due to the leadership of the CSRC. CSRC emphasized its determination to promote a strong corporate governance agenda in China. CSRC has provided basic training for the independent directors required to serve on Chinese boards. As a result of the meeting the Forum and IFC began encouraging the formation of a Chinese Institute or Association of Corporate Directors. The global support of such institutions is a key part of the Forum’s global mission. The time is right for such an organization in China.

After the conference, the PSAG’s Investor Responsibility Task Force held private meetings with chief executives from some of China’s leading listed companies. “These CEO’s clearly understand what it will take to attract the kind of private, long-term capital that our investor group represents,” said Peter Clapman. While investors such as Capital Group are already active in China, a few others were there to investigate the recent opening of local company shares to qualified institutional investors. The group concluded, at least in part, that China still faces some serious structural problems that have to be resolved before the broader market will be attractive to more conservative investors. But they gained an appreciation of the real pioneers in adopting good practices.
Financial Institutions

Financial institutions play a critical role in economic development. Effective institutions allocate capital to enterprises that can make the most productive use of the funds. A broad and deep financial sector is fundamental to building local businesses, large and small. Strong, competitive, and broad-based domestic capital sources are needed for companies to start up and grow.

In China, some of IFC’s largest equity investments have been made in the banking sector. As a significant equity investor in China’s banks and nonbank financial institutions, IFC has an interest in raising governance standards and our significant equity investments provide a platform to influence in this area more effectively.

Governance safeguards not only protect investors in financial institutions. At deposit-taking institutions, where people’s life savings may be at stake, good governance is important for safeguarding other stakeholders. IFC’s governance work with financial institutions complements the support we provide at the operational level—introducing best practices in credit analysis, risk management and portfolio monitoring, and internal controls.

While Chinese banks have a reputation for lax internal processes and governance, IFC’s experience indicates that most want opportunities to improve practices. Management of an increasing number of financial institutions are realizing that they are better served by voluntarily implementing improved practices before competition forces change upon them. Looming market liberalization due to World Trade Organization membership has helped focus institutions on differentiating themselves from competitors. For institutions eager to adopt best practices, working with IFC starts them on the road toward setting themselves apart in the market, and improving their brand and ability to raise capital for expansion.

Building a Modern Bank of Shanghai

One bank that made this connection early on was the Bank of Shanghai, a full-service commercial bank whose primary mandate is to support local privately owned small and medium enterprises. Established in 1995 with a legacy as a cooperative financial institution, it watched banks proliferate along the shores of Shanghai’s Pudong New Area, a district the city government had marked to become country’s new financial center. Suddenly the skyline bristled with potential foreign and local competitors.

IFC began working with Bank of Shanghai by implementing a program of technical assistance aimed at improving operational practices and funded by the European Union and Japanese governments. Given management’s willingness to receive this assistance, Bank of Shanghai was targeted as a good candidate for governance reform. Introducing better governance standards in a prominent financial institution was a priority for IFC because of its potential demonstration impact on other banks in Shanghai and China. The idea was to create a lending institution that could serve as a models.
IFC needed a stronger relationship in order to deliver the sort of support required for Bank of Shanghai to achieve improved practices in corporate governance. In 2000, IFC invested nearly $25 million to take a small equity stake in Bank of Shanghai. IFC was now able to influence corporate governance practices as a shareholder rather than a outside consultant. As a shareholder, IFC was also able to require project environmental and social reviews and an annual environmental performance report, enhancing the overall sustainability of the bank’s operations.

The biggest changes were taken at the board of directors. IFC encouraged Bank of Shanghai to increase the frequency of board meetings and improve the quality of information provided to directors. Many Chinese directors asked few questions at first, and bank management often supplied only information of limited value. But eventually the local directors began coming up with their own questions, many of them quite challenging, regarding the rate of change in the bank’s loans, its deposits, its capital adequacy, profitability, and other key data on performance.

