ASrIA

REPORT

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SRI

IN ASIAN EMERGING MARKETS:

CHINA

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World Bank Group

ASrIA Reports

SRI in Asian Emerging Markets

Sponsored by the **IFC Sustainable Financial Markets Facility**

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Methodology

This Report was produced in collaboration with researchers in each country. Research has largely been conducted by telephone, face to face interviews, media and internet searches.

Disclaimer

ASrIA does not guarantee that every relevant organisation and individual has been covered in each market. With the resources available in each market, the reports make every effort to focus on key areas of relevance, to deliver data that is accurate and opinions that are objective and balanced.

Foreword

The expansion of Asia's private sector and its accompanying investment opportunities are forever changing the global economy. Yet as home to roughly half of the world's population, rapid industrialization, expansion of information technology, and urbanization underway throughout East and South Asia pose enormous challenges that must be recognized by private investors and governments alike. Hundreds of millions of people are in the process of moving permanently from the countryside to cities. Rapidly expanding businesses are making further demands on resources. Throughout the region, clean water, clean air, biodiversity, fisheries, fertile soils, and improved standards of living are all at risk because of unsustainable development.

For the most part, portfolio investors in Asia have yet to explicitly recognize the complex array of issues that could hinder long-term private business and investment returns. The socially responsible investment industry - a $2.4 trillion worldwide industry that includes 760 retail funds and hundreds of institutional investors - has only just begun surfacing in Asia and has yet to fully demonstrate how its techniques can contribute to business performance. Research commissioned by IFC on the SRI industry indicates that SRI assets amount to only $2.2 billion in all emerging markets, including Asia. That is less than one tenth of 1 percent of the worldwide total. Only $1 billion in SRI assets is held by developing country investors.

Evidence shows that SRI investment approaches provide returns at least as strong as funds that don't take social, environmental, or corporate governance factors into account. Well-constructed and well-managed SRI funds have consistently proven to match or outperform their benchmarks. In the context of such enormous challenges facing Asia today, SRI has potential for contributing further to improved environmental and social conditions. SRI investors can also be a factor in improving long-term economic competitiveness by positively influencing corporate behavior and governance.

The International Finance Corporation, the private sector arm of the World Bank Group, shares the caution and conservative nature of most other financial institutions, in line with our fiduciary responsibility to shareholders. Yet in the process of nearly 50 years experience investing in developing countries we have learned how good investment returns are compatible with creating employment, a healthy environment, and an improved quality of life in developing countries. We set high standards for corporate governance and environmental and social performance and innovation, not only to fulfill our development mission, but because our investments in nearly 3,000 companies in 140 countries have demonstrated that there are valuable business benefits from initiatives that help progress toward sustainable development. IFC's experience would indicate that SRI investors likewise may be able to gain insight and better exploit hidden market opportunities by focusing on sustainability leaders.

The International Finance Corporation is fortunate to have been able to work with a partner like ASrIA to bring the message of sustainable investment to a wider audience. SRI has great potential in the emerging markets. Realizing this potential requires objective and thorough analysis of the investment opportunities and barriers; targeted programs of research, awareness raising and capacity building; and strong international partnerships to influence framework conditions and catalyze the market. The pioneering research undertaken by ASrIA and its partners for this report is another significant step forward. More needs to be done, and IFC and its Sustainable Financial Markets Facility look forward to playing their part.

We are grateful to the governments of the Netherlands, Switzerland, and Norway, whose cofounding enabled IFC to sponsor this important work.

Javed Hamid
Regional Director for East Asia & Pacific
International Finance Corporation

China

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1. 0 EXECUTIVE SUMMARY

The concept of Socially Responsible Investment (SRI) is still in the very early stage of being introduced into China. Two decades of fast-paced economic reform and rapid economic growth have left numerous environmental and social problems in their wake. However, the government and increasing numbers of ordinary people realize the importance of following a more balanced development track despite the overall emphasis on economic growth. A number of companies have also started adopting more socially benevolent and environmentally responsible practices.

Facing growing environmental and social challenges as well as increasing competition since China's accession into the World Trade Organization (WTO), a number of new laws and regulations have been drafted to regulate corporate governance, protect the environment and promote social issues. However, the concepts of corporate social responsibility (CSR) and socially responsible investment (SRI) and the basic principle that financial, social and environmental criterias need to be balanced, are still relatively new. The reality of continuing poverty for millions of people can make these issues seem abstract to many in the population. Yet, as this report shows, environmental awareness in particular is quite wide-spread within the general population. Overall, China still faces a steep up-hill task in continuing to spread awareness and encourage the practice of social and environmental responsibility among the population, as well as among the corporate and financial sectors.

2.0 SRI FUNDS

The Chinese financial market is at an early stage of development and investors still face limited investment options. There are no SRI funds and there has been little incentive given the relatively low income of people working in the caring professions, such as nursing and teaching. However, this may change as many innovations are happening in the fund market, including the entry of foreign fund management companies and the need to encourage people to make their own retirement savings.

2.1 Domestic SRI Funds

There are no known domestic SRI funds at present.

2.2 Global SRI Funds Registered For Sale In China

There are no Global SRI funds registered for sale in China at present.

2.3 Global SRI Funds With Significant Holdings In The Domestic Market

There is limited data on Global SRI Funds with significant holdings in China. However foreign investment into Chinese corporations has been facilitated by the listing of Chinese corporations on the Hong Kong Stock Exchange (2.05) and recent moves to facilitate direct foreign investment into the Shanghai and Shenzhen stock markets (2.06). Furthermore, research into major Chinese listed corporations has been undertaken by international SRI research providers (see 3.02) which indicates an interest by global SRI funds.

2.4 Rapid Development Of The Chinese Fund Market

The development of the Chinese fund market can be generalized into three stages:

Development of China Fund Market

Oct 1991		Mar 1998		Sep 2001	
	Stage 1 - Market started under PBC jurisdiction.		Stage 2 - Further regulated development under CSRC.		Stage 3 - Increased competition & innovation.

Important events[1] in the three stages of developing the Chinese Fund Markets:

Stage 1:

- Oct 1991, Wanhan Security Investment Fund and Shenzhen Nanshan Venture Investment Fund established.
- By 1997, China had 73 investment funds with a total capital of Rmb7.3 billion (US$0.88 billion), and less than 10 specialized fund management companies.
- Funds also used for purposes other than security investment.
- Small-sized close-ended funds.

[1] "New Development of the Chinese Fund Market", *China Security Information, October 2002,* www.s-a-c.org.cn/study/m_com/200210/jjx.htm
"The Unconventional Development of the Chinese Fund Industry", China Security Information, October 2002, /www.s-a-c.org.cn/study/m_com/200210/chc.htm

Stage 2:

- Nov 1997, China issued the *Temporary Regulations on Security Investment Fund Management*.
- Mar 1998, first security investment fund management company was founded.
- By 2000, over three million fund investment accounts had been opened.
- By the end of 2001, China has 48 close-ended security investment funds totaling about Rmb 81bn (US$9.76bn).
- Most are growth funds and have very similar structures.

Stage 3:

- Sep 2001, China's first open-ended fund, Hua'an Innovation Investment Fund, was founded.
- Massive capacity building with more competition and product innovation.
- By September 2002, there were 18 fund management companies managing 59 China stock funds with total assets over RMB100 billion (US$12.05bn), about 2% of the Chinese stock market.[2]

2.5 Investment In Chinese Corporations Via The Hong Kong Stock Market

Investment in Chinese corporations was initially facilitated for global investors as a number of Chinese corporations can be invested in via listings on the Hong Kong Stock market. These are known in the market as H-shares and red chips.

"H-share companies refer to companies incorporated in the People's Republic of China and approved by the China Securities Regulatory Commission for a listing in Hong Kong.[3] Shares of these Chinese enterprises are listed on the Stock Exchange, subscribed for and traded in Hong Kong dollars, or other currencies, and referred to as H shares. The letter H stands for Hong Kong. On 15 July 1993, Tsingtao Brewery Company Limited became the first mainland enterprise to list its H shares on the Stock Exchange.

A red chip company is a company that has at least 30% shareholding held in aggregate by Mainland China entities, and/or indirectly through companies controlled by them, with the Mainland China entities being the single largest shareholders in aggregate terms. Or if the shareholding of the company held in aggregate directly and/or indirectly by Mainland China

2 CSRC statistics, www.csrc.gov.cn/CSRCSite/tzjj/jjjg/jjgl.htm
3 From the Hong Kong Stock Exchange Web Site: www.hkex.com.hk/index.htm

entities is below 30%, but is 20% or above and there is a strong influential presence, on a judgemental basis, of Mainland China-linked individuals on the company's board of directors. Mainland China entities include state-owned enterprises, and entities controlled by provincial and municipal authorities.

