Corporate Governance in China: A Step Forward?

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Abstract

This study accesses the progress of corporate governance practice of Chinese listed companies using an international benchmark. Based on Revised OECD Principles of Corporate Governance (OECD, 2004), we develop a corporate governance index (CGI) to measure overall corporate governance and disclosure practices of the 100 largest listed firms in China. The results show that Chinese companies have been making progress in the corporate governance reform and the CGI of Chinese companies are comparable to those of Hong Kong listed companies. Further tests show that there is no relation between market valuation and corporate governance practice or corporate transparency.

Keywords**:** Corporate governance, China.

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I. Introduction

The corporate governance issue has drawn extensive interests of academics, practitioners and regulatory authorities after the 1997-1998 East Asian financial crisis. Both Asian countries and international organizations have launched numerous initiatives to enhance the corporate governance. For example, the Organization of Economic Cooperation and Development (OECD) issued a document entitled 'Principles of Corporate Governance' in 1998 and a revised version in 2004 (OECD, 2004). The intention is to establish an international corporate governance standard. Ultimately, it is hoped that improved corporate governance practices will lead to the value maximization that provides an incentive for corporate managers to improve the corporate governance practice.

China is the one of the largest economies in the world. The pace of economic change in China has been rapid since the start of economic reform just over 27 years ago. According to official statistics, economic growth has averaged 9.5 percent over the past two decades and the trend is expected to continue for some time. National income has been doubling every eight years. In the early 1990s, the government has introduced a wide range of reforms into the state-owned sector that has become a dominating force in the economy. Many state-owned enterprises have been transformed into corporations and listed on stock exchanges[1]. However, the government remains the major shareholder of SOEs through the state shares and legal person shares that account for two-thirds of the total shareholding. Table 1 provides a summary of ownership types of China's listed companies. The privatization of SOEs with the dominant state ownership leads to a new agency problem generating conflicts of interest amongst different stakeholders of companies. As China opens its equity market gradually to the international investment community, the corporate governance standard of Chinese listed companies will have to converge with the international standard to ensure that Chinese listed companies can be able to compete with the peers in the international capital market.

[1] There are two stock exchanges in China. Mainland companies issue A-share and B-share in Shanghai and Shenzhen. A-share is mainly for the domestic investors and B-share is mainly for overseas investors. Mainland companies issue H-share in Hong Kong.

This paper attempts to address three issues. First, China's equity market is still in its infantry stage, we will assess the progress of corporate governance reform of Chinese listed companies using the OECD principles as the benchmark. Second, we will compare the corporate governance practice of China's companies with Hong Kong companies using the same benchmark. Finally, this paper will further examine the relationships between the corporate governance practices and the market valuation of Chinese listed companies.

The sample consists of the 2004 Fortune 100 largest Chinese listed companies. We construct a unique corporate governance index (CGI) based on the OECD principles. There are 86 questions (including sub-questions) classified into five categories - rights of shareholders; equitable treatment of shareholders; role of stakeholders; disclosure and transparency; and board responsibilities. For the market valuation, we use market-to-book ratio (MTBV) and Tobin's Q respectively and control for a number of variables that are considered to affect the firm market valuation.

The empirical result shows that the CGI of Chinese listed companies are comparable with those of Hong Kong listed companies reported by Cheung, Connelly, Limpaphayom and Zhou (2006)[2]. However, we also find that companies with better corporate governance practices measured by CGI *do not* associate with a higher market value in China[3]. When we construct an additional sub-index related to transparency, empirical evidence also shows no statistically significant relation between transparency index and market valuation.

The remainder of this paper is organized as follows. Section 2 presents a literature review. Section 3 gives a brief review of the stock market development in China. Section 4 describes the data and methodology. The results are illustrated in section 5 and the last section concludes the paper.

II. Literature Review

[2] Cheung, Connelly, Limpaphayom and Zhou (2006) apply the same 86 criteria to 168 Hong Kong listed companies based on year 2002 data. One should be cautious in interpreting the comparison result because of the different regulatory requirement between the two markets.
[3] For example, see Black (2001), Black, Jang and Kim (2005), Bebchuk, Cohen and Ferrell (2005), Gompers, Ishii and Metrick (2003), Cheung, Connelly, Limpaphayom and Zhou (2006)

A growing body of literature studies the relationships between corporate governance and firm's market valuation or performance in both developed and emerging markets. In the past, the approach has been to examine specific aspects of corporate governance such as ownership concentration (e.g., Himmelberg, Hubbard and Palia, 1999; Morck, Shleifer and Vishny, 1988), board composition (Agrawal and Knoeber, 1996; Hermalin and Weisbach, 2003), and executive compensation (e.g., Abowd and Kaplan, 1999; Bebchuck, Fried and Walker, 2002). Recently, several studies have utilized a novel approach by constructing an overall governance index and then examine the effect of overall corporate governance practices on firm value (Bebchuk, Cohen and Ferrell, 2005; Gompers, Ishii and Metrick, 2003; Durnev and Kim, 2005; Klapper and Love, 2003; Black, 2001; Black, Jang and Kim , 2006). The logic behind this approach is that corporate governance mechanisms may be substitutes for one another. Consequently, one must consider the overall quality of corporate governance when examining the impact on firm performance.

In one of the most widely cited studies on corporate governance, Gompers, Ishii and Metrick (2003) construct a "Governance Index" to proxy for the level of shareholder rights of approximately 1500 large U.S. firms during the 1990s. The G-Index consists of 24 provisions related to takeover defenses and shareholders' rights. They find that firms with stronger shareholder rights (democratic) have higher firm value, higher profits, higher sales growth, lower capital expenditures, and make fewer corporate acquisitions. They also document a significant relation between G-Index scores and stock returns over the sample period. They posit that weak shareholders' rights create agency conflicts which, in turn, lead to low firm value in the long-run. Recently, the G-Index has become a benchmark for measuring corporate governance quality of U.S. companies.

Bebchuk, Cohen and Ferrell (2005) put forward an entrenchment index based on six provisions – four "constitutional" provisions that prevent a majority of shareholders from having their way (staggered boards, limits to shareholder bylaw amendments, supermajority requirements for mergers, and supermajority requirements for charter amendments), and two "takeover readiness" provisions that boards put in place to be ready for a hostile takeover (poison pills and golden parachutes). These are selected from a total of 24 governance provisions developed by the Investor Responsibility Research Center (IRRC). Examining market valuation and performance of U.S. firms during 1990-2003, they find a negative relation between the index scores and firm valuation, as measured by Tobin's Q. In other words, these entrenchment provisions lead to low market valuation among U.S. firms. Both indexes make an important contribution to the literature on takeover defenses in the US, it is of limited relevance to China's market where hostile takeovers are rare.

Durnev and Kim (2005) use a multi-country approach to assess whether corporate governance predicts firms' market value. They employ the Credit Lyonnaise Securities Asia's (CLSA) governance index and the S&P disclosure score to measure corporate governance practices for a sample of 859 large firms in 27 countries and conclude that firms with higher scores are valued higher in respective stock markets. Although the empirical evidence is quite convincing, there is a limitation to the use of the CLSA index because it utilizes subjective judgments of analysts which, in turn, may create biases in the data. In a separate study, Klapper and Love (2003) also use CLSA governance index and find a positive correlation between market value or return on assets and corporate governance for 374 firms in 14 countries.