As the process of change unfolded, Bank of Shanghai expanded the board’s supervisory powers by setting up independent board-level committees on risk management, auditing, and compensation. This resulted in ongoing changes in the following areas:

**Risk Management.** To consolidate the management of bank-wide risks, Bank of Shanghai broadened the remit of its Credit Management Department, converting it into a revamped Risk Management Department and setting up a credit review center to scrutinize big loans prior to approval. Procedures were established for identifying, quantifying, and managing risks, and for adopting a standardized rating system for internal use. The bank also set up a collateral recovery department to centralize management of large nonperforming assets.

**Environmental Protection.** Because banks face increasing scrutiny, Bank of Shanghai also took steps to manage potential liability stemming from environmental issues related to project financing. The bank established an environmental management system to ensure its lending activities comply with Chinese laws and appointed two senior officers responsible for conducting environmental appraisals on all projects.

**Auditing.** A board-level audit committee was created to ensure the completeness and objectivity of work conducted by external auditors and assess whether the bank’s internal controls were effective and complete. Because management was no longer the auditor’s client, auditors became less vulnerable to pressure from management and more likely to safeguard the interests of the bank’s minority shareholders.

**Executive Remuneration.** A compensation committee was created to review executive pay and create performance-based promotion criteria for senior managers. Criteria involved profitability metrics such as return on equity, capital adequacy, and non-performing loan ratios. Bonuses were tied to managers’ ability to meet those performance targets, making the promotion process more transparent and clarifying the board’s expectations of senior management. Moreover, the existence of an audit committee challenged the assumption common among Chinese enterprises that promotions were doled out automatically by virtue of seniority. IFC worked with the bank to establish a basis for recognizing performance, a controversial and difficult change for many in Bank of Shanghai to accept, but one that was vital to the bank’s transformation into a profit-oriented institution.

**Information Disclosure.** Working with IFC, the Bank of Shanghai modernized its reporting practices in a number of ways. Until 2003, for example, the financial information
released in the bank’s annual report was calculated according to Chinese rather than international accounting standards. In fact, Bank of Shanghai had compiled international-standard data but chose not to release it for fear of confusing stakeholders with what might have looked like two conflicting sets of financial data. Working with management, IFC persuaded the bank to begin releasing IAS figures in its annual report.

Bank of Shanghai’s improved corporate governance regime attracted attention. It was a key factor in the decision by HSBC to take an 8.0 percent equity stake in the bank in 2003. It was the first such investment by a foreign commercial bank in a Chinese bank. Total foreign equity participation has reached 18 percent, allowing Bank of Shanghai to decrease the level of state ownership and diversify its shareholder base.

**Commercial Banks**

In addition to Bank of Shanghai, IFC has committed to take equity investments in five other commercial banks in China, including three other city commercial banks—small, geographically limited lenders that provide critical support to China’s chronically under-funded smaller enterprises. It has also provided technical assistance programs to many banks by replicating the Bank of Shanghai training. Among the banks was the city commercial bank in Chengdu offered assistance through the China Project Development Facility. As part of its support IFC is providing ongoing technical assistance that includes operational practices and strengthens banks’ corporate governance procedures.

While IFC-invested banks have demonstrated a willingness to adopt better practices, much work still needs to be done. As IFC’s relationships with smaller commercial banks mature, it expects to provide additional technical assistance to strengthen the corporate governance and institutional capacity of selected financial institutions. Assistance will include corporate governance assessments and identification and nomination of independent directors. It will also include training in the concepts of corporate governance and the role of the board in the oversight of accounting, auditing, compliance, strategic planning, human resources, and executive compensation.

**IFC Support for Chinese Commercial Banks**

<table>
<thead>
<tr>
<th>Bank</th>
<th>IFC Investment FY</th>
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<tbody>
<tr>
<td>Bank of Beijing</td>
<td>2005</td>
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<tr>
<td>Bank of Shanghai</td>
<td>2000-2002</td>
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<tr>
<td>Chengdu City Commercial Bank</td>
<td>Non-investment</td>
</tr>
<tr>
<td>China Minsheng Banking Corporation</td>
<td>2003</td>
</tr>
<tr>
<td>Industrial Bank</td>
<td>2004</td>
</tr>
<tr>
<td>Nanjing City Commercial Bank</td>
<td>2002</td>
</tr>
<tr>
<td>Xi’an City Commercial Bank</td>
<td>2003</td>
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</table>
Nonbank Financial Institutions: IFC’s Work in the Insurance Sector

Despite their limitations, commercial banks remain the main source of formal financing for businesses in China. The rapidly growing economy will benefit from the development of a broader and deeper market for financial services, yet many basic financial institutions have either been state monopolies or have yet to develop in China.

