Listings by Foreign-Invested Companies on Mainland Chinese Stock Exchanges Once Again in the Limelight

Eiichi Sekine

I. Introduction

With the enactment in May 2007 of legislation governing the establishment of offices in China by overseas stock exchanges and the opening in September 2007 of an office in Beijing by the New York Stock Exchange followed by the NASDAQ, the London Stock Exchange, the Tokyo Stock Exchange, the Singapore Stock Exchange, and the Korea Stock Exchange, overseas stock exchanges have been redoubling their efforts to encourage Chinese companies to list their shares overseas.

Since then, however, attention has turned to moves by foreign-invested companies to list their shares on Chinese stock exchanges. Following the third Strategic Economic Dialogue between the US and Chinese governments in Beijing last December, it was agreed that foreign-invested companies (including foreign-invested banks) will be able to apply to the Chinese government to issue renminbi-denominated shares and bonds.[1] There have been a number of cases in the past of local subsidiaries set up by foreign-invested companies issuing and listing renminbi-denominated shares (so-called "A shares") in China itself. Although a number of Taiwanese and Japanese companies have already issued and listed renminbi-denominated shares, the issue of such shares by foreign-invested companies is once again in the news as a result of the afore-mentioned agreement between the US and China. According to local Chinese news reports, foreign-invested companies other than Japanese companies have approached the China Securities Regulatory Commission (CSRC) and Chinese stock exchanges with a view to listing A shares.[2]

This report examines (1) the listing of A shares by foreign-invested companies amidst renewed interest in the subject among capital market participants, (2) recent moves and financings by foreign-invested companies in China, (3) the attitude of the Chinese government towards (and actual cases of) the listing of A shares by foreign-

1 The Strategic Economic Dialogue, based on an agreement between President Bush and President Hu Jintao, is a forum for the US and China to discuss economic issues and has been held three times (once every six months) since December 2006. Financial market opening has been one of the main issues discussed.

2 The 15 January 2008 issue of China Securities Journal mentions the following nonfinancial corporations and financial institutions in this connection: Coca-Cola, Siemens, HSBC, Bank of East Asia, and DBS.

invested companies in order to form a view of the attitude of the Chinese government and likely moves by Japanese and other foreign-invested companies.

II. Moves into China and Financings by Foreign-Invested Companies

1. Recent moves by foreign-invested companies into China

1) Ways for foreign-invested companies to enter the Chinese market

It is now 30 years since the Chinese government's market-oriented reforms of 1978 paved the way for the entry of foreign-invested companies to the Chinese market. Foreign-invested companies have two main ways of entering the Chinese market: portfolio investment (where there is no local subsidiary) and direct investment (where a local subsidiary is established). There are four different types of direct investment (Figure 1): (1) wholly foreign-owned enterprises (WFOEs), (2) equity joint ventures (EJVs), (3) cooperative (or contractual) joint ventures (CJVs), and (4) foreign-invested companies limited by shares (FCLS). While the first three types are limited liability companies, the fourth is a joint stock company. Collectively the four different types of local subsidiaries are referred to as "foreign-invested enterprises" (in the narrow sense) as distinct from "foreign-invested companies" (in the broad sense), which includes companies located outside China ("overseas companies").

However, in this report we refer to both foreign-invested enterprises and overseas companies as "foreign-invested companies" unless there is a particular reason to distinguish between them.

Figure 1: Types of Foreign-Invested Companies in China and Definitions Used in This Report

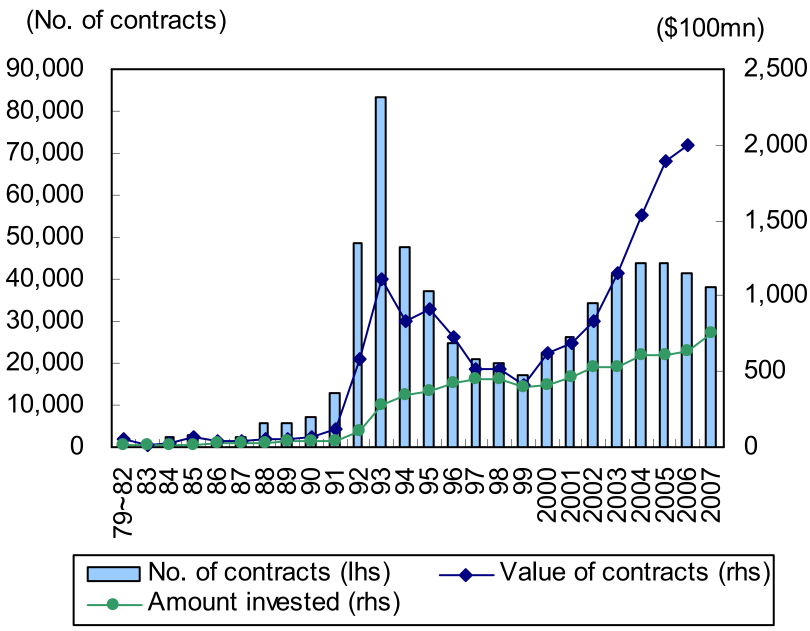
	Location	Company type	Name	Definition
Foreign-invested company (broad sense)	Mainland China (foreign-invested enterprise)	Limited company	WFOE	Wholly foreign-owned limited company
			EJV	Limited joint venture between Chinese and foreign company
			CJV	Joint venture between Chinese and foreign company where each side's rights and obligations are set out in a contract. There are two subtypes: an incorporated (limited company) type and an unincorporated type.
		Company limited by shares	FCLS	Structure can be changed from a newly or previously established limited company
	Overseas	-	Overseas company	-

Note: WFOE = wholly foreign-owned enterprise; EJV = equity joint venture; CJV = cooperative (or contractual) joint venture; FCLS = foreign-invested company limited by shares.
Source: NICMR.

