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"China and the Global Capital Markets"

Good morning.

My name is Michael Geczi, and I am a managing director at The Torrenzano Group, a New York-based strategic communications consulting firm. I am pleased to be part of this morning's public hearing on "China and the Global Capital Markets" and I thank the commission for inviting me to participate.

My views on this important topic are shaped by a number of factors, the most prominent of which is the fact that while living in Hong Kong and working throughout the Peoples Republic of China between late 2000 and 2003 I regularly provided strategic communications counseling to companies based in the PRC. This advice, which I provided to state-owned enterprises (SOEs) and smaller, entrepreneur-based companies, was designed to assist these companies in developing public profiles and corporate reputations – as well as a level of market awareness -- that would be beneficial to them as they considered their various alternatives for raising capital in the West. Ideally, the communications strategies would be appropriate irrespective of whether the companies ultimately attempted to raise capital publicly or whether they were to seek a private investment.

Since returning to the U.S. in 2003, I have continued to focus on Asia-Pacific in general, and China specifically. Accordingly, I regularly discuss positioning strategies and tactics with PRC companies, their legal and financial advisors, and others involved in the global capital-raising process.

I also conducted training sessions on media relations, investor relations and message development. In 2004, for instance, I conducted a strategic communications training session for certain staff members of the Hong Kong Stock Exchange. In the preceding two years, I designed and implemented training sessions for several PRC companies, usually on the topic of how to communicate effectively in the West.

This focus on China builds upon my earlier experiences: first as a financial journalist for 16 years, primarily with *The Wall Street Journal* and *BusinessWeek* magazine; later as the head of capital markets media relations at Merrill Lynch, and for the past 15 or so years as an outside communications consultant. Over the past 12 years, my specialty has been developing and implementing cross-border communications strategies, focusing first on the developed markets of western Europe, and then in the mid-1990s building an expertise in Russia and some of the republics formerly part of the Soviet Union, and then ultimately Asia-Pacific.

The Russia experience, in particular, has been very helpful as a context for viewing the emerging PRC developments. There are some very meaningful similarities and differences when looking at how Russian and Chinese companies have approached corporate profile-building activities in the West. I will touch on these briefly in my remarks.

In your communication of August 2, 2005, you noted that the Commission is particularly interested in exploring five specific questions. I would be pleased to share with you some of my thoughts on each of those areas.

Before I do, however, I would like to make a couple of "affiliated comments" that might be useful as I move through my answers to your direct questions. Irrespective of the questions or focus of interest, I believe there are several factors that are crucial to remember:

First of all, when it comes to the topic of investing in China, it is imperative that we not lose sight of the fact that we are discussing a "seller's market" and not a "buyer's market." As a result, all strategy regarding the marketing of issues or the positioning of companies is colored by the fact that demand sharply outweighs supply. We are not talking about convincing an investor into buying something they don't want. We are talking about letting a prospective investor, who is already strongly inclined toward buying, know that additional supply soon will be available.

Therefore, it seems to me that any concern about the emerging power of the PRC and Chinese companies must look at the demand side of the equation (that is, the investors), with the same degree of interest and concern as when looking at the supply side (that is, the issuers themselves). Stated another way, let me quote from the Organization for Economic Cooperation and Development (OECD), which says: "Unfortunately, capital is rarely 'patient.' In their constant search for investment opportunities, investors will not hesitate to take their money around the globe."

My second point is the following: Many of the questions addressed to this particular panel have gone to the issue of how PRC companies "market" their issues to investors in the West. While that obviously is an important issue, I believe it is important that we remember that PRC companies also are being "marketed to" by Western advisory firms that help them negotiate the capital markets landscape.

Having said that, I now will address your specific questions.

Question #1: How do Chinese firms market their equity and debt issuances in the U.S. as compared to Hong Kong and other exchanges?

This is an interesting question. And I believe it can be answered in a variety of ways.

First of all, regarding the issue of marketing equity and debt issues, there is an important distinction worth noting, and that is the difference between marketing at the time of a public offering (or listing), compared with ongoing marketing – better known as investor relations activities – designed to support and enhance the stock price in open-market trading. Obviously, the top-line answer is as follows: Given the precise nature of Securities and Exchange Commission guidelines, PRC companies market in the U.S. in exactly the same way as companies from other locations, including the U.S.