With entry into the World Trade Organization, the financial sector will be gradually opened to foreign competitors. If Chinese companies are to compete, they must develop quickly and grow rapidly. Good corporate governance will provide safeguards for these nonbank financial institutions to develop.

IFC’s primary contribution to improved corporate governance in nonbank financial institutions has been primarily in the insurance sector. New China Life Insurance Company is a Beijing-based company selling policies in major Chinese cities. Established in 1996, it is one of only five companies nationally licensed to operate in the life, health, and pension insurance sectors.

Following a change in Chinese insurance regulations allowing 25 percent foreign ownership of New China Life, the company has attracted the interest of several foreign investors including a leading international life insurer. IFC took an equity stake in the company. Using the capital from foreign investors, New China Life became a leader in a market that was formerly a state monopoly and is a serious competitor to the foreign insurers now jockeying for position as China’s insurance market opens up due to membership in the World Trade Organization.

IFC’s equity investment in New China Life encouraged better practices.

Meeting procedures. Board meetings and shareholder meetings are designed to air different perspectives. Shareholders are normally consulted only on major issues, while directors are charged with overseeing the entire company. Directors typically decide which resolutions will go to shareholders for approval. New China Life separated the meeting to add clarity to the purpose of each meeting. Additionally, the company can now offer shareholders sufficient advance notice of their meeting.
**Meeting agendas.** As part of its commitment to improved practices, New China Life management has begun providing documentation related to important agenda items prior to meetings. In the past, shareholders or board members were often asked to approve an item after only a brief review during the meetings. By circulating documents well in advance, the company now ensures parties have time to review important issues and board members have adequate opportunity to discuss important issues in advance.

**Financial disclosure.** IFC encouraged transparency and good financial disclosure at New China Life. IFC worked with the company to help it follow its own detailed disclosure procedures more closely, ensuring that shareholders and board members had access to more complete financial information for informed decisions.

**Independent directors.** Chinese securities regulations prescribed that a third of board members for listed companies must be independent as of mid-2003. Yet, New China Life had no history of independent directors. With IFC’s encouragement and motivated by its own desire to have a public listing, New China Life nevertheless appointed the required percentage of independent directors, even before becoming a listed company.

**Board meeting dialogue.** Challenging senior management is not a widely accepted cultural practice among shareholders in China. If handled insensitively, questions are dismissed rather than viewed as an effort to improve company performance. Over time at New China Life, better practices have helped foster an environment where questioning management became permissible. Many Chinese shareholders have become less reluctant to ask questions. Today, the chairman is receptive to questions from shareholders and board members, seeing this as an opportunity to clarify a position or receive feedback that can contribute to further changes.

**Special board committees.** IFC assisted New China Life in setting up committees designed to improve governance by the board. An audit committee now meets regularly and discusses budgets in detail, and an investment committee is under discussion. A nomination committee and a remuneration committee are also functioning well.

Better practices provide a means for improving investor confidence, enhancing corporate performance and increasing access to capital.
While these steps might seem like basic and standard corporate practices, they represented big steps for a Chinese company at the time.

IFC’s experience in working with companies and financial institutions in China has helped us use better corporate governance practices as a key tool in promoting a stronger private sector. Good practices in our client companies in China have provided a means for improving investor confidence, enhancing corporate performance, and increasing access to capital.

**Chengdu Small Enterprise Credit Guarantee Corporation**

Many banks remain unwilling to lend to China’s capital-starved small and medium enterprises until credit risks can be reduced further. Credit guarantee institutions are one channel for reducing those risks.