2) Examples of moves into China by foreign-invested companies

China's Ministry of Commerce has published figures on foreign direct investment (number and value of contracts as well as the actual amount invested) since the reforms of 1978 (Figure 2).[3] Foreign direct investment in China in 2007 (excluding banks, securities companies, and insurance companies) totaled 37,871 contracts (-8.7% y-y) while the actual amount invested was $74,768 million (+13.6% y-y), the largest amount ever.

Figure 2: Foreign-Invested Companies in China



Source: NICMR, from Japan-China Economic Association and Ministry of Commerce data.

A breakdown by country/region of origin reveals that the largest direct investment in 2007 in terms of the actual amount invested was by Hong Kong ($27,703mn). Japan was the fourth largest direct investor ($3,589mn) and the US the sixth largest ($2,616mn) (Figure 3).

3 China's statistics on foreign-invested companies give the number of contracts and the amount of money contracted for as well as the amount of capital actually invested. However, no figures on the amount of money contracted for have been published since 2006.

Figure 3: Breakdown of Foreign Direct Investment in China by Country/Region of Origin

Rank	Country/Region	Contracts		Amount invested	
		Number	Share (%)	$mn	Share (%)
1	Hong Kong	16,208	42.8	27,703	37.1
2	British Virgin Islands	1,883	5.0	16,552	22.1
3	Korea	3,452	9.1	3,678	4.9
4	Japan	1,974	5.2	3,589	4.8
5	Singapore	1,059	2.8	3,185	4.3
6	US	2,657	6.9	2,616	3.5
7	Cayman Islands	342	0.9	2,571	3.4
8	Samoa	765	2.0	2,170	2.9
9	Taiwan	3,229	8.7	1,774	2.4
10	Mauritius	243	0.6	1,333	1.8
(cf.)	EU	2,384	6.3	3,838	5.1
	Total from around the world	37,871	100.0	74,768	100.0

Notes: (1) Ranking is according to the actual amount invested in 2007.
(2) The foreign direct investment figures include inward investment via Hong Kong and tax havens.
(3) The EU has 15 member states.
Source: NICMR, from Ministry of Commerce and JETRO data.

3) Importance of local finance

The reasons for foreign direct investment in China have become more diversified, with a growing number of companies targeting the Chinese consumer, whose income has been steadily rising (domestic-demand-related investment), rather than simply taking advantage of low wage levels to produce exports for either their home market or third countries.[4] A growing number of nonmanufacturing companies (in, for example, wholesaling and retailing) have also entered the Chinese market in recent years.

As the competition between local foreign-invested and Chinese companies has intensified, it has become increasingly important for foreign-invested companies to increase their local content and reduce their costs in order to use the capital they have invested as efficiently as possible. In particular, it has become increasingly important for domestic-demand-related companies, whose revenue is ultimately in renminbi, to be able to raise capital in the same currency.

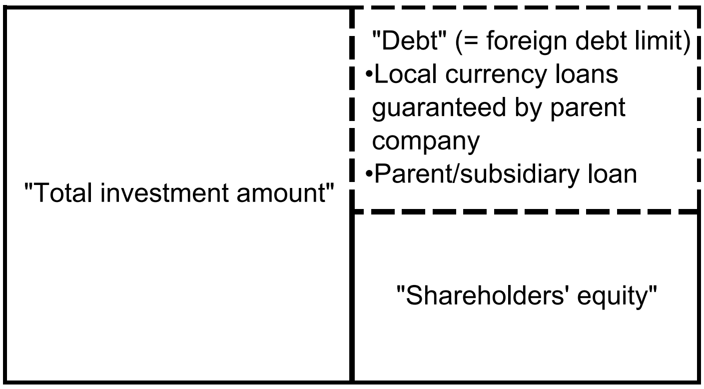
4 According to figures from Japan's Ministry of Economy, Trade and Industry (METI)'s Quarterly Survey of Overseas Subsidiaries, local sales accounted for 45.6% of the sales of local subsidiaries based in China (including Hong Kong) in fiscal 2005, 52% in fiscal 2006, and, most recently, 53.7% in fiscal 2007 Q3 (Oct–Dec).

2. Local financing subject to numerous restrictions

1) Total investment amount and minimum capital requirements

Capital transactions in China are still subject to certain restrictions, including restrictions on the size of foreign-invested enterprises and the industries in which they may operate. As far as the former (company size) is concerned, foreign-invested enterprises need to meet the requirements for "total investment amount" (the total of the shareholders' equity, or capital, needed to start up a locally incorporated company and that company's debt) (Figure 4).[5] A foreign-invested enterprise's level of approval also varies according to its total investment amount.

