

COMMENT: FOREIGN WORKFORCE AND BANK REFORM: CHANGING THE LEGAL LANDSCAPE AND CORPORATE GOVERNANCE LEVELS IN CHINA

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I. Introduction

Corporate governance is a problem in China. By attracting capital and increasing exports, China has enjoyed positive economic growth in recent history.¹ These positive economic indicators, however, have continued to grow despite China's lack of focus on corporate governance issues.² Chinese enterprises, whether State Owned Enterprises (SOEs), privately held companies, or companies owned by both the state and other private entities, have little short-term incentive to be financially transparent.³ These entities largely receive operational funds in both the equity and debt markets regardless of financial transparency levels.⁴ Economic growth, however, will not continue without corporate governance reform. This note provides a brief discussion of Chinese economic history, outlines the issues surrounding China's corporate governance problems, and finally articulates a two-tiered corporate governance solution based on economic reform in a bank-centric economy and human resource allocation utilizing foreign and local workforces.

¹ See UNCTAD *On-Line Handbook of Statistics*, at <http://www.unctad.org> (Nov. 2, 2003).

² See John H. Farrar, *The New Financial Architecture and Effective Corporate Governance*, 33 INT'L LAW. 927, 944 (1999).

³ See Yuwa Wei, *Seeking a Practicable Chinese Model of Corporate Governance*, 10 MSU-DCL J. INT'L L. 393, 399 (2001).

⁴ Todd Kenneth Ramey, *China: Socialism Embraces Capitalism? An Oxymoron for the Turn of the Century: A Study of the Restructuring of the Securities Markets and Banking Industry in the People's Republic of China in an Effort to Increase Investment Capital*, 20 HOUS. J. INT'L L. 451, 467 (1998); See also Jianbo Lou, *China's Bank Non-Performing Loan Problem: Seriousness and Causes*, 34 INT'L LAW. 1147, 1148 (2000).

II. Corporate Governance Problems

A. Foreign Direct Investment

China cannot sustain positive foreign direct investment (FDI) growth if economic reforms to increase corporate governance levels do not improve. FDI is important to any developing country because it represents direct, long-term, non-passive investment in the economy from both individuals and business entities. China has enjoyed positive FDI growth in its industries despite inadequate financial disclosure. Total FDI in China grew from approximately US\$12 billion during 1979-1982 to approximately US\$37 billion by the end of 1993.⁵ China's FDI consists of FDI inflows and outflows.⁶ FDI inflows alone in China reached US\$40 billion and US\$46 billion in 2000 and 2001 respectively.⁷ China is currently one of the world's leading beneficiaries of FDI.⁸ In order to continue FDI growth, China should initiate economic reforms and implement human resource solutions to carry out a comprehensive plan.

B. China is Bank-Centric

1. Equity Markets: Not the Main Capital Source

Chinese entities were once able to raise capital in their domestic stock markets and even in the United States equity markets.⁹ Capital inflows remained strong despite a lack of transparent financials that made valuations and earnings projections difficult, even for sophisticated

⁵ Todd Kenneth Ramey, *China: Socialism Embraces Capitalism? An Oxymoron for the Turn of the Century: A Study of the Restructuring of the Securities Markets and Banking Industry in the People's Republic of China in an Effort to Increase Investment Capital*, 20 HOUS. J. INT'L L. 451, 460 (1998).

⁶ *See Id.* This note focuses on China's FDI inflows.

⁷ UNCTAD *On-Line Handbook of Statistics*, *supra* note 1.

⁸ Ramey, *supra* note 5.

⁹ This article refers to the capital and equity markets synonymously. The capital markets consist of both stock and bond markets. This note, however, disregards the bond market because most entities are not in a position to successfully issue their own debt in China's current stage of economic development. In the bond market, entities can raise capital by issuing their own debt in the bond market, essentially finding investors that will "buy" their debt and effectively become their "lenders."

institutional investors.¹⁰ The current economy no longer affords Chinese entities this luxury, yet there are exceptions. The entities that do use the equity markets, however, raise capital without providing transparent financial statements. When Chinese entities enlist on one of the major United States stock exchanges, financial reporting standards are relaxed due to Securities and Exchange Commission (SEC) rule changes in 1987 that permit United States exchanges to waive or modify certain listing standards for foreign issuers in order to attract foreign companies to U.S. equity markets.¹¹ Thus, Chinese entities still have managed to raise capital in the equity markets while providing relatively poor financial statements.