They face the same rules. And they face the same penalties. I can tell you, from personal experience, about a client of mine that in 2002 had to withdraw its planned IPO in the U.S. because it ran afoul of the SEC's rules regarding the "quiet period" preceding an actual offering. Obviously, the cost to this company and its founders was high; the offering still hasn't taken place. There also is an interesting sidebar story to this example: the excessive publicity occurred in Asia, not the U.S., but nevertheless brought about the SEC's negative reaction.

Returning to you first question: I believe the answer has important sub-points as PRC companies contemplating a public offering in the West face a unique set of challenges distinct from those of U.S. companies.

Ironically, the biggest challenge and the biggest opportunity for PRC companies generally can be described by the same three words: "the China story."

- What do I mean by that? I mean that western investors are drawn to PRC stocks exactly because they are from China, and therefore possess all the explosive growth characteristics one associates with an economy that is growing at 8% or 9% annually.

- Conversely, the biggest cautionary advice that one could give a prospective investor in PRC equities is that these stocks possess all the explosive growth characteristics that one associates with a market bubble – and that the stock market's reaction probably is going to hit each end of the spectrum.

The potential reward and the potential risk are both at the top of the list but, because of market multiples, many investors view the risk as more than acceptable, given the potential reward. The risk, after all, is fixed. The reward is limitless.

Last week's noteworthy IPO by Baidu illustrates this point perfectly. As you know, Baidu shares rose more than 350% in their first day of trading on the Nasdaq Stock Market. It has since fallen back, but remains significantly above its offering price.

Clearly, Baidu's founders and other select early investors in this company stand to make a great deal of money. On paper, they already have. But this wealth building isn't only occurring in the PRC. California-based Google, which owns 2.6% of Baidu, is part of that crowd. So are a large number of U.S. institutional investors that were fortunate enough to acquire Baidu in the offering.

It also is worth noting that Baidu's two founders are veterans of U.S. technology companies. And that's Baidu's top competitor, a company by the name of 3721.com, which was bought in 2003 by Yahoo. The also are media reports this week that Yahoo may be trying to acquire 35% of Alibaba.com, a PRC e-commerce company, for $1 billion.

Now, according to the media accounts that accompanied Baidu's offering, the investment attraction for most investors was that Baidu represents the combination of technology, economic growth and enormous potential consumer demand. It is the quintessential China story.

If you read the same articles, you will see that almost no one is bold enough to predict that Baidu's share price will remain at that lofty level. Why not? Same reason: it is the quintessential China story.

Bottom line: To me, the issue isn't how PRC companies are marketing themselves. It is how investors are investing. It goes back to the OECD statement I read earlier. "Capital is rarely patient."

I also have a second point regarding this question of how PRC companies market themselves in the U.S. vis-à-vis other exchanges. Given the globalization of world markets over the past decade, the issue of whether a PRC stock is listed in the U.S. or in Hong Kong has gotten very close to being irrelevant. The fact is, U.S.-based institutional investors do not limit their investments to shares listed only on U.S. exchanges.

Question #2: Do Chinese firms market their equity and debt issuances differently to individual and institutional investors?

Again, it depends. The IPO market in the U.S., as you all know, is heavily geared toward institutional investors … and individuals traditionally have had a difficult time gaining access to the so-called hot new issues. The pros and cons of this approach obviously have been debated and documented in the past and there have been interesting and important steps taken to address them.

Given this reality about IPOs in the U.S., the fact is that the marketing of PRC stocks to U.S. audiences is very much an exercise in creating institutional demand. It is rarely about reaching the average retail investor.

Generating demand at the institutional level is achieved through SEC-regulated road shows and by non-regulated "word of mouth." This is the same for PRC companies, as well as for companies from Massachusetts or Florida or Montana.

However, within the rules of the SEC, there is opportunity for positioning, especially in the official prospectus and in the road show presentations. In those communications, PRC companies – like companies anywhere – are strongly counseled by their advisors to emphasize those key messages that best shape the company's prospects … and, conversely, best address concerns on the part of possible investors.