The most important difference between a red chip company and an H-share company is that a red chip company is not incorporated in Mainland China."

In 1999, the China Securities Regulatory Commission also started to approve private-owned companies in China to list on the Hong Kong stock market. At present, over 50 privately-owned company have listed in Hong Kong. Their role is now even more important than that of H-shares and red chips. However the reliability of the accounting of some of these companies have aroused the attention of investors in Hong Kong.

2.6 Growing Competition Encourages Product Innovation

The Chinese fund market has undergone substantial development in terms of the total number of products available in the market. However, much of the growth is from the supply side as fund management companies compete with each other with largely un-differentiated fund products. As a result there is potential for SRI funds to stand out as a fresh and differentiated product. Demand for fund products from individual investors is still weak.

Domestic fund management companies are highly competitive in trying to tap into the vast household savings of the Chinese people, much of which has been staying out of volatile stocks, including the various stock funds that dominate the Chinese fund market. Traditionally Chinese are very conservative and prefer to keep their savings in savings accounts in Chinese banks, even at really low interest rates. The entry of the National Social Security Fund into the fund market further illustrates the growing demand for less risky fund products.

SRI funds could be welcomed as a fresh new product in a generally undifferentiated market.

Growing competition among fund management companies, including the newly established joint ventures with foreign financial institutions, further highlights the need for the development of innovative fund products that cater to different investor segments, such as listed open-ended fund (LOF), umbrella funds and principal-protected funds. Introducing these new products will help attract more investors into the fund market. In 2003, China Southern Fund Management Co., Ltd (CSFMC), launched the open-ended contractual 'CSFMC Principal Protected Fund', whose Rmb5 billion (US$ 0.6 billion) allocation was taken up by investors within a month of launch.[4] This further highlights the potential for an SRI product.

Also, foreign institutional investors now have finally gained access into the Chinese security market through the Qualified Foreign Institutional Investor (QFII) model. Since the coming into effect of *the Temporary Regulation on Domestic Security Investment of Qualified Foreign Institutional Investors* in December 2002, the People's Bank of China (PBC) has already approved six Chinese banks and the Shanghai branches of three foreign banks (Standard Chartered, HSBC & Citibank) to handle QFII accounts and manage QFII assets. A number of QFIIs have already been approved (UBS, Nomura Securities, Morgan Stanley, Goldman Sachs, and Citigroup) or are in the process of reviewing. It is estimated that total investment may reach US$1.5 billion.[5] Though the amount of investment is not very significant given the total market value of the Chinese security market, the entry of foreign institutional investors will surely introduce more internationally accepted practices and criteria to China.

[4] China Southern Fund Management Co., Ltd web site, www.southernfund.com

[5] Market Effect of the Initial QFII Investment, China Security News, May 28 2003, (202.84.17.28/csnews/20030528/369521.asp)

2.7 Social Security/ Pension Funds

From 1991, China started adjusting its previous universal pension system under which the employer shouldered the full burden. The current system can be described as a unique "pooled social security fund plus personal retirement account"[6] model. Social security or tax authorities collect funds from both the employers and the employees, and manage the pooled funds.

Now pensions in China consists of three parts:

- ***Basic retirement insurance:*** decided and enforced by the government
- ***Employer supplement retirement insurance:*** decided by employer under government guidelines, managed by institutions approved by government social security authority.
- ***Individual retirement saving:*** voluntary individual retirement account opened at social security institutions accounts in banks.[7]

The State Council decided in 1995 that the burden on the employer should not go above 20% of basic salary. Basic retirement insurance will be 11% of salary ; 8% from individual contributions and 3% from employer contributions.[8]

The rural population (all the population without urban residency - the so-called *hukou*) in China have not been served by any pension system before and have had to rely on themselves. Now China is promoting a rural pension system that is based on individual accounts, mainly funded from flexible individual contributions (usually from age 20~60). Participants start receiving their annuity from the age of 60, and if they die within the first ten years (i.e. before age 70) then the balance remaining in their account will be paid to their relatives. The funds are mainly invested in treasury bonds and bank deposits.

The National Council for Social Security Fund of the PRC (NaCSSeF) was founded in November 2000. It has the responsibilities of setting investment strategy for the national social security fund, organising the fund's implementation, selecting and authorising fund managers, accounting and auditing, and handling funds per the instructions of the Ministry of Finance (MOF), Ministry of Labor (MOL) and Ministry of Labor and Social Security (MOLSS). The use of funds is limited to bank deposits and treasury bonds (handled by the NaCSSeF directly) and other financial instruments with high liquidity (handled by the fund managers). By the end of FY2002, the national social security fund totaled Rmb124 billion (US $14.9 billion) of which 80 billion (US $9.6 billion) from last year, 42 billion (US $5.0 Billion) from the new fiscal appropriation, and 2 billion ($0.24 billion) from investment proceeds. Annual yield for FY2002 was 2.75%.[9] By December 2002, the NaCSSeF had selected the Bank of China and six domestic fund management companies to act as fund managers. It is estimated they will manage Rbm14 billion (US$1.69 billion), which will increase to Rmb30 billion (US$3.61 billion) when more fund managers are assigned.[10]

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7 MOLSS web site, www.molss.gov.cn/column/ylbx/ylbxgn.htm

8 State Council Decisions on Establishing Unified Employee Basic Retirement Insurance System, MOLSS web site, www.molss.gov.cn/correlate/gf199726.htm.

9 The National Social Security Fund Annual Report(2002), China Securities, June 1, 2003

10 China News, December 20 2002, www.chinanews.com/2002-12-20/26/255693.html

2.8 Private Equity Investment And International Funds With Known SRI

A small number of international funds, with socially responsible criteria, are also known to be looking for opportunities in China. For data on other development funds see section 4.01 below:

New Ventures
www.new-ventures.org.cn

New Ventures (a joint-venture of the Citigroup Foundation and the World Resources Institute) targets China as its first step in Asia, seeking investment opportunities of less than US$1 million (with foreign holdings less than 49%) in small and medium-sized private enterprises in the sustainable development field, such as organic agriculture, clean technology, renewable energy, etc. All investments must adopt a social and environmental bottom line.[11]

Asian Development Bank Venture Capital Fund
www.adb.org/Documents/News/2002/nr2002201.asp

In October 2002, the Asian Development Bank (ADB) approved a US$10 million equity investment to establish the first venture capital fund dedicated to China's environment sector, especially opportunities involving the private sector. The fund will invest in 10-20 companies, providing equity capital and leading technology and taking a controlling stake or acquire strong protective rights to enable its active management. The targeted enterprises include waste treatment, environmental monitoring and data management, water sector services, air pollution control, solid industrial waste recycling, and water and energy use management. The fund focuses on the services sector rather than infrastructure projects, trying to protect the environment and promote private sector growth in China. The fund's sponsor is Leading Environmental Services & Solutions Limited (LESS), an investment company with an aggressive international investment program in the environmental sector. The fund aims to mobilize up to US$40 million of equity capital. LESS has agreed to invest an initial US$15 million and could increase this to up to US$60 million in this and similar funds over the next several years.[12]

The China Funds
www.waldenintl.com/main/chinahongkong.htm

China Walden Venture Investments Ltd. and CWV Investment L.P., known as the China Funds, were organized jointly by Walden International and its partners, the International Finance Corporation (IFC), J.P. Morgan Capital International Corporation, Tat Lee Bank Ltd. and ECICS Holdings, Pte., Ltd. Institutional investors in the China Funds include university endowment funds such as the President and Fellows of Harvard College, Regents of University of Michigan, University of Minnesota Foundation and the Common Fund. [13] The IFC invested up to $7.5 million in 1993 as its first investment in a venture capital fund in China. The purpose of the fund is to make profitable investments in joint venture projects in China. Investment will focus on telecommunication products and services, building materials, health care and biotechnology, software, and infrastructure.[14]

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[11] New Ventures China web site, www.new-ventures.org.cn/

[12] ADB web site, www.adb.org/Documents/News/2002/nr2002201.asp

[13] Walden Venture Investments web site, www.waldenintl.com/main/chinahongkong.htm .