Chengdu Small Enterprise Credit Guarantee Corporation was the first Chinese credit guarantee company set up by local and foreign government partners (the city of Chengdu city government and the Swiss government). Although the entity itself was government-funded, IFC decided to support the enterprise and encourage best practices in its governance and operations because of its potential impact on private sector development.

To bring CGC’s governance into line with international norms, China Project Development Facility provided extensive support:

**Drafting legal documentation.** CPDF helped draft legal documents including a detailed shareholders agreement spelling out the rights and obligations of shareholders. The agreement laid out working procedures for the company’s board and delineated lines of authority among shareholders, board members, and management. CPDF also helped strengthen the company’s articles of association and for management to come up with a code of conduct articulating the company’s values and strategic vision.

**Creating an Audit Committee.** CPDF helped CGC select board members with an auditing and finance background to commission outside audits and appoint external auditors.

**Increasing management board efficiency.** Duties of managers and board members were clearly separated to ensure that board members formulated strategy while management implemented it. A proper incentive system was also put into place to align top managers’ compensation with market rates, helping the company attract and retain higher quality executives.
Support for Market Regulation

Although China’s regulatory apparatus is adapting quickly to meet the challenges of a market economy, it is still a work in progress. IFC is supporting China’s effort to build a framework for effective regulation by identifying gaps in the current system, commenting on existing and proposed laws and rules, and responding to the regulators’ demands for strengthening regulatory capacity in key areas—especially those related to financial markets.

On the Right Track

In recent years Chinese regulatory officials have shown impressive zeal in implementing reforms, especially for adopting legislative and regulatory changes aimed at improving corporate governance. In some instances IFC commented on regulations. In others, IFC experiences at the company level, especially in pilot projects, were communicated back to regulators through an ongoing dialogue to help provide perspective that encouraged more thorough and meaningful regulations.

The China Securities Regulatory Commission issued a host of regulations early 2001 that constituted a significant leap toward bringing its regulatory regime into line with international standards. They included a directive mandating quarterly reporting; guidelines on qualifying and appointing independent directors; rules aimed at enhancing disclosure, improving the workings of the stock market, and codifying inspections of listed companies; a national corporate governance code; and an amended directive on the form and content of quarterly reports. More recently, regulations have strengthened the position of minority shareholders.

IFC provided comments on various drafts of the Code of Corporate Governance for listed companies that was prepared by CSRC and was completed in 2002. IFC also provided extensive comments to the drafting of the Code of Corporate Governance for Shareholding Banks drafted by the People’s Bank of China.

In addition to the establishment of a regulatory framework for better corporate governance, significant progress has been made in implementation. For instance, CSRC began delisting firms with poor profit records and has even moved to shut down companies with especially poor governance practices.

In industries that are relatively new to private participation and regulatory oversight in China, such as insurance, regulators may seek guidance to assist formulating effective policies. IFC often works with regulators to determine international practices against which Chinese regulations can be benchmarked. IFC helped create a $250,000 technical assistance program for the China Insurance Regulatory Commission at its outset. The program commissioned a comparative study of regulatory regimes in several developed economies including the European Community, the United States, Canada, Australia, Singapore, and Hong Kong. The program was designed by CIRC, which organized a local team to
carry out the research; IFC arranged funding from the government of Australia. Information derived from the program helped Chinese officials create a regulatory environment in line with international best practices.

Despite these encouraging first steps, regulators still operate under significant constraints. Regulatory bodies may not have the power or the political will to investigate improprieties. “All regulators will tell you they don’t have enough power,” says one of China’s top securities officials. “Often it takes a scandal to really focus people’s will—both legislators and regulators—so as to become stringent in applying the rules.”

**Cultivating Independent Directors**

The boardroom is the battleground for good governance around the world.

Yet boards of directors are new to China’s emerging private sector companies. Traditionally in state owned firms managers, together with their party and government supervisors, play the main role in running companies. Boards of directors are slowly replacing those governance mechanisms in China. Today, cultivating a base of capable directors, especially independent ones, may become the critical factor in determining the success of China’s transition from the old to the new ways of governing companies.

