

Sino-Environment: An S-Chip Scandal

Case Overview

A loan default by the CEO and Chairman of Sino-Environment, Sun Jianrong, triggered a series of events that led to the unraveling of yet another S-Chip scandal plaguing the Singapore stock market. The objective of this case is to allow a discussion of issues such as the business practices and corporate governance of Chinese companies that seek a listing in Singapore, the role of independent directors, and enforcement challenges for foreign companies listed on the Singapore Exchange

About Sino-Environment

“With our new factory due to complete by end 2006, our manufacturing capacity will more than double, from the current approximately three devices per month to approximately seven devices per month. We will also diversify into the treatment and management of other types of industrial waste gases, in particular, sulphur dioxide, which is emitted from power generating facilities. With our strong R&D capabilities and dedicated management team, we are well positioned to benefit and grow in tandem with the continuing industrialisation and increasing awareness of environmental protection in the PRC.”

– Sun Jianrong when Sino first sought listing in Singapore.

This is the abridged version of a case prepared by Chong Jie Ying, Goh Ai Ling, and Koh Kai Ling under the supervision of Professor Mak Yuen Teen. The case was developed from published sources solely for class discussion and is not intended to serve as illustrations of effective or ineffective management. Consequently, the interpretations and perspectives in this case are not necessarily those of the organisations named in the case, or any of their directors or employees. This abridged version was prepared by Elaine Kok Shin Yean under the supervision of Professor Mak Yuen Teen.

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Sino-Environment is an environmental solutions specialist in four main areas: (1) industrial waste gas treatment, management and recovery of volatile organic compounds, (2) industrial and municipal waste water treatment and management, (3) dust elimination, and (4) industrial waste gas treatment and management of sulphur dioxide and oxidised forms of nitrogen.

The company adopts a product differentiation strategy. It uses its research and development capabilities to stay ahead of technological competition and continuously improves its technological and innovative applications.

The Board of Directors

The board consisted of seven directors, with three independent directors (IDs): Goh Chee Wee, Wong Chiang Yin and Pan Jinquan. Goh was appointed as the lead independent director. He sat on the boards of nine other listed companies and also held other key appointments, such as being a director of the National Trades Union Congress (NTUC) cooperatives. Wong sat on the boards of other listed companies and was a senior executive in a healthcare group based in Malaysia, holding positions such as executive director and CEO in hospitals and companies in the group. He was also President of the Singapore Medical Association. The third ID, Pan, had no prior experience sitting on the board of a listed company.

The remaining four executive directors also held key management positions: Sun Jiangrong, Executive Chairman and CEO; You Shengquan, Chief Operating Officer (COO); Professor Li Shouxin, Chief Technology Officer (CTO) and Tan Tar Wuei, Chief Financial Officer (CFO). All three IDs sat on the Remuneration, Nominating and Audit Committees. The board had diverse competencies in business management, science, engineering, accountancy, medicine and economics and at least one had experience in the waste management industry.

Throughout the year, four meetings were held.

The Beginning of the End

The troubles at Sino-Environment started when Sun Jiangrong, CEO and Chairman of Sino-Environment, pledged his entire majority stake of 56.29 per cent (190.8 million shares)¹ in Sino-Environment as part of collateral for a personal loan from a hedge fund. A S\$120 million loan default by Thumb (China) Holding Group Ltd (TCH) triggered the unraveling of Sino-Environment. Unknown to many, TCH was a controlling shareholder of Sino-Environment and was, in fact, an investment firm wholly and beneficially owned by Sun.²

When Sun defaulted on the loan in early March 2009, the hedge fund seized his shares in Sino-Environment and sold off the entire stake in the open market, causing Sun to lose control of the company³. The forced sale of his shares triggered a premature redemption of convertible bonds worth S\$149 million, as the agreement for the bonds included a covenant which requires Sun to remain in control of the company⁴.

The severity of the issue emerged when PricewaterhouseCoopers (PwC) issued an audit disclaimer on Sino-Environment's financial statements due to going concern issues. nTan Corporate Advisory Pte Ltd was then appointed as Sino-Environment's independent financial advisor to assess the implication of the default, as well as implement measures to safeguard the assets of Sino-Environment⁵.