[14] IFC web site, ifcln1.ifc.org/ifcext/pressroom/ifcpressroom.nsf/7fdb52748c77703585256d6200295d26/da6eb0e692883a6285256962006b1314?OpenDocument

IFC - SMEloan (Asia) Joint Investment
www.smeloan.com/en/press/news2001_02.html

The IFC has signed agreements to invest US$20 million in a specialty finance company, SMEloan (Asia), to help expand the company's innovative business model beyond its current market in Hong Kong and southern China to the Asia-Pacific region.[15]

There is a huge amount of privately-invested funds in the Chinese security market which have not been officially registered with the Government. A PBC report estimated that there was RMB 700bn (US$84.3bn) such funds in China[16]; however a more conservative estimate is about RMB 200bn (US$24.1bn). These privately-raised funds are primarily in a gray area with no legal status and regulation. These "underground" funds first appeared in 1993 from various sources and have maintained a rapid growth despite being high risk and having little legal protection. The underground nature of these funds actually makes this market more focused on performance. If this market is legalized, the investment market in China will become much more competitive, with more expertise and market orientation.

2.9 Potential Demand For SRI Investment From Charitable Funds

There are a number of charitable funds in China that have invested in low risk, values based portfolios. Some of them are domestic, and comprise donations earmarked for specific charitable missions, such as the China Youth Fund for Prevention of AIDS (www.sos-aids.org); some are affiliates of international charity organizations, such as the New Path Endowment (www.newpathchina.org)[17]. One article estimates that a number of charitable and other public-benefit funds (including the Shanghai Philanthropy Fund and the China Youth Fund) have over Rmb1.7 billion (US$200 million)[18] in total. Though these funds represent only a tiny fraction of the overall market, their higher awareness of social responsibility issues and less growth-oriented investment strategy might make them the strong potential candidates to support SRI fund products once these are available in the local market.

[15] SMEloan website, www.smeloan.com/en/press/news2001_02.html
[16] *Report of Private-Raised Fund*, Xia Bin, July 2001
[17] The Rmb2.4 million private Newpath Endowment is financially supported by New Path Foundation in New Jersey based on its 2001 agreement with the China Youth Development Foundation (CYDF). Newpath Endowment focuses on service for the elderly, disabled people and other vulnerable groups as well as helping capacity building and resources matching of grassroots community organizations.
[18] The Gray World - Underground Private-raised Funds Look Forward to Become Legal, Security Times, December 09, 2000, stock.163.com/editor/001209/001209_30986(2).html

3.0 SRI Research

3.1 Domestic SRI Research

None that we know of.

3.2 International SRI Research Groups Covering The Domestic Market

The Ethical Investment Research Service (EIRIS)

EIRIS states that it covers 53 companies in Hong Kong and all major global companies with subsidiaries or significant presence in particular countries where human rights issues are of high concern - including China, Burma and North Korea.[19] Chinese companies listed in the Hong Kong Stock Exchange covered by EIRIS have included:[20]

Beijing Enterprises Holdings	China Unicom
China Merchants Holdings	CNOOC
China Mobile	Cosco Pacific
China Overseas Land & Investment	Legend Group
	Shanghai Industrial Holdings

SAM Sustainable Asset Management (SAM)

SAM's coverage of Asia includes selected companies listed in Hong Kong. Chinese companies listed in the Hong Kong Stock Exchange covered by SAM include:[21]

China Mobile
China Unicom
CNOOC

Innovest

Innovest covers limited number of companies in Hong Kong. Chinese companies listed on the Hong Kong Stock Exchange covered by Innovest include:[22]

China Mobile

[19] ASrIA, www.asria.org/sri/asia/research?expand_all=1
[20] ASrIA, www.asria.org/ref/research/lib/EIRISList.pdf
[21] ASrIA, www.asria.org/ref/research/lib/SAMList.pdf
[22] ASrIA, www.asria.org/ref/research/lib/InnovestList.pdf

4.0 SRI RELATED ORGANISATIONS IN CHINA

4.1 International Development Agencies And Funds

4.1.1 Global Environment Fund (GEF), China

www.gefchina.org.cn

GEF is an international fund that promotes environmental cooperation, especially in biodiversity, climate change, persistent organic pollutants (POPs) and land degradation. The UNDP, World Bank and UNEP act as its executive vehicles. In China, the Ministry of Finance serves as the focal point for implementation of GEF projects. The State Environmental Protection Administration (SEPA) acts as the technical support entity to the MOF. It provides the MOF with GEF policy research, operational consulting and project management. The domestic executive agencies for GEF projects in China are wide-ranging, including a number of government ministries and agencies. The China GEF Office was established in September 2000 by MOF and the SEPA.[23] During GEF's trial operation from 1991 to 1994, China had six projects approved and received US$54.61 million from the fund. From 1994 to June 2001, China had over thirty projects approved and/or implemented, with GEF funding of US$322 million, among which 80% related to climate change and 15% to protecting biodiversity.

4.1.2 World Wide Fund for Nature (WWF)

www.wwfchina.org

WWF launched the Corporate Alliance program to develop corporate partnerships. The major target of the program is to promote the awareness of corporate responsibility towards the environment. By sponsoring WWF, companies can have the "opportunity to visibly demonstrate (*their*) recognition of customers concern for the environment - a financial and moral competitive edge"[24]. Participating companies include ABB, BP, Carrefour, HSBC, IKEA, Lafarge, Novozymes, Ogilvy & Mather, Tetra Pak, That's Magazines, 3 Suisses.

4.1.3 The World Bank

www.worldbank.org

As of June 30, 2002, the World Bank Group had funded 239, mainly government, projects in China, totaling approximately US$33.9 billion (net of cancellations), making China's portfolio by far the largest in the Bank. These projects cover all major economic sectors and wide geographic areas in China. Infrastructure (transport, energy, industry, urban development) accounts for more than half of the total portfolio. Agriculture, social sectors (health, education, social protection), environment and water supply and sanitation comprise the remainder. All projects, directly or indirectly, have some impact on poverty alleviation. China is also one of the Bank's best performing member countries in terms of project implementation.

4.1.4 The International Finance Corporation

www.ifc.org

As one of its fastest growing client countries, China is IFC's ninth largest country portfolio. IFC operations in China are focused on encouraging private sector development, promoting corporate governance, supporting the development of China's western and interior provinces (by 2001 eleven projects have been implemented), and promoting private investment in the infrastructure, social services and environmental industries.

Since its first investment in 1985, and as of October 30, 2001, IFC has committed financing for 47 projects in China with US$1.1 billion: US$619 million for IFC's own account, and US$522 million for the account of participating banks.[25] By May 2003, IFC had 59 projects in China. [26]

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[23] GEF China web site, www.gefchina.org.cn

[24] WWF China web site, www.wwfchina.org/english/loca.php?loca=43

[25] IFC Country Factsheet, www.ifc.org/factsheets/images/china-nov01.pdf

[26] Search result of IFC project documents from IFC web site.

4.1.5 Asian Development Bank (ADB)

www.ADB.org

China has been a member of ADB since 1986. ADB annual lending to China increased from US$1.0 billion during 1999 - 2001 to US$1.3 billion in 2002, and is projected to increase to US$1.5 billion during 2003 - 2005. About 77% of recent lending will be used to finance projects in China's poor middle and west regions. Though the transportation sector still keeps its dominant position in ADB lending, funds earmarked for social infrastructure have been increasing.

4.1.6 International Center for Sustainable Development (ICSDC)

www.solarcities.org/index.htm

ICSDS has been working on a number of projects in China since its establishment. It's current projects include the 'Guanghan Model Sustainable Village' project and the 'Greening Beijing for the Olympics' project.

4.2 Non Governmental Organizations (NGO's)

The NGO Sector has grown rapidly and is starting to gain more legitimacy.

Along with the development of the market economy and the transition of government functions, non-government organizations have started growing in number as well as developing their role in offering social services and promoting the public good. Though the Government presently thinks more positively of them than before, there are still many limitations in regulations and administrative procedures that impede the further development of NGOs in China.

However, it is likely that the NGO movement in China will continue to play a more important role in the future environmental movement, public awareness and even the SRI movement in China

Before 1996, all the so-called NGO's in China had to register with the Ministry of Civil Affairs, and associate themselves with a Government agency. NGOs which wish to maintain a higher degree of independence and seek ways to bypass these regulations forgo the legal status of a social organization. In 1996, Miss Sheri Liao started the Global Village of Beijing, which was widely recognized as the first real NGO in China. As China doesn't have any laws on NGO's, all the independent NGO's (including the Global Village of Beijing) have to be registered as normal businesses

The outside world, at the Earth Summit Johannesburg in the year 2002, started to realize that there was a rapidly growing NGO movement developing in China. However, though vast in numbers it is not necessarily flourishing. According to statistics of the Chinese Ministry of Civil Affairs (MCA) "at of the end of 2001 China had 129,000 'social organizations' and 82,000 'private non-profit' organizations."[27] Experts say there may in fact be around 100,000 'private non-profit organizations' in China, with the number increasing every year. "Unregistered NGO's,

[27] www.usembassy-china.org.cn/sandt/ptr/ngos-prt.htm

finally, are perhaps the most numerous type of organisation. The Tsinghua NGO Research Center[28] estimates that nationwide there are 1,400,000, while NPO Network puts the number at 2,000,000."[29] A few months ago, Miss Sheri Liao met with the Chinese government and pushed them to launch new laws to legalize NGO's in China. The feed back was quite positive. The Chinese Government seems to be working on this issue now.

