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Empirical Insights into Supervisory Boards of Listed Companies in China

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Authors' contributions

This work was carried out in collaboration between both authors. Author YT designed the study, performed the statistical analysis, wrote the protocol and wrote the first draft of the manuscript. Authors JAS and YT managed the analyses of the study. Authors JAS and YT managed the literature searches. Both authors read and approved the final manuscript.

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ABSTRACT

This paper addresses a gap in the literature by presenting novel empirical insight, accorded by privileged access to prejudications and legal decisions, into corporate governance in China. A main aim of our work was to assess whether calls for reform of the regulatory system are warranted. We present an inductive piece of research into two-tier boards in Chinese listed companies, incorporating a board of directors and a supervisory board, appointed by and reporting to the shareholders' meeting. Through unique primary-source evidence, and additional evidence from recent legal cases, we illustrate the problems faced by organizations that have had to contend with the inherent difficulties of corporate governance in China. Our findings suggest that the supervisory board, in practice, has limited power, given the conflicting roles of the various members, and that corporate governance might be better maintained by a greater transfer of power to independent directors.

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Keywords: China; corporate governance; empirical evidence; listed companies; supervisory boards; two-tier structure.

1. INTRODUCTION

Before the economic reform of the 1980s in China, the dominant corporations were either collectively- or state-owned [1]. To satisfy the demands of a socialist commodity economy, the Communist Party of China (CPC) launched a series of policies to reform the corporate system. In 1992, CCP regarded the establishment of a modern corporate system as a main objective of economic reform. A collaboration between the State Commission of Restructuring the Economic System and various other governmental representatives led to the Provisional Regulations of Shareholding Enterprises: Opinions on Standards for the Companies Limited by Shares; and Opinions on Standards for Limited Companies and the Like [2].

These two new 'opinions' indicated that the internal supervision of Chinese listed companies was the responsibility of the supervisory board [2]; they were incorporated into Company law of The People's Republic of China (PRC) in 1993, the first time a statutory document had mentioned the corporate governance system [3]. This version of company law (1993, art124) required the supervisory board to have at least three members; furthermore, it stated that members of management teams and boards of directors could not act simultaneously as supervisors. Further requirements were made about the disclosure of individuals' behavior, shareholders meetings, checking of financial statements etc [2]. The law also fixed the tenure of supervisors at three years and permitted members of the supervisory board to be re-elected and reappointed at the shareholders' meeting (Company Law, 1993, art. 125). At the end of 1999, the 9th National People's Congress (13th session) approved 'the resolution on revising the Company Law of the People's Republic of China', which stated that members of supervisory boards in SOEs should be appointed or elected by organizations or departments authorized by the State Council. This revision clearly outlined the role of government in monitoring SOEs, and this role remains unchanged.

Because of poor monitoring performance among supervisory boards in practice [4,1,5,2,6], company law was revised significantly in October 2005, and the new regulations perfected the system of the corporate supervisory board [2]. Xi [3] and Tian [2] identified the main effects of this revision on the regime of the supervisory board. First, company law (2005) confirmed the proportion of employee representation required on the supervisory board, and identified the process for electing representatives: at least one-third of supervisors must be staff representatives of the company and must be elected by the employees in the staff members' meeting (Company Law, 2005, art. 118). Second, the revision specified that it was necessary to have a president of the supervisory board, who should be elected by other supervisors and receive more than half of the votes from all supervisors.[1] In addition, the new law (2005) stipulated the frequency of supervisory board meetings and modified other procedural issues, relating to frequency of meetings, voting on resolutions and monitoring of attendance (Company Law, 2005, art. 120) [7]. In addition, company law (2005) provided some special regulations regarding the numbers and powers of supervisory boards; e.g. requiring more than five members to be on supervisory boards of SOEs. Last but not least, corporate and securities laws required that all financial statements be approved and signed off by the supervisory board. Decisions made in a meeting of the board of directors needed also to be approved by the supervisory board, with any disagreement being reported to the shareholder meetings.[2] It should further be noted that independent directors were introduced to all listed companies in 2003 [8].[3] The publication of the Independent Director Guidelines indicates that independent directors and the supervisory board have been acting as monitors of listed

