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Abstract

Literature suggests two distinct paths to stock market development: an approach based on legal protections for investors, and an approach based on self-regulation of listed companies by stock exchanges. This paper traces China's attempts to pursue both approaches, while focusing on the role of the stock exchanges as regulators. Specifically, the paper examines a fascinating but unstudied aspect of Chinese securities regulation—public criticism of listed companies by the Shanghai and Shenzhen exchanges. Based on both event study methodology and extensive interviews of market actors, we find that the criticisms have significant effects on listed companies and their executives. We evaluate the role of public criticisms in China's evolving scheme of securities regulation, contributing to several strands of research on the role of the media in corporate governance, the use of shaming sanctions in corporate governance, and the importance of informal mechanisms in supporting China's economic growth.

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All interviewees were promised complete anonymity. We thus cite to interviews based on the year in which they occurred, but we do not identify other details regarding the interview location or interviewee.

INTRODUCTION

Developing a robust, well regulated securities market is one of China's biggest institution-building challenges today. Although the stock market has grown considerably in size and stature in its short history, by many measures China has considerable distance to travel before it can claim to possess a truly functional capital market. The creation of a liquid, transparent and well-regulated securities market will be crucial to the efficient pricing and allocation of capital and the growth of promising companies in the future. It is also critical to the sound investment of China's enormous private savings.

Academic literature suggests two distinct paths to this goal. The law and finance literature advanced by La Porta et al. (1997) suggests that stock markets grow in the presence of strong legal protections for investors: "Because a good legal environment protects the potential financiers against expropriation by entrepreneurs, it raises their willingness to surrender funds in exchange for securities, and hence expands the scope of capital markets" (La Porta et al. 1997, p. 1149). Many subsequent studies, including those focused on developing and transition economies, have advocated high quality state-supplied regulation as the key to healthy stock market development (see, for example, Johnson et al. 2000).[1]

A second line of literature focuses on the role of a private actor—the securities exchange—as the provider of investor protection needed for stock market growth. John Coffee, for example, argues that well before the passage of the federal securities laws in the 1930s, the United States enjoyed large and liquid securities markets because the New York Stock exchange created rules that provided investor protection (Coffee 2001b). Taking this claim a step further, other scholars have argued that stock exchanges are not only the first historically, but also the *most effective* regulators of stock market disclosure and behavior (Mahoney 1997; Pritchard 1999). The argument is that stock exchanges, which are typically owned by their members, have strong incentives to adopt rules that meet the needs of investors. One commentator recommends "countries that are at or close to square one—those without an established system of securities regulation"--should seriously consider giving "a large portion of regulatory power to securities exchanges" (Kahan 1997).

China's unique political and institutional infrastructure makes straightforward application of either strand of this policy advice difficult. Political obstacles and weaknesses in basic law enforcement infrastructure constrain the legal approach (Pistor and Xu 2005). At the same time, China's two stock exchanges are not independent of the state and lack significant autonomous regulatory authority, undermining their capacity as self-regulatory organizations. Notwithstanding these obstacles, China has pursued both legal enforcement and the self-regulatory function of the stock exchanges as integral parts

[1] There is a debate in the literature today about whether public or private enforcement of the securities laws contributes to more dispersed share ownership, but commentators on both sides emphasize legal protections as central to stock market development. Compare LaPorta et al. (2006) with Jackson and Roe (2006).

of its capital market developmental strategy. Not surprisingly, the results to date have been mixed. China's stock market has grown to be the twelfth largest in the world on the basis of market capitalization, but it remains underdeveloped in view of China's economic heft and potential, and it suffers from serious problems of fraud, poor disclosure, inefficient pricing, and weak enforcement.

Thus far, the legal approach to stock market regulation in China has received all of the academic attention (Hutchens 2003). In this paper, we focus on the role of the stock exchanges as providers of investor protection. We explore a novel but unstudied form of securities regulation in China—public shaming sanctions imposed on listed companies by the Shanghai and Shenzhen Stock Exchanges.[2] We have data on public criticisms of listed companies imposed by the Shanghai and Shenzhen Stock Exchanges from 2001-2006. We combine event study methodology with qualitative assessments of data and interviews of market participants and regulators to explore the impact of the sanctions on sanctioned firms and directors.

Our paper is related to several different strands of research. In addition to the literature, just discussed, on stock market development, the Chinese case contributes to a small body of literature on the use of shaming sanctions as a corporate governance tool (Kahan and Posner 1999; Skeel 2001). To date, that literature has focused almost exclusively on the United States. But the United States, with its relatively efficient stock market and comparatively robust set of corporate and securities law enforcement institutions, may not provide the best environment in which to consider the effectiveness of reputational sanctions on corporate behavior. China, with a comparatively underdeveloped legal system, may offer a better setting in which to examine the role of reputational sanctions in corporate governance.[3] Indeed, recent research has emphasized the role of reputational mechanisms in buttressing poorly developed formal governance institutions to support economic growth in China (Allen, Qian and Qian 2005). Exploration of the use of stock exchange criticisms in China also contributes to a nascent literature on the role of the media in corporate governance (Dyck and Zingales 2002; Dyck, Volchova and Zingales 2006). As we will show, domestic media coverage of the sanctions of affected firms and individuals serves as an important mechanism of discipline in the Chinese context. Finally, our research is broadly consistent with an emerging scholarly view which identifies devolution of authority, regulatory polycentrism, and experimentation as key features of China's process of legal institution-building to date.

[2] We are aware of only two papers in English that discuss the shaming sanctions. One mentions the phenomenon in passing, and the other analyzes it empirically as a species of governmental securities regulation without providing any institutional context or theory for its role in the regulatory framework. The limited Chinese-language academic literature that mentions exchange sanctions likewise treats shaming sanctions largely in passing.

[3] This speculation is supported by a small literature on norms and corporate law. For example, Bernard Black (2001) has shown that the market rewards firms that signal willingness to abide by norms of good corporate governance in Russia, where law and governance standards are weak. Similarly, John Coffee (2001a) has concluded that "norms may matter most where law is weakest."

Part 1 sets the stage for our discussion by describing stock market development in China on a comparative scale, outlining the steps taken thus far to build a regulatory environment for capital markets in China (including both legal and stock market approaches), and assessing the limitations of these approaches to date.

Part 2 explores the use of public shaming sanctions by the stock exchanges as a means of improving corporate governance in China. We present data on public criticisms of companies and individuals imposed by the Shanghai and Shenzhen Stock Exchanges from 2001 through 2006. We examine the extent to which use of public criticisms represents a delegation of regulatory authority by the China Securities and Exchange Regulatory Commission (CSRC) to the stock exchanges, and consider the possible emergence of regulatory competition between the exchanges.

In Part 3, we attempt to discern the effect of the public criticisms from a variety of different perspectives. We examine the effect of the criticisms on stock price, financing options, and the reputation of individual executives and the corporation itself. Our analysis suggests that public criticisms do matter to a variety of constituencies in China. Moreover, other Chinese regulatory actors have begun using the public criticisms as a touchstone around which to build complementary monitoring devices for firms. These findings strongly suggest that stock exchange criticisms, although largely dismissed or ignored in prior literature on China's securities markets, have become an important tool for combating malfeasance in China's securities markets.

In Part 4, we evaluate the use of shaming sanctions as a regulatory tool in the Chinese context, and tie the specific experience examined here into a larger picture of corporate governance reform and legal development in China. The use of shaming sanctions by the stock exchanges fits a larger (if uneven) pattern of experimentation and decentralized enforcement that has taken root since China's economic and legal reform period began in the late 1970s. Our research is consistent with the findings of other scholars who have emphasized the use of relational or reputational mechanisms as informal supports for China's economic development. Our study, however, provides a more concrete and contextualized example of a reputational mechanism to support economic activity than has been provided in the literature to date. We also show that China's stock exchanges, despite limitations on their independence from the state, may emerge as important actors for strengthening oversight over China's listed companies. Such controlled devolution of authority may be crucial to continuing to strengthen legal institutions in China, just as it has proved an important determinant of China's economic success to date.

1. CHINA'S STOCK MARKETS: REGULATORY AND DEVELOPMENTAL STRATEGIES

As noted above, there is now a large body of literature on stock market development. Generalizing from this literature, we find consensus on several key points: law matters to stock market development, although we don't know under precisely what conditions, or even precisely what constitutes "good" law for this purpose. Moreover, private initiative, commonly in the form of self regulation of members by the stock exchanges, but perhaps also on the part of investors themselves, also matters.

In this Part, using these key points of consensus to frame the discussion, we briefly describe the development of China's stock markets to date. The picture that emerges is entirely consistent with the literature: a market that has grown significantly in a relatively short time under a dual strategy of legal development and self-regulatory initiative,[4] but one whose functions and linkages to the larger economy are still problematic and shallow, plausibly due to the severe confines within which the dual strategy has been pursued in the Chinese context.

1.1. Two Snapshots of China's Stock Markets

China's present stock exchanges were formally approved and established in late 1990 (Shanghai) and in early 1991 (Shenzhen). Their founding came just over a decade after the process of economic liberalization began. This context is important in understanding why the exchanges were established. One major purpose in creating the exchanges was to tap private savings to fund state-owned enterprises (SOEs), which were in the process of being restructured (Dam 2006). SOE listings were viewed from a predominantly developmental perspective—financing local industry, raising fiscal revenues and fueling the ambitions of local officials (Green 2004, p. 10). Another rationale was to stimulate investment sentiment among the public (Green 2004, p. 207). Standard rationales for creating a stock market--financing the most promising investment opportunities in the economy and facilitating secondary trading of shares--appear to have ranked relatively low among the government's list of priorities.

At their inception, the stock exchanges were founded as non-profit membership organizations. They were supervised by the two local governments with some oversight by the local branches of the People's Bank of China (PBOC), the central bank. The inconsistency of local regulation and inadequacy of supervision, which generated some high-profile problems, led to the creation of the China Securities Regulatory Commission (CSRC) and greater centralization of authority over the exchanges in 1992. For the next several years, authority was unevenly distributed among local officials and a variety of central government agencies, including the CSRC, the PBOC, and the Ministry of Finance. It was not until 1998 that oversight of the exchanges was centralized in the CSRC.

Throughout the 1990s the Shanghai and Shenzhen exchanges competed to attract new listings (Renmin Wang 2002; Jin 2003; Jinrong Shibao 2006). In September 2000, the Shenzhen Stock Exchange suspended new listings in order to prepare for the creation of a board of small and medium enterprises. Reports stated that Shanghai and Shenzhen had competed for the right to host the new board focused on small, high-growth and high-tech companies. Shenzhen prevailed, but only after giving up the right to list larger

[4] Or at least what could reasonably pass as self-regulatory initiative under existing political and legal constraints.

companies (Beijing Qingnian Bao 2000; Nanfang Zhoumo 2006).[5] From late September 2000 through May 2004, virtually all new A-share listings in China were on the Shanghai Stock Exchange.

In May 2004, the CSRC, with approval of China's State Council, formally approved the creation of the Shenzhen Stock Exchange's Small and Medium Enterprises Board (SMEB). New listings on the SMEB commenced in June 2004. As of February 2007, a total of 111 companies had listed on the SMEB. In principle, since June 2004 all small and medium companies have listed in Shenzhen, while larger companies have listed in Shanghai (Zhonghua Gongshang Shibao 2004).[6] While there do not appear to be fixed thresholds distinguishing the size of listings on the two exchanges, in general, Shanghai-listed companies tend to be larger, more prominent, and have more connections to state ownership than those listed in Shenzhen. As of February 2007, there were a total of 588 companies listed in Shenzhen and 845 listed in Shanghai.

Today, Chinese stock markets look extremely impressive, particularly given their short history. A snapshot of the current size—as measured by several widely used metrics -- is provided in Table 1.

INSERT TABLE 1 HERE

As Table 1 indicates, as of the end of 2005, China's stock markets were the twelfth largest in the world by market capitalization, fifteenth largest by total value traded (a more accurate measure of their true size, given that most shares of public companies in China are only now becoming tradable as a result of reforms undertaken in 2005 and 2006), and tenth largest by number of listed companies. Table 1 thus lends support to the conclusion of other observers that China has done well in comparison to other transition economies in terms of stock market development, at least as measured by these standard indicators (Pistor & Xu 2005). Nonetheless, the market is still not commensurate with China's huge size along many other economic dimensions such as foreign reserves, trade surplus, private savings, and so on.

But these data may convey a rather misleading picture of the market. The companies listed on the Chinese stock exchanges are small relative to listed firms in other markets, even other transition economies such as Mexico and Brazil. For example, China ranks thirty-second in the world in terms of average size of listed companies.[7] Moreover, the state or state affiliates control about 70% of the companies listed on the Shanghai and

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[5] Shenzhen also successfully resisted efforts to merge the two exchanges (Dongfang Caijing 2001).

[6] A 2006 report in the *China Securities Journal* stated that the standard for determining companies to be listed on the SMEB "is still awaiting clarification," and that the size of companies listing on the SMEB has been gradually increasing (Zhongguo Zhengquan Bao 2006). Some new listings in Shenzhen post-2004 have exceeded the size of certain listings in Shanghai during the same period. The general trend, however, is for smaller companies to list in Shenzhen and for larger companies to list in Shanghai.