Environmental NGO's are taking a leading role.

Given the sensitivity of social and political issues, it seems that environmental NGOs dominate the Chinese NGO stage. Most of these organizations are volunteer organizations that engage in environmental protection and awareness promotion. In terms of geographic region, they are most active in Beijing, Guangzhou, Chongqing and Fuzhou. The active role of university students (For example, in 1999, there were 13 student environmental groups in 11 universities out of the 36 universities in Beijing) makes these organizations camps for training a more environmentally conscious new generation in China.[30] Some of these organizations are:

4.2.1 Institute of Contemporary Observation (ICO)

ico-china.org/english/index.asp

The Institute of Contemporary Observation (ICO) is a grassroots nonprofit and non-government organization for Chinese labour issues. It is the first civilian labour research and serving institution in the Chinese Mainland, and is located in Shenzhen, South China. It includes specialists and scholars from Beijing, Guangzhou, Shanghai and Nanjing who are active in the sociological research, labor protection and training. ICO is continuously seeking to improve the working conditions and promote the social development of Chinese labour.

4.2.2 Friends of Nature (FON)

www.fon.org.cn

FON focuses on public environmental education with lectures, publications, summer camps, public campaign, seminars and field trips. By the end of 2000, FON had about 1000 individual members and more than 30 group-members from different universities and colleges.[31]

4.2.3 Global Village of Beijing (GVB)

www.ifce.org/gvb/introduction.html

GVB registered in March 1996 as an independent NGO in China. It has 11 full time staff and over 1,000 volunteers. Its mission is to enhance public awareness and to promote public involvement in environment protection. In March 1998, co-endorsed by GVB and China Environmental Protection Administration (CEPA), GVB published Citizen's Environmental Guide, China's first guidebook for environmental behavior in citizen's daily life.[32]

4.2.4 The China Green Student Forum(CGSF)

www.civa.org.cn/public/four-1.htm

CGSF is a Beijing-based network of university student environmental groups that has linked around 270 student groups on university campuses throughout PRC.

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[28] www.tsinghua.edu.cn/eng/index.htm
[29] www.usembassy-china.org.cn/sandt/ptr/ngos-prt.htm
[30] Beijing International Volunteers Association website, www.civa.org.cn/public/four-3.htm
[31] FON web site, www.fon.org.cn
[32] GVB web site, www.ifce.org/gvb/introduction.html

4.2.5 Religious NGO's

There are also some religious charities in China, such the Shanghai YMCA/YMCA, which have been engaged in providing community services, especially in serving the urban unemployed, since the 1990s.[33] These organisations could be receptive to SRI investment principles in the future.

4.2.6 Environmental and Social NGO's based in Hong Kong

See our related Hong Kong report for a summary of these organisations.

5.0 PUBLIC AWARENESS

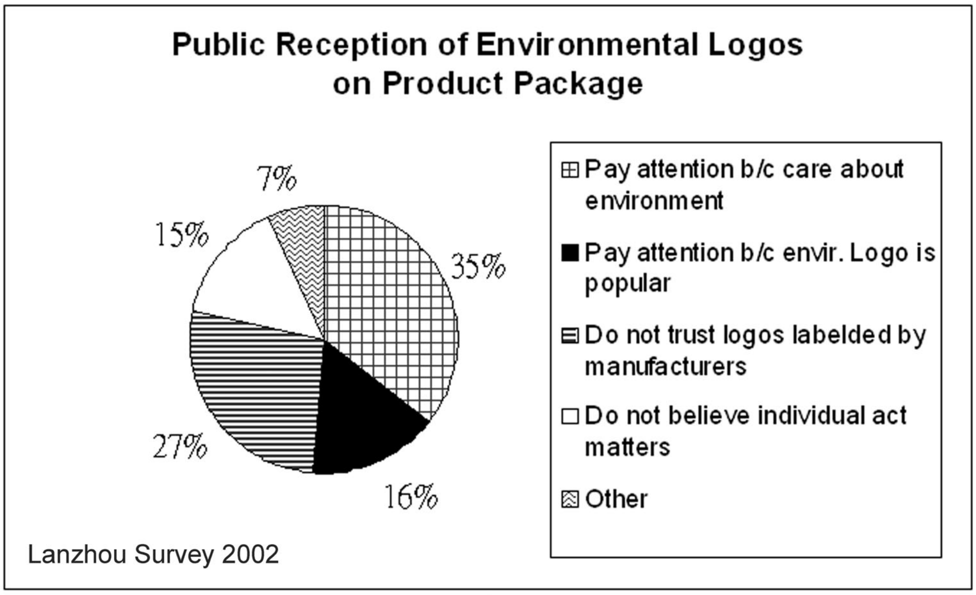
Along with the benefits of economic growth have also come rising social and environmental problems such as pollution, deforestation, failing health care systems in rural areas and broken-down social security systems. However, as the living standards of the Chinese people increase, more and more people are now in a position to think about the environment and the quality of the society that they are living in.

5.1 Growing Public Awareness Of Environment Issues

Public awareness of environmental issues has grown steadily.

Public awareness of environment issues has been growing steadily in China. Air quality reports are regularly included with weather reports in the bigger cities. Also many cities have taken initiatives to replace the use of plastic bags and fast food containers with paper or more environmental friendly bags and packaging to control "white pollution". Furthermore, recycling bins are increasingly appearing in the city streets.

A 1997 survey of junior middle school students in Beijing showed that over 40% read air quality reports, 31% believe their parents show adequate environmental consciousness and actions, and 89% knew the right answers to questions about garbage recycling.[34]



A survey conducted in Lanzhou, Gansu province (a far Western province of China) in early 2000 shows how people's purchase decisions were influenced by the environmental logos on product packages. The numbers shows that public awareness of environmental issues is quite good, and it can be promoted even further by establishing a trustworthy labeling/screening system for consumer products and companies.[35]

Another survey in Guangzhou on the local home improvement market showed that 97.7% people are willing

[33] BIVA web site, www.civa.org.cn/public/four-1.htm
[34] Survey Report on Environmental Consciousness, China Environment Online, www.chinaeol.net/lsxd/mobil/98/dcbg1.htm
[35] Survey result of the Lanzhou University Green Team, greenteam.ep.net.cn/diaocbg.htm

to spend more on environment friendly products. It also showed that consumers are suspicious about the genuineness of environmental logos on products.[36]

In addition to these three surveys, similar results from other surveys show that progress has been made to promote people's awareness of environmental issues. It also reveals that there is a demand for the development of public information sources where reliable information can be obtained by consumers about companies and products. The recent SARS epidemic further raised people's concerns about health and environmental issues. It triggered a series of campaigns to stop some people's habit of eating wild animals.

Green Consumerism is already influencing the corporate sector.

In 2001, the China Consumers' Association (CSA) proposed that "green consumption" should be an important theme for the new century. More than 3,400 branches of the CSA joined the movement and created a strong influence.[37] The CSA was established in 1984 with the approval of the State Council. So instead of being a voluntary body, it is a semi-governmental body that protects the rights of consumers. Its functions include supplying consumers with product information, accepting consumer complaints, supporting product liability lawsuits, consumer rights education, and providing product and service inspection. The CSA or its branches have also developed certain Green labels and organic labels, but the enforcement of the use of these labels is still quite weak and some large companies have been known to acquire their labels by paying money.

Many companies have already recognised this trend and started showing more environmental concerns to improve their public relations image as well as their brand recognition. Mobil China donated Rmb10 million (US$1.2 billion) to the State Environmental Protection Agency of China to establish the "Mobil China Environmental Education Fund", which will support a series of environmental education programs in the following five years. McDonald's puts used battery recycling containers in most of its restaurants. Some foreign retailers promote the use of reusable cloth shopping bags instead of plastic ones.

5.2 Awareness Of Other SRI Related Issues

Expressing concern on social issues is more of a challenge in China.

Public awareness of SRI related issues other than environmental issues is significantly less, due to the sensitive nature of such issues in China. One of the primary goals of the government is to maintain social stability as the social and economic structures of China rapidly transform. Therefore, the government usually does not allow the public to express the concerns on touchy issues such as urban unemployment, poor conditions in sweatshops, and fraud and corruption in the securities market.

With respect to the private sector, foreign-invested companies conducting manufacturing in China, especially the subsidiaries of the bigger multinational companies, sometimes face scrutiny of the labour conditions in their factories by international labour watchdogs as well as by increasingly socially conscious customers.