[1] *This revision also strengthened and expanded the powers and authorities of the supervisors, which included, but were not limited to, the power to: depose directors; convene the shareholders' meeting; attend the directors' meeting as a non-voting delegate; conduct an independent investigation, if necessary; and take legal action against managers and directors who have violated corporate policy (Company Law, 2005, art. 53, 54, 118).*

[2] *See Appendix I for a list of relevant laws and regulations.*

[3] *According to the Independent Director Guidelines from the China Securities Regulatory Commission ([8], art. 4), all listed companies must have installed at least one-third independent directors on the board of directors by June 30, 2003 (Xi, 2009). A subcommittee under the board of directors is also required, and this committee must be numerically dominated by independent directors. Their responsibilities are sometimes regarded as similar to those of supervisors (Xu & Lin, 2016).*

companies since 2003; one could therefore legitimately argue that there are now simply too many watchdogs in Chinese listed companies (see Fig. 1).

Chinese board structure is a unique two-tiered system, containing a board of directors and a supervisory board. According to company law of the People's Republic of China (PRC) (2005) and the self-assessment by the Chinese Securities Regulatory Commission (cited by OECD, [9]), the shareholders' meeting is the supreme authority in the company. This meeting has the power to make decisions concerning major issues and appoint members of both the board of directors and the supervisory board. The Chinese board of directors functions similarly to its Anglo-American counterparts in that it has decision-making power concerning management and sets up special committees, for auditing and remuneration, for example. The board of directors appoints management staff and receives reports from them. PRC company law also requires that one-third of the members of the board of directors be independent directors who have the duty to monitor the behavior of their executive colleagues.

Since 1993, PRC company law has also required all listed companies and non-listed joint-stock companies in China to put in place a supervisory board [1]. Unlike supervisory boards in Germany, where supervisors have the power to appoint members of the boards of directors, the Chinese supervisory board monitors the company, supervising the behavior of the board of directors and the management team, as well as the financial affairs of the company (Company Law, 2005, art. 51). PRC company law underwent significant revisions in 2003, when independent directors were first introduced, but the requirements of the two-tier structure were not changed at that time. Thus, since 2003, there have been two monitoring bodies within Chinese companies: supervisory boards and independent directors (see Fig. 2). This unique model could be regarded as a combination of the Anglo-America one-tier model, Germany's compulsory supervisory board model and Japan's corporate auditors' system [10].

One further special consideration for China must be emphasized here. Normally, in listed companies, the shareholders' meeting is the supreme authority; shareholders nominate and select members of both the board of directors and the supervisory board. In the largest listed Chinese firms, however, the situation is different because of the large proportion of state-owned enterprises (SOEs) on the stock exchange. The proportion of SOEs has decreased since the beginning of China's economic reform in the late 1980s, when all the firms were state- or collectively-owned [1]. Nevertheless, SOEs today still represent a significant portion of the companies listed on the stock exchange [11,12]. The State-Owned Assets Supervision and Administration Commission (SASAC), which is the branch office of the State Council of China, acts as a representative of shareholders in SOEs and has great power in nominating members to boards of directors and supervisors [13]. Finally, there is a Communist Party committee in every state-owned company, and currently the central government considers its role to include leading and monitoring the whole company. This paper, therefore, explores whether the current legislation regaring supervisory boards is sufficient, or overly-controlling, and whether amendments to such legislation is in order.

2. LITERATURE REVIEW

The comparison between two-tier and one-tier board structures is not new to Western countries, especially given the debate about the Anglo-American unitary board system versus the two-tiered system used in other European continental countries [1]. Donaldson and Davis [14] suggested that the division of power and the transparency required among decision makers and monitoring members could help to solve conflicts of interest between principals and agents. Turnbull [15] argued that the inherent concentration of power in a one-tiered board structure increased the possibility of corruption in market-led economies. Critics of the two-tiered board system (e.g. Schneider-Lenne, [16]) regard the supervisory board as unnecessary when the company performs well, and useless when the company performs badly. Although the debate has been discussed since the end of the 20th century, empirical evidence has only recently emerged. Jungmann [17] used data from 25 companies listed on the stock market in the United Kingdom and Germany between 1994 and 2003 to suggest 'it is impossible to consider one of two concurring systems for corporate control as being superior to the other' (p. 462).