[7] It is worth noting that China has far fewer listed companies (1384) than the major developed economies such as the U.S. (5231), or the other large transition economy today, India (4730).

Shenzhen stock exchanges, despite the fact that much of the tremendous growth in the economy has been generated in the private sector, not the state sector.

By other measures, China's stock market appears considerably more marginal. For example, the ratio of external capital to GNP is 16% in China (using only the value traded part of the stock market rather than total market capitalization) versus 40% in a widely used ("LLSV") average. As of 2005, bank deposits were about 18 times larger than stock market capitalization as a percentage of GDP (Investment Perspectives 2005). The ratio of IPOs to population is 0.05 in China versus 1.02 in the LLSV average. As one group of researchers concludes, "[b]oth the scale and relative importance (compared with other channels of financing) of China's external markets are not significant" (Allen, Qian, and Qian 2005).

INSERT TABLE 2 HERE

China's stock markets suffer from serious problems that limit their role in the economy. For example, listed companies in China exhibit low variation (high synchronicity) in firm-specific stock returns,[8] suggesting that the stock market does not allocate capital efficiently. Researchers conclude, "Russia and China, among all transition economies with substantial stock markets, have been least successful at fostering functionally efficient stock markets" (Durnev et al. 2004, p. 623). Chinese stock markets are also believed to be inefficient in pricing capital (Su 2003). In its short history, the Chinese stock market has been beset by scandals. In the period 1999 to 2003, a sharp market decline, there was widespread false accounting and misleading disclosure among listed firms, and several major scandals, including some of the largest listed companies in China. Accounting fraud, market manipulation, and poor disclosure were seen as widespread in the early years of the markets, and remain significant problems today (Chen 2003).

These problems have worked to limit the number of investors in the market along with the importance of the stock markets in China's experiment with capitalism. As one observer puts it, "[i]n economic terms, the impact of China's stock market on the real economy and society as a whole has been marginal, with about 10 million investors." (Chen 2003, p. 453). Although the market boomed in 2006-07 and drew in many new investors, the recent trend appears unrelated to a surge in investor confidence in the structure of the market. In short, China's "newly established Shanghai Stock Exchange and Shenzhen Stock Exchange…are growing in size and volume, but their scale and importance are still not comparable to other channels of financing, in particular the banking sector" (Allen, Qian and Qian 2007).

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[8] Durnev et al. (2004, pp. 593, 595-96) compare the U.S., "a more functionally efficient market," with China, "a more functionally inefficient market" where functional efficiency refers to the ability of a stock market to allocate capital to its highest value uses. Fox et al. (2004) show, in a study of 40 countries, that China has the second to highest level of stock return synchronicity—a measure of share price accuracy, with higher levels meaning less accuracy.

Thus, China's stock market development to date presents a decidedly mixed picture—it is a large market, but one that does not yet play a meaningful role in pricing and allocating capital in the Chinese economy, particularly for firms unconnected to the state. In the next sections, we will see that this mixed picture is precisely the result to be expected based on China's uneven pursuit of the strategies suggested by prior research—the legal approach and the self-regulatory approach.

1.2. The Legal Approach

Given the developmental rationale for the establishment of the exchanges, it is not surprising that investor protection did not receive much attention in the early years of China's stock market. Almost a decade of operation by the stock exchanges passed before the legal system began to respond in a comprehensive way to investor protection concerns. A Securities Law was enacted in 1998. The law gave the CSRC clear regulatory authority over the stock exchanges.[9] The law expressly prohibited disclosure of false information, insider trading and market manipulation, but did not explicitly permit investor lawsuits. This new legal environment was stress-tested shortly after it was put in place, when a serious market decline in 2001 brought numerous lawsuits against listed companies. Initially, the Supreme People's Court (SPC) instructed lower courts not to hear the suits, no doubt reflecting concerns about institutional competency. In January 2002, however, the SPC issued a guideline providing that investor suits for misleading disclosure could be brought, provided the company had been administratively sanctioned for false disclosure by the CSRC. A subsequent SPC regulation in 2003 permitted suits also in cases where the company had been punished for false or misleading disclosure by other administrative departments or found liable in a criminal proceeding. The 2003 regulation also authorized suits where individual company officials, but not the company, had been administratively sanctioned or convicted of a crime.

The CSRC uses three primary tools to sanction listed companies. First, for lesser infractions, the CSRC may issue reprimands called "correction orders," in which a company or individual is told to correct certain behavior.[10] Crucially, however, correction orders are not formal administrative sanctions and thus do not make target companies eligible for civil lawsuits under the SPC ruling discussed above. Second, the CSRC issues more serious administrative sanctions that may take the form of formal warnings or fines.[11] Fines for companies range from 300,000 to 600,000 yuan (approximately $40,000-$77,000); individuals are subject to fines ranging from 30,000 to 300,000 yuan ($4,000-$40,000) (2005 Securities Law art. 193). As discussed above,

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[9] The 2005 Securities Law continues this authority, stating that the CSRC is to "carry out supervision and administration of the securities market" and is responsible for investigating and punishing any violations of the securities laws (arts. 178 and 179).
[10] The CSRC technically may also issue reprimands referred to as "notices of criticism" (*tongbao piping*). However, the CSRC does not appear to have issued any notices of criticism since 2002.
[11] In most cases companies or individuals are both fined and warned; in a small number of cases the CSRC has imposed either only a warning or only a fine.

companies subject to administrative sanctions relating to information disclosure are also subject to potential civil liability. Third, individuals who commit serious violations may also be barred from participation in the securities markets and from serving as a senior manager or director of a listed company (2005 Securities Law art. 233).[12]

INSERT TABLE 3 HERE

Table 3 shows the number of administrative sanctions issued by the CSRC from 2001-2006. Several points are noteworthy. First, from one perspective, the number of sanctions seems rather modest given the ubiquity and severity of the problems with false accounting, insider trading, and inaccurate disclosure in China's stock markets. The institutional and political constraints within which the CSRC operates seem apparent in these rather small numbers. On the other hand, this regulatory activity must be viewed within the developing country context, and considered in light of the youth of the institutions involved. Second, the last row of the table, showing the number of sanctions for misleading disclosure, is the number of companies that are eligible to be sued by investors under the SPC's 2002 and 2003 guidelines.

The difficulties of the legal approach are highlighted by our data. As can be seen from the last row of the table, during the five-year period eighty-seven companies were "suit- eligible" under the criteria specified in the SPC guideline. An additional twelve companies were suit-eligible because they were sanctioned in 2000, and thus came within the two-year statute of limitations that the SPC established when it first authorized such suits in 2002. Thus a total of ninety-nine companies have been suit-eligible as a result of CSRC administrative sanctions. Some additional companies sanctioned by the Ministry of Finance or held criminally liable in this period were also suit-eligible. Complete data on these sanctions are unavailable, but lawyers who have represented plaintiffs in such suits estimate that approximately twenty additional listed companies are suit-eligible as a result of criminal judgments or Ministry of Finance sanctions. Thus, the total number of suit-eligible companies appears to be approximately 120. According to our analysis and to plaintiffs' lawyers, roughly twenty companies have in fact been sued in this period.[13] A sue rate of about seventeen percent may initially strike some readers as high, but recall that in order to be suit-eligible, a company must have *already* been administratively or criminally sanctioned for misleading disclosure. Because the factual finding of wrongdoing has already been made, in theory recovery should be easy: plaintiffs must simply show that they were harmed by the fraud, which is determined on the basis of whether plaintiffs held shares at a certain point. Thus, put differently, although CSRC-sanctioned companies would appear to be easy targets for investor lawsuits, approximately eighty-three percent of the eligible target companies have not been sued. Interviews with plaintiffs' attorneys suggest that many suit-eligible firms have not been

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[12] Further details regarding individuals subject to bans are set forth in the Regulations on Bans on Market Entry (Zhengquan shichang jinru guiding 2006). Market bans are not technically considered to be administrative sanctions. In practice, however, individual who are banned are also subject to administrative sanctions.

[13] There is no comprehensive source of data on cases filed. Data on the number of companies sued is based primarily on review of Chinese media reports, and has been confirmed by conversations with both plaintiffs lawyers and Supreme People's Court officials.

sued because the prospect of recovery is simply too small to justify the expense, time and effort required to bring suit. Doctrinal obstacles and uncertainties, the lack of a class action mechanism to aggregate claims, local favoritism in the courts, uncertain enforcement prospects, political pressure, and a lack of assets against which to collect a judgment from an erstwhile defendant corporation all work to diminish the viability of the legal system as a means of protecting investors. Only a handful of cases thus far have resulted in a judgment in favor of plaintiffs; a small number have also settled. Comprehensive data on such outcomes are not available. One 2006 media report stated that fourteen cases had resulted in judgments or settlements. Lawyers say that only a few cases have resulted in court judgments ordering compensation to plaintiffs (Lu 2006). Many of these judgments and settlements have yet to be enforced, and other cases are languishing in the courts without any apparent progress toward a judgment.

These problems with the legal approach to investor protection may account for the fact that China's stock market is still relatively underdeveloped and insignificant to the economy as a whole. Research by Franklin Allen and co-authors supports this conclusion. Comparing China's investor protections and external financial market development to those of 49 other countries, they find that China appears in the bottom left corner of the matrix (weak investor protections and comparatively small capital market) together with Mexico and Indonesia. Hong Kong and Singapore appear in the extreme upper right hand corner (strong investor protections and comparatively large capital markets), with the UK and the US in the same region (Allen, Qian, and Qian 2005, p. 75).

1.3. The Stock Exchanges as Self Regulatory Organizations

As noted in the Introduction, the legal approach to capital market development does not appear to be the only successful approach, either as a historical matter or from a theoretical perspective. Stock exchanges may be well placed—perhaps even optimally situated—to provide investor protections. However, the literature on stock exchanges as regulators rests on the assumption that the exchanges are private, member-run organizations, an assumption that does not hold for China. As noted above, although the Shenzhen and Shanghai exchanges were initially organized as member organizations overseen by their respective local governments, since 1998 they have been under the direct oversight of the CSRC. The first securities law defined the exchanges as legal entities without profit motive established by China's State Council for the purpose of trading in securities (1998 Securities Law, art. 95). This regulatory re-structuring had important effects on the self-regulatory authority of the exchanges. The CSRC, not the exchanges, has the power to appoint and remove major stock exchange personnel, including the general manager. Until 2006, the CSRC approved the listing of securities on the exchanges, and effectively retained exclusive authority to de-list firms (1998 Securities Law, arts. 55-56).[14] Although the exchanges were legally charged with supervising information disclosure by listed firms, they lacked formal investigative and sanctioning power. As one commentator observed, "[t]he paramount influence of the CSRC's interventionist role in securities regulation has overshadowed the capacity of

[14] Article 57 of the 1998 Securities Law stated that the CSRC could delegate such power to the exchanges.

[China's] stock exchanges to practice their self-regulatory role as mandated by law" (Shi 2007).

In theory, the 2005 revision of the Securities Law moved the exchanges a step closer to actually performing a self-regulatory role. Two changes are significant. First, the law gives the exchanges the power temporarily to suspend trading in securities (2005 Securities Law art. 55) and to de-list companies (2005 Securities Law art. 56).[15] Second, the law now expressly defines China's stock exchanges as self-regulatory organizations (2005 Securities Law art. 102).[16] Commentators and exchange officials have pointed to the change as signifying that the exchanges are no longer state entities, and that the exchanges are moving towards greater autonomy from the CSRC (Finance.sina.com 2005; Xinhua 2005; Zhengquan Shibao 2006; Zhongguo Fugui Wang 2005). In practice, however, the exchanges continue to be subject to the authority and control of the CSRC, with senior officials at both exchanges appointed by the CSRC.[17]

Although the self-regulatory capacity of the two exchanges is a work in progress, they have been proactive in carving out a role for themselves within the narrow political and institutional space provided them by the state. Perhaps not surprisingly, few observers have paid close attention to these efforts, focusing instead on the much higher profile legal approach pursued by the CSRC and private litigants.[18] But as we will see, in overlooking the enforcement role of the exchanges, observers have missed a novel and potentially important experiment in capital market regulation through reputational sanctions. We turn now to an exploration of this experiment.

2. PUBLIC CRITICISMS BY THE STOCK EXCHANGES

[15] In addition to specifying certain conditions under which trading may be suspended or a company may be delisted, the Securities Law also states that the exchange may specify in its listing rules other situations in which a company may be delisted or have trading suspended. Article 60 of the Securities Law gives the exchanges the power, under certain circumstances, to temporarily suspend trading in bonds, and article 61 grants the exchanges similar power to delist companies' bonds. The provisions, however, do not grant discretion to the exchanges to specify additional conditions leading to suspension of trading in bonds. This may reflect the fact that China's bond market is fragmented, with only some forms of bonds being traded on the stock exchanges.

[16] The revised securities law also states that administrative review of decisions to suspend trading or to delist companies shall be handled by a body established by the exchanges. Thus under article 62 of the new law stock exchange decisions to delist or suspend trading in shares or bonds are not subject to review by the CSRC. Prior to the new law, administrative review of decisions to suspend or delist shares was handled by the CSRC (Zhongguo Zhengquan Jiandu Guanli Weiyuanhui Xingzheng Fuyi Banfa 2003, art. 7).