This trend cannot continue if China wants the equity market to become the major vehicle for FDI. Despite positive FDI growth, the equity market is experiencing problems and requiring greater regulation that will ultimately demand greater reporting transparency among both state-owned and commercial Chinese entities.¹² Although the capital markets will be essential for raising investment capital in the long-term, equity markets are at an early growth stage and currently represent a relatively small source of total capital to Chinese industries.¹³ Financial transparency and corporate governance must improve in order for Chinese entities to attract capital to the equity or stock markets in the long-term, and to raise capital in the debt market or from banks.

¹⁰ “Transparent financials” are financial statements such as income statements, balance sheets, and cash flow statements that accurately reflect an entity's financial position.

¹¹ Robert Todd Lang, *Special Study on Market Structure, Listing Standards and Corporate Governance*, 57 BUS. LAW. 1487, 1515 (2002).

¹² Ramey, *supra* note 5.

¹³ *Id.* at 459; Lawrence L. C. Lee, *Integration of International Financial Regulatory Standards for the Chinese Economic Area: The Challenge for China, Hong Kong, and Taiwan*, 20 N.W. J. INT'L L. & BUS. 1, 13 (1999).

2. Debt Markets

While the equity or stock market may be the main source for capital in the long-term, Chinese entities now primarily turn to the debt markets.¹⁴ A bank-centric economy means that most Chinese entities raise capital in the Chinese banking sector, while few depend on raising capital in the United States or China capital markets.¹⁵ Therefore, if SOEs and commercial entities are to obtain necessary funding, they will need to implement a plan focusing on building a strong banking system that will force them to offer transparent financials and increase levels of corporate governance.

C. Non-Performing Loans

1. Bailout Cycles

State Owned Enterprises are the main lending beneficiaries of a bank-centric economy and the primary contributors to China's non-performing loan (NPL) problem.¹⁶ Banks continue to lend to SOEs knowing that the PRC will bail them out, artificially supporting otherwise failing companies.¹⁷ SOEs are not compelled to provide banks with accurate financial statements because funding largely continues, regardless of profitability or cash flow, at the direction of the People's Bank of China (PBOC).¹⁸ China's bank bailout cycles are central to the corporate governance problem. China should therefore focus on banking system

¹⁴ Jianbo Lou, *China's Bank Non-Performing Loan Problem: Seriousness and Causes*, 34 INT'L LAW. 1147, 1159 (2000).

¹⁵ *Id.*

¹⁶ Michael E. Burke, IV, *Improving China's Bank Regulation to Avoid the Asian Bank Contagion*, 17 UCLA PAC. BASIN L.J. 32, 86 (1999).

¹⁷ *See id.*

¹⁸ Lawrence L. C. Lee, *Integration of International Financial Regulatory Standards for the Chinese Economic Area: The Challenge for China, Hong Kong, and Taiwan*, 20 NW. J. INT'L L. & BUS. 1, 12 (1999); The PBOC is the central bank of China since 1983 and the lender of last resort for state-run banks.

reform before stock market regulation to increase levels of corporate governance.

Unfortunately, poor quality loan funding leads to highly leveraged enterprises that commonly result in default.¹⁹ Such NPLs or loans that do not generate sufficient revenue for the lender remain on the banks' balance sheets and are written off only at the direction of the PBOC.²⁰ Estimates of NPL to total outstanding loan ratios among Chinese banks range from thirty to sixty percent, one of the highest NPL levels in Asia.²¹ Economic pressure to create assets through lending compels banks to fund poor quality loans. The pressure to create a larger asset base is due to relatively large amounts of bank deposits, which represent a liability on the balance sheet.²²

If a bank's loan portfolio cannot sustain the ratio of NPLs to performing loans, the PBOC will bail out banks as well.²³ The entire banking system could break down if this cycle continues:

The accumulation of NPLs has historically been one of the direct causes of bank failures. In the United States, loan losses dominated the major bank failures from 1934 to 1983. The recent bankruptcy of China's second largest international trust and investment corporation, Guangdong International Trust and Investment Corporation (GITIC), was more or less due to the large amount of unrecoverable loans.... [I]t would not be exaggerating to assert that if the creation of new NPLs cannot be

¹⁹ Lou, *supra* note 14, at 1162.

²⁰ *Id.* at 1148.