Labour conditions in small factories in China are often still protected from supervision, as local governments maintain cozy relations with investors to boost the local economy. China also has a very poor record on health and safety in the workplace, with 140,000 workplace deaths recorded by the Government in 2001 (up from 109,000 in 2000).[38] But labour conditions in some cases are improving, and a major reason is because export-oriented factories now face increasing scrutiny from their clients.

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36 New Express Daily, Oct 25, 2002, www.ycwb.com/gb/content/2002-10/25/content_441021.htm

37 Consumers' Associations' Role in Promoting Sustainable Consumption, Ning Wanglu, www.gvbchina.org.cn/lib/suscomsumption/ningwanglu.htm.

38 Lives Sacrificed to Progress; SCMP, Tues 8 April, 2003; pA9

Chinese export-led companies increasingly face requests from their buyers to improve social and environmental standards.

As a mass export country of manufactured goods, Chinese companies increasingly face requests from their buyers to meet certain standards. Labour practice is increasingly used in trade disputes as a *de facto* trade barrier against China's exports. For example, Wal-Mart created a labour supervision department in Guangdong and Fujian with over 30 staff. Many foreign companies (such as Wal-Mart, Carrefour, GE, Adidas, Nike, Reebok, Disney, etc.) have paid for the inspection of labour conditions in over 10,000 Chinese factories. Over 50,000 factories have been requested to agree to receive random inspection. There are already companies in China designed to service this need, such as a company called Social Responsibility China that offers SA8000 consulting services.[39]

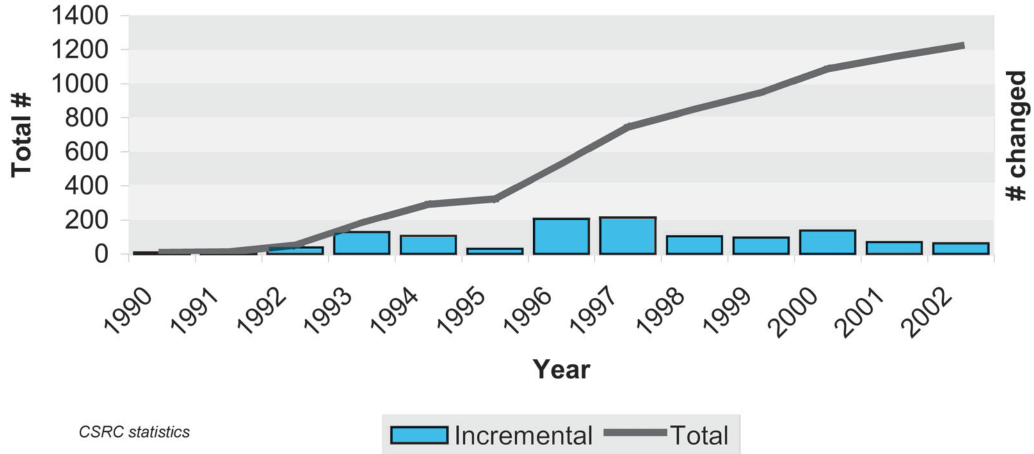
Further information about labour conditions in China and the steps that financial organizations can take to encourage the improvement of labour conditions, is published in a report by ASrIA, "Labour Standards in China, The Business and Investment Challenge."[40]

6.0 CORPORATE GOVERNANCE

6.1 Development Of The Chinese Stock Market

China's securities market is growing very fast. But it still needs improvement in many aspects, such as legal structure, market standardization and investor training.

Number of Listed Companies by Year(1990-2002)



CSRC statistics

Since its first stock exchange, the Shanghai Stock Exchange, opened in December 1990, China's stock market has undergone significant growth. By June 2003, there were 1250 companies listed in the domestic market (A and B shares), with total market value of Rmb 4163bn (US$502 billion), among which Rmb1345bn (US$162 billion) is traded on the market by over 70 million investors.[41]

However, the Chinese security market still has a long way to go to become a secure and transparent market. Many of the shares of listed companies are in the hands of a small number of entities, mostly the state-owned enterprises (SOEs) or related government agencies, which usually have close ties with the management. Some of these so-called "state-owned shares" are not traded in the market. Small investors, mostly individual investors, often become victims of market manipulation of insiders and large shareholders.

[39] www.sa8000.com.cn
[40] ASrIA Publications; www.asria.org/publications
[41] CRSC Statistics, www.csrc.gov.cn/CSRCSite/tongjiku/199911/chtml/y2003/06/a200306.html

6.2 Investment Composition Of The Chinese Stock Market

By April 2002, individual investors accounted for over 90% of the total number of stock trading accounts opened.[42] Their moves make the Chinese stock market more volatile. However, institutional investors have picked up speed in entering the stock market. Foreign financial institutions have also started entering the Chinese security market. The China Securities Regulatory Commission approved the entry of a number of Qualified Foreign Institutional Investors (QFII) that can invest in China's domestic A shares. Also, a number of joint venture investment management companies have been established.

6.3 The Legal Infrastructure And Code Of Conduct

The concept of corporate governance was introduced to China in the late 1980s and early 1990s, as the country tried to transform its state-owned enterprises (SOE) into market oriented modern corporations. Corporate governance initiatives are focused on those companies that listed on China's domestic stock market. The 1993 Corporate Law established the basic legal framework which governs corporate operation and governance.

As the regulatory body of the Chinese stock market, the China Security Regulatory Commission (CSRC) has kept initiating moves to promote corporate governance standards and performance in China.

Regulatory means to improve corporate governance are on going.

Typically, for an SOE listed in the domestic market, only a small fraction of its total shares are traded, while the major shares remain under the control of various entities associated with the government. Small shareholders' rights are easily and often abused by the larger shareholders. Therefore, recent measures have been targeted to strengthen corporate boards, educate investors, conduct independent outside audits, promote information transparency, and establish a stronger regulatory mechanism.

China has revised accounting and auditing rules, making information more transparent to investors. In August 2001, CSRC issued '*the Guidelines to Establish Independent Board Members of Listed Companies*'. It established the guidelines of the qualification, hiring procedures, responsibilities and rights of independent board members.

In January 2002, CSRC and the State Economic and Trade Commission issued *the Corporate Governance Principles for Listed Companies*. It covers the basic regulations about corporate governance, investor protection (especially small investors), and codes of conduct and ethics for corporate management personnel. CSRC will also keep the records of agencies and personnel in the security market. CSRC also holds training programs for independent board members.

The PBC has also issued a series of policies and regulations regarding corporate governance for commercial banks. For instance, a series of guidelines on corporate governance, independent boards of directors and outsider supervision were issued in June 2002, whilst in May 2002, policies on information reporting were published. The policy on information reporting for commercial banks requires all commercial banks, whether domestic, joint-venture or foreign, to adopt the new reporting standards no later than January 2006, depending on their current practice.

Legal frameworks have also been improved. In January 2002, the China Supreme Court gave notice that it will consider civil cases about false information reporting under certain conditions. It has since tried a series of civil law suits against a number of listed companies. This was the first step towards protecting investors interests by granting civil compensation in security related cases.[43]

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[42] Speed Up the Growing of Institutional Investors, www.people.com.cn/GB/jinji/36/20020615/753390.html

[43] CEI, www1.cei.gov.cn/hottopic/doc/zjzt2002042/200207250524.htm

The Government realizes the vital importance of investor protection to the health and development of the domestic security market. At an International Forum on Investor Protection hosted by the Shanghai Stock Exchange in June 2002, Mr. Zhou Xiaochuan, then CSRC chairman, laid down the following measures to protection investors:[44]

- Transparent information reporting
- Investor education
- Regulatory protection of investor interests
- Promote the understanding of shareholder rights in society

Enforcement of corporate governance rules is also being improved, but overall still weak.