[17] Interview 2006-1; Interview 2006-68. For another example, see Liaowang Dongfang Zhoukan (2005), reporting on arguments that the law makes no substantive changes to the division of authority between the CSRC and the exchanges, in significant part because the CSRC continues to select the exchanges' senior officials.

[18] Interestingly, the most extensive treatment of the public criticisms in the English-language literature treats them as indistinguishable from CSRC (government) sanctions, rather than as a self-regulatory initiative of the exchanges (Chen et al. 2005).

The stock exchanges have four primary regulatory tools at their disposal. In ascending order of severity, they are oral warnings, letters of oversight and supervision, notices of criticisms, and the focus of this article -- public criticisms.[19] In addition, the stock exchanges may deem individuals to be unsuitable to serve as senior managers or directors of listed companies; the exchanges may also order companies to remove their company secretaries.[20] Only public criticisms and declarations of unsuitability for office or orders to remove secretaries are made public; the less severe sanctions are considered to be non-public "internal oversight measures."[21]

The use of public criticisms as a regulatory device by the Chinese exchanges is an example of extended institutional borrowing. The practice of publicly censuring listed firms and directors originated in the London Stock Exchange. It was extended in the Financial Services and Markets Act, under which the FSA may publicly censure any director knowingly involved in a breach of the stock exchange listing rules. The censure provisions supplement more formal penalties that may be imposed for violation of the listing rules and Companies Act. The Hong Kong Stock Exchange borrowed the practice of issuing public criticisms from the London Stock Exchange. The two Chinese stock exchanges, in turn, modeled their practice on Hong Kong. The effect of public criticisms as regulatory devices in London and Hong Kong has not been systematically examined. Some scholars, however, have argued that the use of criticisms by the Hong Kong Stock Exchange has contributed to comparatively low levels of private benefits of control among Hong Kong-listed firms (Dyck and Zingales 2001; Dyck and Zingales 2002).

Although the listing rules of both exchanges make clear that violations may subject companies to internal or public sanctions, the conduct that will result in each type

[19] We translate the Chinese term for the sanctions, *gongkai qianze*, as "public criticism." Other writers in English have translated the term as either "public censure" or "public condemnation." Although "public censure" is perhaps a more literal translation of the Chinese, we use "public criticism" because it more effectively conveys the intended reputational effects of such sanctions. The exchanges only started issuing public criticisms in 1999 (Wu 2005).

[20] Warnings are generally issued for only minor infractions. Oversight Letters are slightly more serious, but are still relatively minor notices to companies that appear primarily designed to elicit further information from companies regarding unusual arrangements or activities. Notices of criticism are more serious, and are one step short of a public criticism. Of these lesser forms of oversight measures, Letters of Oversight are by far the most common: the Shanghai stock exchange issued 716 such letters in 2006, although in prior years the highest total number of such letters was 153. The number of oral warnings and non-public notices of criticism issued by each of the two exchanges has generally been a few dozen per year.

[21] Notices of criticism, or *tongbao piping*, the second most serious step the exchanges take against listed companies, are generally not made public. In some cases, however, the exchanges have made such notices public, or companies have disclosed the fact that they have received notices of criticism. News reports also from time-to-time carry details of such non-public sanctions. Interview 2006-77.

In addition, although Notices of Criticism from the Shanghai Stock Exchange are distributed only to the company or individuals being criticized, the Shenzhen Stock Exchange distributes Notices of Criticism to all listed companies. Interview 2006-68. The rationale for informing other companies appears to be that doing so will help the overall functioning of the market by informing all companies of the types of conduct that are being punished. Exchange officials defend the practice of notifying other companies but not the public on the grounds that they are a self-regulatory organization, and are simply making other members of the exchange aware of the misconduct. They also contend that such conduct is not generally so serious as to be of interest to investors.

of sanction is not made public. The listing rules, which were first adopted in 1998 and revised repeatedly thereafter,[22] contain only vague language regarding the circumstances in which the exchanges may issue public or internal sanctions against listed companies. In general, the listing rules state that the exchanges may issue non-pubic or public sanctions against listed companies depending on whether the offending conduct is minor or serious. Similarly, the listing rules state that the exchanges may deem an individual unfit to serve as a director, supervisor, or senior manager of a listed company, but provide no details as to the conduct that will result in such a determination.

The lack of detail in the listing rules leaves extensive discretion in the hands of the exchanges in determining whether companies should be subject to public criticisms or other measures. The Shenzhen Exchange has taken some steps to establish clearer standards. Thus, for example, in 2005 the Shenzhen Exchange issued the *Guidelines for Directors of Listed Companies*, which specify circumstances where an individual may be deemed unsuitable to continue to serve as a director. These include having been subject to two public criticisms or three notices and criticisms within the prior three years (art. 41).[23] The Shenzhen exchange also maintains internal, non-public standards that determine whether particular conduct will result in a public criticism or a lesser form of reprimand. The standards specify certain types of misconduct that will automatically give rise to a public criticism.[24] For other forms of misconduct, including failure to disclose certain related-party transactions or failure to disclose loans or loan guarantees, the exchange's standards look to whether or not the value of the transaction equaled a specified percentage of the company's registered capital or net assets.[25] Exchange officials state that their decision not to make the standards public is due to the fact that the Chinese market "is not sophisticated;" officials are concerned that if companies were aware of the specific standards, they might manipulate their disclosure so as to avoid sanctions.[26] Exchange officials note that in most cases companies are required to disclose transactions that fall below the percentage thresholds as well as those that exceed the thresholds – only the sanction, not the disclosure obligation, turns on the size of the undisclosed transaction.[27]

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[22] The Shanghai and Shenzhen listing rules were identical in their substantive provisions from 2001 to 2006 – reflecting the fact that the rules are drafted in consultation with, and are approved by, the CSRC. The repeated revisions to the listing rules have tended to strengthen the exchanges' oversight powers by adding more specific requirements regarding disclosure obligations and greater emphasis on making disclosed information available to investors. In addition, various revisions have emphasized the exchanges' self-regulatory authority, and have sought to separate the exchanges from the CSRC. For example, earlier versions of the Listing Rules had stated that the exchanges could refer serious cases of misconduct to the CSRC; such language was omitted in revisions made in 2005. Earlier versions of the listing rules permitted the exchanges to issue fines. In practice, however, they rarely, if ever, did so.

[23] Other circumstances giving rise to a ban on serving as a director include a finding that the individual has insufficient time to dedicate to company business, being subject to two public criticisms from the CSRC within three years, serious dereliction of duty or misuse of position, or causing serious harm to the company or the interests of public shareholders. The Shanghai Stock Exchange does not appear to have adopted similar rules.

[24] Interview 2007-1.

[25] Interview 2007-1; Interview 2007-5; Interview 2007-7.

[26] Interview 2007-5.

[27] Interview 2007-5. Officials also state that from time to time they may adjust the standards, and that making specific thresholds public might make such adjustments more difficult.

In interviews, Shanghai officials did not mention the existence of standards similar to those in Shenzhen. Indeed, some exchange officials note and complain about the lack of clear provisions governing the conditions under which companies may be sanctioned.[28] The extensive discretion vested in the hands of the exchanges in making determinations between serious and lesser misconduct may allow the exchanges flexibility in combating new forms of misconduct. But such discretion also suggests that other considerations, including external pressure, may play a role in determining whether a company receives a public criticism of a lesser form of reprimand.[29]

2.1. Data on Public Criticisms

Table 4 sets forth the number of public criticisms issued by both exchanges from 2001-2006. As the Table shows, the Shanghai Stock Exchange issued a total of 109 Public Criticisms between 2001 and 2006. The exchange issued sanctions against 89 different companies. Sixteen companies received two Public Criticisms; one company received three.[30] In addition, eight companies that received Public Criticisms (including three that were criticized twice) were subsequently delisted from the exchange, although not necessarily for the same conduct. During the same period, the Shenzhen Stock Exchange issued 149 public criticisms, against 116 different companies. One company was publicly criticized four times; three were publicly criticized three times; and twenty were publicly criticized twice. Eleven of the companies that received public criticisms were subsequently delisted, including one that had been criticized three times and one that had been criticized twice.

INSERT TABLE 4 HERE

Sanctions are issued by the exchanges for six different reasons: false or materially misleading disclosure, inaccurate or late profit forecasts, failure to make timely disclosure of major corporate matters, failure to undertake approval procedures for related-party transactions, failure to issue periodic reports on time, and failure to carry out other legal obligations. Both exchanges issue the most criticisms for failure to make timely disclosure of major corporate matters (thirty-four percent of the total criticisms

[28] Interview 2006-72.
[29] It is procedurally easier for the exchanges to issue lesser sanctions than more serious ones. In Shanghai, for example, individual departments within the exchange may issue Oral Warnings and Oversight Letters without approval of senior stock exchange officials outside their departments. Most are issued by the Listed Companies Department. Interview 2006-68. Both notices of criticism and public criticisms are prepared by individual departments, generally the listed companies division, but then must be approved by the Stock Exchange Council, which includes directors of the exchange and also department heads from the exchange. Interview 2006-68.
[30] Multiple sanctions against a single company reflect multiple instances of misconduct. The exchanges do not criticize a company twice for the same conduct, although companies frequently have multiple problems – and uncovering one problem may lead the exchanges to discover others. Interview 2007-4.

issued by Shanghai; thirty percent of the total for Shenzhen).[31] About twenty percent of the criticisms at both exchanges are issued for failure to make timely amendments to profit forecasts or for frequent changes to forecasts. Exchange officials noted a trend toward putting more emphasis on disclosure in recent years, in particular information relating to loans and loan guarantees issued in the past.[32]

INSERT TABLE 5 HERE

In the majority of cases in which the exchanges sanctioned listed companies, they also sanctioned individuals.[33] Between 2001 and 2006, the Shanghai Stock Exchange sanctioned 782 individuals; the Shenzhen Stock Exchange publicly criticized 876 individuals. In a small number of cases the exchanges acted against only individuals, not listed companies. Shanghai issued three sanction decisions against individuals only, covering six individuals. Shenzhen issued ten public criticisms against individuals only.

INSERT TABLE 6 HERE

As Table 6 shows, executive directors were the most frequent target of sanctions, followed by supervisors.[34] Independent directors were targeted for sanction far less

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[31] The following table lists the frequency with which various types of criticisms are issued by the exchanges. Many sanctions punish companies for multiple cases of misconduct. In such cases, the table counts a reason as a percentage of the total number of reasons given for the criticism (e.g., a company that is sanctioned for false disclosure and for failure to issue scheduled reports on time is counted as .5 in each category). Thus the total number of companies sanctioned for each category of wrongdoing is in fact higher than indicated in the table below:

Reason for Sanction	Shanghai	Shenzhen
1. False Information Disclosure or seriously misleading statements	7+2/3 (7.30%)	12+1/12 (8.11%)
2. Profit forecast not accurate or not timely (generally failure to amend forecasts in cases of significant discrepancy or frequent changes to predictions)	21+1/3 (19.57%)	30+1/4 (20.30%)
3. Failure to timely disclose major corporate matters	37 (33.94%)	44+3/4 (30.03%)
4. Failure to carry out approval procedures for related-party transactions	17 (15.60%)	24+5/12 (16.39 %)
5. Failure to issue scheduled reports on time	23 (21.10%)	26 (17.45%)
6. Failure to carry out other legally-required obligations	3 (2.75%)	11+1/2 (7.72%)
Total	109	149

[32] Interview 2007-29.

[33] Forty of the sanctions in Shenzhen were against only companies and not individuals; fifty five Shanghai sanctions involved only companies.

[34] Chinese company law provides for a German-inspired supervisory board as well as a board of directors. Most commentators are critical of the corporate governance role actually performed by the supervisory board in Chinese corporations. For example, see Xi (2006).

often, although this appears to be an artifact of the relative newness of the institution. Most companies in China have only recently added independent directors to their boards. In fact, the exchanges appear to be increasingly scrutinizing the roles of independent directors: of the forty Shenzhen Stock exchange sanctions against independent directors, ten were in 2005 and twenty-eight were in 2006.

More severe than issuing a public criticism against an individual is a stock exchange determination that an individual is unfit to serve as a director, supervisor, or senior manager. The exchanges have used this power sparingly. The Shanghai Stock Exchange has declared fifteen individuals to be unfit for service, including ten in November 2006 alone. The Shenzhen Stock Exchange has made only one such determination.[35] Shanghai's dramatic surge in the use of this sanction in late 2006 may signal a policy of making greater use of this regulatory weapon, although it is too early to be certain.

2.2. Delegating Enforcement?

What is the relationship between the respective regulatory efforts by the stock exchanges and the CSRC? The public criticisms issued by the exchanges largely complement, rather than duplicate, regulatory efforts by the CSRC. Some level of coordination of regulatory activity between the CSRC and the exchanges is apparent, but the exchanges also seem to be operating with a degree of autonomy. The motivations for exchange autonomy, however, are ambiguous.