Ideally, these messages are designed to connect the company's prospects to the powerful dynamics of the PRC economy. One major message that regularly is utilized (and proves effective) goes to the issue of building the nation's infrastructure; this has been especially important for energy and telecommunications issues that benefit from that initiative.

In last week's Baidu example, the key message, as I said earlier, was tying the company's prospects to the PRC's massive population. As a result, here are some of the positive themes that were emphasized to investors:

- Second-largest website in China

- Seventh-largest website in the world

- Providing users with access to more than 690 million web pages, 80 million image files and 10 million multimedia files

- Establishing relationships with more than 76,000 third-party websites

Now, as important as these messages were, there also was a powerful message in the fact that Baidu had Google as an investor. In fact, you will see that Baidu regularly was referred to in the media as the Chinese Google in much up of the lead-up to the offering.

Back in Asia, meanwhile – especially in Hong Kong and Shanghai – the story is very different. Although there is a significant institutional base in those major markets, issuers tend to think first about reaching retail investors … and marketing strategies are very much geared toward reaching these "mom-and-pop investors." Hong Kong, in particular, is filled with stories about lengthy lines of individuals extending around city blocks as anxious investors waited patiently to buy a small piece of a new stock issue.

Question #3: What are the most significant expected future listings of Chinese firms in the near term, in the U.S. markets and elsewhere?

My understanding is that several significant offerings are expected in the near to mid-term. Air China, for instance, is expected to attempt a listing, possibly in the amount of $500 million, early in early 2006.

Other noteworthy listings probably will be the largest state-owned banks. The degree to which these institutions are able to clean up their balance sheets – and then accurately articulate progress in doing so to the investing public – will be interesting to watch. The Bank of China, the country's second-largest lender, has made progress in lowering its bad-loans ratio, heeding a government prerequisite for proceeding with an initial public offering.

There's also an interesting – and important – emerging development relating to the way the large banks are positioning themselves for their listings: they are attempting to enhance their attractiveness by taking in well-known Western companies as investors prior to the IPO process. This is exactly the same model I mentioned earlier in referring to the Google investment in Baidu.

Bank of China, for instance, reportedly is negotiating with several potential investors, including Royal Bank of Scotland, UBS and the Asian Development Bank. The Industrial & Commercial Bank of China, the PRC's largest lender, is said to be in talks with a variety of companies – among them American Express and Goldman Sachs – to become investors prior to going public after 2006. The goal not only is to have the better-known company's credibility "rub off" on them, it is to improve their loan books and to better compete with overseas lenders such as Citigroup. Industrial & Commercial is said to be seeking to raise $10 billion.

It's important to note that these real – and prospective – investments by Western financial institutions do not represent a "hand's-off" approach to the market. Says one money manager in a recent magazine article: "Taking a strategic stake will provide the overseas investors with a launching pad into China's banking market, which still not fully deregulated."

And then there is China Construction Bank, the nation's third-largest lender. In June 2005, Bank of America announced that it would inject $3 billion into China Construction Bank, taking an ownership stake of about 9% -- the largest investment by a foreign lender in the PRC. And it was reported this week that HSBC would like to increase its current 19.9% stake in Bank of Communications.

Question #4: How do Chinese firms market themselves differently than firms from others countries?

PRC companies, of course, market themselves differently than firms from other countries. The same can be said for companies based in Eastern Europe; companies based in Latin America, companies based in the European Union … and companies representing various industries and regions in the U.S.

Raising capital requires that companies position themselves in a way that addresses the key questions on the minds of prospective investors. We all know many of these questions, as they have to do with forecasts for sales and profitability and for the likelihood and magnitude of growth in both of those categories.

As I have discussed this issue with PRC companies in the past, the issue of message development and corporate positioning always came down to the following issues:

- Consumer buying power
- Education/skilled workforce
- Impact of WTO

- Improving infrastructure
- Government support
- Ease of entry

Additionally, our discussions always hit on the fact that companies needed to address those key questions that have to do with "risk," such as geopolitical risk; data risk; related party risk, and rule of law risk.

