Stringent listing requirements? It has, arguably or even factually, been much easier for Chinese firms to be listed in Singapore than in Hong Kong, or the US, or mainland China itself

Why S-chip fraud cases keep cropping up

Poor corporate governance is simply a symptom but not the root of the problem

By QIAN MEI LIN

N THE PRECEIVED with the purpose of riding on China’s economic growth, and to develop Singapore’s financial market, the listing of Chinese firms in Singapore (S-chips) has, surprisingly and sadly, resulted in a heartbreaking experience for many Singaporean investors and Chinese firms themselves.

With their reputation tarnished by a notable involvement in frauds, the prices of S-chip stocks have collapsed and remained low for a long period. It is easy to point fingers, put the blame on the poor corporate governance of these culprits, and become biased against all Chinese firms because of certain rogue companies.

However, corporate governance is not unanimous, but a choice of firms and a result of the regulatory environment. Just as human behaviour is the product of society, corporate behaviour is the product of the regulatory and market conditions.

Therefore, poor corporate governance is simply a symptom but not the root of the problem. If the institutional or regulatory rules — whichever give rise to incentives and opportunities to steal as well as myopic behaviour — remain the same, the market will remain doomed for S-chips.

So, what is the root of the problem here? Let’s think about all the agents directly involved. First of all, most S-chips, with some exceptions, are small and medium enterprises in China. The overall awareness of corporate governance and discipline to fulfill fiduciary duty to shareholders is still quite immature in China, particularly among the small firms. It is not surprising to see that firms’ leaders, managers, controlling shareholders, and board of directors are often the same couple of people or closely related.

Yet, given the prevailing free-riding problems in monitoring the management of firms with extremely diverse ownership, such family-owned structures could potentially be a good model of governance in the sense that they reduce the principal-agent problem. We have seen good examples here, such as United Overseas Bank.

Unfortunately, there is also the potential for a bad scenario: controlling shareholders appropriate minority shareholders’ interests. In extreme cases, such tunneling behaviour can go beyond the legal bounds and turn into fraud. So what determines the equilibrium of the game?

We probably cannot expect the management of corporations to be completely altruistic, because probably nobody is. There is always an “envelope” wide to all of us. Therefore, what we can hope for are only a good selection process and an incentive to make firms behave within the boundaries.

The Singapore Exchange (SGX) seems to make the selection during the listing process. No matter how much SGX hosts of stringent listing requirements, it has, arguably or even formally, been much easier for Chinese firms to be listed in Singapore than in Hong Kong, or the US, or mainland China itself.

The effectiveness of regulatory rules relies on a good institutional structure to ensure implementation. The conflicting rules of SGX — a regulator that should ensure the quality of firms, and a profit-making entity that earns fees from listing fees — undermine its role as a watchdog.

A metaphor for this structure is having a drug seller diagnose patients. As a result, many firms are simply packaged to meet listing standards on paper. This is superficial, merely ensuring firms have the required skeletal structures and faces.

Low standards, by themselves, would attract all firms, not only the bad ones. Although similar frauds in Chinese firms have occurred in China, Hong Kong, and the US, why has Singapore attracted proportionately more bad apples compared to the other markets?

Low valuation leads to low quality, and the low quality confirms the low valuation.

It is a vicious cycle. In addition to SGX, investors make the selection of firms.

The answer is: low valuation. A high-quality firm that meets the listing standards of more than one market will naturally choose the one that appreciates it shares more. Low valuation leads to low quality, and the low quality confirms the low valuation. It is a vicious cycle.

In addition to SGX, investors make the selection of firms and it is not even obvious, but also partially responsible for this vicious cycle, not an individual lev.

When the trading of stocks reflects only a “concept” — such as “China”, “Bak,” or “bio” — the market has failed in its role of price discovery. Trading is no longer testing but gambling, because there is little concern for the actual value of a firm. Final investors, if they care about governance, would vote with their feet. They would appreciate firms with good governance, and derate those with bad governance.

However, as it is too costly for individual investors to gather and process information, this price discovery failure should make us think about the role of institutional investors in Singapore — whether and to what degree their existence in Singapore has helped mature the Singapore equity market (or are they just another side to the problem?)

Since the first S-chip scandal in 2007, we have seen many. There have been complaints, discussion, and so-called measures taken. SGX also emphasized the importance of attracting Chinese firms for the development of Singapore financial market. Such superficial talk might marginally influence market sentiment, but without any action targeting the root of the problem, the market would still be trapped by the S-chip stigma, scandal and frauds that keep happening.

It will not be surprising to see more good S-chips volunteering to defect — because they are undervalued. Although certain listing rules make it very costly for them to do so in the short term, these firms will have enough time to adjust and exit in the long term. We have already seen this happening, for instance, in Yangzijiang Shipbuilding.

So, stop blaming competition from Hong Kong, stop blaming the corporate governance of Chinese firms, because these are beyond Singapore’s control. The trigger will be when we start asking ourselves how we can improve.

The writer is an assistant professor in Finance, NUS Business School. She specializes in corporate management, governance of financial institutions, and the financial system in China.