Figure 4: Schematic Diagram of Rules on Total Investment Amount and Foreign Debt



Notes: (1) "Total investment amount" – "shareholders' equity" = "debt" (= foreign debt limit).
(2) "Foreign debt limit" = "short-term (12 months or less) foreign debt" + "cumulative accrued medium- to long-term (more than 12 months) foreign debt".
(3) Debt guaranteed by a parent company is treated as "foreign debt" when it is repaid.

Source: NICMR.

Furthermore, foreign-invested enterprises have to meet certain minimum capital requirements that depend on their total investment amount (Figure 5). This is because, in addition to the minimum capital requirements of Chinese company law,[6] there are separate provisions for imposing higher minimum capital requirements where this is necessary. This is intended to prevent companies being established which are undercapitalized and depend too much on debt.

---

5 China's State Council (i.e., cabinet) is selective about the types of foreign-invested companies it allows, classifying their activities according to its Interim Provisions for Guiding Foreign Investment as "desirable," "permitted," "restricted," and "forbidden." Its Industrial Catalogue for Foreign Investment lists "desirable," "restricted" and "forbidden" activities in more detail.

6 A limited liability company must have a registered capital of at least RMB30,000.

Figure 5: Minimum Capitalization Requirements for Foreign-Invested Enterprises

Total investment amount	Minimum capitalization requirement (as % of total investment amount)	Remarks
$3mn or less	70%	
$3–10mn	50%	Minimum capital requirement of $2.1mn if total investment amount is $4.2mn or less
$10–30mn	40%	Minimum capital requirement of $5.0mn if total investment amount is $12.5mn or less
More than $30mn	At least one third	Minimum capital requirement of $12.0mn if total investment amount is $36.0mn or less

Source: NICMR.

2) Strict monitoring of borrowing limits

Once a company's total investment amount and capital have been decided, the difference between them is its "debt." Any liabilities that a company incurs must not exceed its borrowing limit. Let us know take a look at how Japanese companies have raised funds using their borrowing limits.

As foreign-invested enterprises have not been allowed to raise funds on China's capital markets by issuing corporate bonds or commercial paper, their first recourse will be to borrow the funds from a bank.

There are two types of bank loan in China, depending on the currency involved. One is a foreign currency loan. The lender may be either the Chinese branch of a Japanese bank or the parent company ("parent/subsidiary loan"). The other is a local currency (i.e., renminbi) loan. The lender may be either the Chinese branch of a Japanese bank or a local bank. In the case of both types of loan, a loan from the Chinese branch of a Japanese bank to a Japanese company must normally be guaranteed by the company's parent.

3) Registration of foreign debt as a further factor complicating the monitoring of borrowing limits

A factor further complicating the monitoring of the borrowing limits on foreign-invested enterprises is the strict monitoring of foreign debt. In China, foreign debt (i.e., foreign currency owed to nonresidents by Chinese organizations) is monitored by a number of authorities (the State Development and Reform Commission , the Ministry of Finance, the State Administration of Foreign Exchange), depending on the borrower. Foreign-invested enterprises are required to register any foreign debt with their branch of the State Administration of Foreign Exchange within 15 days of signing a loan agreement.

In addition, foreign-invested enterprises' foreign debt limits are subject to the following restrictions (see Figure 4 above).

(1) Foreign debt incurred by foreign-invested enterprises must not normally exceed the difference between their officially approved total investment amount and registered capital (i.e., their borrowing limit).
(2) Medium- and long-term foreign debt (with a maturity of more than 12 months) is calculated on a cumulative accrual basis. Short-term foreign debt (with a maturity of not more than 12 months) is calculated in terms of balances.
(3) Loans from a local financial institution (including local Chinese branches of Japanese banks) guaranteed by a borrower's parent company are regarded as foreign debt when the parent company repays the debt on behalf of the borrower.
(4) If a foreign-invested enterprise borrows more than the difference between its total investment amount and its registered capital, the department that originally approved it must reassess its total project investment amount.

In practice, this reassessment is likely to take some time. Foreign-invested enterprises therefore need to allow plenty of time for monitoring any loans that are classified as foreign debt and be prepared in advance to arrange a sufficient limit on the assumption of a guarantee by their parent company. Although it is now easier to monitor foreign debt than it used to be as a result of a series of reforms that take the needs of both lenders and borrowers into account, the fact that capital transactions are regulated and the continuing existence of limits on borrowing and foreign debt limit the scope of companies to raise funds.