²¹ *Id.*

²² Essentially, China banks have relatively high deposit levels upon which they must pay depositors interest. Such deposits are bank liabilities. In turn, banks must fund loans to generate revenue in order to offset the interest paid on deposits. Such loans are bank assets.

²³ Lou, *supra* note 14, at 1151.

effectively curbed, the accumulating NPLs will eventually pull down the state commercial banks and even the entire banking system in China.²⁴

High NPL levels directly decrease bank profitability, lower consumer confidence, and decrease export growth and FDI.²⁵ Most NPLs were created after the reform began, highlighting the deficiencies of the reform.²⁶

2. *Monitoring and Enforcement*

Lack of effective monitoring and enforcement contribute to the NPL problem, hampering corporate governance.²⁷ Reforms in the past have not succeeded in large part because of the lack of monitoring and enforcement regimes in place.²⁸ China's current economic stage does not afford it a reputable external auditing authority. Thus, internal mechanisms within the banking sector will have to fulfill this function. It is realistic for banks to perform the financial auditing function. This point is later described.

D. Qualified Financial Underwriters

Obtaining the necessary personnel to successfully implement an effective economic plan is crucial.²⁹ Furthermore, the widespread need for labor management apart from the banking industry has grown from the rising friction between Chinese partners and foreign investors in equity joint ventures.³⁰ As equity joint ventures have grown, so has the conflict between the participants, caused by the diametrically opposed goals of a

²⁴ *Id.* at 1150.

²⁵ Lou, *supra* note 14, at 1153.

²⁶ Lou, *supra* note 20.

²⁷ Zhongfei Zhou & Jingwei Li, *In Search of Approaches to Improving Corporate Governance in China's State-Owned Commercial Banks*, 36 INT'L LAW. 215, 217 (1992).

²⁸ Wei, *supra* note 2, at 414.

²⁹ See Margaret L. H. Png, *Equity Joint Ventures in The People's Republic of China: Problems That Continue After More Than A Decade Under The Open Door Policy*, 24 CASE W. RES. J. INT'L L. 589, 590 (1992).

³⁰ See *id.* at 589 (equity joint ventures provide a direct investment vehicle in which both Chinese partners and foreign investors can simultaneously participate).

planned economy versus the market economy. Friction between these joint venture partners involves three labor management areas: 1) recruitment; 2) dismissal; and 3) bureaucratic interference.³¹ The proposed solution addresses the practical problems of recruitment and retention. China's viewpoint that a foreign workforce may pose a threat to the Chinese culture or economic system is also a concern.

III. Economic History

A. Early Reform

1. People's Bank of China

Both the People's Republic of China (PRC) and the People's Bank of China (PBOC) were founded in 1948.³² The PBOC was China's only bank, performing as a hybrid of a central bank and commercial bank.³³ The PBOC was under highly centralized control, and banks that were subsequently created performed passive roles similar to bookkeepers and cashiers.³⁴ China's financial system was outmoded and fragile from a Western perspective, as all of China's banks were state-owned and undercapitalized.³⁵ Further, many of the loans issued were NPLs to SOEs.³⁶

2. Specialized Banks

In 1978, economic reforms and open-door policies were initiated.³⁷ The reformation of the PBOC into the Central Bank of China in 1983 reflected these new reforms. The PBOC became the lender of last resort,

³¹ Png, *supra* note 29, at 612.

³² Andrew Xuefeng Qian, *Transforming China's Traditional Banking Systems Under the New National Banking Laws*, 25 GA. J. INT'L & COMP. L. 479, 480 (1996).

³³ *Id.*

³⁴ *Id.* at 481.

³⁵ Lawrence L. C. Lee, *Integration of International Financial Regulatory Standards for the Chinese Economic Area: The Challenge for China, Hong Kong, and Taiwan*, 20 NW. J. INT'L L. & BUS. 1, 12 (1999).

