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## Reconstruction of Chinese Supervisory Board Governance :A Cultural Perspective

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**Abstract:** From the perspective of cultural analysis, parallel system of corporate governance model does not fit the traditional Chinese culture. In order to solve validity of the Chinese corporate Supervisory Board it is necessary to address the problem of authority, independence and motivation. So, we propose that we should reform the position of the Supervisory Board, adjust the structure of the Supervisory Board, ensure the condition and heavily punish the violation of the directors and managers.

**Key words:** Supervisory board, parallel system, two-tier system, corporate governance

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### INTRODUCTION

Supervisory Board governance is an important component of corporate governance which should receive due attention both in theory and practice. Monitoring mechanism of existing corporate research literature suggests that design of monitoring mechanism mainly focused on the internal and external control system. The former one includes running mechanism of the Board, large shareholder governance, incentive contracts and debt financing etc. The latter contains political and legal approach to corporate governance, competition in product and factor markets, institutional investors, creditors, control market and career concerns etc. (Li and Dong, 2004). By contrast, the study on monitoring mechanism of Supervisory Board is obviously insufficient.

British and American law countries attached great importance to the Board of Directors governance research without attention to supervisory board governance study. Most of them adopt a single system of corporate governance. In this mode, shareholders will only set the Board excluding Supervisory Board. Board of directors act as both management and supervisory authority, while Audit Committee under the Board assume supervision functions. Civil law countries implement dual corporate governance, they set Board and Supervisory Board under shareholders. The Supervisory Board, as an independent body exercising supervisory authority, oversee the Board of Directors which are responsible for the management of a corporate. Represented by the German company law

which implement dual corporate governance as "shareholder General Assembly-Board of supervisors-Board-business management". Supervisory Board decide the appointment, removal, remuneration of Directors and monitor implementation of resolutions of Board and related business. China's company law adopt the parallel system, that is, "shareholder General Assembly-Board of Directors, Board of supervisors-company management", in which, Board of Directors and the Supervisory Board are parallel institutions. The new companies Act in 2005 improve our system of Supervisory Board. The Act provide Supervisory Board with greater rights, including "recommend dismissing the Director and senior managers", "raise questions on the Board decisions", "lawsuit against directors and senior managers", "find business exceptions and conduct necessary investigations" and "appoint accountants to assist the work, the costs borne by the company" etc. However, cases of illegal operation such as Enron, WorldCom, Parmalat scandal appeared both at home and abroad, Supervisory Board seemed to be useless, weakening of rights, there is a far cry from the role of Supervisory Board in legislation.

Existing literature on governance functions of Supervisory Board are mostly based on the understanding of "failure of internal control of enterprise is not necessarily caused by the defects of the internal system of governance itself" (Zhu, 2004), poor oversight of Supervisory Board is not caused by the system itself but rather in the implementation. "Low Supervisory Board governance is the result of problems in running

processes not itself" (Li and Hao, 2006). Factors affecting the governance of Supervisory Board include rights, responsibilities, independence, expertise, supervisory information, monitoring power, economic system and ownership structure of the Supervisory Board. (Dahya *et al.*, 2002; Dahya *et al.*, 2003; Xiao *et al.*, 2004; Li and Wang, 2005). Strengthened approach include strengthening the independence of the Supervisory Board, introduce an external supervisor (Peck and Ruigrok, 2000); give the Supervisory Board necessary permission, enhance legal rights of determination (Dahya *et al.*, 2003; Xiao *et al.*, 2004); strict conditions for members of Supervisory Board, improving supervisor entry threshold (Zhu, 2004); improve knowledge structure of supervisory board members, increase the independence of members (Dahya *et al.*, 2003; Liu, 2004); improve the structure of the Supervisory Board, specify the number of worker-representatives, enhance the status of the workers on supervision (Zhu, 2004; Li, 2005); clarify relationships between the supervisory system and independent director system (Li, 2005), coordinate the relationship between independent Director and Supervisory Board (Liu, 2008); Optimize the equity structure form a shareholder equity structure of checks and balances among the top shareholders (Li *et al.*, 2006); weaken the Government involvement in corporate governance, expand Supervisory Board information sources of surveillance (Xiao *et al.*, 2004). Japan supervisors Association, Japan Federation of economic organizations, Japa's Liberal Democratic party propose the advice of strengthening independent supervisory system and clarifying the responsibilities to strengthen the supervisory function.

Revised company law offer greater protective right and conditions for Supervisory Board but why they are still poor in over-sighting? Why the introduction of independent director system which is similar to the introduction of independent supervisory system, is not functioning? Because there are serious problems in the assumption of previous studies which considered China's dual corporate governance model of the parallel system was of no defects, completely ignored the cultural and traditional factors. Therefore, we should start with the cultural roots to find reasons and transform China's Supervisory Board system.