Compared to the developed market research, recent research on emerging markets also generates affirmative results. Black, Jang and Kim (2006) construct a corporate governance index (KCGI, 0~100) for 515 Korean companies using a survey conducted by Korea Stock Exchange. The also document a positive relation between corporate governance practices and market valuation, as measured by Tobin's Q and market-to-book ratio. In addition, the two-stage and three-stage least squares analyses confirm their OLS results. In the end, Black, Jang and Kim (2006) conclude that an overall corporate governance index is an important and likely causal factor in explaining the market value of Korean public companies. For Russian firms, Black (2001) constructs a corporate governance risk measure and finds a positive relation between corporate governance behavior and market valuation among a small sample of 21 Russian firms.

Cheung, Connelly, Limpaphayom amd Zhou (2006) examine the relation between corporate governance and firm value by developing an instrument to assess the corporate governance practices of listed companies in Hong Kong. Based on the

Revised OECD Principles of Corporate Governance (OECD, 2004), they construct a corporate governance index (*CGI*) for Hong Kong listed companies. Unlike measures used in other studies, their *CGI* scores reflect not only the presence of good corporate goverance practices but also the variation in the quality of corporate governance practices. In the end, they show that a company's market valuation is positively related to the overall *CGI* score, a composite measure of a firm's corporate governance practices. They also find that the transparency component of the *CGI* score drives the relation with market valuation. In summary, their study provides supporting evidence to the notion that, in Hong Kong, good corporate governance practices are consistent with value maximization.

For listed companies in China, corporate governance remains a contentious issue. There are several studies examining specific aspects of corporate governance in China. Groves, Hong, McMillan and Naughton (1994), Li (1997) and Xu (2000) show that the reform of SOEs in China improves the incentive of firms significantly and the productivity has increased. Bai, Liu, Lu, Song and Zhang (2004) consider a list of corporate governance mechanisms related to Board's composition and characteristics and to investigate their impacts on the market valuation of the firms. Their findings provide empirical support several theoretical predictions specific to corporate governance practices. For example, they find that a large holding by the largest shareholder, the CEO being the chairman or vice chairman of the board of directors, and the largest shareholder being the government having negative effects on firm valuation while the presence of foreign investors and the high concentration of non-controlling shareholding have positive effects.

This study differs from the previous work in the following ways. First, this study applies a comprehensive corporate governance index derived from the 86 criteria of the five OECD principles. This is the first comprehensive corporate governance rating exercise in China. These principles cover five major aspects of corporate governance proposed by OECD. These criteria are based on publicly available information such as annual report, company's website, and company's announcements. More importantly, the scoring procedure used in this study allows for the assessment of the quality of corporate governance practices. This represents a significant improvement from other measures which generally examine the presence or absence of a particular practice. The results from this study can be directly compared to the results by Cheung, Connelly, Limpaphayom and Zhou (2006) who employ a similar measure on listed firms in the Hong Kong market.

III. Institutional Background

The two Chinese Stock Exchanges were established in Shanghai and Shenzhen, in 1990 and 1991 respectively as the major initiative for economic reform. By 2003, there were 1287 companies listed, with total market capitalization more than RMB 4 trillion. The development process of China's stock market is summarized in table 2. Table 3 provides some summary statistics of China's stock market.

To preserve the economy's socialist structure, SOEs have to issue shares to the government when going public. The shares held by government or government agencies are called state shares. The state shares are non-tradable on the stock market as well as legal person shares, which are held by domestic institutions or legal entities. Another type of non-tradable shares is employee shares, which can be purchased by individual employee of listed companies. However, employee shares can be sold in open market after a vesting period. According to table1, about two-thirds of China's listed companies are SOEs and state still remains as the largest shareholder after the firm goes public. However, the government is likely to have goals other than shareholders' value maximization. La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998) assert that the central agency problem in large corporations is to restrict expropriation of minority shareholders by controlling shareholders. Therefore, a controlling government stakeholder can use the listed company as a vehicle to achieve other policy goals even though they may conflict with shareholders' interests (Bai, Li, Tao and Wang, 2000).

The tradable shares can be classified according to the residency of their owner as domestic (A shares) or foreign (B, H and N shares). A-shares are only available to Chinese domestic investors and are dominated in RMB. B-shares, which are dominated in foreign currencies (U.S. dollars for Shanghai Stock Exchange and Hong Kong dollars for Shenzhen Stock Exchange), were available only for non-residents. In 2001, B-shares were made available for domestic investors. Since 1993, Chinese companies were permitted to list on the Stock Exchange of Hong Kong as H-shares, which are subject to more strict listing requirements. Finally, N-shares are traded in U.S stock market in the form of American Depository Receipts (ADRs).

Although China has been actively improving the regulatory framework of corporate governance, the market has been governed for most of the period by the so-called 'administrative governance' approach (Pistor and Xu, 2005). Under the administrative governance, the stock market is heavily regulated by the government and its development has been subject to constant interventions from the government. Often times, government policy is the main instrument to govern and control the stock market. For example, when the market is down, the Chinese government tries to stimulate it by relaxing regulations and policies. When there is a boom, the government reverses its policy and tries to cool down the market (Song, 2002). In fact, some believe that share prices on China's stock markets are purely driven by speculative activities and bear no relationship to the fundamentals of the firms.

Another distinctive feature of china's equity market is the investor base. It can be seen from table 4 for the distribution of both A-share and B-share investors in China that retail investors play account for the majority. This may explain why China has a much higher turnover velocity than other markets as shown in table 5.

To sum up, China's stock market is established under the centrally planned economy and the 'administrative governance' has seriously thwarted the development of effective corporate governance system for Chinese listed companies. Concentrated ownership by state, multiple-goals of listed companies, weak legal system, inadequate financial disclosure, expropriation of minority shareholders by controlling shareholders and short-run speculating investments are found to be the most serious problems in China.

IV. Data and Construction of Corporate Governance Index

Our sample consists of 2004 Fortune 100 largest listed companies in China (see Appendix I). The Fortune ranking is based on total revenue of all Chinese firms listed over the world, including Hong Kong, China Mainland, New York, London, Singapore and NASDAQ. For the 2004 ranking, the total revenue of the 100 largest corporations in China ranges from 4.45 billion RMB to 324.2 billion RMB. Due to data availability, we get a sample of 97 listed firms for ranking. After dropping financial firms, we have a final sample of 89 listed firms.

Based on Revised OECD Principles (OECD, 2004), we develop a corporate governance index constructed by 86 questions (including sub-questions)[4]. The 86 questions are classified into five OECD corporate governance principles: rights of shareholders; equitable treatment of shareholders; role of stakeholders; disclosure and transparency; and board responsibilities. The full questionnaire is attached in Appendix II.

Some questions concerning about the rights of shareholders and the equitable treatment of shareholders are related to the first four provisions in Bebchuk, Cohen and Ferrell (2005). However, their last two provisions on the hostile takeover are not applicable in China because of the concentrated ownership by state and the inactive takeover market. We highlight some thoughts in the questionnaire design.