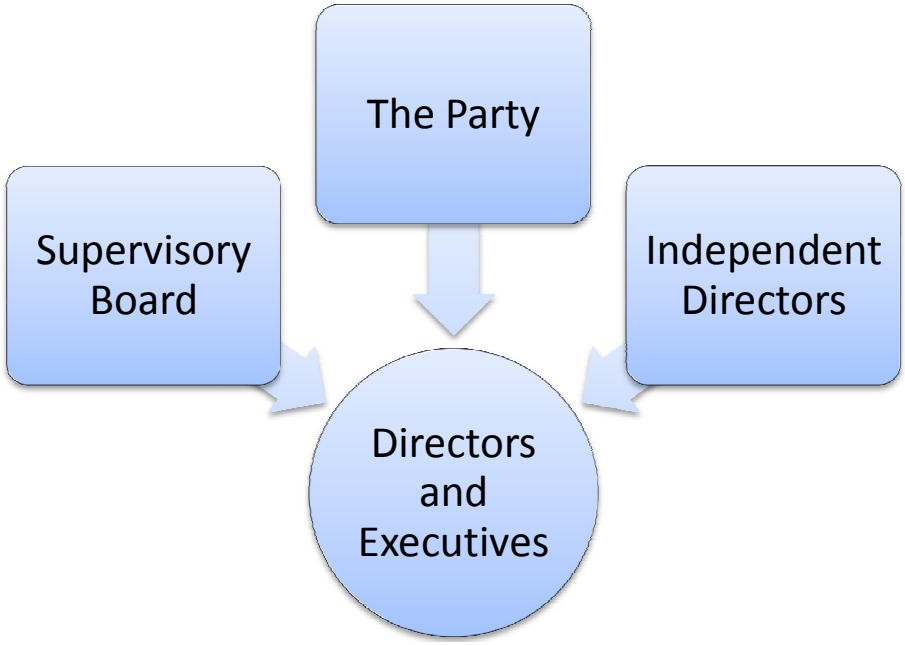

Fig. 1. Monitoring bodies in Chinese listed companies

By contrast, studies of Chinese supervisory boards are quite new, among both English and Chinese scholars. Studies tend to focus on different aspects, with mixed result [18,10]. The number of empirical studies in English has increased since 2005 [19,20,21,9,2,12], probably because of the publication of the new company law in 2005. On the other hand, Chinese publications tend to use theoretical or legal analysis.[4]

Tam (1999) and Tian [5] concluded that Chinese corporate governance structure should be regarded as an Anglo-American unitary system because of the perceived ineffectiveness of supervisory boards. Both suggested that Chinese corporate governance was concentrated in the boards of directors, with supervisory boards being nominal, ineffective and weak [4,5]. Goodall & Warner [28] found that informal interaction between members within the company was a better way to deal with conflicts than a formal meeting, perhaps because it is inappropriate in Chinese culture to have direct conflicts with others during formal occasions.

Dahya et al. [1] interviewed 28 directors, supervisors and executives from 16 listed companies in 1999, finding a lack of legal power, responsibility, independence, professional capacity, and insufficient information for supervisors to do their jobs [29]. The monitoring function of supervisory boards was always usurped by CCP or the government. Therefore, they concluded that supervisory boards had no real function. They further argued that supervisory boards should play an important monitoring role, similar to that of the auditing committee under the one-tiered board structure, and suggested that 'if the working of the supervisory board improved, corporate governance will inevitably improve' [1]. The researchers attributed the uselessness of the supervisory board to the transitional nature of the Chinese economy and suggested that a good way to improve the effectiveness of these boards would be a political reform that eliminates the influence of CCP and the government in company operations.