³⁶ *Id.*

³⁷ Lan Cao, *Chinese Privatization: Between Plan and Market*, 63-FALL LAW & CONTEMP. PROBS. 13 (2000).

an official central bank and statutory body answerable only to the National People's Congress (NPC), in an attempt to create a banking model similar to the United States' Federal Reserve System.³⁸ Subsequent to the reformation of the PBOC, “the commercial lending business was separated from the PBOC and [was] transferred to newly created ‘specialized banks.’”³⁹ China created four state-controlled commercial banks, or specialized banks in the mid 1980s: the Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China (ABC), the Bank of China (BOC), and the People's Construction Bank of China (PCBC).⁴⁰ These specialized banks were labeled the “big four.”⁴¹ The organizational principle of the financial system at that time was “unified leadership and division of specialism. The overall financial system implement[ed] the unified policy, plan and system which [was] stipulated by the State. Each specialized bank [had] its special responsibility in its own field.”⁴²

B. Reform in the 1990s

1. Policy Banks

In the 1980s, China's banking system simply consisted of a central bank surrounded by specialized banks.⁴³ Bank reform in the 1990s attempted to build an efficient and autonomous banking system through commercial banks.⁴⁴ The Commercial Banking Law of the People's Republic of China states that commercial banks should be supervised by the central bank, and “should be operated under the principles of efficiency, safety and liquidity.”⁴⁵ In 1994, China enacted three reforms to

³⁸ Qian, *supra* note 32, at 481.

³⁹ *Id.*

⁴⁰ *Id.* at 482.

⁴¹ *Id.* at 488.

⁴² *See id.*

⁴³ *See id.* at 481.

⁴⁴ *See* Qian, *supra* note 32, at 482.

⁴⁵ *Id.* at 488.

work towards bank commercialization: 1) reform its foreign exchange control system; 2) open up banking industry to foreign participation, allowing foreign partners to invest in financial institutions; and 3) establish three policy banks, which provide “policy loans” that are usually non-performing and thus are often not creditworthy for funding under normal commercial bank standards.⁴⁶

This discussion will focus on the third option previously mentioned: the formation of policy banks, which are primarily responsible for non-commercial, state-initiated, non-performing loans. The three policy banks are: 1) the Import-Export Bank, which funds large state-initiated trade deals; 2) the State Development Bank, which finances infrastructure developments; and 3) the Agricultural Development Bank of China, which finances agricultural procurement for rural development.⁴⁷ In an effort to convert specialized banks into commercial banks, policy banks release the specialized banks of their obligation to fund non-performing policy loans typically used to finance SOEs and other government projects.⁴⁸ Policy banks therefore permit specialized banks to concentrate on funding profitable commercial loans.⁴⁹ Most specialized banks have yet to be converted into commercial banks.⁵⁰ China may intend to convert the “big four” into commercial banks, yet this is not viable in the short to intermediate term.⁵¹

Emergence of the three policy banks has, however, allowed commercial banks to form; in addition to the three policy banks and the

⁴⁶ *Id.* at 484.

⁴⁷ Lawrence L. C. Lee, *Integration of International Financial Regulatory Standards for the Chinese Economic Area: The Challenge for China, Hong Kong, and Taiwan*, 20 *Nw. J. INT'L L. & BUS.* 1, 13 (1999).

⁴⁸ *See id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ For purposes of this note, short and intermediate term time frames are approximately five and fifteen years respectively.

“big four” specialized banks, ten commercial banks have formed as of 1995.⁵² Positive growth may continue as commercial banks concentrate on profitable loans based on sound credit analysis.

2. The Commercial Banking Law of the People's Republic of China

The Commercial Banking Law of the People's Republic of China (CBL), enacted in 1995, is a core piece of legislation that governs the development of Chinese commercial banking.⁵³ Commercial bank development is guided by three principles outlined in the Commercial Banking Law: efficiency, safety, and liquidity.⁵⁴ The CBL notes that operations should be independent from any external interference and should rely on the following canons: 1) self-operation; 2) self-risk management; 3) self-responsibility for profits or losses; and 4) self-restraint.⁵⁵ The CBL is the main legal instrument that aids commercial bank formation.⁵⁶

IV. Analysis

A. Interest Rate Reform

Banks receive their allocated lending quotas based on the borrowing demands of their markets.⁵⁷ Lending quotas are then balanced against the banks' deposits.⁵⁸ The problem, however, is that deposit levels and lending demand do not always coincide. Banks that are deposit poor must receive aid from the PBOC to fund loans.⁵⁹ However, banks are more often subjected to lending pressure based on relatively high levels of

⁵² Qian, *supra* note 32, at 484.

⁵³ *See id.* at 488.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ William D. Holmes, *China's Financial Reforms In The Global Market*, 28 LAW & POL'Y INT'L BUS. 715, 720 (1997).