To be effective, directors must know their rights and responsibilities. But because China has no tradition of active, independent boards, many do not. Boards ultimately function as a check on the power of management or majority stakeholders—a new concept to most directors. Often, they do not fully understand the responsibilities of the job, and lack rudimentary knowledge of the decision-making mechanisms used by corporate boards.

As a result, many Chinese company boards fail to function effectively. This situation won’t change until there is better knowledge of directors’ roles and strong incentive for individual directors to better educate themselves. In many market economies, there are real legal consequences if directors fails to perform their fiduciary duties. While some problems have been fixed, Chinese law has not yet fully evolved to the stage where the consequences of a breach of duty are clear.

With the emergence of independent directors in China, the process is beginning to change. CSRC has begun to require that every listed Chinese company make at least one-third of its directors independent. The rule begins the process of increasing the autonomy of boards from management.

Implementation will take time. There are few qualified candidates—experienced people who understand and can carry out the role of an independent director. CSRC has recognized the need for capacity building to support regulations requiring more independent directors. It established training programs to educate and train corporate directors of listed companies.

Such training offers its own challenges. China’s unique cultural and business environment limits the usefulness of training materials developed elsewhere in the world. Western experience is needed, but can only be effective when combined with local knowledge to develop materials that respond to the specific requirements of Chinese listed companies. To overcome those challenges, IFC offered assistance to CSRC.
IFC partnered with the Australian Institute of Company Directors, an organization that provides training to company directors in Asia Pacific. The Institute has emerged as a regional player in disseminating best practices in corporate governance, and has helped set up Institutes of Company Directors in other countries across Asia Pacific. Working with IFC and CSRC, the Institute designed a training program for directors of listed companies aimed at accomplishing the following objectives:

- Familiarizing participants with basic principles of business law, accounting, strategic direction, and governance
- Creating a code of conduct for directors
- Training and supporting local tutors who could continue the program
- Establishing an Institute of Directors in China

Such a program is improving participants’ capacity to perform as independent directors by enhancing their professionalism, skill, and knowledge. By qualifying Chinese tutors, the program also creates a local capacity to train listed companies’ directors and independent directors.

IFC also wanted to ensure the program remained effective even after external support was withdrawn. This objective was achieved by developing course content and a curriculum that remained the intellectual property of CSRC after the project ended, and by training tutors who could continue teaching company directors in the future.

“We found to our surprise that many more people enrolled than we thought,” said one senior Chinese official. “As a result, we’ve created quite a number of these courses. We have trained 10,000 people over the past few years, including professionals such as lawyers and accountants, institutional investors, and academics. We now have a well-developed roster of teachers, mainly from Qinghua and Fudan Universities. Classes are held in Shenzhen, Shanghai, and Beijing. We normally get between 200 and 400 students per class.”
Training is just the beginning. Ultimately, China must develop a business culture where directors know what is expected of them and are motivated to do the job in a manner that benefits the overall system. For that to happen, a director’s liabilities must be made credible: Those who do wrong, or fail to do right, must pay a price. And if there is a price, there must be insurance. Many Chinese candidates for directorship are not wealthy by international standards. If found liable for substantial fines, they may be unable to pay. Insurance companies must offer directors and officers insurance, a common practice internationally. It benefits the markets by exposing insurance companies to greater liability and encourages them to scrutinize the individuals they insure.

**Looking Ahead**

China presents exciting opportunities for regulatory reform and improved corporate governance. Learning from both the successes and the increasingly well documented failures in other markets, China can build on global experience to build its own regulatory institutions with solid foundations. But these opportunities come freighted with risk—mainly the risk that China’s pioneering private sector companies will fail to set good examples. In a transition economy, power of precedent is crucial, so practices developed in today’s economy are likely to have long-term consequences for China’s institutions.