In most cases, exchange sanctions are separate from and do not lead to CSRC punishment. Only twenty-six of the eighty-nine companies sanctioned by the Shanghai exchange were also subject to CSRC administrative punishments, of which only ten cases involved the same or related conduct. The same tendency is evident in Shenzhen. Twenty-seven companies were sanctioned by both the Shenzhen Stock Exchange and the CSRC, of which only seventeen cases involved the same or related conduct. The lack of overlap in part reflects the fact that many of the exchange sanctions are for conduct that is not serious enough to lead to CSRC action.[36] Moreover, the exchanges sometimes do not criticize a company if it has been or will be sanctioned by the CSRC for the same conduct.[37]

The exchanges are not required to notify the CSRC of decisions to criticize companies prior to doing so, and in most cases the exchanges do not consult with the

[35] In contrast, during the same period the CSRC issued market bans, ranging from three years to life, against eighty-two individuals. CSRC regulations specify that the CSRC may ban individuals found to have committed serious breaches of the law or administrative regulations from participation in China's securities market for periods ranging from three years to life (Zhengquan shichang jinru guiding 2006). In contrast to CSRC market bans, exchange declarations of unfitness to serve have no time limit.
[36] Similarly, oversight letters and oral warnings generally relate to violations of exchange rules, and rarely involve overlap with CSRC regulations. Interview 2006-68.
[37] Interview 2006-68.

CSRC prior to taking action.[38] In serious cases, however, the exchanges confer with the CSRC prior to taking action.[39] The exchanges do inform the CSRC of both public criticisms and of the non-public notice and criticisms after they are issued.[40]

Exchange officials argue that they are largely autonomous in their decisions to sanction, but in practice the relationship may be somewhat more complex. In some cases, the exchanges coordinate their activities with the CSRC.[41] Sometimes misconduct first comes to light through exchange criticism; the CSRC then follows up and eventually decides to sanction the companies.[42] In others, misconduct is first uncovered by the local branch office of the CSRC and then reported to the exchanges for sanction. In sensitive cases, the CSRC may instruct the exchanges not to get involved.[43] Despite the theoretical independence of the exchanges from the CSRC under the new securities law, in practice the exchanges' roles continue to be both coordinated with and subject to oversight from the CSRC.

As a matter of regulatory strategy, exchange sanctions have some significant advantages over CSRC actions: the exchanges generally take action within a few months against companies that violate the listing rules; sometimes they act within a few days of discovering misconduct.[44] By contrast, it is common for CSRC punishments to be issued two or more years after the wrongdoing occurred.[45] Yet some argue that the CSRC is encouraging a greater role for the exchanges in overseeing listed companies in order to reduce its own role.[46] According to such arguments, the CSRC is overworked; it also often comes under extensive external pressure not to take actions against listed companies. Encouraging the stock exchanges to play a greater role may deflect some of the pressure. Some lawyers argue that encouraging the exchanges to play a greater role also allows companies to be sanctioned without incurring the risk of civil litigation, as exchange sanctions cannot serve as a basis for civil suits brought by shareholders. This view is not uniformly held, however, in particular because civil liability is not yet a major concern for most listed companies.

Data for the years 2001 to 2006 reported in Table 4 suggest that the frequency with which the exchanges impose public criticisms has fluctuated from year to year, generally ranging from ten to twenty-five a year. Officials with both the Shanghai and Shenzhen exchanges, however, state that in recent years both exchanges have moved toward stricter standards governing public criticisms, and stricter application of their

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[38] Interview 2007-1. As noted above, prior to 2005 the listing rules explicitly stated that the exchanges could refer serious cases to the CSRC.
[39] Interview 2006-7.
[40] Interview 2007-5.
[41] Interview 2006-72.
[42] Interview 2006-7; Interview 2007-6.
[43] Interview 2006-68.
[44] Exchange officials state that it is rare for more than six months to elapse from the time the exchange uncovers wrongdoing to the time they issue a sanction, and that they frequently issue public criticisms within one or two months. Interview 2007-5.
[45] The CSRC is perceived as moving slowly in its sanctioning activity. Interview 2007-5.
[46] Interview 2006-61; Interview 2007-35.

rules.[47] Officials comment that the exchanges and the market are placing greater attention on sanctions.[48] This reflects a general trend in the PRC capital markets: regulators and investors alike are paying more attention to the fundamentals of corporate governance.[49] Exchange officials state that in recent years companies are clearly taking the risk of being sanctioned far more seriously than they did in the past.[50]

Table 4, viewed in tandem with Table 3, does not reveal any obvious trend toward reduced CSRC oversight in favor of the exchanges. The CSRC issued a total of 199 sanction decisions between 2001 and 2006, with a high of 49 in 2004 and a low of 17 in 2002. Of these, a total of 87 sanctions related to disclosure problems, with a high of 27 in 2004 and a low of 6 in 2002. The data, however, do make clear that the CSRC is targeting only a small percentage of the companies and individuals publicly criticized by the exchanges, suggesting that the public criticisms are complementing CSRC enforcement.

In conclusion, the CSRC seems to be encouraging the exchanges to play a greater enforcement role,[51] but the reasons for doing so are ambiguous. It may be part of a regulatory strategy to maximize sanctioning capacity and improve compliance with disclosure obligations, by granting greater autonomy to the exchanges. An increased role for the exchanges may also reflect the real difficulties the CSRC faces in its attempt to address the myriad of problems in China's securities markets: the CSRC may not be able to tackle all disclosure issues, even if wanted to do so. But it may also be motivated by the desire to insulate the CSRC from political influence by companies seeking to block the imposition of administrative punishments.[52]

2.3. Regulatory Competition?

Whatever the larger forces driving the use of public criticisms by the exchanges, the data suggest that Shanghai and Shenzhen do not utilize this form of self-regulation to the same extent. Shenzhen has issued more sanctions than Shanghai, despite having significantly fewer listed companies. In fact, as a percentage of listed firms, in any given year and over the six year period, the Shenzhen Stock Exchange has issued about twice as many public criticisms as the Shanghai Stock Exchange.[53]

The frequency with which public criticisms are issued by the two exchanges may simply be endogenous to the firms listed on the exchanges. Shenzhen lists comparatively smaller firms than Shanghai, and small firms are more likely than large firms to be

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[47] Interview 2006-63; Interview 2007-1; Interview 2007-6.
[48] Interview 2007-5.
[49] Interview 2007-35.
[50] Interview 2007-1.
[51] Interview 2007-1.
[52] Interview 2007-1; Interview 2007-6.
[53] Shenzhen criticizes from 3% to 6% of listed firms in a given year, and total criticisms equal 28% of the average number of listed firms over the six-year period. Shanghai has consistently criticized about 2% of listed firms in a given year, and total criticisms constitute 14% of the average number of listed firms over the six-year period.

sanctioned for fraud by the CSRC and stock exchanges (Chen et al. 2005). This could be because smaller firms may have weaker governance practices than the larger firms, resulting in the issuance of more sanctions. Shanghai Stock Exchange officials (unsurprisingly) offer this explanation.[54] Alternatively, larger firms may be more politically insulated from criticism than smaller firms. Unsurprisingly, Shenzhen stock exchange officials favor this explanation.[55] Data from CSRC sanctions provides some support for the Shanghai argument: during the period under study, the CSRC issued administrative sanctions stemming from false or misleading disclosure against forty-three Shenzhen-listed companies versus forty Shanghai-listed firms, despite the fact that far more companies are listed in Shanghai.[56] As we discuss further below, both exchanges sanction private companies more often than state-owned companies, despite private companies making up a minority of all listed firms. This fact, however, can support either view: private firms may be less connected than state-owned firms, but it also may be the case that on balance private firms tend to have weaker governance than state-owned public companies.

But the difference may also represent different regulatory strategies by the two exchanges, reflecting the competitive positions of the two organizations. The Shenzhen Stock Exchange has long been regarded as the weaker sibling of the Shanghai Exchange. Although the two exchanges do not compete directly for listings in most cases, in a larger sense both exchanges are competing with Hong Kong and Singapore for listings, particularly over the long-term. The Shenzhen Exchange's more aggressive regulatory approach may be part of an attempt to distinguish itself from the Shanghai Stock Exchange, and to close the distance between it and its rival. Observers not affiliated with either exchange argue that the Shenzhen Exchange is more aggressive in policing its companies than its counterpart in Shanghai.[57] Indeed, Shenzhen Exchange officials assert that they have tried to become stricter in their oversight of listed companies to generate greater confidence in the market.[58] The stricter standards in Shenzhen are reflected not only in the numbers of sanctions issued, but also in the clearer standards that apply (at least internally) for deciding to issue public criticisms, and in the stricter standards governing directors that apply to companies on the SMEB.[59]

The Shenzhen Exchange's strategy of stricter enforcement is not universally viewed as positive for the development of China's securities markets given current institutional realities. Some market actors claim that strict enforcement of rules is counterproductive and unrealistic at this stage of China's development. Regulatory flexibility, the argument goes, is better suited to current market conditions.[60] The

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[54] Interview 2006-68.
[55] Interview 2007-5; Interview 2007-7; Interview 2007-35. Some Shenzhen officials do, however, also accept that large state-owned companies, which predominate in Shanghai, may also have stronger corporate governance practices than many of the small private companies listed in Shenzhen.
[56] The total is 83, not the 87 reported in Table 3, because four sanctions reported there were against individuals only.
[57] Interview 2006-7; Interview 2007-35.
[58] Interview 2007-1; Interview 2007-5.
[59] *See infra.*
[60] Interview 2007-30.

Shanghai Stock Exchange is widely perceived as more flexible, easier to communicate with, and more willing to negotiate to resolve problems than the Shenzhen Exchange.[61] The Shenzhen Exchange is perceived as more rule- and disclosure-oriented.[62] As one lawyer argued, "Shanghai has a more practical appraisal of reality."[63]

Regardless of which self-regulatory strategy is better suited to development of China's stock markets, the available evidence suggests that the two stock exchanges, despite their limited room for autonomous action, are pursuing somewhat different paths toward that goal. Indeed, the fact that the exchanges are competing with each other at all suggests that the exchanges have become more autonomous, at least as compared to the recent past. Such trends also support the impression that the regulatory roles of the exchanges reflect a conscious effort by the CSRC not only to delegate authority, but also to encourage experimentation and innovation. Even subtle competition may be a means of fostering multiple approaches to enforcement.

3. EFFECTS

The discussion to this point raises an obvious question: should we care? The role of stock exchange criticisms in the development of China's capital markets depends upon their effectiveness. In this part of the paper, we try to assess their effect on a range of market actors—investors, creditors, directors and other corporate officials, and the corporate entity itself. We acknowledge the inherent difficulty of this task, and concede the necessarily impressionistic nature of our some of our analysis. However, the discussion that follows is based on both widely used event study methodology and extensive interviews of market participants in China. A remarkably consistent picture emerges from our research: the public criticisms matter, and they are taking on greater importance in the regulatory scheme.

One measure of the effects of public criticisms is the degree to which company officials try to persuade the exchanges not to issue them. Exchange officials state that they are frequently subject to pressure from companies not to issue sanctions.[64] Prior to issuing a public criticism, the exchanges inform the target companies of their decision and permit the companies to reply within a specified period.[65] However, there are no procedures governing how responses are to be handled.[66] Sometimes companies and

[61] Interview 2007-29.
[62] Interview 2007-29; Interview 2007-30; Interview 2007-34.
[63] Interview 2007-34. The lawyer gave the example of disclosure requirements regarding related party transactions, whereby companies are required to disclose transactions beyond a certain size. As the lawyer explained, one company he represents engaged in transactions that exceed this threshold every day, thus in principle requiring disclosure of each. He asserted that the Shanghai Exchange would understand if the company failed to disclose each individual transaction, which the Shenzhen Exchange "would just sanction you." Interview 2007-34.
[64] Interview 2006-68; Interview 2006-69; Interview 2007-1.
[65] Interview 2006-72; Interview 2007-5.
[66] Interview 2006-68.

individuals try to persuade the relevant departments at the exchanges not to issue criticisms; in other cases they seek to influence the leaders of the exchanges.[67] Companies occasionally use lawyers and legal arguments to lay out a defense, but much more commonly they rely on relationships and in-person discussions to persuade senior officials at the exchanges or the CSRC.[68]

Efforts to persuade the exchanges not to issue public criticisms are sometimes successful. In 2005, the Shanghai Exchange issued public criticisms against eighteen companies. In approximately ten additional cases, however, the exchange dropped proceedings against companies after the initial notification that it intended to publicly criticize them.[69] (Figures regarding Shenzhen were not available.) Although officials claim they rarely change a decision after an initial determination,[70] they acknowledge an occasional change in response to lobbying efforts. Most often this takes the form of not targeting particular directors for public criticism.[71] Shenzhen officials noted that they have attempted to insulate themselves from such pressure by creating clear internal standards specifying when sanctions shall be issued, and by vesting the decision to issue a sanction in a committee made up of officials from a variety of departments – and not only with the leaders of the exchange.[72] In Shanghai, by contrast, exchange leaders make the final decision regarding sanctions. At present, there is no mechanism for appealing exchange sanctions. However, both the Shenzhen and Shanghai exchanges are now discussing creating a committee consisting of exchange officials and members from outside the exchanges that would serve as an appeals body for public criticisms.[73]

It is, of course, difficult to discern whether the exchanges drop cases due to convincing legal and technical arguments or as a result of other forms of influence. Either form of persuasion is likely to be effective in a given case.[74] One perception is that Shanghai Stock Exchange officials are more susceptible to relational influences due to the larger number of high-profile state-owned companies listed there.[75] Regardless of the type or effectiveness of lobbying, the frequency and intensity of individual and

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[67] Interview 2006-68; Interview 2006-72; Interview 2007-1.