3. Impact of tightening policy of financial authorities

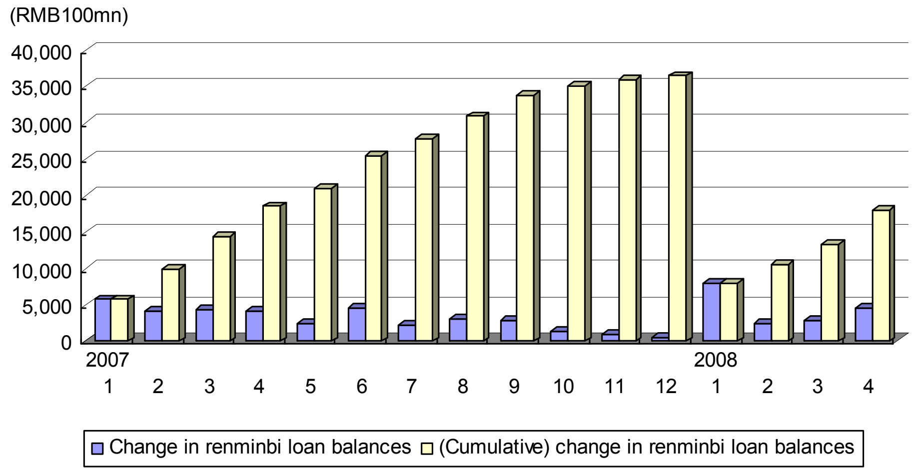
A further factor complicating the use of strictly monitored borrowing limits and foreign debt limits is the tightening policy of the financial authorities. Since 2007, the financial authorities have strengthened the ceiling on bank lending as well as increasing loan and deposit rates, raising the reserve requirement ratio, and making greater use of open market operations.

One is setting (or tightening) the ceiling on renminbi loans (in the domestic market). Since the Communist Party Congress in mid-October 2007, China's Banking Regulatory Commission (CBRC) is reported to have instructed commercial banks not to increase their loan balances.[7] An analysis of month-end renminbi loan balances in 2007 reveals that the net increase declined as the year-end approached. Similarly, an

[7] See Nihon Keizai Shimbun, 2 December 2007.

analysis of the cumulative change in loan balances in the same year reveals that the net annual increase was more or less unchanged at about RMB3,500 billion from end-October, indicating that the net annual increase in loan balances was, to all intents and purposes, capped at the equivalent of a 10-month increase as a result of the ceiling (Figure 6). In 2008, however, loan balances increased by a net RMB800 billion in January alone and by a cumulative RMB1,800 billion in January-April. This means that, if the same ceiling is applied as in 2007 (RMB3,500 billion), 49.3% of this year's ceiling has already been used as of end-April and that, in the second half of the year, financial institutions are likely to become increasingly reluctant to lend.

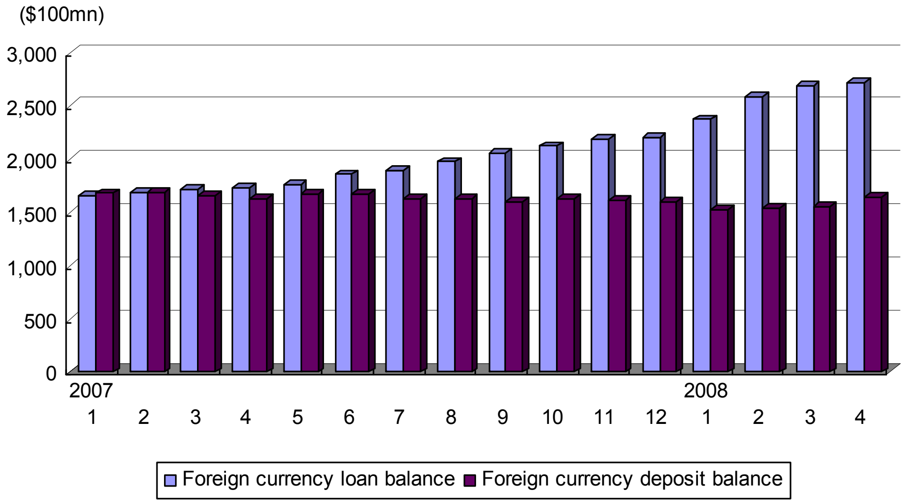
Figure 6: Changes in Renminbi Loan Balances (2007, Jan–Apr 2008)



Source: NICMR, from People's Bank of China data.

The other is the trend of foreign currency loans and deposits (in the domestic market) (Figure 7). Foreign currency loans are funded either by foreign currency deposits or by foreign currency borrowed overseas. While foreign currency deposit balances have been declining or growing only very slightly on a monthly basis since the second half of 2007, foreign currency loans have increased as an alternative to renminbi loans. This indicates that the foreign currency loan/deposit ratio of Chinese financial institutions has been rising (i.e., that their foreign currency liquidity position has been deteriorating). Also, the Chinese authorities have been tightening their control over the means available to Chinese financial institutions to borrow foreign currency overseas. When Chinese financial institutions (whether local or foreign-invested) borrow foreign currency from overseas, this is regarded as "foreign debt." In 2007, the Chinese authorities adopted and implemented a policy, which we believe is still in force, to reduce the country's short-term foreign debt in order to stop inflows of hot money. Financial institutions may therefore find themselves unable to meet corporate demand for funds as their access to overseas sources of foreign currency loans is also restricted.

Figure 7: Foreign Currency Loan and Deposit Balances (2007, Jan–Apr 2008)



Source: NICMR, from People's Bank of China data.