For the rights of shareholders, we examine how shareholders could participate in the major company decisions. For example, can shareholders ask questions in the Annual General Meetings (AGMs) and can they nominate or remove directors? We also examine the amount of information disclosed in the notice to call AGMs. For the equitable treatment of shareholders, we examine whether the companies have explicitly mentioned one-share, one-vote in their article of association and facilitate proxy voting by minority shareholders. We also include questions on the disclosure on insider trading and related- party transactions. The third part of our survey is on the role of stakeholders in corporate governance. We examine the company disclosure on employee benefits, welfare and long-term incentive scheme and disclosure on environmental issues. The fourth part is on the disclosure and transparency. We assess the amount of information (financial and non-financial) disclosed in the company annual report and the company website. Do they disclose a transparent ownership structure? Is the financial report disclosed in a timely manner? The last part is on the responsibilities of the Board. We assess the quality of the Audit Committee report included in the annual report. We also assess the monitor role of the board.

[4] The questionnaire consists of 47 major questions. Some major questions contain several sub-questions. If we include sub-questions, there are totally 86.

The corporate governance practices of listed companies are examined from the public shareholders' perspective, using publicly available information that they can obtain in reaching their investment decisions. Our data sources include annual reports, articles of association, memorandums of association, notices to call shareholders meetings, AGM minutes, company websites, analyst reports and other sources. Companies are then rated for each of the 86 questions. For rating purpose, we have a clear standard to identify good, fair or poor and the corresponding score is 3, 2 or 1.[5]

The scores from each question are compiled into sub-index for each category. Next, scores from sub-indices are combined into an overall corporate governance index. In the process, we also assign a weight to each category according to its importance and number of questions within it. The weight assigned to each category is: rights of shareholders (20%); equitable treatment of shareholders (20%); role of stakeholders (5%); disclosure and transparency (25%); and board responsibilities and composition (30%).[6]

We calculate each sub-index as the weighted average score of its contained questions and a corporate governance index is calculated for each company as the average of five sub-indices weighted by the assigned weights. Therefore, the corporate governance index is also ranged from 0 to 100. Better-governed firms have higher scores.

Furthermore, we construct another index to access firms' disclosure performance by including all questions related to transparency and the list of questions can be found in Appendix II. The non-disclosure-related questions are included in a non-transparency index.

[5] For example, question E.12 asks 'Among board of directors, how many are independent non-executive directors (INED)?' If the percentage of INED is above 50 percent, then the company will be classified as 'good' and gets a score of '3'. If the percentage is below 25 percent company will get 'poor' and '1'. The companies with percentage of INED between 25 percent and 50 percent are ranked 'fair' and get a score of '2'. In addition, each company is assessed by two different raters to ensure consistency. Final results are cross-checked by the auditors and the project leaders.

[6] When constructing a corporate governance index, the proper survey weighting scheme for survey questions remains an open issue. The weighting scheme used in this study is based roughly on the number of questions in each survey category. Lacking a definitive means to determine which questions are more important and should carry more weight, we repeat our analysis by assigning equal weights to the five categories. The results from an equal weighting scheme are not reported but are similar to the results reported in this paper.

Accounting information and firm performance data are obtained from DataStream. Ownership structure is obtained from annual reports. All data are processed according to the firm's fiscal year.

V. Results

A. Summary Statistics

A major contribution of this study is to construct a corporate governance index (CGI) for the Fortune 100 largest listed companies in China. Table 6 provides some descriptive statistics of CGI, transparency index, non-transparency index and the five sub-indices. The index ranges from 43.3 to 71.2 on a scale from 0 to 100 and the average score is 55. Higher score implies better corporate governance according to OECD principles. The CGI of Chinese listed companies are comparable with those of Hong Kong listed companies reported by Cheung, Connelly, Limpaphayom and Zhou (2006) - Hong Kong Company's scores range from 32.9 to 76.4 and an average of 48.3. However, one has to be cautious with the interpretation whether Chinese listed companies are better governed than Hong Kong listed companies because of different disclosure requirement for listed companies in these two markets. When we searched for information on listed companies for the CGI, China's listed companies have more information available than Hong Kong companies. This is consistent with finding reported by Cheung and Jang (2006) who compare the listing requirement among nine East Asian economies and find China has the most stringent rule and requirement for listed companies. However, they also report the market perception represented by fund managers, that China is the market with the worst corporate governance standard among nine economies. They conclude that the gap between the two surveys is attributable to the poor law enforcement in China.

Table 7 shows the descriptive statistics of companies included in our sample. The average market value of our sample is 23.03 billion RMB, which is relatively large compared with the average market value of 3.3 billion RMB of all China's listed companies in 2003. The average Tobin' Q is about 1.022. The market-to-book ratio is 2.564. The return on Asset is 5.428 percent and the debt-to-equity ratio is 0.72. On average, the largest shareholder holds approximately 54.8 percent of outstanding shares of the company and the state is the largest shareholder in 70 out of 89 firms. The shareholdings owned by state account for 58.42 percent on average while the top

5 shareholders hold an average of 68.24 percent shares of the company. Among these companies, 19 firms have the same person serving as both CEO and board chairman; 34 firms are listed on overseas stock markets including NYSE, London, Singapore and Hong Kong.

B. Regression Results for MTBV and CGI

One purpose of our paper is to examine the relation between CGI and the market valuation of China's 100 largest listed firms. We use the market-to-book ratio (MTBV) as a proxy for a company's market valuation. To deal with the endogeneity problem between the firm value and corporate governance attributes (Black, 2001), we include a comprehensive set of control variables to limit omitted variable bias, as well as the potential endogeneity problem. In addition, we use the instrumental variable as a robust test.

The definition of all variables used in our study is listed in table 8. The regression results are shown in Table 9 that show *no* statistically significant correlation between corporate governance practice and market valuation. The coefficients for CGI are not statistically significant in all regressions in Table 9. This implies that good corporate governance measured by CGI *does not* guarantee a high market valuation in China's stock market. This finding is not consistent with other findings that corporate governance and market valuation are positively related (Bai, Liu, Lu, Song and Zhang, 2003; Black, Jang and Kim, 2006; Cheung, Connelly, Limpaphayom and Zhou, 2006).

C. Results for Control Variables

To ensure the robustness of our results, we include a set of control variables to avoid potential mis-specification in this research. The rationale of the models and the OLS regressions results are described below.

Firm Size

Firm size can affect both market valuation (MTBV) and a firm's governance practices. For example, large firms may have more resources to undertake additional corporate governance initiatives because large firms receive a lot of attention from the investing public so they have to disclose more information. We use the natural logarithm of total assets (LnTA) to control for firm size and find the coefficient on LnTA is significantly negative in all regressions. Our OLS results are similar if we substitute natural logarithm of total sales or total market capitalization for total assets.

Profitability

Profitability is very likely to be positively related to market valuation. We therefore control for the effect of profitability on market valuation with return on asset (ROA). The result shows that the coefficients for ROA are not statistically significant. This may imply that investors in China do not value Chinese listed firms based on their profitability.

Risk Factors

Both firm leverage and liquidity can affect MTBV and corporate governance. We use current ratio and debt-to-equity ratio as control variables for the risk factors of a firm. The coefficient for current ratio is not statistically significant while the debt-to-equity ratio has a statistically significant positive relation to market valuation.

