

# On the Independence of Independent Director System of Listed Companies in China

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## Abstract

As the core of independent director system, the independence of independent director is the soul of independent director system. However, at present in China, due to the uneven quality of independent directors, inadequate access to information and many other factors, the independence of the independent director system is flawed, and there are such phenomena as "dumb and sensible" and "independent directors are not sensible". This paper starts with the theoretical analysis of the independence of independent directors, analyzes the flaws in the independence of independent directors in China, and finally puts forward some suggestions on how to improve the independence of independent director system.

## Keywords

Independence; Defect; Improve.

## 1. Introduction

From the name of independent director system, we can find that independence is the core of independent director system. On the premise that the independent performance of the independent director system is fully reflected, the independent director system can not only further improve the corporate governance structure of listed companies in China at present, promote the standardized operation of listed companies, but also achieve the purpose of protecting the legitimate rights and interests of minority shareholders from infringement. However, in practice, there is still a certain distance between the independence of the independent director system and people's expected goals, and there are still some defects in the independence, and the positive functions of the independent director system have not been fully exerted. Therefore, starting from the theoretical analysis of independence, it is of great significance to discuss the existing defects and put forward relevant improvement measures.

## 2. Theoretical Analysis of the Independence of Independent Directors in China

### 2.1. The Concept of Independence of Independent Directors

At present, there is no unified explanation for the definition of the independence of independent directors in academic circles. As the saying goes, "The benevolent sees benevolence, the wise see wisdom", some scholars believe that the independence of independent directors means that independent directors, as external directors, can independently perform their duties as directors without any external factors to safeguard the interests of shareholders (especially small and medium shareholders) and the whole company. [1] Some scholars believe that the independence of independent directors means that independent directors of listed companies can be independent of the company decision makers and express their opinions on decisions from the perspective of minority shareholders when making major decisions. [2] However, the author thinks that the first two definitions have their own narrowness. The first one only

excludes the influence of "external factors", without considering whether the professional level of independent directors can support them to perform their duties independently under the influence of their own quality or quality. At the same time, this view is too absolute. The independence of independent directors is a kind of relative independence, which is not influenced by any external factors, because independent directors have to rely on the management of the listed company to provide relevant information. The limitation of the second view lies in that it only needs to be independent of the company's decision makers, but it doesn't take into account that other functional departments within the company also have certain influence on the independence of independent directors.

To sum up, the author thinks. Independence of independent directors means that independent directors, as external directors, should not only be independent of all major shareholders of listed companies and not be subject to any other functional departments of the company, but also be independent in the exercise of power and economic status, and at the same time be professional, so as to finally realize the purpose of supervising and balancing major shareholders and safeguarding the interests of small and medium shareholders.

## 2.2. Characteristics of the Independence of Independent Directors

(1) Relative independence: The nature of independent directors determines that they cannot be absolutely independent of listed companies. The independence of independent directors is relatively independent, and their expressions of will must be based on the information provided by the managers of listed companies. Only by obtaining the required information in time can independent directors play their independent role faster and more accurately.

(2) Salary independence: If independent directors want to be independent, they can't have interest relationship with listed companies, and the most direct embodiment of interest relationship is salary. Only by cutting off the direct salary relationship between independent directors and the company can independent directors have no scruples when expressing their intention, otherwise there will be a situation of "short-handed", which will not only weaken the ability of independent directors to check and balance with major shareholders, but even cause independent directors to cling to major shareholders and harm the interests of small and medium shareholders together.

(3) Independent decision-making: that is, when independent directors express their will, they must try their best to reduce the influence of other factors on the decision-making. This is because independent directors have the right and obligation to express their will in favor of maximizing the interests of the company within the scope of their functions. [3]

(4) Independence: It is necessary to make clear the specific functions of independent directors, such as nomination, assessment, audit of the company's financial statements, etc., so as to prevent the overlapping and overlapping of functions with other departments, thus causing conflicts, reducing efficiency, damaging the interests of listed companies and failing to maximize the interests.