Therefore, with companies finding it difficult to borrow either renminbi or foreign currency, they have increasingly had to consider alternatives to bank loans. The situation is even more difficult for foreign-invested companies, which are subject to the afore-mentioned limits on borrowing and foreign debt. They have therefore begun to consider issuing corporate bonds and commercial paper (two areas that have still to be deregulated) as well as A shares (an area that has already been opened up to the local subsidiaries of foreign-invested companies).

III. Listing of A Shares by Foreign-Invested Enterprises

1. Legal framework

1) General framework

New share issues and share listings in China are governed by the New Company Law and New Securities Law, both of which came into force on 1 January 2006, and conducted according to the following five sets of associated rules: (1) Measures for the Administration of Securities Issuance by Listed Companies (in force since 8 May 2006), (2) Measures for the Administration of Initial Public Offering and Listing of Stocks (in force since 18 May 2006), (3) Measures for the Administration of Securities Issuance and Underwriting (in force since 19 September 2006), (4) Measures for the Public Offering Review Committee of the CSRC (in force since 9 May 2006), and (5) Interim Measures on Securities Issuance and Listing Sponsor System. We will not go into the rules' detailed provisions for share offerings and issues.[8] However, the procedures for listing differ from those in Japan in the following respects.

8 For further details see Nomura Institute of Capital Markets Research, "Chugoku Shoken Shijo Taizen" [Compendium of Chinese Securities Markets], Nihon Keizai Shimbunsha, Ch. 1, 2007.

The first concerns the body responsible for screening listing applications. In China, the CSRC, which reports directly to the State Council (i.e., the cabinet), is responsible for vetting companies that apply to issue shares as well as the terms of these issues and for granting the final approval for such issues. To be more precise, companies that apply to list their shares have to be recommended by the underwriter and apply to the CSRC as well as a stock exchange for a listing, final approval for which is given by the CSRC's Public Offering Review Committee.

The second procedure for listing that differs from the system in Japan is the sponsor (or sponsorship) system. Under this system, a securities company familiar with the procedures for listing shares acts as an advisor ("sponsor") to companies listing or issuing shares for the first time. This is similar to Japan's lead manager system. However, in China the "sponsor" is also legally responsible for ensuring that a company meets its disclosure requirements after its shares have been listed.

2) Rules governing foreign-invested enterprises

The offering and listing of shares in foreign-invested companies is governed by a number of special regulations: the Provisional Regulations of the Ministry of Foreign Trade and Economic Cooperation (now the Ministry of Commerce) on Several Issues Concerning the Establishment of Foreign-Invested Companies Limited by Shares (promulgated in January 1995), the Opinion on Some Issues in Relation to Listing Foreign-Invested Enterprises (promulgated by the Ministry of Foreign Trade and Economic Cooperation, now the Ministry of Commerce, and the CSRC in October 2001), and the Special Regulations of the CSRC Governing the Content and Format of Offering Prospectuses of Foreign-Invested Enterprises (promulgated in March 2003) (Figure 8). In particular, the Opinion on Some Issues in Relation to Listing Foreign-Invested Enterprises is clearly conscious of foreign-invested enterprises listing on domestic stock exchanges, following China's accession to the World Trade Organization (WTO).

Figure 8: Special Regulations Governing Listings by Foreign-Invested Companies Limited by Shares

Promulgating department	Date of promulgation	Name
Ministry of Foreign Trade and Economic Cooperation (now Ministry of Commerce)	January 1995	"Provisional Regulations on Several Issues Concerning the Establishment of Foreign-Invested Companies Limited by Shares"
Ministry of Foreign Trade and Economic Cooperation (now Ministry of Commerce), CSRC	October 2001	"Opinion on Some Issues in Relation to Listing Foreign-Invested Enterprises"
CSRC	March 2002	"Special Regulations Governing the Content and Format of Offering Prospectuses of Foreign-Invested Enterprises"

Source: NICMR.

The main points of these special regulations are listed in Figure 9. However, the regulations on "sponsors" (i.e., company founders) will probably have to be amended to take account of the New Company Law. This is because the special regulations state that at least three of the five sponsors (i.e., a majority) must be Chinese. (This is in line with Article 75 of the Old Company Law, which states: "To incorporate a joint stock limited company, there shall be five or more sponsors, of which more than half must have their domicile within the territory of the People's Republic of China.") As a result, foreign-invested enterprises sometimes had to rearrange their capital structure (e.g., by transferring some more of their equity to the Chinese sponsors) when converting to a joint stock limited company before an initial public offering or listing. However, Article 79 of the New Company Law states: "To establish a joint stock limited company, there shall be not less than 2 but not more than 200 initiators [i.e., company founders], of whom half or more shall have a domicile within the territory of China." As a result, the existing special regulations will have to be amended. Moreover, it is questionable whether it is appropriate to automatically apply the new law to initial public offerings and listings by wholly foreign-owned enterprises, which have increased since China joined the WTO.