To answer further, let me give you a sense of the conversation I would conduct with a PRC company:

Ideally, we tell the PRC companies they should begin the communications programs early in the process, as far out as 12 to 18 months before they actually would attempt an IPO. This pre-IPO positioning program ideally would include a media outreach program including briefings, roundtables and interviews; a proactive program of industry analyst meetings; the regular dissemination of corporate information through media releases and news bulletins to key stakeholders; active participation in industry discussions, and the contribution of industry opinion articles.

In the instance of an SOE, we would discuss the need to differentiate the company from other SOEs. We would discuss the need to demonstrate management autonomy, transparency and corporate governance advances. We also would develop a program to raise the company's accessibility to Wall Street securities analysts and influential media.

We also would discuss the need to get beyond what the West sees as SOE stereotypes; that is, whether the company is viewed as government-controlled or government influenced. This message, as we know, was used very extensively – and successfully -- in the recent CNOOC/Unocal/Chevron control contest, where CNOOC was portrayed as being an acquisition arm of the PRC government.

We would discuss how the company could articulate and brand its vision and strategy. And how we could create a "public face" for the company, perhaps by leveraging customer and/or partner testimonials to endorse the company's "brand platform."

For instance, a PRC company might highlight business milestones with public announcements of deals it is doing with new partners, or new ventures or business opportunities, or even a new business direction. Another strategy is to position the company by announcing its financial performance through results announcements and media and/or analysts briefings … even though the company isn't yet listed and therefore not required to do so. One of the most important and popular strategies/tactics is to initiate the regular flow of information regarding corporate governance from the board to key stakeholders.

Question #5: How thorough are the transparency and corporate governance standards of Chinese firms accessing U.S. and international capital markets? How do

> those standards comport with U.S. disclosure and transparency rules for foreign registrants?

I am not an attorney, and my two colleagues can speak to the specifics of this question far better than I can. However, I do have a few comments.

It is clear that one important result of the adoption of Sarbanes-Oxley requirements for non-U.S. companies is the following: Because these companies generally have been required to abide by the same rules, these non-U.S. companies now have every right to assert that prospective investors should have the same degree of confidence in the integrity and accuracy of their financial statements and disclosures as they do in U.S. companies. Moreover, if you look at the Board of Director structures of the companies, many of them also have in place independent directors, audit committee financial experts and corporate governance structures followed in the West.

Secondly, I would say that some of the PRC companies are succeeding in breaking out of the mold. In fact, the "China stock sector" no longer trades en masse as the individual issues no longer share the same characteristics.

BusinessWeek recently stated it this way: "investors finally have the information they need to sort out the darlings from the dogs." Now, this of course is in sharp contrast to the example of China Life, which went public with great fanfare in December 2003 with a dual listing on the New York and Hong Kong stock exchanges, but failed to disclose accounting irregularities at the parent company until after the successful IPO.

Indeed, there are problems. The widely followed Corporate Governance Update issued annually by the Asia-based CLSA investment research firm and the Asia Corporate Governance Association stated in 2003 that most of the improvement has been in form, and that the commitment to those statements and obvious actions are not yet clear.

I mentioned earlier that that the Russian examples provide an interesting paradigm through which the PRC examples can be viewed. This is especially true in the area of corporate governance. In the late 1990s and early 2000s, for instance, many of the Russian companies achieved great success in utilizing corporate governance as a positioning tool for establishing their corporate reputations.

I don't think it would be unfair to say, in fact, that corporate governance was co-opted by many of the Russian companies as a public relations tool. They made a lot of statements expressing their commitment to good corporate governance. They established all the appropriate board committees. And they appointed independent directors, just as corporate governance "best practices" suggested they do.

At this point, I don't see the PRC companies going down the same path.

In closing, I want to state clearly that investing in PRC companies carries both risk and reward. That is a characteristic of the capital markets. As such, I believe all parties –

issuers, advisors, investors, regulators, and exchanges – have an important responsibility to ensure the integrity of the process. But I also believe that the marketplace, despite some missteps, essentially is efficient and self-governing.

I also believe that the barriers have come down, and that we have a 365/24/7 marketplace. U.S. companies are going to continue to seek interesting and appealing opportunities everywhere in the world. We can only expect that non-U.S. companies will view their opportunities the same way.

Thank you very much.

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