[68] Interview 2006-70. Lawyers, exchange officials and company managers say that it is rare for companies to involve lawyers in such negotiations. Interview 2007-5; Interview 2007-29; Interview 2007-34. Doing so, said one CEO, would simply make matters more tense. Interview 2007-29. Exchange officials say that they are unlikely to be influenced by non-legal arguments – but also acknowledge that they sometimes cannot avoid other forms of pressure. Interview 2006-72. One CEO said that companies facing sanction will first seek to argue their case with lower-ranking officials on the merits, but will not hesitate to seek out more senior officials if necessary to avoid being sanctioned. Interview 2007-29.

[69] Interview 2006-68.

[70] Interview 2007-5.

[71] This is particularly the case when individuals can show that they objected to the decision or action that resulted in the sanction. Interview 2007-5. Officials also said that in some cases companies provide additional facts that persuade the exchange that the initial infraction was not as serious as first contemplated. *Id.*

[72] Interview 2007-5. Senior officials of the exchange participate in the committee, and thus may exert some influence on committee votes, but they formally only have individual votes in committee discussions. Interview 2007-1; Interview 2007-5.

[73] Interview 2007-7.

[74] Interview 2006-71; Interview 2007-1.

[75] Interview 2007-1.

corporate efforts to persuade the exchanges to drop the sanctions is compelling evidence that the targets of public criticisms take them seriously.

3.1. Share Price Effects

We attempted to measure stock market reaction to the public criticisms. Using standard event study methodology,[76] we measured stock price effects of the first public announcement of the public criticism by a stock exchange, typically by publication in one of China's three major securities industry newspapers. We measured the cumulative effects on the securities of all firms listed on the Shanghai and Shenzhen exchanges subjected to public criticism for the most serious categories of misconduct, including failure to disclose material information and failure to conduct related-party transactions according to required procedures, over the period 2001 to 2006.[77] Publication of the criticisms resulted in negative and significant abnormal returns for both the Shanghai and Shenzhen exchanges in all specifications of the data but one.[78]

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[76] In a stock market event study, cumulative average returns (CARs) are estimated by summing estimated abnormal returns over an event window. We use the market model to calculate abnormal stock returns. For the Shanghai Stock Exchange, we used the A Share Index to control for the effect of market-related variation on a given stock return. For the Shenzhen Stock Exchange, we used the A Share Index.
We examined two event windows: a 3-day event window [-1,1] and a 5-day event window [-2,2]. The estimation window dates from -250 to -7 for the 3-day event window and from -250 to -8 for the 5-day event window.

The cumulative abnormal return from day τ_1 to day τ_2 ($CAR(\tau_1, \tau_2)$)is calculated as:

$CAR(\tau_1, \tau_2) = \sum_{\tau=\tau_1}^{\tau_2} AR_\tau$, sum of sample-average abnormal returns through the event window $[\tau_1, \tau_2]$, in which AR_τ represents the sample-average abnormal returns on the day τ $(\tau_1 \le \tau \le \tau_2)$.

$$AR_\tau = \frac{\sum_{i=1}^{N} AR_{i,\tau}}{N}$$

Where,

$AR_{i,\tau}$: company-specific abnormal return of stock i at time τ

N : number of stocks in the sample

In the market model, $AR_{i,\tau}$ is calculated as $AR_{i,\tau} = R_{i,\tau} - \hat{\alpha}_i - \hat{\beta}_i(R_{m,\tau})$. where $R_{i,\tau}$ is the actual stock return of company i at time τ and $R_{m,\tau}$ is the market return at time τ . The parameters $\hat{\alpha}_i$ and $\hat{\beta}_i$ are estimated from the market model

$$R_{i,\tau} = \alpha_i + \beta_i R_{m,\tau} + \varepsilon_{i,\tau}$$

$$E(\varepsilon_{i,\tau}) = 0 \qquad \mathrm{var}(\varepsilon_{i,\tau}) = \sigma^2_{\varepsilon_i}$$

[77] We excluded from the sample firms for which complete data were unavailable, firms that were delisted, and where share trading had been suspended or otherwise displayed erratic and unexplained price movements. The sample was comprised of 68 observations for the Shanghai exchange and 98 observations for the Shenzhen exchange.

[78] Negative abnormal returns on the Shenzhen exchange were only marginally significant using a five-day event window.

We also measured the stock market reaction to the first company disclosure of the underlying misconduct that eventually resulted in the public criticism. Company disclosure resulted in significant negative abnormal returns for both exchanges in all specifications.[79] Since the company disclosure occurred, on average, 45.8 days prior to the Shanghai Stock exchange criticisms and 66.5 days prior to the Shenzhen criticisms, it is fair to assume that some of the disclosures were prompted by the threat of criticism.[80]

INSERT TABLE 7 HERE

Thus, our findings suggest that the stock exchange criticisms prompt disclosure of information that the market finds meaningful. Moreover, the market reaction to the stock exchange criticism itself suggests that, even after the underlying corporate information has been disclosed, the public criticism leveled by the stock exchange is itself deemed to be a significant event by investors. Investors appear to care about the public criticisms.

Our findings are generally consistent with prior studies, though most findings are not directly comparable to our own. The only prior English-language study on stock price effects of criticisms found negative and significant abnormal returns to public criticisms issued between 1999-2003 (Chen et al. 2005)[81] The findings of Chinese-language studies are mixed, though most find a significant effect.[82] Some scholars find that exchange sanctions have a greater effect on share price than do CSRC sanctions – although they explain this finding by noting that the market is more likely to be aware in advance of CSRC investigations than of exchange sanctions.[83] Other studies find that

[79] We again excluded from the sample firms for which complete data were unavailable, firms that were delisted, where share trading had been suspended or otherwise displayed erratic and unexplained price movements. The sample was comprised of 87 observations for the Shanghai exchange and 138 observations for the Shenzhen exchange.

[80] Of course, we cannot rule the possibility that causation runs in the other direction in some or many cases: namely, that corporate disclosure of bad conduct prompted a stock exchange criticism shortly thereafter. But given that the companies in our sample were criticized for failure to make timely disclosure of material facts or failure to abide by related party transaction procedures (not for disclosing bad conduct alone), it seems rather unlikely that a large number of the firms in our sample suddenly—unprompted by any regulatory pressure—decided to disclose past bad conduct, leading ultimately to a stock exchange criticism.

[81] Due to the methodology employed by the authors of this study, however, these findings are not directly comparable to ours because their data include some public criticisms issued by the CSRC as well as the stock exchanges and cover an earlier time period.

[82] For example, one study of the consequences of exchange sanctions in 2001 and 2002 found significant market reactions to public criticisms imposed by the exchanges. Not surprisingly, the study found that the effects were insignificant in cases where the misconduct had already been disclosed. (Dong n.d.**).** Another study examined the market effects based on the type of conduct being sanctioned, finding that misrepresentations regarding income-related information and violations relating to failure to disclose related-party transactions or financial guarantees had the most significant effects on share price; sanctions relating to untimely disclosure and unauthorized use of funds generated no significant market reaction. However, the study did not distinguish between CSRC and exchange sanctions (Xue, Dong, and Guan 2004).

[83] For example, one study that examined sanction data from 1993 to 2001 (including both exchange and CSRC sanctions) found significant market effects of public sanctions, but no effects of non-public sanctions and warnings. The study also found greater effects of exchange sanctions than CSRC sanctions, with the authors suggesting that the likely reason was prior market awareness of CSRC proceedings (Mao

effects on share price are negligible; one less rigorous study suggests that share price may actually increase upon the issuance of an exchange sanction.[84] None of the studies, however, examines the broader potential effects of stock exchange public criticisms, as we do below.

Before we turn to broader effects, however, we wish to address several potential objections or qualifications to our findings. First, investors may react to a public criticism not because of concern about the quality of the company's public disclosures or corporate governance practices, but because they believe a sanction signals that a company has fallen out of political favor. Put differently, investors may believe that a stock exchange criticism is a statement that a company lacks sufficient political leverage to avoid punishment, and is thus unable to compete fully in China's politically sensitive marketplace. Implicit in this possible response to our findings is the view that the exchanges are neither independent nor politically neutral. If this view is accurate, the exchanges would target only small or politically unconnected companies.

The data show, however, that although the majority of sanctioned companies are indeed private, the exchanges have also targeted some key state-owned enterprises. Table 8 classifies sanctioned companies as either private or state-owned. Table 8 includes only those companies sanctioned for major misconduct – the same companies used in our event study sample. For state-owned companies, the table indicates whether the controlling shareholder (or parent thereof) was a national, provincial, or local governmental entity. At the national and provincial level, distinctions are also drawn between companies directly or indirectly under the National State-Owned Assets Supervision and Administration Commission and those controlled by other central government entities. The distinction reflects the fact that shares in many of China's most important state-owned companies (which the exception of those in the financial services industries, which are controlled by a separate holding company) are controlled by the Assets Commission. The Assets Commission holds controlling stakes in 158 key central companies; through these holdings it directly or indirectly oversees 165 publicly listed

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and Wu n.d.). Another early study of exchange and CSRC sanctions using event study methodology likewise found that exchange sanctions had more significant effects than CSRC sanctions (Wen & Yang 2002). *See also* Yan, Chen & Zhou (2006), who argue that exchange sanctions have a greater effect on share price than CSRC sanctions, likely because the market is frequently aware of CSRC proceedings well ahead of the formal announcement of a sanction; the study also found that sanctioned companies were most likely to come from electronic and light manufacturing industries, and argued that a high rate of recidivism suggested low deterrence value of both CSRC and exchange sanctions.

Such findings are not uniform: a study that used event study methodology to analyze CSRC and exchange sanction data from 1999 to 2005 found that market reaction to exchange public criticisms was weaker than that to CSRC sanctions. The study found a significant negative market reaction to both CSRC sanctions and exchange public criticisms. The study also showed market reactions strengthening over time (Zhang 2006).

[84] One study argued that the effects of public criticism have actually weakened over time, and that the stock prices of some companies have increased upon the company being publicly criticized. The study's finding were largely anecdotal, however, and the author does not appear to have used event study methodology (Zhang 2005).

companies.[85] Provincial assets commissions likewise hold shares in key provincial company. Thus in general, companies managed by the Assets Commission are likely to be politically more important and more influential than other state-owned companies.

INSERT TABLE 8 HERE

Table 8 reveals two noteworthy facts. First, private companies make up the majority of sanctioned companies – roughly fifty-eight percent of all sanctioned companies were private. This contrasts with the market as a whole, where the majority of listed companies are state-owned or affiliated. Although neither the exchanges nor the CSRC appear to provide a breakdown of the total number of companies by ownership, officials at the exchanges estimated that state-owned companies account for approximately sixty percent of listed companies. The greater frequency with which private companies are sanctioned may suggest that private companies are easier targets than state-owned companies, as they may lack the same political connections. But the trend may also reflect lower governance standards in private companies, an opinion voiced by many of our interviewees.

Second, although most sanctioned state-owned companies are attached to provincial or local governments, a significant number of sanctioned companies were major state-owned companies directly under the supervision of the Assets Commission. Sanctioned companies included Shanghai Worldbest Pharmaceuticals, a major pharmaceutical producer and a subsidiary of one of China's leading industrial conglomerates; Xinjiang Tunhe Investment Co. Ltd, China's largest importer and exporter of food products; Jinan Qingqi Motorcycle Co., Ltd, a key manufacturer that is directly under central Party-state management; and China Eastern Airlines, one of China's three biggest airlines. Most of these companies are household names in China.

In Shenzhen, the sanctioned companies were perhaps somewhat less-well known, but nevertheless included six attached to the State Assets Commission. These included Shenyang Chemical Co. Ltd, a major chemical producer that is a subsidiary of one of China's largest chemical companies, China National Blue Star; Sinosteel Jilin Carbon Co. Ltd., which is China's largest carbon producer, and a subsidiary of Sinosteel, one of China's major steel-trading firms; and San Jiu Medical and Pharmaceutical Co. Lt, a major pharmaceuticals company.

These data do not prove lack of political interference in the stock exchange criticism process; indeed, as we discuss further below, political ties do seem to affect sanction decisions in some cases. But the data show that the exchanges have in some cases been willing to sanction influential, well known state-owned or affiliated companies. This suggests that politics alone cannot explain the exchanges' behavior – and also that investors are not likely to be acting purely on a perception that sanctioned companies have fallen out of political favor.

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[85] For a list of companies controlled by the Assets Commission, see http://www.sasac.gov.cn/zyqy/qyml/default.htm. For listed companies under its control, see http://www.sasac.gov.cn/zyqy/qyml/default.htm.

Another possible interpretation of our findings is that, in a relatively inefficient market, investors may simply be reacting uncritically to *any* negative attention brought to bear on a listed firm by an organ of the state. While we cannot discount this interpretation completely, the event study data do not appear to support this interpretation. As Graphs 1 and 2 show, stock price reaction to both company disclosure and stock exchange criticism over a long (20 day) period following the event suggests an efficient market response to negative information, with stock prices falling sharply at the event date followed by a prolonged and relatively stable period of negative cumulative abnormal returns. If the market were reacting blindly to negative governmental attention, stock prices could be expected to rebound quickly or move more erratically in the period following the event.

