

A Summary of Research on the Application of Independent Director System in China

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Abstract: As a supervisory system, the independent director system should be a fair third party. However, for a long time, due to "soft mouthed and short handed", it has gradually become a "vase", and even a channel for major shareholders of some companies to share benefits with "relatives and friends". In the recent case of corporate financial fraud, independent directors were sentenced to assume joint and several liability for compensation, and then dozens of enterprises saw the resignation of independent directors, which aroused the attention of the society to independent directors. A large number of scholars also wrote about their thinking on the independent director system.

Keywords: Independent director system, Corporate governance, System of board of supervisors.

1. Introduction

The independent director system is an important institutional arrangement to improve the governance of listed companies. The independent director system of listed companies was introduced from the United States as an imported product. The purpose and original intention of the introduction was to make up for the imperfection of the supervision mechanism in China's traditional dual system corporate governance model and prevent the company from "owner absence" and "insider" control. However, after the introduction, there were many problems, such as the fact that the name of the independent director was not unique, the functions of the independent director and the board of supervisors overlap and the resulting internal friction. These problems eventually lead to the limited role of the independent director, and it is difficult to achieve the original intention of the system design. To change this situation, only by clarifying the functions of the board of supervisors and independent directors, establishing independent directors' incentive and restraint mechanism, information transmission mechanism, independent directors' market mechanism, and the pre-discussion mechanism of independent directors' decision-making, can the original intention and purpose of the introduction of the system be realized.

2. Current Situation of Independent Director System in China

When it comes to the current situation of China's independent director system, we have to bring up the financial fraud case of Kangmei pharmaceutical. In 2019, the state issued a new securities law, established a litigation system for securities special representatives with Chinese characteristics, and significantly increased the punishment for securities violations. Kangmei Pharmaceutical is the first case after the revision of the new securities law. It is also the civil compensation case for misrepresentation of listed companies with the largest number of plaintiffs and the highest amount of compensation heard by the court so far. It is worth noting that in this punishment, the independent directors of Kangmei Pharmaceutical were jointly and severally liable, and five of

their independent directors were sentenced to assume joint and several liability ranging from 5% to 10%. Among them, Jiang Zhenping, Li Dingan and Zhang Hong bear joint and several liability within 10%, equivalent to about 246million yuan; Guo Chonghui and Zhang Ping bear 5% joint and several liability, equivalent to about 123million yuan. Among the five independent directors, one is the deputy chief accountant of the accounting firm, and the others are professors and doctoral tutors from famous universities. Independent directors are often punished as the relevant responsible person in the administrative punishment of the CSRC, but there is no precedent for assuming joint and several liability for civil compensation. After the judgment of the Kangmei pharmaceutical case is made, it have an impact on the independent directors who make up the number and the companies suspected of fraud. According to media reports, within a week after the judgment of the case of Kangmei pharmaceutical, dozens of companies had resigned their independent directors. Some of them also caused disputes. For example, the resignation of Shi Ximin, an independent director of Kaishan holdings, led to the inexplicable fact that Kaishan holdings became a "problem company" in the eyes of shareholders, and its share price fell. Kaishan holdings expressed strong dissatisfaction and condemnation to Shi Ximin, saying that it "refused the company's retention request and insisted on resigning under the condition that it is easy to mislead investors". After the case of Kangmei Pharmaceutical, the independent directors who just want to earn "extra money" but only ask about the affairs of listed companies may have to weigh the ratio of risk to income.

3. On the Causes of the Invalidation of the Independent Director System

China has introduced the independent director system for more than 20 years, but the role of independent directors has not been brought into play, and the independence of independent directors has been greatly affected. In this regard, this paper analyzes and summarizes the problems of China's independent director system from three aspects: individual, enterprise and country.

3.1. The Lack of Energy Input of Independent Directors

First of all, from the individual level of independent directors, the lack of energy input of independent directors affects the effect of performing their duties. From the current situation of the industry, as experts and scholars with good reputation, rich experience and outstanding ability in some industry fields, independent directors usually serve as board members of more than one company, that is, they are often part-time. This part-time status objectively makes it difficult for independent directors to ensure that they can invest a lot of time in the corresponding listed companies in most cases.

3.2. The Controlled Allowance and Asymmetric Information

Secondly, from the perspective of the enterprise level, on the one hand, the controlled allowance and remuneration makes the independent directors unable to achieve real independence. According to common understanding, an important aspect of corporate governance is to maintain the independence of the board of directors. The independence of the board of directors is generally considered to mean that the decision-making process of the members of the board of directors can be independent of the management of the company, including, of course, the manager, and hold the same interest position with the owners of the company. However, according to the structure of the existing listed companies, the standard for independent directors to receive allowances and remuneration is formulated by the board of directors first, and then reviewed and approved by the general meeting of shareholders. Therefore, the independence of independent directors is greatly reduced, and the status quo of being independent in name but not in reality makes it difficult to achieve the original intention and purpose of their system design. On the other hand, independent directors' access to information is not smooth. There are still many obstacles between the independent directors and their goals to maximize the interests of shareholders. In practice, the identity of independent directors is special, and they need necessary information to assist decision-making. However, it is difficult for them to participate in the board of directors and obtain other internal information of the company. The inferences and conclusions drawn in the absence of basic information will inevitably deviate from the objective facts. These shortcomings will seriously restrict the normal supervision role of independent directors.