⁵⁸ *Id.*

⁵⁹ *Id.* at 721.

deposits in relation to loans outstanding.⁶⁰ Thus, the PRC should permit the PBOC to give interest rate relief to banks with high deposit levels. This interest rate subsidy would allow depositors to earn interest at relatively higher rates, yet would allow banks to receive fund loans based on prudent credit analysis without undue pressure to make sub-par loans.

Specifically, the PBOC should make partial interest payments to depositors in order to relieve liquidity pressures in banks and reduce vulnerability to market and credit risk. When banks receive deposits, they must in turn make interest payments to depositors. Banks are therefore under pressure to lend that same money out in order to create assets or loans that offset such liabilities or deposits. Banks should have a “safety net” only in regards to having large amounts of deposits. Chinese government subsidies would reward banks for holding deposits by relieving bank pressure to fund unnecessary low quality loans.⁶¹ This is an intermediate term solution that would be phased out in the long-term.

B. Credit Autonomy with Central Bank Control

This proposal emphasizes enforcement of Article 7 of the CBL, which is essential to increasing transparency levels among SOEs and commercial enterprises. Article 7 states, “When engaging in credit business, a commercial bank shall strictly examine the credibility of a borrower and persist in extending loans against collateral in order to ensure recalling loans on time.”⁶² Contrary to the theory that pure market forces should lead China out of its economic difficulties, China will

⁶⁰ *Id.*

⁶¹ In essence, such subsidies lower real interest rates that banks pay out to depositors.

⁶² The Commercial Banking Law of the People's Republic of China, Article 7, 1995.

benefit by maintaining central control of banks through the PBOC, yet giving commercial banks the autonomy to underwrite loans.⁶³

Credit autonomy is key to commercial banking success. Nothing will replace funded loans based on sound credit analysis; however, in the event of non-performance, the collateral mentioned in Article 7 gives banks recourse.⁶⁴ Commercial banks should have the right to receive compensation through this collateral in the event of default.⁶⁵

Although commercial banks would have credit analysis autonomy, bank management and establishment would be controlled by the PBOC as stated in Article 11 of the CBL: “The establishment of a commercial bank shall require the examination and approval of the People's Bank of China.”⁶⁶ In addition to establishment, the PBOC should have central control over various aspects of operation. For instance, fund reserve requirements among specialized, commercial and policy banks would be determined by the PBOC.

C. No Bailout Provision

In addition to credit analysis autonomy, commercial banks must be allowed to fail. If the PBOC artificially supports otherwise failing banks, accounting transparency among its clients will not improve. A “no bailout” provision should be enacted in the CBL.⁶⁷ The PBOC should set specific standards by which banks must abide in order to avoid compulsory shut down, thus providing banks an incentive to demand transparent financials from their clients.

⁶³ The PBOC could still have macro-economic control over interest rates and other monetary policy, yet would provide an environment where commercial banks could build healthy loan portfolios.

⁶⁴ *See supra* note 62; Collateral against a loan provides a guarantee that helps mitigate the lender's risk in the event of default.

⁶⁵ Qian, *supra* note 32, at 489.

⁶⁶ The Commercial Banking Law of the People's Republic of China, Article 11, 1995.

⁶⁷ Chapter VII of the CBL offers provisions for takeover and termination, but does not expressly provide parameters for mandatory bank failure.

D. Emergence of Commercial Banks

Some believe that the “big four” should be transformed into commercial banks.⁶⁸ Commercial banks arising as the primary source of debt financing is a creditable long-term goal, but the “big four” specialized banks should not be transformed into commercial banks. Rather, new commercial banks that target a particular market niche should develop. Commercial banks should gradually take loan market share away from the “big four,” reducing their prominence in the market over time.

E. Finding a Qualified Workforce

A balance of bank credit analysis autonomy and central bank management control will provide the foundation for improved corporate governance. Economic mechanisms such as a “no bailout” provision and interest rate reform will allow the commercial bank industry will grow in a healthy manner, leading to higher corporate governance among SOEs. Implementing this economic plan, however, requires qualified personnel to manage and perform the financial underwriting. Although cultural barriers and the apprehension of hiring a foreign workforce exist, China has a long-term interest in considering the proposal.

The proposed solution involves a combination of bank reform and human resource allocation. Recruiting personnel from a qualified local talent pool should be a long-term objective. Short and intermediate term solutions are to obtain a qualified workforce. The recruitment solution entails primarily hiring returnees. A secondary component of the solution includes recruiting expatriates, while fostering an environment where local workers can be hired and even trained within the long-term.