INSERT GRAPHS 1 AND 2 HERE

3.2. Other Consequences

The limited prior work on the exchange sanctions (almost all of it in Chinese) has focused exclusively on share price. But given market conditions and the larger political and social context in which Chinese listed firms operate, such a focus may miss other, possibly more salient, effects of public criticisms on firms and individuals. To gauge the broader impact of the public criticisms (some of which are not reputational, but rather of more direct regulatory effect), we examined the legal framework surrounding their application, and conducted extensive interviews with potentially interested constituencies in China, including officials at both the Shenzhen and Shanghai Stock Exchanges, CSRC officials, a central bank official, lawyers, bankers, and the CEO of a firm facing public criticism by the Shenzhen Stock Exchange.

3.2.1. Financing

The most direct consequence to a firm receiving a public criticism by a stock exchange today is that its equity financing options are seriously compromised. Regulations first adopted in 2002 and then made stricter in 2006 provide that listed companies may not issue new publicly traded stock if the company or any of its currently-serving directors, supervisors, or senior management has been publicly criticized by a stock exchange in the preceding twelve months (Shangshi gongsi zhengquan faxing guanli banfa 2006, arts. 6, 11). Similarly, a private placement of shares is impermissible if a company's current directors or senior managers have been sanctioned in the prior year (Shangshi gongsi zhengquan faxing guanli banfa 2006, art. 39).[86] And a company may not make an initial public offering of shares if any of its

[86] Private placements are barred if current directors or senior management have been sanctioned by the CSRC within the past three years. The rules do not appear explicitly to ban a company from selling shares through a private placement if the company or its supervisors, or any directors or senior officers who have already been removed from office, have been sanctioned. The rules thus could be read to permit a private offering where only the company or supervisors has been publicly criticized or where directors have been supervised but removed from office. The rules thus suggest that looser rules apply for private placements than for public offerings, and may reflect CSRC policy of encouraging private offerings.

directors, supervisors, or senior managers has been subject to a public criticism from a stock exchange within the preceding year (Shouci gongkai faxing gupiao bing shangshi guanli banfa 2006, art. 32).[87] One exchange official referred to the effect of these rules barring share offerings as "huge."[88]

The severe consequences of public criticisms for companies contemplating new share issuances provide the exchanges with significant influence. Thus, for example, the exchanges may use the threat of a sanction to force a company to disclose certain information or to take other actions that may be unrelated to their disclosure obligations.[89] The vagueness of the listing rules gives the exchanges particular leverage over listed companies, as there is a wide range of possible interpretations of companies' disclosure obligations.[90]

Exchange criticisms can also affect a company's ability to obtain bank loans or issue commercial paper.[91] The exchanges make information regarding companies that are subject to public criticism available to the Peoples' Bank of China (PBOC), to ensure that banks are aware that companies have encountered problems.[92] As a result, public criticism of listed companies may affect the terms of loans the companies obtain – in particular when the criticized conduct is serious.[93] In addition, regulations issued by the PBOC provide that firms may not issue commercial paper if they have committed a serious violation of law or regulation within the preceding three years (Duanqi Rongziquan guanli banfa 2005, art. 10). Although the regulations do not expressly provide that a stock exchange criticism constitutes a serious violation, central bank officials are said to hold that interpretation. The exchanges are now working with officials in the banking sector to create a credit reporting system, which will include data on stock exchange criticisms.[94] Exchange officials state that they view attempts by banks and others to use public criticisms for their own purposes to be a positive development.[95] Exchange officials note that banks' reliance on exchange sanctions expands the influence of the exchanges and their sanctions.[96]

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[87] In the case of individuals sanctioned by the CSRC, the specified period is three years. Rules that were in force between 2002 and 2006 likewise stated that listed companies seeking to issue new shares could not do so if they or any director had been subject to a public criticism by a stock exchange within the prior twelve months (Guanyu shangshi gongsi zengfa xingu youguan tiaojian de tongzhi 2002). The rules did not appear to cover public criticisms against supervisors or senior management. Similar restrictions applied if the company or directors had been punished by the CSRC in the prior year.

Rules in place beginning in 2001 likewise stated that, in deciding whether to authorize a company to issue new shares, the CSRC should give "substantial consideration" to whether the company had been sanctioned by an exchange or by the CSRC within the past year.

[88] Interview 2007-6; see also Interview 2006-69 (noting the importance of the rules).

[89] One lawyer recounted how the Shenzhen exchange had used the threat of a public criticism for unrelated conduct to push a company to complete its corporate restructuring more quickly. Interview 2007-34.

[90] Interview 2007-34.

[91] Interview 2006-1; Interview 2007-5.

[92] Interview 2006-68.

[93] Interview 2006-68; Interview 2006-72.

[94] Interview 2006-1M; Interview 2007-5.

[95] Interview 2007-1.

[96] Interview 2007-5.

3.2.2. Regulatory Consequences for Individuals

A variety of collateral consequences befall individuals who have been criticized by the stock exchanges. Publicly criticized directors may in practice, if not formally, be forced to resign, in particular for companies listed in Shenzhen. According to various regulations promulgated by the exchanges and the CSRC, listed companies in China are required to have independent directors (Clark 2006, p. 177). Shenzhen Stock Exchange rules governing independent directors state that during the mandatory review of directors prior to their election, the exchange will "emphasize" whether an independent director has been subject to either a public criticism or a notice and criticism from an exchange or an administrative sanction from the CSRC within the prior three years (Duli dongshi beian banfa 2005, art. 3).[97] The rules also state that when an individual is nominated to serve as an independent director, such nomination must state whether the individual has been subject to any such punishments within the prior three years. Although the rules do not specifically bar individuals who have been criticized or sanctioned from serving, in practice the rules have such an effect.[98] Independent directors who are named in a public criticism cannot be reappointed as independent directors – at the company that is being sanctioned or elsewhere.[99]

Criticisms may also affect compensation of criticized individuals. CSRC regulations governing listed companies' share incentive plans state that no individual who has been subject to a public criticism by an exchange within three years may be included as beneficiary of such a plan (Zhongguo Zhengquan Jiandu Guanli Weiyuan Hui Guanyu Fabu "Shangshi gongsi guquan jili guanli banfa" (shixing) de tongzhi 2005). Similarly, Shenzhen SMEB regulations state that companies must withhold or retract any bonus payments or allowances made to company officials who are subject to public criticisms (Shenzhen Zhengquan Jiaoyisuo Zhongxiao qiyeban touzizhe quanyi baohu zhiyin 2006, art. 43).[100]

Exchange criticisms may affect other market participants as well, in particular employees of underwriters and securities fund companies. CSRC provisions impose bans on employees of underwriters if they or the issuers they are serving are subject to public

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[97] Rules governing the Shenzhen SMEB also state that the chairman of a company's board of directors should resign if the company (not the individual) is subject to an administrative penalty from the CSRC or a public criticism from the Shenzhen Stock Exchange and the violation is "serious" (Shenzhen Zhengquan Jiaoyisuo Zhongxiao Chuangye Bankuai shangshi gongsi dongshi xingwei zhiyin 2005, art. 29). The regulations state that the chairman shall personally apologize to shareholders, and in serious circumstances resign. Similarly, article 41 of the regulations state that an individual who has been subject to two or more exchange public criticisms or three or more exchange internal criticisms within a three year period will be deemed to be unsuitable to serve as a director for companies listed on the SMEB. Similar provisions apply if the individual has been criticized by the CSRC twice within three years.

[98] Shanghai does not appear to have similar rules.

[99] Interview 2007-1. Exchange officials state that it is somewhat rare for directors at one company to serve as directors elsewhere, although some independent directors serve at multiple companies.

[100] Similar provisions do not appear to apply to the primary Shenzhen board or on the Shanghai Exchange. The Shenzhen Investors Rights guidance also requires companies to disclose in the form of an "investors risk disclosure" serious cases of internal or public criticism, or determinations of unfitness to serve against company directors (art. 51).

criticisms. Provisions regarding sponsors of securities offerings impose a three month ban on individuals serving as sponsors, if they or the issuers they are serving as sponsors are subject to a public criticism during the due diligence period prior to a public offering or a supervision period after the public offering (CSRC, Zhengquan faxing shangshi baocun zhidu zhanxing banfa 2003). Sponsoring institutes (generally underwriters) must replace criticized individuals serving as sponsors if they wish to proceed with an offering. CSRC regulations likewise state that the exchanges may recommend that senior managers of securities fund companies be removed from office if they have been subject to an exchange sanction within the past twelve months (CSRC, Zhengquan touzi jijin hangye gaoji guanli renyuan renzhi guanli banfa 2004).

3.2.3. Reputational Effects

Companies and individuals fear stock exchange sanctions for another important reason: reputational effects. Companies are required to disclose both the fact that they have been subject to criticism from a stock exchange and the reasons for such criticism in their annual report (Zhongguo Zhengquan Jiandu Guanli Weiyuanhui guanyu yinfa "gongkai faxing zhengquan de gongsi xinxi pilu neirong yu geshi zhunze di 2 hao niandu baogao de neirong yu geshi" (2005 nian xiuding) de tongzhi 2005).[101] Moreover, the fact that a company or individual has been publicly criticized is virtually always reported in the Chinese media. Criticisms can also result in the exchanges taking steps to designate a company's stock as high risk. In Shenzhen, the direct effects appear clearer than in Shanghai. Both exchanges rate the quality of a company's information disclosure, and a sanction generally correlates with a low or non-passing rating from the exchanges. For Shenzhen such ratings are made public and posted on the exchange's website; in Shanghai the reports are apparently not made public. Although being sanctioned does not automatically lead to a listed company being designated as high-risk by the exchanges, Shenzhen officials state that multiple sanctions can contribute to such a designation.[102]

The reputational effects of a sanction may be even more significant than the inability of a company to raise new funds. This may be particularly the case in China, where both individual career prospects and corporate performance may depend heavily on reputation.[103] All market participants we interviewed for this study agreed that exchange sanctions will have a serious impact on companies' and individuals' reputations. One exchange official commented that criticism will result in "lots of pressure" on both the companies and individuals who are criticized.[104] A lawyer remarked that being sanctioned will affect investors' trust in a company, particularly

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[101] The 2005 notice is the most recent notice governing the content and format of annual reports. Similar provisions regarding disclosure of exchange Public Criticisms existed in notices that applied in prior years, and are also included in the CSRC's notice governing semi-annual reports.

Although companies subject to exchange criticisms are required to disclose the fact of the criticisms, they are not generally required to apologize. Interview 2006-7. In two cases in our sample, however, the Shenzhen Exchange ordered sanctioned companies to issue public apologies to stockholders. Both sanctions were issued in 2002.

[102] Interview 2007-5.

[103] For an extended discussion of reputation rights of companies and individuals, see Liebman (2006).

[104] Interview 2206-63.

given that the market is moved by rumor.[105] Some noted the official role of the exchanges means that exchange sanctions will send a clear message to investors that a company's problems are severe. As the lawyer explained, "Investors will think that [misconduct] is no big deal unless the government cares."[106] Once the exchanges act, however, the companies will suffer negative effects.

Yet the most significant consequences on companies' reputations are more difficult to quantify. Lawyers say that companies do not want to be known as having problems.[107] Exchange officials say that being criticized will affect "companies' trust in society" as well as the jobs of corporate officials.[108] Likewise, weakened corporate reputations may affect their ability to earn profit.[109] For state-owned companies, exchange sanctions may have indirect political consequences on companies as well as managers, directors, and supervisors. Being criticized may affect companies' relationships with state entities that control the company – and that designate senior company management. Similarly, an exchange criticism may impede a company's ability to engage in mergers or reorganizations. Although the consequences of being subject to criticism by an exchange appear far less serious than those of being sanctioned by the CSRC, companies nevertheless fear any official exposure of wrongdoing.