Ownership Structure

Ownership structure plays an important role in corporate governance practice. It is particular important in China because most China's listed companies are owned by the government. For our sample, the state or state agency owns 48.8 percent of listed companies on average. In 70 firms of our sample, the government is the largest shareholder. We control for shareholdings owned by state among the top 10 shareholders, the shares held by the largest shareholder, the shareholding owned by the top 5 shareholders. We also include a dummy variable that equals to 1 if the top 5 shareholders hold more than 50 percent of the firm. We find a U-shaped relation between state-owned shares and MTBV, which is consistent with Tian (2002). When the government shareholding is small, the market valuation decreases with an increased size of government shareholding. When the government shareholding is sufficiently large, the firm's market valuation increases with increased government shareholding. This U-shaped relationship between government shareholding and corporate value is interpreted by the aggregated impacts of the grabbing and helping hands of the government shareholder. We also find that when the top 5 shareholders shareholding is large, the market valuation is also high.

Board Composition

Companies with high proportion of executive directors on the board may be an indicator for bad corporate governance and may be undervalued by investors. In contrary, a high proportion of independent non-executive directors may imply good shareholder protection and be valued by investors. We employ the percentage of executive directors and independent non-executive directors to control. Both the coefficients are not statistically significant.

Other Governance Practice Dummies

CEO duality, audit committee, nomination committee and remuneration committee are considered to be the recommended best practice. Companies with such best practice may be favored by the market. However, the coefficients are not statistically significant.

Listed Time

Firms listed longer could differ from younger firms both in MTBV and CGI. We use natural logarithm of listed days as a control variable. The variable is not statistically significant.

Listed Overseas

Firms that listed on overseas stock markets such as NYSE, Hong Kong and London etc, are open mainly to foreign investors and regulated by more restrictive rules. We include a dummy variable which equals to 1 if the firm is listed on more than two stock exchanges. If the firm is listed as A-shares and B-shares at the same time, the dummy is also equal to 1. The coefficient is not statistically significant.

D. Regression Results for Transparency Index

Although CSRC has issued various disclosure rule and regulation, the validity of the disclosed information of listed companies is doubtful. The listed companies use technical terms so intensively that the announcements are too complex to understand. Therefore, more disclosed information without proper monitoring may not enhance transparency. This involves the integrity of the financial intermediaries. Consequently, we expect to find no statistically significant relation between corporate disclosure and transparency and market valuation.

We decompose the CGI into two sub-indices: the transparency index and non-transparency (governance factors that are not related to transparency) index. We construct transparency index by including all questions related to transparency and disclosure. Table 10 presents the regression results using these two indices as independent variables. Control variables are the same as the regression of MTBV against CGI. As expected, the coefficients of the two indices are not statistically significant at conventional levels.

E. Regression Results for Sub-index

In this paper, we have classified question items into five categories of the corporate governance index: rights of shareholders; equitable treatment of shareholders; role of stakeholders; disclosure and transparency; and board responsibilities. It is also plausible that a particular aspect of OECD's corporate governance principles, not the overall index, has a strong association with firm performance. Therefore, we further investigate the relation between each category and market valuation.

Each sub-index is constructed by including all the questions and sub-questions within this category and rescaled to 0-100. The regression results are reported in table 11. Again, we do not find any statistically significant relation between market valuation and scores from the sub-index.

F. Robustness

To check the robustness of our findings, we perform some additional empirical tests. We first employ alternative proxies as dependent variable and independent variables. Second, we examine the stability and the internal consistency of our questionnaire. In other words, if we omit some question(s) in the questionnaire, will this omission change the findings substantially?

Other proxies

Tobin's Q and return on equity (ROE) are used as proxy for market valuation. When we replace MTBV by Tobin's Q and ROE, the empirical results are similar.

There is no statistically significant relation between market valuation and corporate governance practice.

We also replace some independent variables by various other proxies in all regressions such as total asset replaced by total sales or total market value and ROA replaced by ROE. Our main results remain unchanged. The market valuation is not related to either CGI or transparency index or any individual sub-index.

Number of Questions

To ensure the result is not dominated by any specified question(s), we remove question(s) from the questionnaire randomly and rank the companies by the new CGI. If there is no question(s) that plays a dominating role, then the new ranking will be similar to the old ranking of companies. This experiment includes three steps. First, we compute a new CGI by removing randomly one question from the 86 questions and rank the 89 companies. Second, the Spearman rank correlation coefficient between the new and the original rankings of companies is calculated. Third, we repeat the above procedure for ten times. Furthermore, we extend our experiment by removing two, three, five and ten questions randomly. The Spearman rank correlations in all the experiments are above 0.97, which implies that the new and original rankings are highly and significantly correlated. Most rank correlations are larger than 0.99, even by removing 10 questions. This provides evidence that the ranking of companies is not dominated by any question(s).

Instrumental Variable

One problem troubling all corporate governance studies is the potential for endogeneity. The instrumental variable approach is widely used (e.g., see Bhagat and Black (2002) and Black, Jang and Kim (2006)) as a means to resolve the problem. However, it is difficult to find an instrument highly correlated with the variable of interest but uncorrelated with the error term of the true structural model. Nevertheless, we acknowledge the problem and attempt to identify an instrument in our study to address the problem of endogeneity.

We note that an increasing number of mainland China-incorporated companies have listed in overseas since 1993. There are differences in corporate governance requirement for Chinese companies listed in China and overseas. For example, a separated set of listing requirements is designed for Chinese issuers to obtain and maintain a listing on the stock exchange of Hong Kong (HKEx, listing rules, 1999)[7]. The regulatory requirement causes important distinctions between mainland-listed and overseas-listed Chinese companies, leading us to argue that the differences in corporate governance between the two groups of Chinese companies are exogenous. The overseas listing (*Overseadum*) is used as the instrumental variable in the two-stage regression for the performance measures[8]. We do not report the additional results in order to economize on space and the results are consistent with our previous findings that *CGI* is not related to the three performance measures of Chinese listed companies.

VI. Conclusions

This study introduces a comprehensive corporate governance index to measure the corporate governance mechanisms in China's equity markets. This paper attempts to use the OECD principles of corporate governance to measure the progress of the corporate governance reform among 100 largest Chinese listed companies. We find that the *CGI* of Chinese listed companies are comparable with those of Hong Kong listed companies using the same benchmark. Although one has to be cautious in the interpretation of the comparison, this provides evidence to show Chinese listed companies has been making progress in corporate governance reform.

The second part of the paper examines the relation between the *CGI* with market valuation of Chinese listed companies. Conventional wisdom suggests that good corporate governance should lead to better performance and, in turn, higher firm valuation. The reason is that good corporate governance helps ensure that managers will act on behalf of shareholders and make decisions that maximize firm value. Empirical evidence from the U.S. markets and other emerging markets have provided support to the notion that companies with good corporate governance practices also

[7] Chapter 19A of the Exchange Listing Rules (Listing Rules, 1999) provides a thorough and complete description.

[8] In order to be a valid instrumental variable, the *Overseadum* satisfies two conditions in the regression model. First, the covariance between *Overseadum* and the residual (ε) from regression model is equal to zero. The second condition is that the covariance between the *Overseadum* and *CGI* is not equal to zero.

exhibit relatively better performance. The empirical evidence shows no statistically significant relation between market valuation and corporate governance practice, as measured by the corporate governance index, among Chinese listed companies. Additional investigation also reveals no significant relation for individual sub-index or transparency index and market valuation. The result indicates that the market valuation of Chinese listed companies is not *yet* related to their corporate governance practices. The paper provides evidence that China has made a step forward in corporate governance reform. However, to have corporate governance play its important role in China, there is a long way to go.

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Table 1 Summary of Ownership Types of China's Publicly Listed Companies

The table presents the ownership types of China's publicly listed company over the period from 1993 to 2001. The data source is Fan and Wong (2004) and Fan, Wong and Zhang (2005). Here the ownership is judged based on the status of the controlling shareholders.