The China Security Regulatory Commission has established a set of rules about corporate reporting to protect the interests of investors. The rules govern the content, format, reporting procedure and certain specific cases. Also, the CSRC has strengthened its powers of enforcement. By November 2002, a total of 114 violations of over 90 companies had been dealt with either by the stock exchanges the company was listed on or the CSRC. Punishment ranged from public reprimand to administrative punishment.[45] In 2001 alone, the CSRC investigated 33 cases about untruthful information reporting, punished 80 managers from 8 listed companies, and 37 CPAs from 3 accounting firms.[46]

6.4 Legal Framework For Shareholder Protection

China's legislature passed *the PRC Securities Law* in December 1998, which came into effect on July 1, 1999. The main goal of the law is to "standardize the issuing and trading of securities, to protect the lawful rights and interests of investors, to safeguard the social and economic order and the public interest and to promote the development of the socialist market economy."[47] The courts have started playing a role in disputes in the financial sector. For example, in 2001, a local court in Shandong province ruled that a stock analyst's article had misled an individual investor and granted the plaintiff's compensation claim.[48]

In early 2000, two local courts turned down two lawsuits filed by investors based on *the Securities Law* due to lack of appropriate legal interpretation. Furthermore, in September 2001, the Supreme Court issued a circular that suspended the acceptance of cases based on charges of fraudulent reporting, insider trading and market manipulation. Later amendments made by the Supreme Court in January 2002 and January 2003 opened the door again for investors to file lawsuits on charges of fraudulent reporting. An example is the ST Dongfang case in which individual investors in several provinces hired law firms to handle their suits against the company. By July 2003, the local court that had jurisdiction over the ST Dongfang's headquarters had already received over 200 individual claims for compensation totaling over Rmb28 million (US$ 3.37 million).

However, interpretation regarding insider trading and market manipulation is still insufficient. The problem of legal independence in China also further hinders the protection of investors.

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[44] CEI, www1.cei.gov.cn/hottopic/doc/zjzt2002042/200206281218.htm
[45] Department of Listed Company Supervision of CSRC web site, www.csrc.gov.cn/CSRCSite/deptlistcom/super/super.htm.
[46] CEI, www1.cei.gov.cn/hottopic/doc/zjzt2002042/200205172214.htm
[47] PRC Securities Law, passed on Dec.29, 1998, effective from Jul. 1, 1999, law.beelink.com.cn/fagui/zqf.htm
[48] China Security News, 202.84.17.28/csnews/20010907/123720.htm

6.5 Investor Governance - Auditing And Supervising Listed Companies

As mentioned above, the major problem of the Chinese stock market is the over-concentration of shares in the hands of government related entities, as most companies listed are SOEs whose majority shares are still controlled by the enterprise, or related government agencies, such as local state-owned asset management administrations. Many large companies in China are also controlled by Princelings (the children of high Government officials or former high Government officials). They have a very good network with banks and the district Governments. These types of relationships form a very strong network that can gain control of loan sources, market share, and district government policy making. There is virtually no limit on the extent to which this kind of network can produce false accounting statements. This is the main reason for current speculation that the bad debt of the Bank of China is like a bottomless black hole.

Murky ownership increases the risk of moral hazard, and in most such cases, the interest of individual investors is at risk, such as has been shown in the fraud case of Yin Guangxia. The company made up false sales revenues of over Rmb1 billion ($ 0.12 billion), which later led to a loss of Rmb 6.8 billion ($0.82 billion) of its market value.

The Standards of Listed Companies Administration was issued on January 9, 2002. It explained the basic standards of listed companies, ways of investor protection and the obligations and responsibilities of board members, auditors and senior managers. However, there is still a long hill to climb before listed companies can be persuaded to discipline their behavior according to these compulsory standards.

6.6 Investor Education

The majority of individual stock investors in China have little financial knowledge. For them, the stock market is more about speculating than investing. Most of the investors have little awareness of self-protection and risk control. Chinese securities regulatory bodies began to emphasize investor education in 2001 after disruptions in the market. Many investor education activities have been offered to investors, but almost all these educational activities are for the market promotion of related services and products, such as technical analysis and more recently, for financial planning.

The Government is stressing the importance of investor education.

Compared with more developed markets, investor education in China is still in its infancy. Lack of resources results in inefficient investor education, which makes investors more suspicious of such activities. However, the government has realized that investor education is one of the best ways to prevent fraud and corruption in the security market and has been giving increasing importance to it.

The media plays an increasing important role in keeping the market clean. The Chinese media is in a transition phase and has started playing something of a watchdog role in promoting market development. Increasing competition among mushrooming media companies is pressuring them to improve the quality and integrity of their reporting. However, political sensitivities, which can be very inclusive in China, often put a significant restraint on the media.

The Chinese media is developing a watchdog role.

Pressure on corporate governance issue has also been exerted on Chinese corporates listed on the Hong Kong stock market, where shareholder activism is increasingly influential. This could prove a major gateway for introducing corporate governance reform into the Chinese financial markets.

Hong Kong could prove a major gateway for influencing corporate governance reform in China.

7.0 CORPORATE RESPONSE

In response to both government regulations and the popular perception of investors, more and more companies are now taking action to promote their own image by following the code of conduct of good corporate governance behaviors. Accounting, auditing and reporting is increasingly being brought into line with reality.

7.1 Environmental Standards And Reporting

As mentioned above (5.2) increasing numbers of companies in China are coming under pressure, particularly from clients, to adopt higher environmental and social standards. As a result many companies have taken steps to enable them to meet international standards such as ISO14001 or other standards set by individual clients (which are usually similar).

Over 1000 companies have obtained ISO 14001 certification.

The State Environmental Protection Administration started promoting ISO14000 standards in 1996. There are now already over 1,000 Chinese companies, many of which are foreign or joint venture companies, which have obtained the ISO14000 certification, such as VW Shanghai, GM Shanghai, Legend, Haier, Konka, Kelong and Huawei. There are also a number of industrial parks that obtained the certification, such as in Suzhou, Dalian, Shanghai and Shenzhen.

"Generally speaking, brand names are doing a better job than retailers; popular brands are doing better job than companies with less reorganization; companies in footwear, toys, garments pay closer attentions to these issues than companies in other industries such as electronics, pharmaceutical, chemical, etc.; and American and European companies are ahead of companies from Japan, Korea, Singapore and other regions."[49]

Also, some companies have begun first steps to include environmental issues into their reporting. This is particularly the case where the companies are meeting the ISO14001 environmental management system, such as China National Petroleum Corporation.

Subsidiaries of some multinational corporations, who are required to report in other countries, have been leaders in adopting environmental reporting. However a number of domestic companies that have realized that it is one way to meet popular concerns about environmental issues.

7.2 Environmental Awards And Other Environmental Initiatives

Companies also show their environmental concerns as a way to establish better PR among more environmentally conscious consumers. For example, Ford set up the Ford Motor Environment Award program to sponsor programs in environmental protection and education. For more information on environmental awareness also see 5.1.

[49] Kaiming Liu, Executive Director, The Institute of Contemporary Observation; ico-china.org/english/Newstype.asp?Title=CSR%20in%20China

7.3 Philanthropy By Chinese Corporations

Many Chinese companies do practice philanthropy, such as donating to funds that help rural poor children gain access education, or which provide disaster relief. For instance within the last year, many companies donated money and materials to help fight SARS.

According to Chinese tax laws, personal donations to education and other charities can be deducted from taxable income; corporate donations made to public-interest and disaster relief programs are tax deductible to the limit of 3 percent of total tax payable. The Government also issues policies concerning the tax treatment of specific purpose donations. For example, donations made to not-for-profit senior citizen care services and donations funding nine-year compulsory education (elementary and junior middle school) in rural areas are tax deductible. [50]

7.4 Awareness Of Social Responsibility And Adoption Of CSR

Some multinational companies have provided some information about social responsibility on their web sites as part of their global image building efforts, such as SAP, Dupont and Dow Corning.

At a conference on "Labour Relations and Corporate Social Responsibility under Globalization", held at Renmin University, Beijing in 2002, representatives of global corporations and anti-sweatshop activists came together to discuss issues related to corporate social responsibility (CSR), working conditions and labour relations. "The various presentations on CSR trends and initiatives revealed quite clearly that the contemporary CSR agenda is still in its infancy. Not only are new methods, tools and approaches being tried out, but the number of companies involved remains relatively small. CSR is, nevertheless, gradually evolving and maturing. The most obvious change is the shift from so-called "corporate self-regulation" - where, for example, companies unilaterally designed and implemented codes of conduct - to "co-regulation" or "multistakeholder" initiatives where some companies collaborate with NGOs, trade unions and bi-lateral and multilateral organizations in voluntary initiatives associated with codes of conduct, monitoring, verification, reporting and certification."[51]

CSR is gradually evolving, including some collaboration with NGO's.

[50] China Youth Development Foundation, July 2002, www.cydf.org.cn/news/findnews/shownews.asp?newsid=5670
China Youth Development Foundation 2001/07/04

[51] Utting, Peter; CSR and Labour Issues in China: Reflections on a Beijing Conference; ico-china.org/english/Newstype.asp?Title=CSR%20and%20Labour%20Issues%20in%20China

8.0 MICRO-FINANCE AND COMMUNITY INVESTMENT

8.1 The Special Character Of Micro-Finance In China

Micro-finance in China is well established with about 500 programs directed at the rural and urban poor.