⁶⁸ Qian, *supra* note 32, at 482.

1. General Recruiting Options

China needs qualified financial underwriters and managers to initiate economic reform. Due in part to tremendous foreign investment growth over the last two decades, China has had difficulties hiring and retaining qualified employees.⁶⁹ In addition, friction within joint equity ventures between Chinese partners and foreign investors increased as foreign investment grew.⁷⁰ As equity joint ventures have grown, so have the conflicts between the participants, caused by the diametrically opposed goals of a planned economy versus the market economy.⁷¹ China's economic complexity as a large developing economy and cultural barriers to accepting a foreign workforce contribute to this friction.⁷²

Recruiting qualified professionals poses entirely different problems from hiring low-cost, unskilled labor. China needs financial underwriters at all levels, including executive management. The major challenges for the PRC lie in finding qualified local talent, especially at managerial levels, and in cultural assimilation for a newly hired foreign workforce, particularly expatriates. Three general recruiting options are available: 1) hire local workers and college graduates and provide on-the-job training; 2) hire "returnees"; and 3) hire expatriates.⁷³ Returnees are local residents who have studied and/or worked abroad who want to return to China.⁷⁴ Expatriates are generally described as non-Chinese persons from the West

⁶⁹ Ames Gross, *Recruiting Professionals in Southeast Asia*, 7 SUM INT'L HR J. 16 (1998). (Publication page references are not available for this document.)

⁷⁰ See Png, *supra* note 29, at 589. Joint equity ventures are enterprises owned jointly by Chinese partners and foreign investors.

⁷¹ Png, *supra* note 29, at 589.

⁷² Mao-Chang Li, *Legal Aspects of Labor Relations in China: Critical Issues for International Investors*, 33 COLUM. J. TRANSNAT'L L. 521, 525 (1995).

⁷³ See Gross, *supra* note 69; Ames Gross, *Strategies for Successfully Recruiting Staff for China*, 5 FALL INT'L HR J. 41 (1996). (Publication page references are not available for this document.)

⁷⁴ See Gross, *supra* note 69.

who work in China.⁷⁵ The proposed recruiting and retention solution implements variations of all three options.

2. Local Recruiting

Hiring local workers is not entirely viable in the short-term because the pool of qualified skilled local workers is too small.⁷⁶ Alternatively, companies may provide their employees with on-the-job training to the relatively select few who display potential as financial underwriters and managers. The drawback of such training, however, is that once training is received, employees may switch to higher paying jobs at other companies. In the⁷⁷ past, poaching, or recruiting from other regions that effectively “steal” employees away from a particular country, has caused 20 to 30 percent annual employee turnover in Thailand's finance and banking industry.⁷⁸ China, however, can mitigate this risk by implementing various employment programs to reduce turnover.⁷⁹ Long-term employment contracts can be signed, but other benefit plans may be more effective.⁸⁰ For example, retirement benefit plans that are at least partially company funded and vest after a certain period of time may provide an incentive for workers to stay with their current employer.⁸¹

3. Returnees and Expatriates

Returnee and expatriate recruiting may offer China more highly qualified skilled workers than local recruiting in the short-term, making a combination of all three human resource options a practical solution for

⁷⁵ *Id.* For purposes of this note, expatriates include Overseas Chinese who are hired to work in the PRC. Overseas Chinese are ethnic Chinese who were born outside of, and live in a country other than Mainland China, or who have acquired residency abroad.

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ Ames Gross, *Strategies for Successfully Recruiting Staff for China*, 5 FALL INT'L HR J. 41 (1996). (Publication page references are not available for this document.)

⁸⁰ *Id.*

⁸¹ *Id.*

the PRC. Hiring returnees or locals who have studied and/or worked abroad and want to return to China, is another way to find qualified candidates. Returnees may be more qualified than some of the local workforce, while providing other advantages distinct to their group classification. Unlike the majority of expatriates, returnees speak the local language, tend to present less housing problems, and have fewer difficulties meeting visa requirements.⁸² In addition, returnees who studied in Hong Kong could arguably provide the strongest immediate contribution as high quality candidates that could most easily assimilate to China's culture. Hong Kong is regarded as foreign to the PRC.