**Analysis:** To a certain extent, the system is a product of culture. Corporate governance are different in different culture (Wang and Feng, 2006). For example, Anglo-Saxon culture, Germanic culture, Confucian culture corresponds to English-American model, German model, Southeast-Asia model respectively. Western culture is the "culture of rule", "Western governance is legal

governance on the basis of contractual relationship. The relationship between human beings is a contractual relationship of rational mind" (Zhang, 2006). Traditional Chinese culture is "Etiquette Culture". "Traditional Chinese governance is ethical governance built on ethics." "With the advantage of low cost, easy to operate, the ethical governance which focus on ethics, lack the rigid treatment and binding legally. In order to avoid failures in governance, traditional Chinese - style management adopt family-control based on blood ties, rural margin and highly centralized management manner" (Zhang, 2006). Xiao T.F.'s "different patterns" suggest that a "different-pattern" society is made by numerous private relations network. The network like a spider's Web, based on itself, like a stone being thrown in the water, the social relations are being built circle by circle (Fei, 1985). "Traditional Chinese-style management construct the governance organization in accordance with the 'different-pattern' relationship" (Zhang, 2006). "With the development of modern economy, the network organization with the ties of consanguinity, geo is expanded to the one with the ties of geo and rural edge". After reform and opening up, economic governance concepts, governance organization and governance method are different formally but their contents are not changed radically (Zhang, 2006). Therefore, there are significant differences among the cultural traditions of China and the United States, Germany and other Western countries, China's traditional culture have obvious "official standard" which emphasizes grades, centralized management, "on the only" and "patriarchal", lack of legal tradition and spirit of rule.

In order to get great independence, the Supervisory Board, as the supervisory authority, should follow the route of "authority-independence-enthusiasm"; only when they get great independence can they have a high degree of enthusiasm and then keep high efficiency, play the role of supervision to ensure the sound operation of the company and shareholders' interests. "Position, power and quality constitute the three basic requirements of the principal authority on supervision" (Zhong, 1993). In the Chinese corporate governance, Supervisory Board and Board of Directors are parallel structures which gain equal status, considering the equal status, even with more powers, due quality, the authority cannot be guaranteed, the oversight role cannot be played to the full. In practice, because the personnel selection, remuneration, working conditions are controlled by the Board of Directors, Supervisory Board were often stay in a vulnerable position, there is no doubt that Supervisory Board system were null and void. Therefore, from a cultural perspective, parallel system of corporate governance is not adapted to

the cultural tradition of China, a two-tier system of corporate governance would be advisable.

**Findings and recommendations:** From a cultural perspective, parallel system of corporate governance is not adapted to the cultural tradition of China it is necessary to reform Supervisory Board and resolve its authority, independence and participation issues.

Introduce the two-tier system of corporate governance. To change the current disadvantaged position of Supervisory Board, we can draw on the experience of Germany, set the Supervisory Board under the general meeting of shareholders but above the position of Directors and managers. In this system, Supervisory Board just take the responsibility of supervision which does not participate in decision-making.

Adjust the structure of Supervisory Board, specify the number of worker-representatives, get banks involved in monitoring. Supervisory Board is composed of internal and external supervisors. Internal supervisors include shareholders' representatives and trade union representatives shareholder representative are elected by the general meeting of shareholders, workers' representatives are elected by the Trade Union or Trade Union Congress of the General Assembly. To embody the full participation, staff supervision, management, protection of workers' legitimate rights and interests it is really necessary to specify the number of worker-representatives. In the process of enterprise reform, enterprise take a huge risk, the specific human capital of workers are precipitated in State-owned enterprises, our operation is directly related to the income of workers, on this point, workers are eager to participate in supervision, workers' representation can be defined as not less than one-third. In the reform of State-owned enterprises, the Bank takes on plenty of allowance for doubtful accounts, bad debt losses of enterprises, most of the corporate rely on funds from Bank loan, soundness of the banking operations are related to the national economic security and the company management has a direct impact on Bank. As the main creditor, Banks have a strong sense of motivation and control of the company's managers; with specialized knowledge and professional skills, banks have the ability to monitor operators; banks have ample means of mastering company business information, supervision cost is low. Therefore, the allocation of control rights to the Bank is rational and effective it is advisable to introduce banks in the Supervisory Board, like that in Germany's universal banking system and the Japanese main bank system.

Protect the operating conditions of Supervisory Board. Although the revised company law provide

conditions but that is not clear enough which should be refined. Funding of the Supervisory Board should be independent and sufficient, annual budget should first be proposed by Supervisory Board and then get approval from shareholders, the specific expenditures are decided by the Chairman of Supervisory Board. Supervisors' remuneration should be decided by shareholders, no longer being decided by the Board. Post arrangement after supervisor expiry term should be decided under clear and specific rules with labor protection without restriction of Directors.

Intensity penalties of Directors and Managers. At present, Manager market in China is still immature it is difficult to restrict offenses of directors and managers, thus, we need to intensity penalties of Directors and Managers, give full play to supervisory function. As to violations deeds, they should get multiple fines besides confiscation totally; option and award plan got improperly should be canceled and confiscated; For serious violations constitute criminal, they should held criminal responsibility; For violations of state-owned enterprise, "one vote reject" system could be implemented, remove their duties and qualifications.

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