Development of micro-finance in China can be described in three stages. The first stage, from the early 1980s to 1993, was characterized by several small-scale trial projects supported by international organizations. These trial projects succeeded and micro-finance in China started scaling up. The second stage, from 1993 to 2000, was a major part of the national poverty alleviation plan, mostly targeting the rural population. The third stage began in 2000 when micro-finance started being accessible to the unemployed and other disadvantaged groups in urban areas. The development of micro-finance is also the result of increased international micro-finance activity, an increasing demand for more credit and poverty-reduction tools in a deepening marketing economy, and the necessity to improve rural financial services in less developed areas of China.[52] Dr. Tang Min of ADB estimates that by 2003 there were about 500 microfinance programs operating in China.

Micro-finance is mostly referred to as "microcredit" in China, and it has the following two characteristics:

1. It is a government-lending program mainly focused on poverty alleviation rather than private financial services. The government funds the programs at preferential rates. In 2002, the average annual lending rate of microfinance in China is 8% while the national standard lending rate is 5.3%, which is much lower than the other countries' 15%~20%[53]. However, the financial service charges hardly cover the costs of making the loan. These programs therefore provide little return to participating financial institutions. However, the government is trying to help by increasing the interest rate ceiling to twice the state rate of 6% this year. Further easing of the ceiling in future is also believed to be possible. Experience in other Asian countries, such as the Philippines, has shown that interest rates slightly higher than the regular bank lending rate is sustainable; for the banks and the borrowers, as long as the loans are very small.

2. Programs are governed by strict rules set by the government, such as in the newly issued '*Managing Rules of Microcredit Collateral Loan For Laid-off Employees*',[54]. Including such as: a strict ceiling on interest rates, the nature of the fund source, and who can be participating institutions. The People's Bank of China (PBC) lays down most of the regulations. Microcredit institutions, eligible only after being sanctioned by the Government or the PBC, have very limited flexibility in adjusting interest rates. The sole source of funds comes from Government poverty alleviation funds or aid from international organizations. No savings are allowed into the microcredit process.

International NGO's have a role in introducing best practice.

Some international NGOs have been trying to introduce international best practices for micro-finance in China, within the limitations of the government-regulated framework. Though limited in volume and availability, these funds constitute an indispensable part of microfinance in China.

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52 Sun, Ruomei, The Development of Microfinance in China

53 Strategy of Microcredit in China, www.chinanewsweek.com.cn/2002-12-13/1/790.html

54 *Managing Regulations on Microcredit Secured Loans to the Unemployed*, www.china.com.cn/chinese/PI-c/259958.htm

8.2 Government - Supported Microcredit Programs

Microcredit funds in China only target three socioeconomic groups: the rural poor, urban lay-offs, and college and graduate students (new graduates for seed money or for students to pay the costs of studying abroad).

Microcredit for the rural poor consists of microcredit loans and group-liability loans. Rural Credit Cooperatives (RCCs), supervised by the PBC, are the official operating institutions. The RCC micro-loan program was introduced in 1999 but become active at the end of 2001, after the PBC ordered all RCCs to start microfinance businesses to initiate credit in villages and townships. By September 2002, over 90% of all RCCs were providing microfinance services to farmers[55]. Their main source of funds comes from the PBC. Over the ten-year development period, PBC statistics[56] show the following numbers by June 2002. Combined, the two kinds of loans serve 46% of the rural households that need a loan:

	Microcredit Loan	Group-guaranteed loan
Volume of loans made (RMB)	69.6 billion	26.8 billion
Providing RCCs as in numbers	31,446	17,195
Providing RCCs as percent of national total	90%	49%
Number of rural borrowers (households)	43.18 million	9.54 million

Inspired by successes in rural areas, the Chinese government initiated another large-scale microcredit activity to cope with growing urban unemployment. In June 2003, the PBC issued '*Managing Rules of Microcredit Collateral Loan For Laid-off Employees*', requesting all local city government fiscal agencies to establish microcredit collateral funds to serve "the laid-off employees", who can apply for loans of up to Rmb20,000 (US $2410) with maturity within 2 years. Meanwhile, some provinces and municipalities, such as Guangdong and Tianjin, also launched some trial microcredit programs for new university graduates to start micro-enterprises

For rural microfinance projects, the government is targeting the poorest regions, mostly in the west and inland China. Also, different emphases have been given to farmers applying for microfinance loans in different areas. In Northeast and Northwest China, the main aim is to help farmers manage their farming needs; in Central China, loans can be used flexibly if the purpose is to reinvest in production; in the coastal areas in East China or rural areas close to major cities, farmers can apply for loans for business other than agriculture, even including consumption, such as child education and house-building. [57]

International organizations fund several microfinance projects in China. The UNDP funded 16 poverty reduction projects in China with total funding of US$19.32 million, among which US$8.21 was for a revolving fund. The UNDP projects adopted the Grameen model of group borrowing. AusAID also funds a project in Qinghai with a total of US $1.67 million. [58]

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55 PBC Leader Emphasizes on Improving Rural Microfinance Services, Nov 2002, www.pbc.gov.cn/xinwen/detail.asp?col=xinwen&ID=523

56 *PBC Statistics Show Rural Microcredit Making Progress,* www.aweb.com.cn/2002/7/16/200271680706.htm

57 PBC Circulatory on Improving Rural Microfinance Lending Services, April 2002, www.pbc.gov.cn/jinrongfagui/detail.asp?col=xinwen&ID=939

58 Sun, Ruomei, The Development of Microfinance in China

8.3 Private Sector Financing Activities

There is an urgent need for private financing for entrepreneurs.

As the market economy takes root in China, the need for private sector financing has been growing significantly. But the lack of an appropriate legal and operational framework hinders development. Much private financing still remains underground. Many starting entrepreneurs do not have access to formal sources of credit despite their urgent need. Kellee S. Tsai said, "The vast majority of private businesses in China rely on informal finance, or what economists call the "curb market", for their start-up and working capital needs. These informal financing mechanisms range from interest-free loans between friends and relatives, to sophisticated financing arrangements that circumvent national banking laws in creative ways."[59]

In responding to the situation mentioned above, China has already begun private financing trials in cities such as Shanghai, Guangzhou, Jinan and Chengdu. The trials showed a number of problems: insufficient information about private financing solutions, lack of reliable credit records, lack of good communication and collaboration among different banks and banks in different areas, and the lack of an appropriate legal framework. The latter makes it especially hard for microfinance institutions to get funding from channels other than government poverty alleviation funds.

Overseas organizations fund some micro-credit projects in China. For example, the Jianhua Foundation in Hong Kong funds a program in the city of Zhangjiakou, Hebei province, northeast of Beijing. And Oxfam Hong Kong began supporting development and relief projects in China in 1987. From 1996 onwards, Oxfam has conducted efforts in micro-credit and poverty alleviation.[60]

8.3.1 The Funding the Poor Cooperative(FPC)

Funding the Poor Cooperative (FPC) microfinance project was an action-research program launched in 1993 by the Rural Development Institute (RDI) of CASS. It was modeled after the Grameen Bank solidarity group methodology to provide loans to the rural poor. Since 1994, FPC of CASS has set up 15 sub-branches within 3 county level branches in Yixian County of Hebei Province, and Yucheng and Nanzhao Counties of Henan Province. It is undergoing a transition from a pilot program to an institution.[61] Now it has served over 15,000 households (90% in poverty) and lent out over Rmb 68 million (US $8.2 million) with repayment rates as high as 95%.[62] The funds mainly come from overseas donations and aid from individuals and organizations. Citibank recently committed US $1.3 million through the Grameen Trust to the Center, which might be used by FPC. Limited by funding, the FPC limits the amount of the initial loan to Rmb1,000 (US $120.5), and the total amount below Rmb 3,000 (US $361.4). FPC sources indicate that this is the only microfinance project with a clear sanction from the PBC.

8.3.2 China Micro-Credit Center

The Micro-Credit Center was founded by the Rural Development Institute of CASS, in which Professor Du Xiaoshan is an important leader, in cooperation with the CGAP (Consultative Group to Assist the Poorest). It helps with micro-credit related training (using CGAP materials) and has established the China Micro-credit Member Network, which engages in setting up a micro-credit database and websites, running seminars and exchanging best practice ideas.[63]

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[59] Informal Finance and Private Sector Development in China, www.microfinancegateway.org/cache/2958.htm

[60] Oxfam Hong Kong web site, www.oxfam.org.hk/english/projects/asia/index.shtml#china

[61] Sun, Ruomei, The Development of Microfinance in China

[62] China Youth Development Foundation web site, www.cydf.org.cn/news/findnews/shownews.asp?newsid=7494

[63] Ibid.