3.3. The Internal Friction of Management Resources

Finally, from the national level, the overlapping functions of independent directors and the board of supervisors lead to the internal friction of management resources. In China's current corporate governance structure, the board of supervisors is composed of supervisors elected by the general meeting of shareholders and supervisors elected by the company's employees. It supervises and inspects the company's business activities in accordance with the law. It is a permanent supervisory body of joint-stock companies. Its main functions and powers include supervising and inspecting the company's financial and accounting activities; Supervise and inspect whether the company's board of directors, managers and other management personnel violate laws, regulations or the articles of association when

performing their duties. The overlapping of the functions of independent directors and the board of supervisors can easily lead to the internal consumption of enterprise management resources, and may even eliminate the scarce supervision effect. Practice has proved that these problems have reached the point where they must be solved.

4. Suggestions on Perfecting the Independent Director System

In order to give full play to the effectiveness of independent directors, we must start with the system. In view of the above in-depth analysis of the reasons for the failure of the independent director system, the following suggestions are put forward to improve the independent director system:

First of all, clarify the institutional functions of the board of supervisors and independent directors, so as to realize a clear division of labor and perform their respective duties. In theory, the introduction of the independent director system will cause the overlap between the independent director system and the corporate governance structure, and affect the effectiveness of the corporate supervision organization. In practice, the division of labor should be determined according to the supervision stage of their respective roles. To this end, we must first deal with and coordinate the relationship between the two systems of independent directors and the board of supervisors, reduce confrontation and conflict, increase unity and complementarity, and then achieve the effect of positive synergy. According to the provisions of the company law of China, the functions and powers that the board of supervisors can exercise include inspecting the company's finance, attending the meetings of the board of directors as nonvoting delegates, supervising business activities, correcting the bad behavior of senior executives, proposing to convene an extraordinary general meeting of shareholders, etc. To sum up, it is to exercise the responsibility of financial supervision of the company and supervise the legitimacy of the duties of directors, managers and other personnel. That is, the supervisory responsibilities undertaken by the board of supervisors. First, the board of supervisors comprehensively supervises the financial operation of listed companies. Second, the board of supervisors supervises the legitimacy of the post related behaviors of senior managers and directors. Rationality supervision should be based on the fact that the behaviors of directors and senior executives significantly violate the obligation of proper management and the obligation of full care. The supervision of the board of supervisors is the supervision of the special external supervision organization of the board of directors, which must be reflected in the event and afterwards. Supervisors have less right to know than directors. Even if they can attend the meeting of the board of directors as nonvoting delegates, they cannot vote on the resolutions of the board of directors. The lack of voting rights and the restriction of the right to know make the right of supervision limited. The scope of functions and powers of independent directors has been stated in the guiding opinions. In addition to the statutory functions and powers of directors, independent directors also have several special functions and powers in order to better achieve the supervision effect, such as prevention of related party transactions, expressing independent opinions on major decisions of the company, expressing independent judgment on personnel and remuneration of the company. Make specialized intellectual

support for the board of directors, and effectively improve the scientificity and rationality of decision-making by participating in the decision-making of the board of directors. The supervision and supervision power exercised by independent directors essentially belongs to the internal supervision of the board of directors. The supervision is reflected in the fact that independent directors can make professional judgments on whether to damage the rights and interests of the company and minority shareholders according to the contents of the decisions made by the board of directors in advance, and may exercise their voting rights to block the formation of decisions.

Secondly, establish an incentive and restraint mechanism for independent directors to provide power guarantee for the implementation of the independent director system. Strengthening the incentive and management of independent directors is an important means to ensure their correct and reasonable performance of their duties. As far as independent directors are concerned, they should focus on spiritual incentives, supplemented by material incentives. As independent directors, generally speaking, the material conditions are relatively good. Combined with Maslow's demand theory, self spiritual satisfaction, including good evaluation of career ethics, is more important for them, and material rewards are only auxiliary. At the system design level, reduce the factors that have a negative impact on the independence of independent directors, and at the system level, do a good job of escorting independent directors to exercise their powers independently. From the perspective of management, the company's independent directors should not only strictly abide by the statutory responsibilities and obligations to the members of the board of directors, job qualifications, information disclosure and work commitments, but also strictly implement the "listed companies should list the views and opinions expressed by independent directors on decision-making occasions in public disclosure documents", Measures such as "counting the number of independent directors attending the meeting and taking it as a reference for remuneration calculation". On the one hand, these measures can improve the directors' due diligence in performing their duties, on the other hand, they can put the decision-making behavior of independent directors under the supervision of the public.