Rules prescribing a fixed number of independent directors effectively begin the process. Going forward, the challenge will be to ingrain principles of fairness, accountability, transparency, and fiduciary duty in management and governance practices. The long term benefit to the economy will be sufficient investor protection that ensures China will remain attractive to capital in the long term.
## Selected IFC Support Across Industrial Sectors

<table>
<thead>
<tr>
<th>PROJECT</th>
<th>FISCAL YEAR</th>
<th>SECTOR</th>
<th>CORPORATE GOVERNANCE SUPPORT</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASIMCO</td>
<td>2004</td>
<td>Automotive</td>
<td>IFC is helping improve practices and policies that resulted in new audit and compensation committees of the board of directors.</td>
</tr>
<tr>
<td>CSMC Technologies Corp</td>
<td>2004</td>
<td>Electronics</td>
<td>IFC provided materials developed by Corporate Governance Unit to help select board members and establish board committees. IFC placed an observer on the board to work with it on developing better board meeting procedures and practices.</td>
</tr>
<tr>
<td>Chengdu Huarong Chemical Company</td>
<td>1999-2002</td>
<td>Chemicals</td>
<td>IFC encouraged better practices, supported by seat on board, and assisted selection of outside directors. IFC encouraged improved financial reporting and auditing of financial statements.</td>
</tr>
<tr>
<td>China Green</td>
<td>2004</td>
<td>Utilities</td>
<td>IFC providing corporate governance assessment; improvement program tailored to the specific needs in the areas of: shareholder rights and equitable treatment; the board of directors; transparency and disclosure; and commitment to corporate governance. Provided training to the relevant staff and board members.</td>
</tr>
<tr>
<td>Great Infotech</td>
<td>2003</td>
<td>Technology</td>
<td>IFC is helping the company transform from a family-owned business to an institutional investor-sponsored professional business. IFC helped the company to identify two independent nonexecutive directors who will contribute to the development of board practices that are in line with best international practices. The company is preparing for an IPO on the Hong Kong Stock Exchange. IFC intends to work with company management on corporate governance related issues to ensure compliance with the higher standards expected of listed companies.</td>
</tr>
<tr>
<td>Fenglin Group</td>
<td>2004</td>
<td>Forestry</td>
<td>IFC has encouraged several improvements, including the appointment of a credible auditor and preparation of financial statements according to international standards. The company has separated its fibreboard business from other businesses to increase transparency. The board will be expanded and IFC will continue to advise the company on improving practices to help the company prepare for listing on a public exchange.</td>
</tr>
<tr>
<td>Jilin Zhengye Agricultural Development</td>
<td>2003-2004</td>
<td>Agribusiness</td>
<td>IFC provided technical assistance to develop an enterprise resource planning system. This effort will contribute to better accounting practices and transparency for managing and directing the company.</td>
</tr>
<tr>
<td>Nanjing Kumho Tire</td>
<td>1996-2004</td>
<td>Automotive</td>
<td>IFC has an observer on the board who provides advice to help the company improve practices.</td>
</tr>
<tr>
<td>Planation Timber Products</td>
<td>1996-2001</td>
<td>Forestry</td>
<td>IFC encouraged PTP to establish strong corporate governance as its business expanded, including adoption of international accounting standards and audits by an international firm.</td>
</tr>
<tr>
<td>Shanxi Antai Group</td>
<td>2004</td>
<td>Mining</td>
<td>Antai sought a partnership to tap into IFC’s knowledge of best practices in environmental management and corporate governance. In adopting better practices it hopes to build stronger credibility for a possible listing of its shares internationally.</td>
</tr>
<tr>
<td>Southern Aluminum Industry Co.</td>
<td>2004</td>
<td>Aluminum</td>
<td>IFC is jointly developing a corporate governance action plan with the company to improve its practices.</td>
</tr>
<tr>
<td>Wumart Stores</td>
<td>2004</td>
<td>Retail</td>
<td>Wumart sought IFC’s participation in its initial public offering to signal a commitment to meeting high standards in order to improve access to capital. As an equity investor, IFC will advise through its Corporate Governance Unit on corporate governance practices to help it adopt practices.</td>
</tr>
</tbody>
</table>