Returnees, however, may have potential conflicts with local staff over status issues.⁸³ This problem is inapplicable to expatriates. Local employees and returnees may compare and evaluate each other in a manner that expatriates would not be subject to because they are not ethnic Chinese.⁸⁴ In addition, expatriates may have managerial skills that returnees who have recently graduated from academia may not have.⁸⁵ Both returnees and expatriates may be more expensive and often demand more benefits than local workers.⁸⁶ Similar to returnees, expatriate costs for recruitment and retention compared with local workers is significantly higher in terms of salary and other possible costs.⁸⁷ Additional costs may include expenses for cars, drivers, maids, club memberships, taxes and placing their children in expensive international schools.⁸⁸ Weighing all factors, returnees are more desirable than expatriates.

⁸² See Gross, *supra* note 69.

⁸³ *Id.* See Gross, *supra* note 79.

⁸⁴ See Gross, *supra* note 69; Gross, *supra* note 79.

⁸⁵ See Gross, *supra* note 69; Gross, *supra* note 79.

⁸⁶ See Gross, *supra* note 69; Gross, *supra* note 79.

⁸⁷ See Gross, *supra* note 69.

⁸⁸ *Id.*

4. Professional Foreign Recruiting

In fact, the financial premium that China could pay should extend to projects that actively recruit Chinese students, particularly in the United States. Such a proposed project can be compared to Indonesia's home placement program at Northeastern University in Boston called "Home Country Placement."⁸⁹ Over 100 major U.S. and Indonesian companies make daily requests to this center, matching inquiries with student profiles, allowing Indonesian students in the U.S. to find employment in their home country.⁹⁰ Adopting a similar program in China would allow the PRC to recruit among a pool of qualified graduates. In addition, traditional search firms can be effective in finding mid to upper level executives whether they are returnees or expatriates.⁹¹

Taxes also influence foreign recruiting. To encourage short-term expatriate hiring, China should not levy taxes on these foreign workers or the companies that hire them, a practice that other countries like Malaysia and Indonesia follow.⁹² Such taxes should be unnecessary in the long run because market forces alone should discourage companies from hiring too many expatriates.

5. Cultural Challenges

It is in China's long-term economic interest to accept a foreign workforce despite personality differences and possible perceived cultural threats. The economic advantages to foreign recruitment outweigh the cultural disadvantages. To some extent, it can be argued that financial skills required for commercial bank underwriting transcends cultural barriers. Further, proper credit analysis does not involve political influence. In addition, local employees have much to learn from foreign

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ See Gross, *supra* note 79.

⁹² See Gross, *supra* note 69.

workers. Returnees who studied in the U.S. may be familiar with both Chinese and Western cultures and could provide an immediate contribution.

Despite the advantage of multiculturalism, China may perceive such employees as a cultural threat. China may fear that returnees and expatriates would impose their views on labor rights, and assert rights to assemble and form unions. This is a legitimate concern, but economic demand for such workers supercede these obstacles. The reality is that local employees have much to learn from foreign workers in this specialized field.

China ought to refrain from implementing government regulations stipulating that foreign workers may fill a skilled position only if there is no comparably qualified local worker. Such legal provisions exist in Thailand, Malaysia, Indonesia, and the Philippines.⁹³ In a period during which highly qualified workers are needed, China should be able to hire well-qualified returnees rather than merely competent local workers. Implementing such regulations may cause locals to view that foreigners are taking their jobs. Again, economic necessity supercedes this concern.

6. Long Term Educational Investment: Key to Local Workforce

pects of local recruiting should be a major focus for China in the banking sector. Heavy educational investment in China should mirror some of the successful efforts in Southeast Asia to combat the shortage of educated workers in that region.⁹⁴ For instance, the Indonesian government has received large World Bank loans to increase its educational facilities.⁹⁵ One loan for \$164 million was granted to finance education projects funding junior secondary education and to improve the

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

quality and efficiency of Indonesian high schools and universities.⁹⁶ Thailand has invested \$415 million for a skills development plan to train 1.9 million workers and 24,390 instructors and to construct labor development centers nationwide.⁹⁷ In addition, Thailand has eased the requirements for establishing a private high school or university, only requiring that 80 percent of the students be Thai and that English be a mandatory language.⁹⁸ Long-term educational funding has been successful in various other Asian regions, which suggests that funding in China could be similarly successful.