The consequences for non-state companies may be even more significant. The CEO of a non-state company listed in Shenzhen that had been informed of the Shenzhen exchange's intention to issue a public criticism, explained the potential consequences of being publicly shamed.[110] The executive explained that the company is trying to be known as a high quality company; receiving a public criticism "will cause problems."[111] Being sanctioned would affect the company's ability to raise additional capital, its relationship with banks, and its ability to engage in restructuring and mergers. It will also affect the company's standing with investors. The CEO argued that few investors pay attention to corporate disclosure, but they will take note that a company has been subject to an official sanction. The CEO noted that the company was not state-owned. If state-owned companies encounter problems, the executive argued, banks and the local government will work with the company to address the problems; private companies do not enjoy the same protections.[112]

The CEO also contended that the Shenzhen Exchanges' more aggressive strategy in recent years may create disincentives to provide accurate disclosure. The CEO acknowledged that the company had engaged in misconduct by failing to disclose certain loan guarantees, but noted that the problems occurred in the past, before the current management team took over. Indeed, the problems were disclosed by the new

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[105] Interview 2007-34.
[106] Interview 2007-34.
[107] Interview 2006-71.
[108] Interview 2006-72.
[109] Interview 2006-72.
[110] The company was, at the time, also being investigated by the CSRC. Interview 2007-29.
[111] Interview 2007-29.
[112] Interview 2007-29. In the case of individuals, however, the consequences for managers and directors of state-owned companies appear to be as or more severe. *See infra.*

management: "We tried hard to reveal [the past problems]. Now they will sanction us. This is not fair."[113] Were they to be punished, the executive argued, it would send a message to other companies that they will be sanctioned for fully complying with disclosure obligations regarding past misconduct: "If [the exchange] punishes us, others will be encouraged to cover-up."[114] The executive conceded that an internal sanction was appropriate, but argued that publicly shaming the company would achieve little.[115] China's markets are maturing, said the CEO, but the exchanges should not move too far ahead of the market in its enforcement strategy.[116] The company has made major improvements in recent years, and should be encouraged rather than punished. Echoing current central government concern with social stability, the CEO noted that there was a potential risk to the state if the exchanges were too aggressive: the company has hundreds of workers, whose livelihoods could be affected if the company's business suffers as a result of being subject to a public criticism.[117]

The CEO's assessment that the consequences of exchange sanctions have become more significant in recent years is shared by exchange officials. Exchange officials note that in the past, companies paid little regard to the possibility of being sanctioned – with some saying that they did not care if they were sanctioned. In contrast, today, companies take extensive steps to try to avoid sanctions.[118] Nevertheless, not all companies give the threat of sanctions the same emphasis. One lawyer commented that companies who have strong reputations will treat the threat of being criticized very seriously; companies that are already encountering difficulties may be less concerned.[119] Likewise, exchange officials state that some companies continue to disregard the threat of exchange sanctions.[120]

As with sanctions on companies, the most significant effects on individuals may be intangible. Officials, lawyers, and corporate officials all stated that the consequences of a public criticism on an individual's reputation can be severe. Corporate officers and independent directors frequently attempt to persuade the exchanges to sanction only the company, not them individually.[121] Many argue either that they were unaware of the conduct, or had no choice but to acquiesce because they were assigned to serve as a director by the company's controlling shareholder.[122] Many independent directors are academics or well known people who fear that the criticisms will harm their public standing.

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[113] Interview 2007-29.

[114] Interview 2007-29.

[115] The CEO stated that being sanctioned internally would also have an effect on an individual's long-term job prospects, as individuals are required to disclose the fact they have been sanctioned internally as well as publicly. But the consequences of an internal sanction would not be as severe as those resulting from a public criticism. Interview 2007-29.

[116] *Id.*

[117] Interview 2007-29.

[118] Interview 2007-5; *see also supra*.

[119] Interview 2006-70.

[120] Interview 2007-9.

[121] Interview 2007-1; Interview 2007-5; Interview 2007-8.

[122] Interview 2007-5. Exchange officials comment that many such directors appear to have virtually no prior awareness of their legal obligations as directors.

The effects on non-independent directors' reputations can also be severe. Non-independent directors likewise may fear that being sanctioned may affect their ability to obtain employment in the future.[123] Executives at state-owned companies are generally appointed by the government department that oversees the company. Their next position thus frequently is within government: as one lawyer observed, someone who is a CEO of a state-owned company today may be appointed governor of a province next year.[124] Being sanctioned may affect executives' career path within the Party-state system.[125] The CEO of the non-state company facing a possible sanction explained the possible effects of a public criticism: "It will harm my reputation; this looks very bad."[126] Although none of the existing directors were at the company at the time the misconduct occurred, the exchange had listed the current directors as potential targets of a sanction. The executive noted that a criticism of an individual would harm that person's ability to obtain a position at another company. Prospective employers will see only that the individual has been sanctioned, rather than inquiring whether the misconduct occurred on the individual's watch.

4. EVALUATION

We began the paper by noting several strands of literature related to our research on stock exchange criticisms. In this final section, we examine the contributions of our research to these separate literatures. We begin by assessing the benefits and costs of this form of regulation in the contemporary Chinese context.

The most obvious advantage of shaming sanctions is low cost enforcement. Shaming works as a punishment and a deterrent because reputations are valuable assets, and shaming injures reputation (Kahan and Posner 1999). Our qualitative empirical assessment of public criticisms strongly suggests that both corporate and individual reputations matter in China, and that firms and individuals fight to stave off criticism from the stock exchanges. We have also presented evidence that other parties shun (or raise their price for dealing with) firms and individuals that have been publicly criticized by the exchanges. These findings suggest that public criticisms are doing some work in punishing and deterring improper corporate conduct by listed firms in China, though we cannot make any definite claims about the extent to which this is true. The criticisms thus provide a comparatively low cost regulatory tool.

Shaming sanctions may be more effective where the surrounding institutional environment is comparatively devoid of alternative deterrence and punishment mechanisms. Certainly that describes the current situation in China, where, as we have seen, the stock market is not yet supported by a robust network of enforcement institutions. The primary market regulator, the CSRC, is well intentioned and perhaps as

[123] Interview 2007-8.
[124] Interview 2007-35.
[125] Interview 2007-35.
[126] Interview 2007-29.

aggressive as it can be given its resource constraints and limited political breathing room. But it is ill-equipped to serve as the sole monitor of the capital markets. Shareholder litigation, which in the United States serves as a crucial complement to SEC oversight, is simply not yet a viable means of investor protection in China. Other potential actors, such as active institutional investors, civil society organizations, and a free financial press, are also either missing or at a nascent stage of development. In such an environment, the stock exchange criticisms appear to be an important part of China's current regulatory regime. Perhaps their role will fade as surrounding institutions develop greater capacity, but currently they seem to be gaining in importance in the regulatory regime.

We do not claim that shaming is necessarily more effective in China than elsewhere. But reputational sanctions may have particular force in China given both the underdeveloped status of China's legal institutions, and the strong emphasis on reputation evident in Chinese society today (Liebman 2006). The use and effectiveness of shaming sanctions is also not surprising given China's legal history. Shaming played an important role in China's imperial legal system, most notably in the wearing of the cangue, and in the Chinese legal system prior to the reform era. Shaming as a mechanism of political and social governance played a major role during the Cultural Revolution, suggesting perhaps some type of cultural or social affinity for this tool of public ordering, at least among those in positions of authority. Indeed, one explanation for why Chinese law provides robust protection for reputation rights today – in particular when contrasted with other forms of individual rights – is a desire to avoid to the reputation-based attacks of the Cultural Revolution.

Might the recent experience of exchange sanctions hold lessons for other areas where under-enforcement of law remains a problem? We are wary of declaring reputational sanctions to have extensive application outside the corporate governance context. The recent use of shaming sanctions by the Chinese police against prostitutes in Shenzhen touched off widespread outrage and condemnation within China, reflecting how far China has come from the pre-reform era (Magnier 2006). But our findings are also consistent with the view, set forth by one of us elsewhere, that public exposure may be the single most effective tool for combating wrongdoing in China today (Liebman 2005). Some of the institutional characteristics of China's stock exchanges are unique. For example, the exchanges do not have close political ties to the companies they oversee, and most of the companies that they oversee are not from their local jurisdictions. Local protectionism thus appears to be a far less significant factor than it is in many areas in which China suffers from under-enforcement of laws and regulations. Nevertheless, even in areas where local protectionism is a major problem, including perhaps most notably environmental law, there may be lessons from the experiences of China's stock exchanges: limited devolution of power to relatively autonomous institutions may have a significant effect. And targeting the reputations of wrongdoers may be more practical, and more effective, than more complicated or cumbersome enforcement actions which rely upon a host of complementary enforcement institutions.

China's stock market development to date provides important comparative evidence in support of the literature on stock exchanges as providers of investor protection. Of course, the Chinese context is distinctive and cannot be squarely equated with the historical experience of the United States or the U.K. which inspired this literature. But within the distinctive constraints of contemporary Chinese institutions and politics, stock exchange criticisms appear to be an innovative and proactive experiment in investor protection to raise the quality and stature of the stock market. The experience of the Shenzhen Exchange in particular highlights the role of self-interest as a motivation to provide investor protection. In order to compete effectively, exchanges must be concerned about the governance practices of listed companies and the quality of the information disclosure regime. This motivation holds even where, as in China, the exchanges are extensions of the state rather than private membership organizations. The London and Hong Kong Stock Exchange pioneered the use of public criticisms as a regulatory device to improve investor protection. Acting on similar motivation, mainland Chinese stock exchanges appear to have effectively transplanted this regulatory technique into a more state-centered market system.

The benefits of the stock exchange criticisms as deployed in China, however, appear to extend beyond investor protection. We find particularly intriguing the fact that other regulators and market actors are beginning to piggyback on the stock exchange criticisms. As shown above, the CSRC now ties capital raising and independent director criteria to the stock exchange sanctions. The central bank is making use of the information produced by the stock exchanges in building a national credit rating system. Available evidence suggests banks already take account of the criticisms in their loan decisions at some level. And somewhat more speculatively, prosecutors and political actors appear to use the sanctions as a signaling device to identify "bad actors" whose conduct requires special scrutiny. In this way, the stock exchange criticisms have become a focal point for further regulatory development and market policing. Cooperative interactions among governmental and market actors are expanding the scope and impact of the stock exchange criticisms.

Our study also offers a perspective on the small body of literature discussing the role of the media in corporate governance. The principal conclusion of this literature, which focuses exclusively on investor reaction, is that international media exposure can be a useful corrective to corporate governance problems, particularly in a transition economy such as Russia, by amplifying the reputational cost of misbehavior (Dyck, Volchova and Zingales 2006). Our study of the Chinese situation both supports and departs from this conclusion. Clearly the sanctions gain force through publication in the media. Indeed, the interaction between the stock exchanges and the media seems crucial to the functioning of this system of punishment and deterrence. Here too, we see collaboration among separate institutions as a means of creating a novel form of informal regulation. The stock exchanges use the media to publicize the sanctions, and media coverage increases the reputational effect on the offender (Dyck and Zingales 2002; Dyck, Volchova and Zingales 2006). However, in China, it is domestic, not international, media coverage that matters. We are unaware of any reference, let alone coverage, of Chinese stock exchange criticisms in the international media. Also note that the reputational impact of the criticisms (and media coverage thereof) extends well beyond the investing public, to encompass other regulators, banks, government officials, and prospective employees of corporate management.

At first glimpse the important role of China's non-free media in corporate governance issues might appear counterintuitive. In practice, however, the Chinese media enjoy significantly more autonomy in reporting on financial misconduct than they do reporting on most other areas of Chinese law and society. China's leadership has clearly recognized the valuable role the media can play in curbing corporate misdeeds – even as they continue to limit the media's ability to report on many other areas. And the Chinese media remain arms of the Chinese Party-state: there are virtually no privately owned media outlets in China. The Chinese media's long history of serving as both state mouthpiece and as an important intelligence gathering institution for Party-state leaders results in media whose reports are often particularly influential (Liebman 2005).

Public criticisms, like any other form of regulation, have costs and limitations. As Dan Kahan and Eric Posner have noted, there is no reason to believe that the level of deterrence provided by shaming sanctions is optimal, because the reputational injury to the offender depends on highly idiosyncratic variables that are not fully known to the government (in our case, the exchange) when it imposes the penalty (Kahan and Posner 1999, pp. 373-373). Plainly, the level of deterrence provided by the stock exchange criticisms has been insufficient to deter significant levels of bad conduct in the Chinese stock market. Moreover, though the criticisms may be a relatively cheap form of enforcement for the government, they may be costly to society. This is particularly true if the stock exchanges impose criticisms erroneously or for motives unconnected to investor protection. We have no evidence that this occurs, but the procedural vagueness surrounding the sanction decisions and the lack of a formal appeal mechanism are certainly cause for concern. Even where criticisms of listed firms are 100% accurate and well intentioned, shaming a corporation can adversely affect the reputations of individuals who were not involved in the wrongdoing.

While we cannot provide a definitive assessment of the contributions of stock exchange criticisms to China's capital market development, our study does provide one of the most concrete examples available of a phenomenon other scholars (Allen, Qian and Qian 2005) have argued is key to China's economic growth in the absence of robust legal institutions—reputational mechanisms to support market activity. In the case of China's securities market, the threat of reputational sanctions appears to provide the exchanges with significant leverage to achieve the primary goal of any securities regulatory regime—namely, corporate disclosure of material information. Moreover, the purely reputational effects of the sanctions are buttressed by formal rules restricting the financing ability of firms subject to public criticism. Whatever its shortcomings, this scheme of regulation appears to be simultaneously providing a measure of investor protection and serving as the basis for more formal regulatory efforts to bolster the quality of information relevant to equity and bank finance.

Our analysis also highlights parallels with other reforms at the edges of the legal system. As one of us has pointed out in a different context, the Chinese legal system contains space for innovation by a range of actors (Liebman 2006, pp. 107-108). Experimentation and devolution of lawmaking or law enforcement activity are common to legal reforms across a range of substantive and institutional areas in China. In the case of stock market regulation, we see a modest devolution of authority and the creation of multiple, overlapping lines of regulatory authority. Hence we see explicit and implicit devolution of authority by the CSRC to the exchanges. In a system where rival interests and institutional capacity may make it hard for CSRC to play a greater oversight role, devolution is becoming an effective tool.