Then, establish an information transmission mechanism to facilitate independent directors' access to information. At present, the relevant personnel of the company's functional departments are relatively unfamiliar with the rights and responsibilities of independent directors. In view of this situation, we should strengthen publicity and optimize the information acquisition channels of independent directors from the system level to ensure that the information acquisition channels of independent directors are smooth. Establish a system that the company must notify the independent directors in advance of all matters that need to be decided by the board of directors, and provide special data for the independent directors. If the amount of special data provided is insufficient and the content is incomplete, it can be supplemented according to the requirements of the established procedures. If the company refuses to provide corresponding data due to gross negligence or even malice, Or if the information provided is insufficient, or if no notice is given in advance, the independent director has the right to request the board of directors to postpone the meeting. In order to change the unsmooth situation of information access,

listed companies can make full use of the advanced technology of modern network information, shorten the time of information exchange to the greatest extent, and improve the speed of information transmission, such as online office, electronic archiving, and real-time data sharing. At the level of information transmission institution setting, it is suggested that the company should explore step by step, and finally gradually create an information transmission mechanism that mainly relies on internal information transmission, supplemented by external information transmission. Provide opportunities and channels for independent directors to participate in the professional committees closely related to their duties, improve the participation of independent directors in the company's affairs, such as the audit committee, the nomination committee, the Remuneration Committee, etc., promote the participation of independent directors in the company's affairs, absorb the information necessary for the performance of their duties, and have a comprehensive and full understanding of the formation process of decision-making, Provide basic conditions and facilities for independent directors to fully perform their duties.

Thirdly, it is necessary to establish the independent director market mechanism to realize the professionalization and marketization of independent directors. Independent directors are relatively suitable candidates in the effective entrepreneur market. The formation of the independent director mechanism is inseparable from a sound talent market competition mechanism. Only by cultivating a good talent competition mechanism can we effectively ensure the quality of independent directors and the degree of dedication to their duties. In order to improve the scientificity and rationality of independent directors' decision-making, the company needs to significantly adjust the company's management mechanism, such as innovatively establishing an independent, market-oriented, professional and socialized independent directors' office. If the independent directors' office is established, it will undoubtedly facilitate independent directors' access to business-related information to a great extent, So as to promote the exchange and accumulation of business experience of independent directors, and fundamentally and effectively improve the business level and performance ability of independent directors. With the formation of the competition mechanism in the talent market at the present stage in China, a good selection, evaluation, reward and punishment mechanism is constantly improving. From the overall development process of the system, the only way to promote the independent director system to enter China's listed companies and give full play to its efficiency is to take the road of professionalization and marketization.

Finally, establish a pre discussion mechanism for independent directors' decision-making to improve the performance effect of independent directors. From the perspective of system design, the establishment of an effective pre discussion mechanism for independent directors' decision-making can improve the performance of independent directors. For example, as a pre emptive procedure, the concluding views made by independent directors are all discussed and adopted at a meeting composed of professional managers, investment experts, accountants, lawyers and other professionals, so as to realize the first step of screening the decisions, give play to the advantage of collective wisdom and brainstorming, and put forward suggestions for revising unscientific decisions, Put forward effective optimization suggestions for unreasonable decisions,

and ultimately serve to improve the scientificity, rationality and efficiency of the company's decisions.

5. Conclusion

In the process of corporate governance, in the face of the existing or possible friction between the independent director system and the board of supervisors system, only in combination with the characteristics of China's corporate system and practice, can we take targeted and effective measures to achieve division of labor and cooperation in terms of responsibilities, achieve complementary advantages, and minimize confrontation and conflict. Through the cultivation of the market mechanism of independent directors, promote the realization process of the professionalization and marketization of independent directors; Through the establishment of the market access mechanism for independent directors, provide the ability and quality guarantee for the independent director system; Through the establishment of the incentive and restraint mechanism of independent directors, it provides power guarantee for the implementation of the independent director system; Through the establishment of information transmission mechanism, it provides convenience for independent directors to obtain information, so as to substantially protect the independent directors' right to obtain information. In addition, in order to effectively improve the performance effect of independent directors, independent directors should also be organized to hold relevant learning and training in a planned way, and independent directors should be regularly organized to conduct business exchanges. Only in this way can the independent directors have the conditions to obtain the company's internal information required for performance of their duties, improve the performance effect and promote the decision-making efficiency of the board of directors. Only in this way can we realize the advantages of the system to the greatest extent, tap the potential of the system, and realize the original intention and purpose of the introduction of the system.

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