Seeing Red

PwC was engaged to review "significant cash transactions" between January and March 2009, which coincided with Sun's loan default⁶, when Sino-Environment failed to produce its first quarter results in May 2009. This raised doubts on CFO Tan Tar Wuei's resignation at end April for 'personal reasons'. No action was taken to appoint a new CFO by management.

The other executive directors (EDs) - the CEO, CTO and COO -, dropped a bombshell in the market on 5 May 2009, when they tendered their resignation en-masse without giving any reasons⁷. The independent

directors (IDs) pleaded with the executives to remain on board to ensure that operations ran smoothly⁸. On 29 May 2009, all three executives were reinstated while Tan, the former CFO, was reinstated as a non-executive director⁹. However, it emerged that during the period after they had tendered their resignation, the key management had retained control of the PRC subsidiaries and held access to the company's bank accounts.

Sino-Environment's shares finally ceased trading in September 2009. Things took a turn for the worse when PwC's special audit revealed that at least S\$85 million worth of cash transactions were made without any approval or authorisation from the board¹⁰, amongst other dubious transactions where cash was evidently siphoned off the company's books.

Roadblocks

The individuals responsible for the questionable transactions made things difficult when PwC went to China to conduct audits. "Special" bank officers were pre-arranged to "deal" with the auditors, forced them to leave the bank premises, and were unwilling or unable to verify statements shown to them. As a result, PwC had to cease further investigations.

Back in Singapore, accusations and counter-accusations were thrown in public. The IDs accused the EDs of mis-using their power as directors. The EDs responded that the financial controller appointed by the board had mis-used the company's funds by paying professional fees to PwC and nTan instead of repaying the outstanding convertible bonds. This time, the IDs called for the immediate resignation of the EDs.^{11,12}

Taking Action

To protect their interests, the minority shareholders of Sino-Environment called for an Extraordinary General Meeting (EGM) at the end of November 2009¹³. In his attempt to appease the shareholders, Sun told David Gerald, President and CEO of the Securities Investors Association (Singapore) (SIAS) that Sino-Environment had a cash reserve of S\$40

million in its China bank account although the actual amount turned out to be only S\$31 million.^{14,15} Sun's actions led to Sino-Environment being rapped by the market regulator, Singapore Exchange, for not providing full disclosure to the public but selective disclosure to Gerald¹⁶.

The IDs decided to seek legal recourse to remove the EDs in December 2009 but this proved unnecessary as the EDs resigned en-masse for the second time before the EGM could be held. On 10 February 2010, Sam Chong Keen was appointed as the new CEO of Sino-Environment¹⁷.

The End of the Road?

Barely six months into his two-year term, Sam, the new CEO who was hired to restructure the company, stepped down on 11 May 2010¹⁸. Fresh roadblocks arose when the new management flew to China to obtain authorisation letters for access to the company's bank accounts and to locate missing documents, but the only letter obtained was for a new bank account controlled by Sam¹⁹.

Furthermore, a substantial number of staff members with in-depth knowledge about the company had resigned and little help was forthcoming from the PRC authorities and Sun. Despite evidence of money being moved around in two different accounts, the Fuzhou investigation bureau found Sun not guilty of misappropriation²⁰.

After concluding that it was unable to facilitate the cash and special audits by PwC, the board finally decided to place Sino-Environment under judicial management²¹.

Discussion Questions

1. Comment on the composition of Sino-Environment's board of directors before the scandal. Are there red flags that should have raised concerns with investors?
2. Based on this case, what are some of the key challenges faced by directors and auditors in Chinese companies listed in Singapore?
3. To what extent should the independent directors be held accountable for the problems in Sino-Environment?
4. What are the challenges faced by Singapore regulators for Chinese companies listed in Singapore?
5. Based on this case, are there any changes in corporate governance rules that should be introduced?
6. Should Chinese companies listed in Singapore be subject to a different regulatory framework and different corporate governance rules?

Endnotes:

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