(5) Independence: Independent directors must be independent of the company's management and major shareholders, and professionals who have no relatives, interests, etc. The independence of status lays the foundation for their independent decision-making and judgment. [4]

## 3. Defects in the Independence of Independent Directors in China

### 3.1. Can You Play Independence?

#### 3.1.1. Talent Accomplishment Remains to Be Discussed

Since the introduction of the independent director system in China is later than that in developed countries, the current legal provisions have not made relevant provisions on the

criteria for selecting independent directors, and under the specific national conditions, there is no professional talent training mechanism for the independent director system. The comprehensive talents needed by China's independent director system are still a blank to be filled.

In most developed countries, retired directors of other companies or professionally trained people serve as independent directors of listed companies, who have accumulated rich working experience and professional knowledge. On the other hand, in China, the position of independent director is often held by celebrities in different fields, such as writers, professors and others. Listed companies blindly pursue the celebrity effect, ignoring that the single professional knowledge ability of these people does not match the comprehensive ability that independent directors should possess, and the social experience of corporate governance of such personnel cannot be verified, resulting in that independent directors can not play an adequate role of supervision and checks and balances to major shareholders in their tenure. At the same time, because of the scarcity of qualified independent directors, there will be situations in which independent directors have multiple roles, which often leads to ineffective supervision or even errors.

In the case of "Vanke Equity Dispute" between Vanke and Baoneng Department in 2016, Zhang, an independent director, chose to apply for voting to avoid when he met with major decisions of the company. In addition, despite the interest relationship between him and Vanke, he was still elected as an independent director, which seriously exposed that it is difficult for independent directors in China to be truly independent in identity and economy. [5]

### **3.1.2. Information Access Channels Are Single and Restrict Independence**

Independent directors, as outsiders, do not hold other positions in the company except directors. At the same time, because of the need to reduce their decisions from external factors, independent directors do not work in the company except to attend relevant meetings or discuss relevant decisions. Most of the information of listed companies is held by the management of the company. This, to a certain extent, limits the sources of independent directors' access to information, resulting in serious information asymmetry. It greatly reduces the timeliness and omnibearing of independent directors' access to information. Although independent directors have the right to know as other directors do, the ways to obtain relevant information of the company mainly include obtaining through the secretary of the board of directors, providing written materials regularly or irregularly by the company, listening to the chairman's introduction, listening to the report of the management, searching by themselves, etc. However, in the practical process, its access to company information is mainly provided by the secretary of the board of directors and the company regularly and irregularly, and the channel is relatively single. [6]

## **3.2. Dare to Play Independence**

### **3.2.1. The Legal System Needs to Be Improved, Resulting in Partial Lack of Independence**

Since the introduction of the independent director system in China, independent directors have developed to some extent, but the relevant legal system in China is still not perfect.

First of all, the current laws and regulations such as the Company Law and the Securities Law only stipulate whether to establish an independent director system, but do not specify the status of independent directors in detail, such as establishment, business scope, responsibilities and so on. However, it is only stipulated from the guidance and guidelines with lower legal rank, but this is far from the legal status that independent directors should have.

Secondly, in terms of protecting the functional power of independent directors from infringement, there is a lack of specific and powerful legal supporting provisions, so

independent directors often dare not play games with major shareholders in the company based on risk considerations, resulting in the situation of "vase directors". Due to the lack of supporting guarantee, the effectiveness of the exercise of independent directors' powers is limited, so that independent directors are only named as directors, but their powers cannot be effectively exercised.

Finally, there are no clear provisions on the division of responsibilities, exemption and disciplinary consequences of independent directors, which will lead to the ambiguity of the scope of independent directors' obligations and the possible consequences of their misconduct.

### **3.2.2. The Functions of Independent Directors and the Board of Supervisors Overlap**

The independent director system originated from countries that adopted the "unitary system" model, such as Britain and the United States, as the internal supervisory organ of listed companies. However, the supervisory board set up at the beginning of legislation in China is the supervisory organ of listed companies, which plays a supervisory role in financial management and management behavior of listed companies. Later, China introduced the independent director system, and the corporate governance model adopted the "dual system" model, that is, both the independent director and the board of supervisors have the supervisory power of listed companies, which will lead to overlapping functions of the independent director and the power entrusted by the law to the board of supervisors, with blurred distinction, which will easily lead to contradictions, leading to inaction of both in supervision, kicking the ball in responsibility or even double failure of supervision, and ultimately harm the interests of the company.