Figure 9: Main Points of Special Regulations Governing Listings by Foreign-Invested Companies

• A foreign-invested enterprise planning to list must first convert to a company limited by shares
• It must have passed the annual inspection for foreign-invested enterprises during the three years preceding its application
• Its operations must conform to the "Interim Provisions for Guiding Foreign Investment" and the "Industrial Catalogue for Foreign Investment"
• At least three of the five sponsors (i.e., a majority) must be Chinese (i.e., foreign-invested enterprises may have to transfer some more of their equity to the Chinese sponsors)
• After listing, the foreign-owned shares of a foreign-invested company limited by shares must not be less than 10% of the total shareholders' equity
• After listing, a foreign-invested company limited by shares must return its certificate of approval if its foreign-owned shares account for less than 25% of the total shareholders' equity (i.e., it will lose its status as a foreign-invested enterprise and become a Chinese-invested enterprise)

Source: NICMR, from Special Regulations.

2. Most A share listings have been by Taiwanese and Japanese companies

An analysis of the figures on A share listings by foreign-invested enterprises reveals that, while most listings have been by Taiwanese companies, Japanese companies have accounted for a significant proportion of the listings by other foreign-invested enterprises (Figure 10).[9]

In October 1996, Shenyang Neu-Alpine Software Co., Ltd. (a joint venture between Alpine Electronics, Inc. of Japan and Neusoft Group, Ltd., China's largest software company) was the first Japanese company to list A shares on the Shanghai Stock Exchange.[10] This was an exception as at that time there were no special regulations governing listings by foreign-invested enterprises. In January 1999, a joint venture between the medium-sized Japanese textile manufacturer Matsuoka Corp. (based in Fukuyama in Hiroshima Prefecture) and its Chinese partner became the first Japanese company to list B shares.[11] The joint venture's A shares were subsequently listed in March 2001.

In May 2004, a joint venture between the Japanese automobile component manufacturer Mutsumi Special Alloy Industry Co., Ltd. (based in Machida in Tokyo) and its Chinese partner became the first non-Taiwanese foreign-invested enterprise to list A shares on the Shanghai Stock Exchange following the promulgation of the Opinion on Some Issues in Relation to Listing Foreign-Invested Enterprises in October 2001. In May of the following year, a joint venture between the Japanese clothing manufacturer Mitsuwa Co., Ltd. (based in Seki in Gifu Prefecture) and its Chinese partner listed A shares on the Shenzhen Stock Exchange. What Matsuoka, Mutsumi and Mitsuwa have in common is (1) that they have listed on a Chinese stock exchange even though they are unlisted medium-sized companies in Japan, (2) that their Chinese operations have been doing well and they therefore need access to a plentiful supply of local currency (i.e., renminbi), and (3) that listing A shares has given them access to low-cost local funds for capital investment.

---

9 As the stock codes of Chinese stock exchanges do not distinguish between Chinese and foreign-invested companies, we have used information from Chinese securities companies and media reports to do this.

10 See Mitsuhiro Seki, "Chugoku no Sangaku Renkei" [Cooperation between Industry and Academia in China], Shinpyoron, Ch. 3, 2007. Shenyang Neu-Alpine Software Co., Ltd. was the first Chinese software company to list on a stock exchange.

11 B shares are issued with a view to being purchased by foreign investors and are traded in foreign currency, although par value is in renminbi. Since February 2001, Chinese investors with access to foreign currency have also been allowed to trade them.

Figure 10: Actual Listings of A Shares by Foreign-Invested Enterprises

Listed company	Date listed	Exchange	Industry	Parent (country/ region)	(name)	Pre-IPO shareholding (foreign investors)	Issue price (RMB/share)	Issue PER	Issue amount (RMB10,000)	(expenses)	Lead manager	Market cap as of 08/6/11 (RMB10,000)	(¥100mn)
Shenyang Neu-Alpine Software Co., Ltd.	96/6/18	Shanghai	IT	Japan	Alpine Electronics, Inc.	37%	6.98	17.45	10,470	450	Huaxia Securities (now China Securities)	1,579,610	2,452
Shanghai Matsuoka Co., Ltd.	01/3/28	Shanghai	Textiles/ apparel	Japan	MATSUOKA Corporation, Ltd.. (Fukuyama, Hiroshima Prefecture)	n.a	16.4	n.a	132,840	4,141	Guotai Junan Securities	409,734	636
Zhejiang King Refrigeration Industry Co., Ltd.	03/12/30	Shanghai	Electronics	Taiwan	Chen Tianlin	45%	7.30	20.00	29,200	1,800	United Securities	105,215	163
NBTM New Materials Group Co., Ltd.	04/5/11	Shanghai	Machinery	Japan	Mutsumi Special Alloy Industry Co., Ltd. (Machida, Tokyo)	60%	10.00	13.89	45,000	1,800	Guolian Securities	124,925	194
Hefei Rongshida Sanyo Electric Co., Ltd.	04/7/27	Shanghai	Electronics	Japan	Sanyo Electric Co. Ltd. (Moriguchi, Osaka Prefecture)	35.38%	2.60	18.18	22,100	2,008	Ping An Securities	254,745	395
Jiangsu Sanyou Group Co., Ltd.	05/5/18	Shenzhen	Textiles/ apparel	Japan	Mitsuwa Co., Ltd. (Seki, Gifu Prefecture)	40%	3.55	21.65	15,975	1,355	Guoyuan Securities	90,188	140
Shenzhen Globe Union Industrial Corp.	05/5/25	Shenzhen	Building products	Taiwan	Globe Union Industrial (BVI) Corp., etc.	97.48%	8.60	20.48	43,860	2,003	GF Securities	142,621	221
Guangzhou Seagull Kitchen and Bath Products Co., Ltd.	06/11/24	Shenzhen	Building products	Taiwan	n.a	52%	8.03	27.69	35,734	1,481	China Merchants Securities	167,580	260
HL CORP (Shenzhen)	07/1/12	Shenzhen	Machinery	Taiwan	n.a	79.90%	3.40	29.99	23,120	1,476	Ping An Securities	147,668	229
GEM-YEAR INDUSTRIAL CO.,LTD.	07/1/26	Shanghai	Machinery	Taiwan	Chin Champ Enterprise Co., Ltd., etc.	98.62%	4.26	23.72	89,460	2,726	Huatai Securities	507,329	787
Shanghai Hanbell Precise Machinery Co., Ltd.	07/8/17	Shenzhen	Electronics	Taiwan	Capital Harvest Technology Limited, etc.	98.50%	9.08	29.97	34,504	2,146	Fortune Securities	248,325	385
Shanghai CIMIC Tile Co., Ltd.	07/8/23	Shenzhen	Building products	Taiwan	CIMIC INDUSTRIAL INC.	96.37%	5.08	29.88	48,260	2,648	Guosen Securities	254,600	395
(cf. B shares) Shanghai Matsuoka Co., Ltd.	99/1/18	Shanghai	Textiles/ apparel	Japan	MATSUOKA Corporation, Ltd.. (Fukuyama, Hiroshima Prefecture)	n.a	0.28	5.54	21,384	2,133	Shenyin & Wanguo Securities	97,066	151