Yet the recent experience in China's securities market may be particularly noteworthy because although experimentation and devolution in lawmaking and in economic policymaking are common in China, devolution of enforcement powers has been less successful. Local protectionism is perhaps the single biggest problem undermining China's efforts to strengthen its legal system, and the combination of devolved authority and local protectionism frequently leads to under-enforcement. In the case of exchange sanctions, however, devolved authority is contributing to more effective oversight – in part because of the absence of local protectionism (or perhaps more accurately, because the local incentives operating on the exchanges favor stronger, rather than weaker, enforcement), and in part because the exchanges have relied on reputational sanctions, rather than more formal punishments. The exchanges' institutional interests in expanding their own authority and influence have played an important role in such developments. Modest forms of regulatory competition are also emerging between the two exchanges, and may likewise be providing incentives to the exchanges to expand their influence.

CONCLUSION

We have examined China's legal and self-regulatory strategies for capital market development. Although progress to date is mixed, we have uncovered a feature of Chinese securities regulation that has thus far received almost no attention: the role of reputational sanctions imposed by the stock exchanges as a mechanism of punishment and deterrence in the capital market. Although this regulatory mechanism may take a rather unorthodox form, our empirical evidence and interview results strongly suggest that the market is punishing bad conduct. The broader lessons from this novel experiment for the securities law and for Chinese law more generally, may not be known for years. But one conclusion is clear: new forms of governance are being created in the interstices of what we normally perceive of as a clear dichotomy between state and private regulation of the securities markets. China's institution-building exercise in the area of capital markets is worth understanding at a deep level of institutional detail. This article has been a first step in that direction.

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Table 1

WORLD RANKINGS OF MARKET CAPITALIZATION, VALUE TRADED, AND NUMBER OF LISTED DOMESTIC COMPANIES, 2005

Rank	Market	Total Market Capitalization (US$ millions)	Rank	Market	Total Value Traded (US$ millions)	Rank	Market	Number of Listed Domestic Companies
1	United States	16,997,982	1	United States	21,509,979	1	United States	5,143
2	Japan	4,736,513	2	Japan	4,997,414	2	India	4,763
3	United Kingdom	3,058,182	3	United Kingdom	4,167,020	3	Romania	3,747
4	France	1,710,029	4	Germany	1,763,155	4	Canada	3,271
5	Canada	1,480,891	5	Spain	1,557,246	5	Spain	3,300
6	Germany	1,221,250	6	France	1,475,537	6	Japan	3,279
7	Hong Kong	1,006,228	7	Korea	1,202,976	7	United Kingdom	2,759
8	Spain	960,024	8	Italy	1,115,224	8	Korea	1,643
9	Switzerland	938,624	9	Saudi Arabia	1,103,502	9	Australia	1,620
10	Australia	804,074	10	Switzerland	883,270	10	China	1,387
11	Italy	798,167	11	Canada	845,017			
12	China	780,763	12	Netherlands	757,437			
			13	Taiwan	618,207			
			14	Australia	616,115			
			15	China	586,301			

Source: S&P Global Stock Market Factbook (2006)

Table 2
COMPARISON OF EXTERNAL CAPITAL MARKETS (MEAN)

Country	English origin average	French origin average	German origin average	Scandinavian origin average	LLSV origin average	China (2002)
External capital/GNP	0.60	0.21	0.46	0.30	0.40	0.49 (0.16)*
Domestic firms/Pop	35.45	10.00	16.79	27.26	21.59	0.93
IPOs/Population	2.23	0.19	0.12	2.14	1.02	0.05
Total debt/GNP	0.68	0.45	0.97	0.57	0.59	0.35 (0.79)**

Source: Adapted from Allen et. al. (2005)
*External capital/GNP ratio using the floating supply or value traded portion of the market capitalization.
**Total debt/GNP ratio using bank loans issued to all sectors including the state sector.

Table 3

CSRC SANCTIONS, 2001-2006

		2001	2002	2003	2004	2005
Total Number of Sanction Decisions	29	17	35	49	43	2006
Sanctions Directed against Entities or Entities and Individuals	24	13	33	39	38	25
Sanctions Directed against Individuals Only	5	4	2	10	5	18
Total Number of Companies Sanctioned	24	13	33	39	38	7
Listed Companies	8	5	17	26	14	18
Securities Entities (includes Securities Companies and subsidiary organizations)	9	3	7	3	20	13
Law Firms	0	0	0	0	0	3
Accounting Firms	4	4	4	4	2	0
Asset Appraisal Firms	0	0	0	1	0	1
Other types of companies	3	1	5	5	2	0
Total Number of Individuals Sanctioned	115	70	147	283	154	1
Company Directors	79	53	130	241	117	101
Company Non-Director Employees*	1	3	4	7	10	69
Company Supervisors	0	0	0	1	0	6
Securities Industry Employees	16	4	4	20	20	0
Certified Public Accountants	16	9	9	12	7	15
Lawyers	0	1	0	0	0	4
Certified Public Values	0	0	0	2	0	0
Others	3	0	0	0	0	0
Cases Involving Information Disclosure	8	6**	17	27**	15**	7

Source: CSRC web site

NOTE: One case from 2001 appears to be missing from the website and thus is not included in the table.

* Typically a chief accountant or financial supervisor.

** One case included in the total is a sanction against an individual only, not the company.

Table 4
NUMBER OF PUBLIC CRITICISMS OF LISTED COMPANIES BY STOCK EXCHANGES, 2001-2006[127]

Year	Shanghai Stock Exchange	Shenzhen Stock Exchange
2001	16 (646)	32 (514)
2002	16 (715)	21 (509)
2003	19 (780)	17 (507)
2004	21 (837)	18 (540)
2005	18 (834)	33 (544)
2006	19 (840)	28 (533)
Total	109	149

Source: Stock Exchange Public Criticisms
( ) indicates number of listed companies as of December 31[128]

[127] The data include all publicly available exchange-issued public criticisms. It is possible that a small number of additional public criticisms were issued but not listed on the exchange's website.
[128] Numbers of listed companies are from the websites of the Shanghai and Shenzhen Stock Exchanges.

Table 5

NUMBER OF CRITICISMS OF INDIVIDUALS, 2001-2006

	Shanghai Stock Exchange	Shenzhen Stock Exchange
2001	11	105
2002	156	28
2003	173	110
2004	134	101
2005	159	256
2006	149	276
Total	782	876

Source: Stock Exchange Public Criticisms

Table 6

POSITION OF CRITICIZED INDIVIDUALS

Position of Sanctioned Individual	Shanghai Stock Exchange	Shenzhen Stock Exchange
Executive Director	645	735
Independent Director	25	40
Board Secretary	11	7
Supervisor	91	64
Chief Accountant/CFO	4	3
Other Management	6	27

Source: Stock Exchange Public Criticisms

Table 7

STOCK PRICE REACTION TO CRITICISMS AND CORPORATE DISCLOSURE

	# of Observations	CAR 3-day	Z-value (CAR 3-day)	CAR 5-day	Z-value (CAR 5-day)
Public Criticism SHSE	68	-0.0207	-3.68***	-0.0272	-3.75***
Public Criticism SZSE	98	-0.0096	-2.05**	-0.0058	-0.96
Company Disclosure SHSE	90	-0.0368	-7.59***	-0.0421	-6.72***
Company Disclosure SZSE	140	-0.0364	-9.40***	-0.0396	-7.93***

** Significant at 0.05 level

*** Significant at 0.01 level

Table 8

COMPANIES SANCTION FOR MAJOR MISCONDUCT BY STATE-AFFILIATION[129]

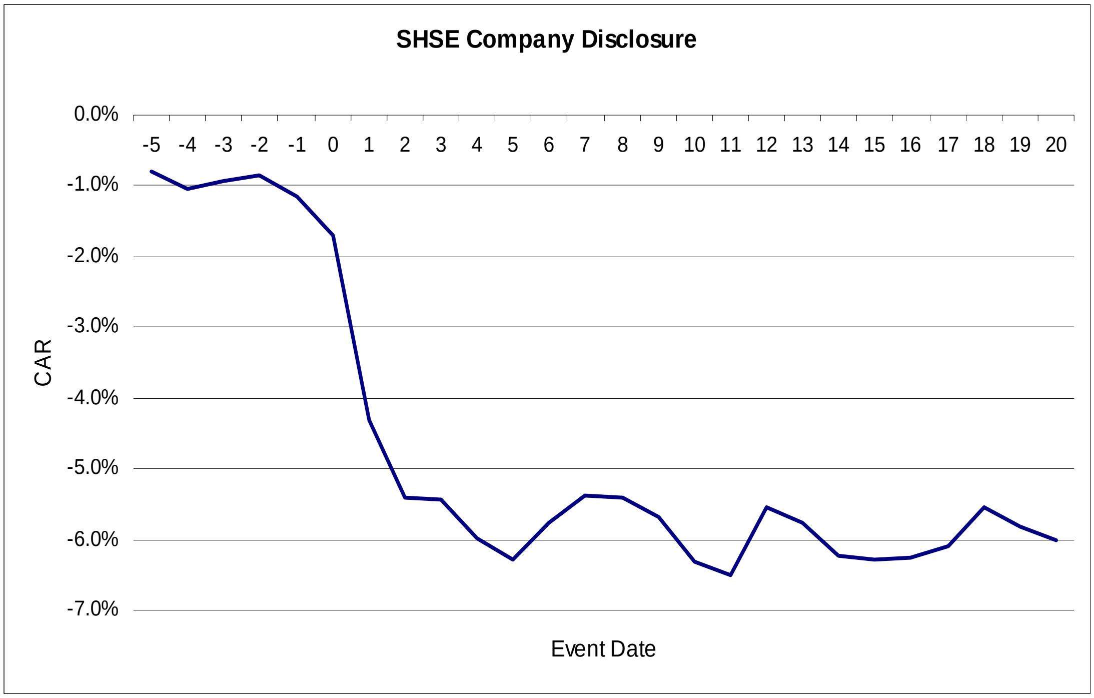
Actual Controlling Entity	Number of Sanctioned Companies -Shenzhen	Number of Sanctioned Companies -Shanghai	Total
State-Owned Companies			
National State-Owned Assets Supervision and Administration Commission	6	6	12
Other Central Government Departments and Commissions	2	6	8
Provincial State-Owned Assets Management Authorities	15	9	24
Provincial governments	2	1	3
Other (lower-ranking governments)	22	12	34
State-Owned Companies Total	47	34	81
Private Companies	70	43	113
Total	117	77	194

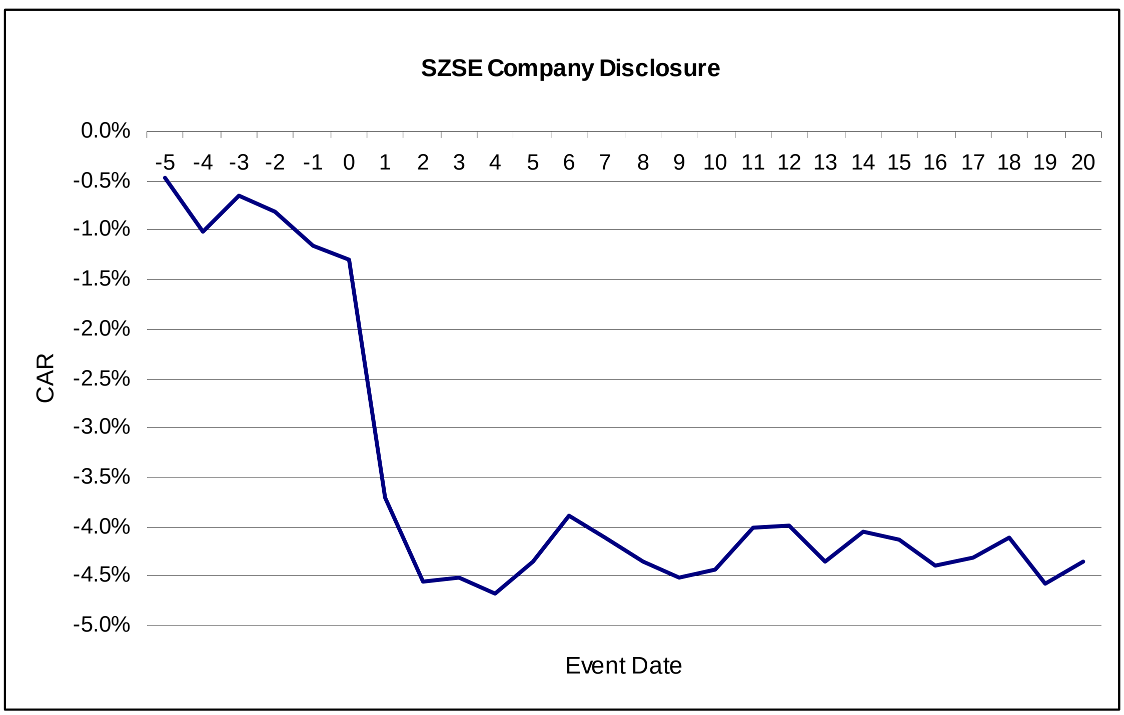
Source: Calculations based on company annual reports

129 Sanctions for minor misconduct – most often failure to file timely reports – have been excluded. Information on ownership was obtained from review of company annual reports.

Graph 1

STOCK PRICE REACTION TO COMPANY DISCLOSURE





Graph 2

STOCK PRICE REACTION TO STOCK EXCHANGE CRITICISMS