## **4. Suggestions to Optimize the Independence of Independent Directors in China**

### **4.1. Raise the Threshold of Independent Directors**

At present, independent directors have mixed positions. Although the qualifications of independent directors have been defined and required in various documents, there are still many problems, such as the provisions are too broad to be effectively implemented. [7] In order to improve the present situation, on the basis of changing the election method, it is necessary to form a professional training mechanism for the independent director system according to the Guiding Opinions: "Independent directors and those who intend to serve as independent directors should participate in the training organized by the China Securities Regulatory Commission and its authorized

Institutions according to the requirements of the China Securities Regulatory Commission", and carry out standardized training and assessment for candidates. A listed company can screen and appoint candidates according to their knowledge, major, background and whether they are independent of the listed company, so as to fundamentally improve the quality of independent directors, eliminate unqualified candidates in a fair, just and open way, and ensure the high quality and purity of the employees. It is also possible to stipulate the criteria for the selection of independent directors by issuing clear laws and regulations and relevant documents.

### **4.2. Improve the Effective Information Acquisition Mechanism**

In order to solve the problem of single access to information of independent directors, effectively protect independent directors' right to know, obtain enough information, expand information sources, and ensure the timeliness, effectiveness and accuracy of independent directors' access to information, so as to better understand the situation of enterprises and make correct decisions and judgments, we can start from two aspects.

On the one hand, it can be directly stipulated in the company's articles of association that independent directors have the right to obtain information directly from relevant stakeholders,

so as to avoid the limitation, one-sidedness and accuracy of information provided by management and ensure that the information comes from the truest first-hand sources.

On the other hand, there should be institutional arrangements for independent directors' information acquisition. Symmetry of information and ensuring the right to know are the necessary conditions and keys for independent directors to perform their duties and functions. [8] In order to make the obtained information sufficient for it to play its role, it is necessary to establish and improve the domestic information disclosure system and information transmission system to ensure that independent directors can make decisions objectively and fairly by obtaining true and effective information.

### **4.3. Establish and Improve Relevant Laws and Regulations of Independent Directors**

The development of independent director system in China is still very weak, so it is necessary to improve it from the legal system level. First, it is necessary to add the content of independent directors in relevant legal provisions to better clarify the legal status of independent directors, or to fill the gap in establishing the legal status of independent directors by means of legal documents and judicial interpretations, so as to serve as the legal basis and guiding principle of independent directors in China. Secondly, to issue supporting documents to ensure independent directors to exercise their functions and powers better, and to improve the incentive mechanism, independent directors should be given enough legal authority to get rid of the current situation that independent directors dare not speak independently. Third, stipulate the specific rights and obligations of independent directors, so that independent directors can know fairly well when exercising their functions and powers, and establish a strict accountability mechanism. If the behavior of independent directors in enterprises violates the relevant provisions, China Securities Regulatory Commission should impose strict economic penalties and administrative penalties on independent directors according to the relevant provisions after verifying that their behavior does have problems. [9]

### **4.4. Clarify the Functions of Independent Directors and the Board of Supervisors to Promote Complementary Advantages**

In order to give full play to the double-layer supervision advantages of independent directors and supervisory board, it is necessary to scientifically and reasonably divide their responsibilities and coordinate their relationship. This makes it clear that independent directors and the board of supervisors are mutually parallel functional departments. The board of supervisors can't participate in the decisions of the board of directors, and has no authority to supervise the major decisions made by listed companies. It can be seen that most of the supervision conducted by the board of supervisors is external supervision. Although independent directors are independent, they belong to the board of directors in essence, and have the right to participate in the decisions of major issues of the board of directors, which belongs to internal supervision. It is necessary to combine external supervision with internal supervision, so that independent directors and the board of supervisors can perform their duties in their work and play their respective functions within the scope of their authority. It is also necessary to share information effectively between the two parties, so as to avoid overlapping in exercising their functions and powers, so as to complement each other's advantages, promote the rapid development of listed companies and maximize the interests of enterprises.

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