Research on Some Defects and Its Measures of Corporate Governance in Transnational Firm Groups of China

Chen-yun YE and Ju HUANG
No.2 Beinong Rd., Changpin District, Beijing, China, 102206

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Abstract. The aim of this paper is discuss corresponding issues on the corporate governance of Transnational Firm have a considerable effect on the development strategy and competitiveness. With the world economy becoming globalization trend, Chinese economy is growing rapidly and the international competitive market which companies participate in is prone to be complicated increasingly. This paper first tries to analysis the current status of corporate governance and the pertinent core issues in Chinese Transnational Group Enterprise, and then further discusses and studies the feasible model on corporate governance of them. The conclusion of paper is offering a specific corporate governance model which all companies can choose and follow, it is still advantageous to senior management who are exploring actively the construction of appropriate corporate governance mechanism in Chinese Transnational Firm Groups.

Introduction

The financial regulators in most countries including China have adopted and implemented a series of new financial regulation after the latest round of global financial crisis. Meanwhile, the ability to implement new regulations and prevent violations is also gradually strengthened. Confronted with the opportunity and challenge which derive from economic globalization and economic structural transformation, Chinese government is endeavoring to ameliorate the corporate governance. For example, the China Securities Regulatory Commission has decided to further improve the system of independent directors and introduced the guidelines of corporate governance principles on listed companies and non-listed companies. Nevertheless, it still needs to make more strenuous efforts in system construction to consummate the behavior or mechanism of corporate governance and improve the efficiency and quality of enterprise operation. From the comprehensive perspective of market competition and spearhead the whole industry by means of undertaking high-end power service and participating in international competition. Consequently, they can influence and promote the development and expansion of financial management and control, in order to solve the principle–agent problems which are caused by the separation of management right and ownership, company owners are supposed to make effective control and supervision on the financial situation of manager. And this subject on corporate governance has aroused essential public concern for a long time.

Brief Overview of Current Status of Chinese Transnational Group Enterprise Corporate Governance

The corporate governance of Chinese Transnational group enterprise possesses both the universal governance characteristics which exist in general companies and the specialties of group companies. Since the corporate governance of group enterprise breaks the boundary of corporate governance of single company, it is inclined to meet more problems. Besides the common problems such as lack of clarity of property rights, investor uncertainty and insider control, it also has certain inherent problems. According to the research reports which are offered by Macroeconomic Research Institute of State Planning Commission and Enterprise Research Center of State Economic and Trade at the end of 2008, the main problems of Chinese group enterprises are as follows:
There isn’t Sound Supervisory Institution.

Currently most directors of board lack certain necessary auxiliary institutions, such as financial audit committee, remuneration and promotion committee and so on. Even the investment committee and audit committee exist in some group enterprises, they only have limited rights. And the audit committee members are entirely composed of insiders. So they are difficult to supervise the senior management in group enterprises.

There is Lack of Advanced Operating and Managerial Mechanism.

The relationship between parent company and subsidiary company has two opposite inclinations. The first is that the parent company controls the operating activities of subsidiary company considerably. This method simply imitates the traditional management of large factories. On this condition which right is over-centralized, the subsidiary company cannot exert a positive effect in the development of whole group enterprise. The another is that each subsidiary company has high degree of autonomy so that parent company has no effective control in the significant operating activities of subsidiary companies. These two extreme relationships do essential harm to the progress of group enterprise. And now the latter which is more serious is becoming the unavoidable bottleneck of corporate governance in group enterprise. And then, the parent company usually takes advantage of the subsidiary company to avoid external supervision and consequently leads to certain problems. The outstanding one is the implicit guarantee, namely the parent company gives guarantee to related party by using of subsidiary company so that is can avoid regulations on information disclosure. What is more serious is that some parent companies transfer assets and earnings to subsidiary companies and the interests of minor shareholders are harmed. And there are certain parent companies hiding earnings illegally by taking advantage of subsidiaries companies. It is the incompleteness of corporate governance structure and imperfect external supervision mechanisms that cause numerous difficulties in the amelioration of corporate governance structure.