Part of China's educational investment should include extending scholarships to students in various technical fields involving financial underwriting. A similar scholarship program has been administered in the Philippines, where that country's Department of Science and Technology offered 3,500 scholarships to Master's degree candidates in the fields of science and mathematics.⁹⁹

It is difficult to determine the long-term economic success of certain projects, but quantifiable results are available. For example, in Malaysia, the number of first degree candidates increased from 15,000 to 75,000 between 1975 and 1993.¹⁰⁰ Progress monitoring challenges should not, however, deter China from a long-term investment in building a major quality education program. Economic complexity is greater in China's large economy. Financial risks of long-term educational investment are higher than in smaller economies, but opportunity costs for not implementing an educational plan are even greater.

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ See Gross, *supra* note 69.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

V. The Solution

Long-term objectives are addressed, yet short-term and intermediate term goals are mainly discussed. Thus, stock markets may be a primary capital source in the long-term, but economic reform involving the debt market is the key to improving corporate governance over the next fifteen years. Further, the greatest source of human capital should ultimately derive from local Chinese sources, yet short and intermediate solutions primarily involve recruiting and retaining a qualified foreign workforce.

Economically, China should focus on building a sufficient banking system rather than its capital markets to improve corporate governance; this however, is not a new idea.¹⁰¹ Further, economic reform to regulate state enterprises through market forces and incentives instead of inefficient central planning has been a common mantra as well.¹⁰² What is novel is that the proposal allows the PBOC to maintain centralized control over the banking industry while giving banks complete autonomy to perform credit analysis and build their loan portfolios. For example, the PBOC can subsidize interest rate payments to depositors in order to provide interest rate relief to banks, while still allowing them to perform credit analysis with complete autonomy. Also novel is the idea that commercial monitoring problems can be resolved through bank demand for financial transparency among its corporate clients. Monitoring would take place as banks periodically analyze company financials during an ongoing relationship with clients that maintain loans. Thus, there is no immediate need for a third party to monitor or enforce corporate governance activities within companies. Further, the PRC would let banks

¹⁰¹ David Eu, *Financial Reforms and Corporate Governance in China*, 34 COLUM. J. TRANSNAT'L L. 469, 472 (1996).

¹⁰² *Id.* at 470; Lou, *supra* note 11, at 1156. See also Jeffrey E. Garten, *Self-Regulation in the Global Context*, 2000 COLUM. BUS. L. REV. 23 (2000).

fail when loan portfolios could not sustain liabilities. Thus, company enforcement to become transparent would not be a large issue. The risk of bank failure compels entities to provide solid financial statements in order to obtain and retain debt funding. Indeed, banks would no longer be able to fund non-performing loans if they are allowed to fail. In turn, entities would be permitted to fail under a “no bailout” provision in the CBL, providing proper incentive to report accurate financial statements. Thus, companies could not continue to obtain loans without being fully financially transparent.

Recruiting and retaining qualified financial underwriters and managers are among China's largest challenges. A qualified workforce is necessary to implement complex financial underwriting. A short-term primary goal of recruiting returnees with a secondary aim to employ expatriates, and a long-term focus on cultivating a qualified local workforce will fulfill China's human resource demands. Cultural differences between local and foreign workers are not ignored. Financial cost and complexity of building an educational program are also recognized. Despite cultural and economic challenges, China has the long-term economic incentive to implement a foreign workforce.

VI. Conclusion

Attracting foreign capital is necessary for China's continued economic growth. A major obstacle, however, is the lack of corporate governance and accounting transparency in the PRC. China has had many problems with the efficiency and effectiveness of its financial regulation.¹⁰³ Many proponents advocate a market discipline to allow the free markets to solve China's financial woes.¹⁰⁴ However, allowing

¹⁰³ Jeffrey E. Garten, *Self-Regulation in the Global Context*, 2000 COLUM. BUS. L. REV. 23, 32 (2000).

¹⁰⁴ *See id.* at 23.

market forces to operate freely is too drastic and unrealistic in the PRC. The economic proposal is pragmatic. Additionally, recruiting highly qualified underwriters from outside the People's Republic of China (PRC) to perform complex, in-depth credit analysis, is a key component in developing a comprehensive solution that allows commercial banks to perform their own independent credit analysis while still maintaining macro-economic control over the banking industry.

China is a developing country with tremendous societal and economic potential. Government control, financial autonomy, and a collaboration of human resources from neighboring regions and other countries may help China solve their corporate governance problems.