8.3.3 The Longshuitou Mini-credit Poverty Relief Foundation

The privately founded and non-profit Longshuitou Foundation was established in 1993. Now it has grown to Rmb250,000 (US$54,000) and spread over three villages in Shanxi province in North China. The fund was implemented by economists, Mao Yushi and Tang Min. The fund adopts the Grameen bank model and includes a zero interest "fund for helping the poor" and a 6 percent " interest bearing fund" from private contributors. The fund is loaned to farmers at 12%.

8.3.4 The Beijing Fuping Domestic Service School

The school is another project funded by economists Mao Yushi and Tang Min. The school recruits and trains women from poor rural areas (average household cash income around Rmb2,000/year) to become domestic helpers, then helps them to find jobs in Beijing. The tuition and living expenses for the training period will be covered from their salary after work, usually equal to one months salary, about Rmb5~600. The school is a non-profit organization and all revenues will be used to maintain and expand its operation. It has trained over 1,000 domestic helpers and will train about 5,000 per year. There is also plans to create jobs for urban laid-offs by employing them as community level managers of the trained domestic helpers.

8.4 Impediments And Prospect Of Microfinance In China

Though China has successfully reduced its poverty population during the last two decades at a dazzling speed, there are still many remaining in poverty. Official statistics show that by the end of 2002, China still has 28.2 million people in absolute poverty and 58.25 million as low-income in its vast rural area.[64] Whilst the urban unemployed totalled 4.64 million by June 2002.[65] Meanwhile, income disparity has been growing fast. Under such a severe situation, the potential market for micro-finance is very high.

After ten years of trial, microcredit has achieved certain goals in terms of poverty alleviation, but it is still in a nascent stage and faces a series of impediments.

The current strict management of the PBC is far from enough for the long-term development of micro-finance in China, such as the establishment of independent micro-finance institutions and audit systems. Another necessary step is to build up the research and consulting capacity of the microfinance institutions so that a competent local personnel team can offer related help to borrowers.

With its accession into the WTO, China will open its financial markets, including the micro-finance market. More and more foreign financial institutions and social organizations will try to tap this huge market with their expertise. With such external supports and stimulus, we expect that China will eventually have to respond more actively to the existing problems and build up a more competitive micro-finance capability.

[64] Poverty in China 2002, www.scagri.gov.cn/x0814.htm
[65] Urban Unemployment Keeps Rising, www.voa.gov/chinese/worldfocus/fri/07260207chinaunemploymentrater.htm

9.0 ASSESSMENT OF THE FUTURE MARKET FOR SRI

Drivers for SRI in China

- Export market drives corporate environmental and social standards
- Government strongly behind corporate governance improvement, supports improved corporate environmental standards and starting to show understanding and support for CSR
- Huge strategic and economic focus on the environment by the Government
- Future opportunities such as the Beijing Olympics
- Growing NGO sector in China and surveys show awareness of environmental issues in the general population
- Nascent fund industry and growing investment culture, however uniformity of products
- Some SRI research of Chinese companies has already been conducted

Conclusion

- SRI funds may be an angle for future participation in the market
- Focused education of the financial sector on SRI very important
- Engagement in the market by global SRI funds would provide a model

China's National Report on Sustainable Development, published on August 23, 2002, notes that the Government has set specific objectives and goals for sustainable development as well as promulgating a number of laws, these includes a law on a population plan, six laws on environmental protection, and thirteen laws on natural resource management. All these measures are formalizing and codifying strategies and policies for sustainable development, thus laying down the foundation for the future development of SRI in China.

The report has found that there is a growing awareness of sustainability issues both within the general population and the government and that there is increasing planning, legislating and investment by the government on environmental infrastructures and other initiatives. However, on the other hand, growing awareness must be balanced with the increasing materialism of the Chinese urban population on the one hand and the massive numbers of Chinese that still live in poverty on the other. Also, the positive initiatives by the government need to be balanced by an awareness of the clear problems in enforcing legislation or verifying the effectiveness of sustainable development programs.

One of the key issues one has to take account of in China is the sheer scale of initiatives. The fact that the NGO sector is a new and fragile phenomenon, but that it already numbers hundreds of thousands of groups is one striking example. The fact that there are estimated to be over 500 micro-finance programs active in China is another.

The future market for SRI in China will grow as people increasingly become not only more aware and concerned about the environmental and socio-economic problems which accompany economic development but also educated on how to respond to these challenges.

Chinese stock markets are growing, both in size and sophistication, but they still face huge, if not overwhelming, corporate governance challenges. Fraud, corrupt networking at the highest levels and untrustworthy accounting and reporting are among the prime issues that the market faces. Market investors still have few channels for challenging or verifying company information or in appealing against market manipulation. The report has established that Chinese investors are overwhelmingly conservative, with the vast majority keeping their savings firmly in bank savings accounts. However those that have ventured onto the market have adopted a primarily speculative, short-term approach. This is partly a function of a lack of effective education, but it is also a reflection of the lack of trust that investors probably have in the potential for finding long-term safe investment in the stock market. Almost certainly corporate governance standards will have to be seen to be radically improved before small investors can be encouraged to consider more long term investments in the market. The chances are that investors will respond with more willingness to invest in longer-term options such as funds once higher corporate governance standards can be demonstrated. SRI funds have the potential to stand out as fresh and interesting options to the current undifferentiated fund products on the market.

With respect to the corporates, it is clear that environmental and social awareness standards are improving, and that concepts such as CSR are being introduced into China. The pressures of export trade have encouraged the adoption of standards such as ISO14001 and SA 8000 by many companies. However these are still relatively new concepts and it will still take some time for them to really take root within the wider corporate sector. A primary role that SRI funds can play within the corporate sector is to encourage more transparency and the wider adoption of environmental and social reporting. SRI funds can therefore play a role in drawing together the ongoing corporate governance initiatives with the environmental and social trends that are also taking place. If the more positive trends that this report has identified develop then it will attract long-term SRI investors into the market. Foreign SRI funds, if they can be encouraged to enter the market, can potentially play a very important role in fostering SRI, by introducing their established practices and their years of expertise.

10.0 RESEARCH PARTNER

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11.0 GLOSSARY

ADB	Asian Development Bank
CASS	China Academy of the Social Science
CGAP	Consultative Group to Assist the Poor
CGSF	The China Green Student Forum
CSFMC	China Southern Fund Management Co., Ltd
CSR	Corporate Social Responsibility
CSRC	China Security Regulatory Commission
EIRIS	The Ethical Investment Research Service
FON	Friends of Nature
FPC	Funding the Poor Cooperative
GEF	Global Environment Fund
GVB	Global Village of Beijing
H Shares	H-Share Companies refer to companies incorporated in the People's republic of China an approved by the China Securities Regulatory Commission for a listing in Hong Kong.
ICSDC	International Centre for Sustainable Development
LESS	Leading Environmental Services & Solutions Limited
LOF	Listed Open-ended Fund
MOF	Ministry Of Finance
MOL	Ministry Of Labour
MOLSS	Ministry Of Labour and Social Security
NaCSSeF	National Council for Social Security Fund
PBC	People's Bank of China
POPs	Persistent Organic Pollutants
PRC	People's Republic of China
QFII	Qualified Foreign Institutional Investors
RCCs	Rural Credit Cooperatives
RMB	Ren Min Bi (1 US$ = Rmb8.3)
SA 8000	SA 8000 is a standard for social accountability in the workplace
SAM	Sustainable Asset Management
SEPA	The State Environmental Protection Administration
SME	Small and Medium sized Enterprises
SOE	State Owned Enterprise
SRI	Socially Responsible Investment
UNDP	United Nations Development Programme
WTO	World Trade Organization

ASrIA, Association for the Sustainable and Responsible Investment in Asia
www.asria.org

ASrIA is a not-for-profit membership association dedicated to promoting sustainable and responsible investment (SRI) practice in Asia. ASrIA has over 100 members including investment institutions managing over US$2 trillion in assets. In order to raise awareness about SRI, ASrIA has run conferences, seminars and workshops, and published wide-ranging research on SRI issues. ASrIA has also created a network of people and organizations committed to developing SRI in Asia. ASrIA's website, www.asria.org, is the primary resource for SRI in Asia, already attracting over 1,800 page views per day and 5,000 subscribers to the regular e-bulletin.

What is SRI?

Sustainable and Responsible Investment (SRI), also known as Socially Responsible Investment, is investment which allows investors to take into account wider concerns, such as social justice, economic development, peace or a healthy environment, as well as conventional financial considerations.

The most successful SRI funds provide investors with dual returns:

- Financial returns that compare well to, and often exceeding, the returns of conventional investments
- Social and environmental rewards that go beyond the direct financial return to the investor

SRI is therefore a positive economic choice about the way we live and the world we live in.