YEAR	Number of listed companies	Local government (%)	Central government (%)	Privately-controlled firms (%)	Collective (%)	Widely-held (%)	Miscellan-eous (%)	Unidentified (%)
1993	166	77.71	6.63	3.01	3.01	1.81	3.61	4.22
1994	285	75.44	6.32	3.86	4.21	1.05	4.56	4.56
1995	309	75.73	7.12	3.88	3.88	0.97	3.88	4.53
1996	486	73.05	9.67	4.94	3.91	0.41	4.32	3.70
1997	719	70.93	11.68	5.29	4.45	0.14	4.45	3.06
1998	825	68.97	12.73	7.15	4.12	0.12	4.48	2.42
1999	923	65.44	13.76	8.99	4.33	0.22	4.88	2.38
2000	1,060	63.11	14.62	10.85	3.87	0.19	5.66	1.70
2001	1,134	61.38	15.26	12.79	3.44	0.09	5.82	1.23
Total	5,907	67.39	12.56	8.38	3.96	0.30	4.94	2.51

Table 2 Development of China's Stock Market

This table presents the chronology of reform initiatives on the state-owned sector in China.

Year	Event
1978	Third Plenum of the 11th Central Committee of the Communist Party of China
1979	Reform of SOEs began
1990	Shanghai Stock Exchange was in operation
1991	Shenzhen Stock Exchange was in operation
1991	B-shares launched
1992	The Chinese Securities Regulatory Commission (CSRC) was set up
1993	H-shares permitted
1993	the Central Party of China convened the Third Plenum of the 14th Central Committee
1993	Company Law was promulgated
1998	Securities Law was promulgated
1999	the Ministry of Finance revised the Accounting Law launched in 1985
2001	B shares opened to domestic individual investors

Table 3 Summary for China's Stock Market

This table presents the summary statistics of the stock market in China during the period 1992-2004.

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Number of Listed Companies (A&B Shares)	53	183	291	323	530	745	851	949	1088	1160	1224	1287	1377
Number of Listed Companies (B Shares)	18	41	58	70	85	101	106	108	114	112	111	111	110
Negotiable Market Capitalization (Bil Yuan)		86.16	96.89	93.82	286.70	520.44	574.54	821.40	1608.75	1446.32	1248.46	1317.85	1168.86
Total Market Shares (Bil Shares)	7.32	32.87	63.95	76.56	111.04	177.12	234.54	290.89	361.34	483.84	546.30	599.79	671.47
Total Market (Bil Yuan)	104.81	354.15	369.06	347.43	984.24	1752.92	1952.18	2647.12	4809.10	4352.22	3832.91	4245.77	3705.56
Total Volume (Bil Shares)	3.69	22.66	101.33	70.53	253.31	256.00	215.25	293.24	475.84	315.23	301.62	416.31	582.77
Total Turnover (Bil Yuan)	68.30	362.72	812.76	403.65	2133.22	3072.18	2352.73	3131.96	6082.66	3830.52	2799.05	3211.53	4233.39
Turnover Ratio-Shanghai(%)			1134.65	528.72	913.43	701.81	453.63	471.46	492.87	269.33	214.00	250.75	288.71
Turnover Ratio-Shenzhen (%)			583.83	254.52	1350.35	817.43	406.56	424.52	509.10	227.89	198.79	214.18	288.29
P/E-Shanghai		42.48	23.45	15.70	31.32	39.86	34.38	38.13	58.217	37.71	34.43	36.54	24.23
P/E-Shenzhen		42.69	10.37	9.35	35.42	39.86	30.59	36.30	56.04	39.79	36.97	36.19	24.63
Number of investors(10000)		835.17	1107.76	1294.19	2422.08	3480.26	4259.88	4810.63	6154.53	6965.90	7202.16	7344.41	7211.43

Source: The Chinese Securities and Futures Statistical Year Book, 2005

Table 4 Investors Summary in 2002-2004

This table presents the participation of the individual and institutional investors in A-share and B-share markets. There is also a further breakdown of investor participation in Shanghai and Shenzhen Stock Exchange. The statistics show there is relative large participation of individual investors in the A-share market in both Shanghai and Shenzhen Stock Exchange. The unit here is 10000.

Panel A.1: A shares Investors Summary 2002			
	Total	Shanghai	Shenzhen
Total Investors	6727.5	3470.19	3257.31
Institutional Investors	34.52	18.10	16.42
Individual Investors	6692.98	3452.09	3240.89
Panel A.2: A shares Investors Summary 2003			
	Total	Shanghai	Shenzhen
Total Investors	6823.76	3491.52	3332.24
Institutional Investors	32.20	18.21	13.99
Individual Investors	6791.56	3473.31	3318.25
Panel A.3: A shares Investors Summary 2004			
	Total	Shanghai	Shenzhen
Total Investors	7055.48	3623.24	3423.24
Institutional Investors	33.96	19.23	14.73
Individual Investors	7021.52	3613.01	3408.51
Panel B.1: B shares Investors Summary 2002			
	Total	Shanghai	Shenzhen
Total Investors	154.26	96.42	57.84
Institutional Investors	1.76	0.96	0.8
Individual Investors	152.49	95.46	57.03
Panel B.2: B shares Investors Summary 2003			
	Total	Shanghai	Shenzhen
Total Investors	157.48	97.73	59.75
Institutional Investors	1.60	0.78	0.82
Individual Investors	155.89	96.95	58.94
Panel B.3: B shares Investors Summary 2004			
	Total	Shanghai	Shenzhen
Total Investors	160.26	98.97	61.29
Institutional Investors	1.71	0.87	0.84
Individual Investors	158.55	98.1	60.45

Source: The Chinese Securities and Futures Statistical Year Book, 2003-2005

Table 5 Turnover Velocity of Domestic Shares

This table presents the turnover velocity of some selected equity markets during 1994-2004. The statistics show that both Shanghai and Shenzhen have the highest turnover velocity among the Asian markets and developed markets.

	Shanghai	Shenzhen	Taiwan	New York	Tokyo	Korea	London	Hong Kong	Thailand	Singapore
1994	1135	584	366	53	25	174	77	40	63	28
1995	529	255	228	59	27	105	78	37	40	18
1996	913	1350	243	52	27	91	58	44	30	14
1997	702	817	407	66	33	146	44	91	50	56
1998	454	407	314	70	34	207	47	62	69	64
1999	471	425	289	75	49	345	57	51	78	75
2000	493	509	259	88	59	243	69	61	55	59
2001	269	228	207	87	60	219	84	44	91	59
2002	214	199	217	95	68	254	97	40	90	54
2003	251	214	191	90	83	193	107	52	136	74
2004	289	288	177	90	97	147	117	58	111	61

Source: The Chinese Securities and Futures Statistical Year Book, 2005;
World Federation of Exchange Website

Table 6 Descriptive Statistics of CGI and Sub-indices

This table presents the summary statistics of the corporate governance index and the five sub-indices of 89 Chinese listed companies in our sample. All the indices are ranged from 0 to 100.