Notes: (1) In May 2001, Shenyang Neu-Alpine Software Co., Ltd. was renamed Shenyang Neusoft Co., Ltd. Similarly, in October 2006, Shanghai Matsuoka Co., Ltd. was renamed Shanghai Nine Dragon Co., Ltd.
(2) We have converted renminbi to yen at the State Administration of Foreign Exchange's central rate as of 11 June 2008 (RMB1 = ¥15.52).

Source: NICMR, from company prospectuses and Haitong Securities data.

IV. Outlook

1. Attitude of Chinese government

While China's Ministry of Commerce has encouraged foreign-invested enterprises to list on Chinese stock exchanges as part of its policy to attract foreign capital, China's financial authorities have studied this option as part of their policy to revitalize the country's capital markets, gradually deregulate capital transactions, and make full use of the country's savings surplus. In the last three issues of its annual "International Financial Market Report," first published in 2005, the People's Bank of China's International Financial Market Analysis Group (based at the Bank's Shanghai Head Office) has proposed the following action on share issues: (1) that companies listing for the first time should list both A and H shares,[12] (2) that companies with H

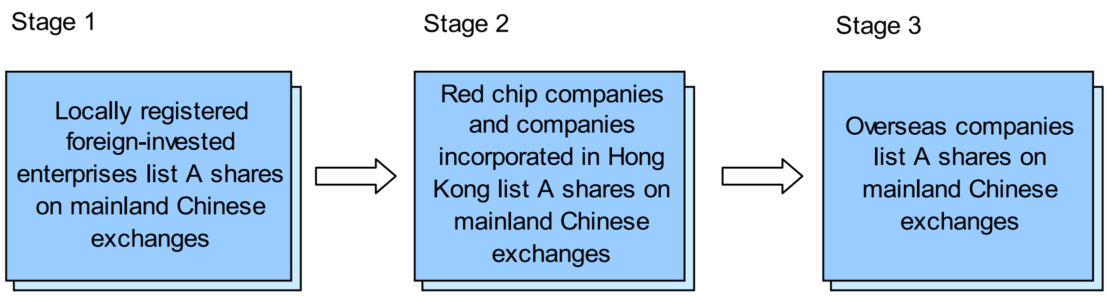
[12] H shares are those shares offered for sale to foreign investors and listed on overseas stock exchanges that are also listed on the Hong Kong Stock Exchange.

shares should issue A shares in China itself, (3) that red chip companies[13] should issue A shares in China itself, (4) that foreign-invested enterprises should issue A shares, (5) that overseas companies should issue A shares, and (6) that Chinese depositary receipts (CDRs) should be developed.

The CSRC still intends to encourage foreign-invested companies to list A shares, partly as a result of the agreement reached after the third Strategic Economic Dialogue between the US and Chinese governments in Beijing last December (see Chapter 1). One of the priorities for 2008 identified at the National Work Conference on Securities and Futures Supervision held by the CSRC in January 2008 was to improve the quality and quantity of listed companies, while studying the possibility for (and encouraging) red chip and other overseas companies to list A shares was identified as one of the means of achieving this. In particular, mainland listings by red chip companies can be seen as part of a move to encourage Chinese companies that have listed on overseas stock exchanges to "come home."

According to reports in the Chinese media[14] and interviews with Chinese securities companies, the CSRC has decided that, now that foreign-invested enterprises have begun to list on Chinese stock exchanges, the next move should be to study the possibility for (and encourage) red chip companies to do this (e.g., by means of Chinese depositary receipts), and then to encourage overseas companies to list A shares (Figure 11).[15] However, the CSRC has yet to announce a timetable for such moves, whether by red chip companies or overseas companies.

