

The Effects of Sarbanes-Oxley on China's U.S.-Listed Companies

by

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The purpose of this session is to describe how new U.S. securities regulation affects any Chinese company currently listed, or considering a listing, on a U.S exchange. I'm not going to spend my time today by giving you a line-by-line review of the new rules and regulations. Rather, I'll try and provide you with an overview of the implications of these regulations and the environment that spawned them.

Any company that intends to compete for capital in the U.S. must adhere to the governance and disclosure standards that U.S. companies follow. I know that there are instances where the regulations do not apply to non-U.S. issuers. However, I don't think that a foreign issuer has the option to elect these exemptions. U.S. investors will discount any potential investment that carries the slightest hint or risk from sub-standard governance and disclosure practices. Accordingly, if a foreign issuer is serious about competing for capital in the U.S., it must adopt and implement world-class governance and disclosure practices.

In fact, I think the discussion today is not about compliance with Sarbanes-Oxley and other exchange listing requirements, but rather about companies making leadership in governance and disclosure core corporate competencies. I also believe that the credibility of the investment environment has been so shaken that companies must look to reputation as a key indicator of their attractiveness to investors.

What led us to the present situation was a history of the aggressive promotion of false value in the dot-com era, the impact of rich executive compensation packages on the need to "make the numbers," and the preferential, and perhaps illegal, disclosure practices of a portion of corporate America. Contrary to many who decried the new regulations, I think these actions on the part of our legislators and securities regulators were long over due. Today, because of Sarbanes-Oxley, NYSE, NASDAQ, and Regulation FD, trust can be restored in the markets and all investors can feel that they are playing on a level field.

Further, I think that there has been a sea change in investor attitudes about what's important in evaluating companies. Reputation is becoming a key value driver for companies. Indeed, in an investor sentiment tracking survey conducted earlier this year, 64% of those interviewed said that a company's reputation was more important than a year ago.

The mania over pure financial performance may be waning. Non-financial value drivers are reported to be gaining in importance among institutional investors. These include quality of management, governance and disclosure, brand equity, intellectual and human capital, innovation, and alliances/partnerships. For the first time in the 30 years of an important portfolio manager tracking study, quality of management replaced EPS growth as the leading factor that money managers rely on for making investment decisions. An Ernst and Young study, Measures that Matter, found that these non-financial values drivers account for 35% of the value that institutional investors accord to a company. The same study found that these factors are more important to an IPO's success than financial factors. Noted accounting Professor Baruch Lev of New York University has empirical evidence that these non-financial factors account for 50% of a firm's value. Importantly for those of you here today, investors will pay 28% more for emerging market companies that practice good corporate governance.

I'd like to leave you with a few suggestions for Chinese companies (or any non-U.S. company) who wish to raise capital in the U.S. equity markets.

First, make corporate governance and transparency best practices a core, corporate competency. Be a leader, not a follower, or worse, a complier.

Second, embark on a multi-channel corporate awareness building campaign far ahead of the capital-raising event. Build your reputation and then sustain it through an effective integrated corporate communication program.

Finally, under promise and over deliver. Nothing can damage the long-term credibility of a company with investors than an over-hyped launch followed by performance that fails to meet expectations.

There's a world of opportunity awaiting Chinese companies who are confident and bold enough to become leaders in the world of investor and corporate communication.

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