Variable	Mean	Median	Minimum	Maximum	Std Dev
CGI	54.79	54.65	43.31	71.18	5.50
Sub-index A	38.88	38.33	21.67	60.00	9.16
Sub-index B	71.15	72.50	30.00	135.00	11.51
Sub-index C	17.77	12.50	0.00	68.75	16.64
Sub-index D	72.88	72.70	53.29	88.16	7.22
Sub-index E	45.59	44.05	21.43	69.05	10.16
Tindex	55.27	56.25	35.23	71.59	8.72
Nontindex	47.84	47.56	32.93	68.90	6.88

CGI	Overall corporate governance index
Sub-index A	Rights of shareholders
Sub-index B	Equitable treatment of shareholders
Sub-index C	Role of stakeholders
Sub-index D	Disclosure and transparency
Sub-index E	Board responsibilities and composition
Tindex	Transparency index constructed based on all disclosure related questions
Nontindex	Non-transparency index constructed based on non-disclosure related questions

Table 7 Summary Statistics

This table provides the summary statistics of our sample companies. These characteristics include some corporate governance measures. The definition of these variables can be found in table 8.

Variable	Mean	Median	Minimum	Maximum	Std Dev	No. of '1' values (for dummy variables)
Total Asset (in mil RMB)	31674.06	9662.51	913.20	531734.78	80826.37	
Market Value (in mil RMB)	23025.72	7394.21	803.35	469168.56	63168.27	
Tobin's Q	1.02	0.93	0.12	2.87	0.57	
ROA (%)	5.43	5.11	-19.37	15.74	4.68	
ROE (%)	14.57	13.98	-37.99	69.07	12.14	
MTBV	2.56	2.34	0.28	11.53	1.71	
Current ratio	1.33	1.23	0.26	3.14	0.54	
DE ratio (%)	72.62	44.43	0.00	617.09	93.42	
Largest (%)	54.79	55.83	11.19	90.00	18.38	
Top5 (%)	68.24	70.60	17.48	94.34	17.42	
Stateshares (%)	48.84	57.13	0.48	90.00	19.87	
Listed_days	2342.48	2260.00	62.00	6517.00	1313.11	
Indeperc	0.31	0.33	0.00	0.56	0.08	
Exeper	0.34	0.31	0.11	0.78	0.17	
Overseadum	0.39	0	0	1	0.491	34
Ceodum	0.21	0	0	1	0.412	19
Cgdum	0.71	1	0	1	0.457	63
State1st	0.79	1	0	1	0.412	70

Table 8 Variables Definition

This table provides the definition of the variables included in the analyses. CGI, A100-E100, Tindex, Nontindex are all scaled to 0-100.

Variables	Description
CGI100	Overall corporate governance index
A100	Rights of shareholders
B100	Equitable treatment of shareholders
C100	Role of stakeholders
D100	Disclosure and transparency
E100	Board responsibilities and composition
T	Transparency index constructed based on all disclosure related questions in the survey
N	Non-transparency index constructed based on non-disclosure related questions.
MTBV	Defined as market value of common stock/ book value of common stock.
ROE	Return on equity
ROA	Return on asset
Q	Tobin's Q, defined as (market value+long-term debt) /total assets
LnTA	Natural log of total asset
LnMV	Natural log of market value
LnSales	Natural log of total sales
Current	Current ratio
Deratio	Debt to equity ratio
Indeperc	Percentage of independent directors on the board
Exeper	Percentage of executive directors on the board
Top5	Percentage of total outstanding shares held by five largest shareholders
Concentrate	Whether the shareholding of the top5 shareholders is more than 50%, 1 is yes, 0 is no.
Cgdum	Whether the firm has a nomination committee or a audit committee or a remuneration committee, 1 is the firm has at least one committee and 0 is the firm has no such committee
Ceodum	Whether CEO of the firm and Chairman of the board is the same person. 1 is yes, 0 is no.
Largest	The shareholding of the largest shareholder
Largestsqr	The square of largest shareholder’s holding
Stateshares	The shareholdings owned by state
Statesqr	The square of stateshares
Listed_days	The listed days of a firm from its IPO day to the end of 2003
Overseadum	Whether the firm is listed on the overseas markets including NYSE, London, Hong Kong and Singapore, 1 is yes and 0 is not

Table 9 OLS results between MTBV and CGI with control variables

This table reports the regression model using the market-to-book value (MTBV) as the dependent variable and corporate governance index as the independent variable. The other regression models (2)-(4) include other control variables. T-statistics, based on White's Heteroskedasticity-Consistent Standard Errors & Covariance, are reported in parentheses. * represents significance level at 10% (two-tailed test), ** represents significance level at 5% (two-tailed test), *** represents significance level at 1% (two-tailed test).

	MTBV			
	(1)	**(2)**	**(3)**	**(4)**
Intercept	3.985 (1.41)	13.117** (2.55)	20.242*** (3.2)	17.584** (2.29)
CGI100	-0.019 (-0.37)	-0.017 (-0.36)	-0.027 (-0.52)	-0.041 (-0.7)
LnTA		-0.587** (-2.19)	-0.963*** (-3.14)	-0.864** (-2.45)
ROA		0.044 (0.54)	-0.035 (-0.43)	-0.027 (-0.27)
Deratio		0.007** (2.63)	0.007** (2.62)	0.007** (2.29)
Current		-0.486 (-0.8)	0.463 (0.79)	0.558 (0.86)
Stateshares			-0.176** (-2.39)	-0.180** (-2.23)
Statesqr			0.002** (2.3)	0.002** (2.18)
Largest			0.027 (0.23)	0.050 (0.38)
Largestsqr			-0.001 (-1.14)	-0.002 (-1.24)
Top5			0.075*** (3.07)	0.070** (2.67)
Concentrate			-1.132 (-0.85)	-1.136 (-0.76)
Ceodum			0.346 (0.51)	0.297 (0.31)
Cgdum			-0.336 (-0.51)	-0.366 (-0.51)
Exeper				1.264 (0.48)
Indeperc				3.727 (1.01)
Overseadum				-0.213 (-0.34)
Listed_days				<0.001 (0.17)
Adjusted R^2	-0.017	0.148	0.351	0.304
F-Stat	0.13	2.81**	3.16***	2.33**

Table 10 OLS results for Transparency Index with Control Variables

This table presents regression model using the market-to-book value (MTBV) as the dependent variable and the transparency index and non-transparency index as independent variables. The other models (2-4) include other control variables. T-statistics, based on White's Heteroskedasticity-Consistent Standard Errors & Covariance, are reported in parentheses. * represents significance level at 10% (two-tailed test), ** represents significance level at 5% (two-tailed test), *** represents significance level at 1% (two-tailed test).

