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Credit Ratings In China Can Be Mere Guesswork

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INTERNATIONAL CREDIT-RATING companies charging into China are operating in such darkness that many investors question the value of their work in the country.

Demand for credit ratings—an assessment of how willing and able a borrower is to repay debts—is growing as more Chinese companies raise capital from international investors. But faulty accounting, poor corporate governance and a lack of disclosure hamper the raters' efforts.

China doesn't adhere to international accounting standards, and publicly listed companies can be controlled by private parent companies that aren't required to disclose financial information. To make matters worse, the government issues misleading statistics.

CREDIT MARKETS

Whether rating companies succeed in enhancing transparency among Chinese companies is a key test as the nation attempts to develop world-class capital markets.

If Fitch Ratings, Moody's Investors Service and Standard & Poor's can push companies into releasing more information and their ratings are seen as reliable, that could help bolster confidence in China as it looks to foreign investment to fuel its growth.

Though China is opening, it's a slow process. Brian Colton at Fimalac SA's Fitch Ratings in Hong Kong, rates China's sovereign bonds. Part of his job is to assess China's economy. But Mr. Colton says he's never sure how reliable the data are. He often tallies the gross domestic product figures of China's 23 provinces and seven administrative regions and finds the total is different than the national GDP figure issued by Beijing. "Sometimes you have a column of figures that don't add up to the total at the bottom. It's that bad," he says.

However, China is a potentially lucrative market, with more than eight million corporations and 130 banks hungry for capital to expand. Since 1998, the annual value of initial public offerings in China has increased nearly 50% while bond issuance has doubled, according to financial data provider Thomson Financial.

So far, the international ratings companies combined have rated fewer than 100 Chinese enterprises. Ratings companies charge as much as $80,000 for an initial rating and up to $40,000 a year to maintain surveillance on companies and adjust ratings as needed.

Critics say the raters' work in China is useless

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China's Murky Data Cast Doubts on Work Of Credit Agencies

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because it's based on limited information. They are also alarmed by the willingness of the companies—which have been criticized in recent years for failing to spot trouble at Enron Corp. and other accounting blowups—to work around big problems. "If you have any credibility, you would probably be rating everything junk in China," says Scott Kennedy, an assistant professor at Indiana University in Bloomington, Indiana, who specializes in China's political economy.

Brad Aham, an Asian equities portfolio manager at State Street Corp., who has $2 billion invested in emerging Asian markets, puts it this way: "Credit rating agencies can keep the markets abreast of ongoing structural problems in China, but in terms of data that affect markets on a daily basis, rating agencies aren't that useful."

Fitch, Moody's and McGraw-Hill Cos.' S&P are focusing on the Chinese government's sovereign bonds and companies listed on stock exchanges outside the mainland, where disclosure is better than at nonlisted enterprises. Publicly listed companies such as China Mobile (Hong Kong) Ltd. and Huaneng Power International Inc. have had their bonds rated investment grade.

Charles Chang, an associate director at Fitch Ratings in Hong Kong, was able to rate a Chinese retailing company that was considering a bond issue in 2002, despite the fact that there was little information available about China's retail sector or the company's finances. To compensate, he constructed "stress scenarios," and hypothesized about the company's ability to cope if retail sales fell sharply or the economy slowed suddenly. "It wasn't easy," he says.

Fitch and Standard & Poor's have begun conducting public-information ratings, which use publicly available information and media reports to evaluate a company rather than consultations with management. Fitch and S&P say such ratings are necessary in China, where company cooperation is hard to get. But in China such ratings can rely on censored media reports. Moody's has stopped public-information ratings, saying they're inaccurate.

Indiana University's Mr. Kennedy says the rating companies give Chinese institutions inappropriately high ratings because they weigh favorably the country's huge economic growth and government support of state-owned enterprises. Fitch, Moody's and S&P each tie their ratings on China's banks to the ratings on the government's bonds. But executives say they have to do this because the country's banks are insolvent, with nonperforming loans accounting for as much as half the total loan portfolios.

Ratings companies say problems are inevitable as China moves from a state-planned economy to a free market economy. They add that they are more critical than China's domestic credit-rating firms. And they say that China is making efforts to improve corporate governance, making it mandatory for public companies to report financial data on a quarterly basis rather than every six months and opening two national accounting institutes to train people in international accounting.

"You'll never have all the facts," says Wei Yen, a China bank analyst at Moody's, a unit of Moody's Corp., in Hong Kong. "You get what information you can and make a decision based on your logic."