The 2005 revision of the company law was regarded as a significant improvement in the legal environment of corporate governance [30,3,2,10,31]. The findings of studies on supervisory boards specifically have been mixed. For instance, Firth et al. [20] explored the relationship among levels of informativeness of earnings in Chinese listed companies, showing that larger, active boards could 'increase the earning-return association, reduce absolute discretionary accruals and have higher quality

[4] *e.g. Cao, [22]; Ding, [23]; Mei, [24]; Wang et al., [25]; Yang, [26]; Zhou, [27];*

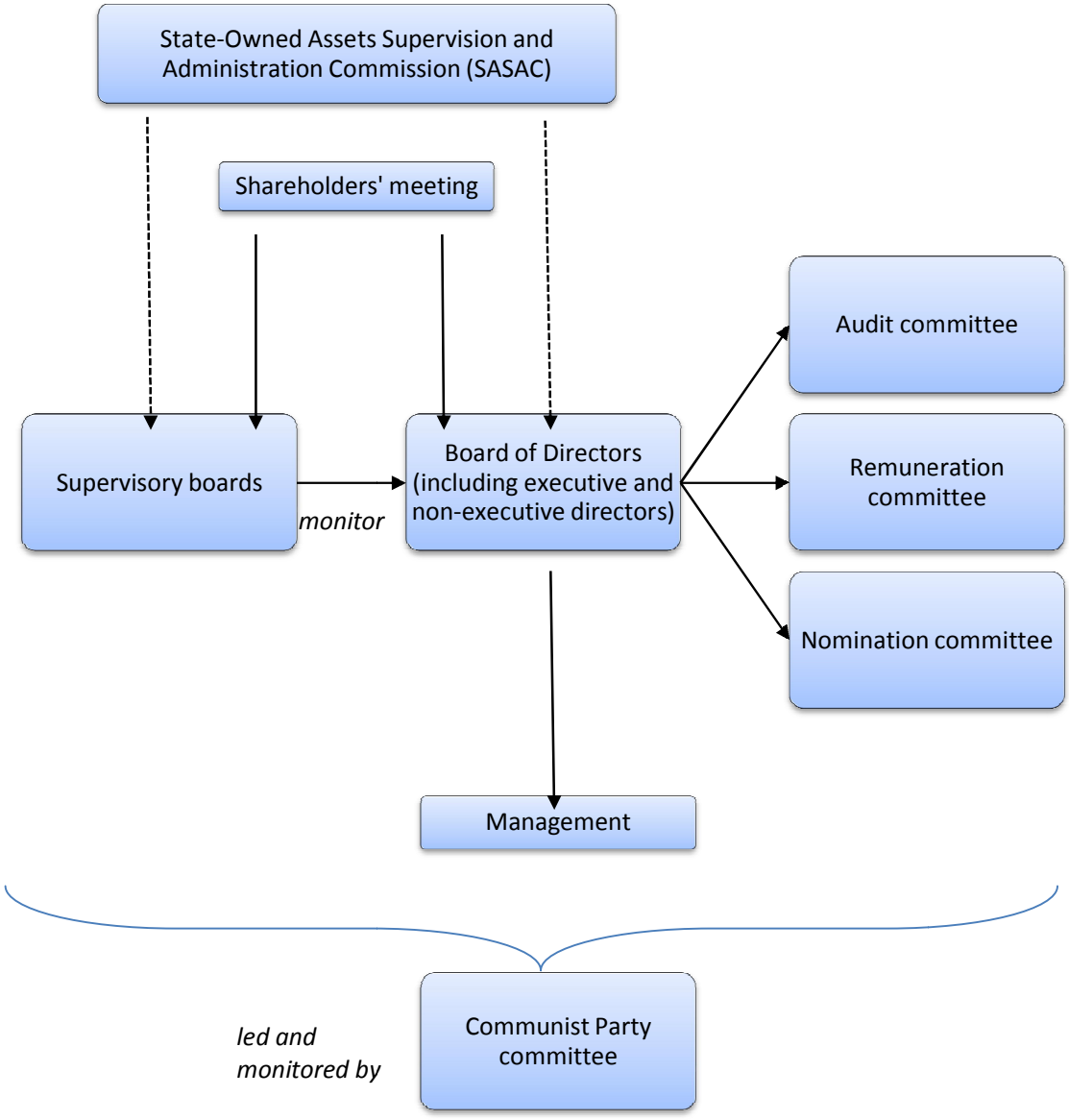

Fig. 2. Board structure in China

financial statements based on the auditors' opinion' (p. 493). Wu et al. [32] observed a negative connection between the frequency of supervisory board meetings and the financial risk-taking behavior of management based on data collected from 2001 to 2006. Ding et al. [10] explored board chair pay and the size of the supervisory board using almost 3,000 observations made between 2005 and 2006, and the results showed a negative relation between these two factors. Jiaguo et al. [21] used four listed companies in the Henan province to analyze the independent status of the supervisory boards, showing that the supervisory board was not independent of the board of directors, and that the independence of the supervisory board depended greatly on the status of the management. And Chen et al, [33] suggested that 'regulatory authorities in emerging economies … should focus on

improving the true independence of board directors and the monitoring power of supervisory directors in order to address controlling-shareholder expropriation and enhance the quality of corporate governance.'

Recent studies have focused more on the relationship between the independent directors and the supervisory board. Tian [2] argued that supervisors are mainly focused on questions of legality, whereas independent directors mainly work to assess the efficiency and capacity of the company's operators from an objective angle. However, Xu and Lin [13] suggested that the responsibilities of independent directors and supervisors largely overlap but that neither has real authority to affect management decision-making processes.

Two empirical studies on this topic, in the Chinese academic literature, were identified from the China National Knowledge Infrastructure (CNKI) and China's core journal and citation database. Yuan et al. [18], for example, used 3,389 listed companies from 1999 to 2003 to explore the relationship between the characteristics of the supervisory board and the financial performance of the company. Regression analysis showed that there was no relationship between the financial performance of the company and the status of the supervisory board (including frequency of meetings, ratio of external supervisors and