	MTBV			
	(1)	(2)	(3)	(4)
Intercept	3.9359** (1.83)	13.7481*** (3.39)	13.1209** (2.59)	11.7577* (1.93)
Tindex	0.0209 (0.78)	0.0274 (1.1)	0.0205 (0.73)	0.0148 (0.51)
Nontindex	-0.0467 (-1.22)	-0.0531 (-1.55)	-0.0338 (-0.76)	-0.0373 (-0.8)
LnTA		-0.6310*** (-2.75)	-0.6927** (-2.38)	-0.6685** (-2.04)
ROA		0.0780 (1.21)	0.0938 (1.31)	0.1022 (1.32)
Deratio		0.0078*** (3.3)	0.0081*** (3.24)	0.0083*** (3.11)
Current		-0.5544 (-1.11)	-0.2833 (-0.51)	-0.1541 (-0.26)
Stateshares			0.0224 (0.51)	0.0262 (0.56)
Statesqr			-0.0003 (-0.44)	-0.0003 (-0.48)
Largest			-0.0742 (-0.74)	-0.0693 (-0.67)
Largestsqr			0.0004 (0.46)	0.0004 (0.36)
Top5			0.0511** (2.16)	0.0494* (1.96)
Concentrate			-0.3589 (-0.3)	-0.3123 (-0.22)
Ceodum			0.4988 (0.86)	0.4730 (0.69)
Cgdum			-0.4019 (-0.66)	-0.5530 (-0.85)
Exeper				1.0438 (0.51)
Indeperc				3.4012 (0.95)
Overseadum				0.1209 (0.22)
Listed_days				<-0.0001 (-0.13)
Adjusted R^2	-0.0031	0.2008	0.1674	0.1184
F-Stat	0.9	3.68***	1.92**	1.48

Table 11 OLS results for Sub-Index with Control Variables

This table reports the regression results using the market-to-book value (MTBV) as dependent variables and sub-indices as independent variables. These models also include the control variables. T-statistics, based on White's Heteroskedasticity-Consistent Standard Errors & Covariance, are reported in parentheses. * represents significance level at 10% (two-tailed test), ** represents significance level at 5% (two-tailed test), *** represents significance level at 1% (two-tailed test).

	MTBV				
	(1)	(2)	(3)	(4)	(5)
Intercept	10.7588* (1.82)	10.9766* (1.79)	10.1204* (1.77)	11.9639* (1.98)	9.0702 (1.58)
A100	-0.0117 (-0.43)				
B100		-0.0131 (-0.39)			
C100			0.0009 (0.55)		
D100				-0.0434 (-0.88)	
E100					0.0290 (0.97)
LnTA	-0.6301** (-2.02)	-0.6195* (-1.98)	-0.6298* (-1.98)	-0.5502* (-1.71)	-0.6481** (-2.09)
ROA	0.1108 (1.46)	0.1097 (1.44)	0.1136 (1.5)	0.1261 (1.65)	0.1228 (1.62)
Deratio	0.0085*** (3.21)	0.0086*** (3.26)	0.0086*** (3.23)	0.0087*** (3.32)	0.0086*** (3.28)
Current	-0.1057 (-0.18)	-0.0800 (-0.14)	-0.0945 (-0.16)	-0.0287 (-0.05)	-0.1043 (-0.18)
Stateshares	0.0342 (0.72)	0.0296 (0.63)	0.0304 (0.65)	0.0385 (0.81)	0.0400 (0.85)
Statesqr	-0.0004 (-0.64)	-0.0004 (-0.59)	-0.0004 (-0.58)	-0.0005 (-0.77)	-0.0005 (-0.77)
Largest	-0.0883 (-0.87)	-0.0891 (-0.88)	-0.0880 (-0.87)	-0.1148 (-1.09)	-0.0946 (-0.94)
Largestsqr	0.0005 (0.53)	0.0005 (0.51)	0.0005 (0.51)	0.0007 (0.69)	0.0006 (0.59)
Top5	0.0532** (2.16)	0.0517** (2.07)	0.0533** (2.16)	0.0602** (2.34)	0.0616** (2.38)
Concentrate	-0.2310 (-0.17)	0.0475 (0.03)	-0.1212 (-0.09)	-0.0194 (-0.01)	-0.2506 (-0.18)
Ceodum	0.5241 (0.78)	0.4948 (0.73)	0.5538 (0.83)	0.4665 (0.7)	0.6754 (1.0)
Cgdum	-0.8230 (-1.48)	-0.7514 (-1.28)	-0.8184 (-1.44)	-0.7913 (-1.43)	-1.1550* (-1.78)
Exeper	1.2118 (0.59)	1.2109 (0.59)	1.2669 (0.62)	1.4160 (0.7)	1.3494 (0.67)
Indeperc	3.2079 (0.91)	3.4572 (0.98)	3.3722 (0.95)	3.7879 (1.08)	2.2592 (0.62)
Overseadum	0.1794 (0.33)	0.1759 (0.32)	0.1743 (0.32)	0.3279 (0.58)	0.2645 (0.48)
Listed_days	<-0.0001 (-0.08)	<-0.0001 (-0.06)	<-0.0001 (-0.02)	<-0.0001 (-0.09)	<0.0002 (0.08)
Adjusted R^2	0.1259	0.1252	0.1224	0.1365	0.1395
F-Stat	1.54	1.54	1.53	1.6*	1.61*

Appendix I Fortune 100 largest listed companies in China

China Petroleum & Chemical Corporation
PetroChina Company Limited
China Mobile (Hong Kong) Limited
China Telecom Corporation Limited
China Life Insurance Company Limited
China Unicorn Limited
PICC Property and Casualty Company Limited
Minmetals Development Co., Ltd.
Baoshan Iron & Steel Co., LTD.
CNOOC Limited
China Resources Enterprise Limited
Sinopec Shanghai Petrochemical Company Limited
Sinopec Zhenhai Refining & Chemical Company Limited
TCL Corporation
CITIC Pacific Limited
Legend Group Limited
Huaneng Power International, Inc.
Aluminium Corporation of China Limited
Sinopec Yangzi Petrochemical Co., Ltd.
Jilin Chemical Industrial Co., Ltd.
BOC Hong Kong (Holdings) Limited
Sinotrans Limited
China Southern Airlines Company Limited
Shanxi Taigang Stainless Steel Co., Ltd.
UT Starcom Incorporated
TCL International Holdings Limited
Zhongxing Telecom Co., Ltd.
Maanshan Iron & Steel Company Limited
Beijing Shougang Co., Ltd.
AviChina Industry & Technology Company Limited
COFCO International Limited
Angang New Steel Co., Ltd.
Chongqing Changan Automobile Co., Ltd.

Bengang Steel Plates Co., Ltd.
BOE Technology Group Co., Ltd.
Great Wall Technology Co., Ltd.
Jinzhou Petrochemical Co., Ltd.
Sinochem International Co., Ltd.
Shanghai Construction Co., Ltd.
Laiwu Steel Co., Ltd.
Ningbo Bird Co., Ltd.
Inner Mongolian Baotou Steel Union Co., Ltd
Sinopec Yizheng Chemical Fibre Company Limited
Torch Investment Co., Ltd.
Brilliance China Automotive Holdings Limited
Gree Electrical Appliances, Inc. of Zhuhai
Beijing Datang Power Generation Company Limited
Shanghai Pharmaceutical Co., Ltd.
FAW Car Co., Ltd.
Sinopec Qilu Co., Ltd.
Anyang Iron & Steel Inc.
Panzhihua New Steel & Vanadium Co., Ltd.
XiamenC&Dlnc.
Yanzhou Coal Mining Company Limited
Beijing Enterprises Holdings Limited
Huaxia Bank Co., Ltd.
Sinopec Kantons Holdings Limited
China Overseas Land & Investment Limited
Huadian Power International Corporation Limited
Shenzhen Kaifa Technology Co., Ltd.
Tsingtao Brewery Company Limited
Hangzhou Iron & Steel Co., Ltd.
Henan Shuanghui Investment & Development Co., Ltd
SGIS Songshan Co., Ltd.
Nanjing Textiles Imp & Exp Corp., Ltd.
Guangzhou Pharmaceutical Co., Ltd.