Core Defects in the Corporate Governance of Chinese Transnational Enterprises

Most Parent Companies Haven’t Established Modern Corporate Governance Structure According to the Company Law

The manifestation includes that there is lack of compliant board of supervisors and board of directors and the corporate governance structure is incomplete. It is common that the board of directors and managements are overlapped with each other in a high degree and both the managerial right and decision-making right are possessed by them. This structure obviously is disadvantageous to the mutual supervision. And the establishment of governance mechanism in foreign subsidiary company is also a long-term process.

The Relationship of Property Right between Parent Company and Subsidiary Company isn’t Clear

Now most of the Chinese large group enterprises are formed by merger and acquisition. On this condition, a dozen or even dozens of wholly-owned subsidiary and joint stock subsidiary make the relationship of property right unclear and the shareholders, managements and supervisors difficult to separate. In order to strengthen the control of subsidiary companies especially those in abroad, the parent company usually centralize the decision-making right. So the strong senses of bureaucratic management and extensive pattern of control finally render the foreign subsidiaries lack of adequate initiative and independent flexible adaptability to the market.

Lack of Effective Supervision and Relevant Institutional Arrangement of Checks and Balances

Many parent companies don’t have the ability to effectively supervise and regulate the financial operations of foreign subsidiaries. As a result, the financial positions of foreign subsidiaries is complex and confusing. As for the operating activity, numerous subsidiaries are responsible for it without the regulation of parent company. This makes the supervision even more difficult. Virtually all these
problems can be deemed at the incomplete of corporate governance structure in group enterprises. Nevertheless, the explanations on them don’t describe the most substantial and core parts in the corporate governance. Though the governance problems deriving from Chinese group enterprises are bound to involve the Chinese Transnational companies, we should attach more importance to the particular characteristics of corporate governance in Transnational companies. So it is indispensable for us to analysis the current status of corporate governance in Chinese Transnational enterprise from the perspective of its particular characteristics. The foreign subsidiaries in Chinese Transnational enterprises include joint ventures and sole-ownership companies whereas the latter is majority of them on the ground that it can diversify the risk with the companies in host country. In the joint ventures, the holding company is usually Chinese part. Beside these, the form of transnational merge, research and development and strategic alliance also are applied by parent company.

**Manager Appointment Mechanism.** Most of Chinese foreign subsidiaries are state-owned. As a result, the designation of managers only follows the practice of state-owned enterprises. According to the statistics, more than 85% factory director and manager are appointed by government authorities and party’s organization departments instead of selected by capital owners who bear the risk in competitive market. This designation system is a kind of government appointment system in essence. The selection of chairman of board of directors and CEO confines to a limited area. On this basis, the personnel system in parent company decides the manager selection system in foreign subsidiaries.

**Capital Finance Mechanism.** There are enormous foreign subsidiaries having not established sound capital finance mechanism. Many financial statements of subsidiaries are not promptly reported to the parent companies. And the internal control isn’t implemented properly, self-monitoring and restraint mechanism aren’t perfect and the effective external supervision is insufficient. Recently some researches conclude that very small number of foreign branches of state-owned enterprises even become the money-laundering center of domestic corruption.

**Manager Incentive Mechanism.** It is a general truth that the salaries of foreign subsidiaries’ managers in Chinese Transnational enterprises are relatively low. Although the total disbursements of assignment are high, it is still low to some degree when compared with the standard of living in host country. Another undeniable fact is that the managers in foreign subsidiaries don’t have stock options and this easily leads to the short sight of managers. Managers who lack of adequate material incentives largely rely on their own morality and conscience to not fraud and corrupt. On the other hand, the managers in foreign subsidiaries also have a great deal of autonomy rights in pricing, selection of sales network, staff employment, market development and financial management. All these increase the risk of moral hazard and strengthen the short-term opportunism of managers.

**The Counter Methods and Suggestions on Construction of Appropriate Model of Corporate Governance in China’s Transnational Group Enterprises**

It is indispensable to consider what type of corporate governance model that Chinese Transnational group enterprises can follow properly. However, the specific model can only be determined according to the actual situations of Transnational enterprises. This paper offers the following countermeasures:

**Governments at All Levels Should Actively Create a Favorable Atmosphere for Transnational Enterprises to Participate in International Competition.**

**The Size of Corporate Structure should be Appropriate.** One of the premises on the formation of effective corporate governance structure is that it must be compatible with the development of companies. Considerable number of state-owned enterprises at present has a common problem is that they establish the corporate governance structure regardless of the stage of development. As a result, the costs are increased, the decision-making process becomes even more complicated and the efficiency and effectiveness decline sharply. So it is necessary to give full consideration to the state of growth and the scale of development when constructing the corporate governance structure. Specifically, the enterprises
should establish corporate governance structure according to their own conditions. As for certain enterprises, they even can consider to postpone it and not establish it.