Figure 11: Trend in Listing of A Shares by Foreign-Invested Companies



Source: NICMR, from media reports and Haitong Securities data.

If red chip companies are to list on mainland stock exchanges, a number of hurdles will have to be overcome. These are similar to the hurdles that will have to be overcome if overseas companies are to list on mainland stock exchanges. These include: how to deal with A share companies whose capital does not exceed the RMB30 million minimum required by the New Securities Law; how to convert capital to renminbi; and what to do about discrepancies between Chinese and foreign

[13] Red chip companies are Chinese companies incorporated in Hong Kong.
[14] China Securities Journal, 4 March 2008 and 6 May 2008.
[15] The issue of Chinese depositary receipts is not yet permitted.

accounting standards and years.[16] We think existing rules will have to be amended and new rules written.[17]

2. Japanese listing candidates

As far as Japanese companies are concerned, we see two possible developments.

1) Listings by medium-sized Japanese companies on mainland stock exchanges

One, as exemplified by Mutsumi Special Alloy Industry Co., Ltd., is for medium-sized companies to list shares on a mainland stock exchange. It is no exaggeration to say that, when medium-sized Japanese companies set up operations overseas because their domestic market looks like shrinking (as their business partners set up operations on the Chinese mainland and Japan's demographic situation deteriorates), they are risking their future. If they do this, they will not only need to source their basic materials locally in order to keep their local production costs as low as possible, but they will also need access to local sources of investment capital. As far as their parent companies are concerned, their businesses are now, to all intents and purposes, located overseas. Therefore, if their parent companies are unable to spare additional investment capital, they will increasingly have to look for local sources of capital. Also, the financial authorities' more restrictive monetary policy (see above) has made it increasingly necessary for medium-sized Japanese companies to be able to tap Chinese capital markets without having to resort to borrowing from a bank. Possible sources of local capital include, in addition to the main board, the Growth Enterprise Board, a venture capital market which the Chinese government hopes will be ready to open this year. Companies operating in Hong Kong as well as the mainland also have the opportunity to list in Hong Kong.[18]

---

16 China Securities Journal, 1 February 2008. It will presumably also be necessary to clarify what conditions a foreign-invested company must satisfy as an issuer if it is locally incorporated as a holding company.

17 In addition, candidate companies for listing will have to satisfy the requirement to use international accounting standards (a requirement for listed companies since 2007) and meet the environmental standards for listed companies, which were tightened up earlier this year. With regard to the latter, the State Environmental Protection Administration (now the Ministry of Environmental Protection) announced on 25 February 2008 that companies in industries with a high environmental load would have to obtain its written consent if they wished to apply to the CSRC for a listing or to issue new shares. The industries to which this applies are thermal power generation, ironmaking, cement, electrolytic aluminum, metallurgy, chemicals, petrochemicals, coal, building materials, papermaking, brewing, pharmaceuticals, fermentation, textiles, leather, and mining.

18 On 1 December 2007 at the Sixth Small and Medium-Sized Enterprises Financing Forum, Mr Lin Zheying, Vice Director General of the Department of Foreign Investment Administration of the Ministry of Commerce, said that the Ministry would support foreign-invested companies seeking to list on a mainland stock exchange and, in particular, would strengthen its ties with the CSRC and the stock exchanges in Shanghai and Shenzhen in order to help foreign-invested companies to list on the Growth Enterprise Board, which is due to open later this year.

2) Listings by large Japanese companies on mainland stock exchanges

Another possible development is that large Japanese companies with large numbers of local employees will list on mainland stock exchanges. Business costs in China have been rising as a result of a change in investment conditions without precedent in recent years: harmonization of corporate income tax (abolition of preferential tax treatment for foreign-invested companies), increases in the minimum wage, enhanced rights for workers (e.g., as embodied in the new Labor Contract Law), inflation, a stronger local currency, and measures to protect the environment. Japanese companies with local operations in China therefore need to increase their productivity as well as reduce their costs by increasing their local content. In order to increase their productivity, they will have to provide attractive working conditions (including fringe benefits) and incentives. One such option would be to give their local employees the opportunity to acquire shares in them. One way of doing this would be to allow them to acquire shares in the Japanese parent company. China's capital controls now allow individuals to acquire foreign shares directly, and, furthermore, employees are allowed to acquire locally listed shares by means of an employee share ownership plan or stock options.[19] Also, once Chinese depositary receipts are allowed, employees of foreign-invested enterprises will be able to acquire shares in their parent in the form of such receipts. Allowing red chip companies to issue such receipts would therefore also be an important first move for foreign-invested enterprises.

As foreign direct investment in China becomes more established and foreign-invested companies increase their local content, it will be interesting to see how the Chinese authorities and both companies and financial institutions respond to (1) the recent tightening of monetary policy in the short term, (2) the need to develop China's capital markets in the medium to long term, and (3) the need for sources of capital other than bank loans.

19 According to METI's latest Quarterly Survey of Overseas Subsidiaries (see above), local subsidiaries of Japanese companies (including those in Hong Kong) employed 1,112,799 persons as of end-December 2007.