Appendix I Fortune 100 largest listed companies in China (Continued)

Digital China Holdings Limited

Tangshan Iron & Steel Co., Ltd.

Sichuan Changhong Electric Co., Ltd.

China Eastern Airlines Corporation Limited

Beiqi Futian Automobile Co., Ltd.

China International Marine Containers (Group) Limited.

GD Midea Holding Co., Ltd.

China Merchants Bank Co., Limited

Konka Group Co., Ltd.

Hunan Valin Steel Tube and Wire Co., Ltd

Handan Iron & Steel Co., Ltd.

China Minsheng Banking Corp. Ltd.

Shanghai Pudong Development Bank Co., Ltd.

China Aviation Oil Singapore Corporation Ltd.

QingdaoHaier Co., Ltd.

Shanghai Friendship Group Incorporated Co.

Sinopec Beijing Yanhua Petrochemical Company Limited

Harbin Pharmaceutical Group Co., Ltd.

Shanghai Automotive Co., Ltd.

Shanghai Material Trading Centre Co., Ltd.

Nanjing Iron & Steel Co., Ltd.

Amoisonic Electronics Co., Ltd.

Wuhan Steel Processing Company Limited

Tsinghua Tongfang Co., Ltd.

Lianyungang Ideal Group Co., Ltd.

Guangzhou Iron & Steel Co., Ltd.

Weiqiao Textile Company Limited

China Vanke Co., Ltd.

Yibin Wuliangye Co., Ltd.

Inner Mongolia Yiii Industrial Group Co., Ltd.

Guangdong Kelon Electrical Holdings Co., Ltd.

Guangdong Electric Power Development Co., Ltd.

Shijiazhuang Refining-Chemical Co., Ltd.

Shenzhen Development Bank Co., Ltd.

Appendix II Corporate Governance Questionnaire

Question Number	Survey Question
	Section A -- Rights of Shareholders
A.1	Does the company offer other ownership rights beyond voting?
A.2*	Is the decision on the remuneration of board members or executives approved by the shareholders annually?
A.3*	How is the remuneration of the board presented?
A.4*	Quality of Notice to call Shareholders Meeting in the past one year.
	(i) Appointment of directors, providing their names and background
	(ii) Appointment of auditors, providing their names and fees.
	(iii) Dividend policy, providing the amount and explanation.
A.5	Did the Chairman of the Board attend at least one of AGM in the past two years?
A.6*	(i) Did the CEO/Managing Director attend at least one of the AGM in the past two years?
*	(ii) Is a name list of board attendance available?
A.7	Do AGM minutes record that there was an opportunity for shareholders to ask questions/ raise issues in the past one year?
	(i) Is there record of answers and questions?
	(ii) Is any resolution being solved?
A.8	Does the company have anti-takeover defenses?
	(i) Cross shareholding
	(ii) Pyramid holding
	(iii) Board members hold more than 25% of share outstanding
	Section B -- Equitable Treatment of Shareholders
B.1	Does the company offer one-share, one-vote?
B.2	Is there any mechanism to allow minority shareholders to influence board composition?
B.3	Have there been any cases of insider trading involving company directors and management in the past two years?
B.4*	Does the company provide rationales/explanations for related-party transactions affecting the corporation?
B.5	Is the company a part of an economic group where the parent/controlling shareholder also controls key suppliers, customers, and/or similar businesses?

* denotes item included in the Transparency Index

B.6* Has there been any non-compliance case regarding related-party transactions in the past one year?

B.7* Does the company facilitate voting by proxy?

B.8* (i) Does the notice to shareholders specify the documents required to give proxy?

(ii) Is there any requirement for a proxy appointment to be notarized?

B.9* How many days in advance does the company send out the notice of general shareholder meetings?

Section C -- The Role of Stakeholders in Corporate Governance

C.1* Does the company explicitly mention the safety and welfare of its employees?

C.2* Does the company explicitly mention the role of key stakeholders such as customers or the community at large (or creditors or suppliers)?

C.3* Does the company explicitly mention environmental issues in its public communications?

C.4 Does the company provide an ESOP (employee share option program), or other long-term employee incentive plan linked to shareholder value creation, to employees?

Section D -- Disclosure and Transparency

D.1* Does the company have a transparent ownership structure?

(i) Breakdown of shareholdings.

(ii) Is it easy to identify beneficial ownership?

(iii) Is director shareholdings disclosed?

(iv) Is management shareholding disclosed?

D.2 Does the company have a dispersed ownership structure?

D.3 Is the company's actual ownership structure obscured by cross-shareholdings?

D.4* Assess the quality of the annual report. In particular, the following:

(i) Financial performance

(ii) Business operations and competitive position

(iii) Board member background

(iv) Basis of the board remuneration

(v) Operating risks

D.5* Is there any statement requesting the directors to report their transactions of company stock?

D.6 Does the company use an internationally recognized accounting standard?

D.7* (i) Does the company have an internal audit operation established as a separate unit in the company?

(ii) To whom does the internal audit function report, please identify?

* denotes item included in the Transparency Index

D.8* Does the company perform an annual audit using independent and reputable auditors?

D.9* Are there any accounting qualifications in the audited financial statements apart from the qualification on Uncertainty of Situation?

D.10* Does the company offer multiple channels of access to information?

(i) Annual report
(ii) Company website
(iii) Analyst briefing
(iv) Press conference/ press briefing

D.11 Is the financial report disclosed in a timely manner?

D.12* Does the company have a website, disclosing up-to-date information?

(i) Business operation
(ii) Financial statement
(iii) Press release
(iv) Shareholding structure
(v) Organization structure
(vi) Corporate group structure
(vii) Annual report downloadable
(viii) Be provided in both Chinese and English

Section E -- Responsibilities of the Board

E1.1* Does the company have its own written corporate governance rules?

E1.2* Does the board of directors provide a code of ethics or statement of business conduct for all directors and employees?

E1.3* Does the company have a corporate vision/mission?

E.2 Does the regulatory agency have any evidence of the firm’s non-compliance with rules and regulations over the last three years?

E.3* Assess the quality and content of the Audit Committee Report in the annual report.

(i) Attendance
(ii) Internal control
(iii) Management control
(iv) Proposed auditors
(v) Financial report review
(vi) Legal compliance
(vii) Conclusion or opinion

E.4 Have board members participated in the China Securities Regulation Committee (or equivalent) training on corporate governance?

E.5 How many board meetings are held per year?(at least twice one year is required in China)

E.6 (i) Is the chairman an independent director?
(ii) Is the chairman also the CEO?

* denotes item included in the Transparency Index

E.7	Does the company have an option scheme which incentivizes top management?
	(i) Did the company have the option (and/ or other performance incentive) schemes in the past but still in effect?
	(ii) Does the company currently have option (and/or other performance incentive) schemes?
E.8	Does the board appoint independent committees with independent members to carry out various critical responsibilities such as: audit, compensation and director nomination?
	(i) Audit
	(ii) Compensation
	(iii) Director nomination committee
E.9	What is the size of the board?
E.10	How many board members are non-executive directors?
E.11*	Does company state in its annual report the definition of ‘independence'?
E.12	Among directors, how many are independent directors?
E.13*	Does the company provide contact details for a specific investor relations person?
E.14*	Does the company have a board of directors report?
E.15	Does the company disclose how much they paid the independent non-executive directors?
E.16	Do the company provide training to directors (including executive and nonexecutive directors)?

* denotes item included in the Transparency Index