**The Principle-agent Relationship Should be Established Clearly.** The relationship of principle-agent in western well-known Transnational companies is extremely clear while it is usually ambiguous in Chinese Transnational enterprises. Some scholars contribute the problems of corporate governance in state-owned enterprises to the over-length of principle-agent chain. In this case, the last chain is a “spent force” which can’t have an effect on the corporate governance. While from the perspective of famous western Transnational enterprises, the key point is that whether the principle-agent itself has a outstanding transmission mechanism and whether the accountability of each principle and agent is clear.

**The Entity Which is Ultimately Responsible for the Property Right Should be Specific.** The typical form of property right in western Transnational enterprises is “single dominant shareholder” or “several dominant shareholders”. However, its governance is usually effective. As a matter of fact, the key issue in corporate governance is that whether an entity can be accountable for the property right rather than that whether a “single dominant shareholder” exists. If there isn’t such an entity existing, the dilution of property right is still useless. So when establishing the corporate governance structure in state-owned enterprises, we not only need to reform the system of property right but also seek for a professional entity who are capable for bearing the risk of property right supervision.

**The Legal Obligations and Responsibilities Beard by Managers Should be Strengthened.**

The rights and obligations are always inseparable. The managers should bear the operating risks and legal obligations when they own the pertinent rights. They should be responsible for the appreciation of company’s assets. If the issue of legal liability isn’t solved appropriately, the opportunistic behavior of managers will always exist. In the case of bearing legal liability, the competent managers will standardize their operations and actively create the enormous value for companies. On the other hand, the incompetent managers will be punished and then opt put and let those in promising. The government can establish an enter and exit mechanism by laws and regulations in lieu of administrative arrangements and spontaneous market forces. Only strengthening the legal obligations and responsibilities which are undertook by managers continuously can better promote Chinese Transnational enterprises to fulfill all the commitments and obligations to domestic and foreign investors and more effectively protect the legitimate rights and interests of all investors. And this also makes due contribution to the efficient allocation of resources in Chinese capital market and the enhancement of core competitiveness of Chinese companies in global market.

**Full Use of the Media which Has Unique Features and Advantages in Social Moral Evaluation and Strengthen the Supervision of Social Media and Public Opinions on the Information Disclosure of Listed Companies**

As an information carrier, the media has a distinctive advantage in supervising the information disclosure of listed companies. The large number of diverse media is able to cope with enormous listed companies whereas China has only one Securities Regulatory Commission. Reporters different with investors have the rights and freedom in covering the listed companies and the stakeholders. They can learn about the internal conditions of listed companies from all aspects and find certain suspicious points. It needs strenuous efforts to take those potential advantages. The priority is to give the legitimate right of criticizing and reporting to media. This is a significant part of media freedom and a necessary insurance of media supervision. The regulations and provisions concerning the information disclosure of listed companies should clear that the media has right to publish the information of listed companies and verify those information. The ultimate goal of media supervision on listed companies is regulate the development of them and it is beneficial to the local economy.
Conclusion

On the circumstance that the right of company is over-centralized and the directors of board can’t function effectively, we need to strengthen the mechanism of checks and balances continuously, achieve the coordination with the incentive and constraint and improve the regulatory function of directors of board and board of supervisors continuously if we want to further ameliorate the structure of corporate governance in Chinese Transnational enterprises. In order to achieve this goal successfully, we must attach essential importance to the dual supervision effects of internal and external governance and take advantage of institutional arrangements to make the members of board of supervisors fully grasp the relevant operating information. Meanwhile, the supervision mechanism as a third party can render the more objective information for stakeholders. In summary, we should consider the existing characteristics of Chinese companies and then gradually establish and improve the innovative corporate governance which possesses the functions of checks and balances according to them.

Reference