percentage of shares held by the supervisory board). Wang et al. [25] used similar methods to analyze 1,128 listed companies from 2005 to 2007, but found contradictory evidence that there was a *strong* relationship between the situation of the supervisory board and the financial performance of the company. Other Chinese literature on this topic focuses on theoretical analysis but provides no empirical evidence. Most of this literature suggests that the supervisory board in China is unique and should play a more important role in corporate governance (cf. Mutlu et al., [34]).[5]

Plenty of scholars offer suggestions for improving the effectiveness of the supervisory board in China. Before 2005, such recommendations included political reform [1,6], clearer regulation about the responsibilities and powers of supervisors [1,35] and the introduction of independent directors [1]. More recently, this advice has turned to a greater focus on the roles of independent directors and supervisors. Xu and Lin [13] and Tian [2] argued that the responsibilities of independent directors and supervisors should be more clearly delineated. Hu et al. [36] suggested that ownership concentration was hindering the governance role of directors and supervisory boards. In addition, the external nature of supervisors has attracted attention, and some scholars have suggested that supervisors should have the same power as directors, insofar as it relates to access to operational and management data [10,2]. Our work extends this body of literature by providing empirical evidence of the efficacy of the current supervisory board measures that are in place.

3. MATERIALS AND METHODS

3.1 Theory

Previous scholars have used a positivist approach, without considering its weaknesses, in trying to identify the relationship between the effectiveness of the supervisory board and variables based on idiosyncratic models; so there is no consensus either about the effectiveness of Chinese supervisory boards or how to measure that effectiveness. It should be noted, however, that there is little literature on Chinese supervisory boards, so the time is ripe to adopt an alternative perspective in the field of Chinese corporate governance structure [31].

An interpretive approach adopts the ontological position that reality is socially constructed and continuously changing because of the ongoing social interactions in society. Supporters of the interpretive approach assume that reality is based on different contexts, including historical, economic, social and organizational contexts [37,38,39]. Therefore, it is impossible for any knowledge to be generalized. Rather, the interpretive approach focuses on situated validity and aims to provide a logical explanation and subjective interpretation according to different contexts (Cunliffe, 2011). Because of the relatively subjective nature of this approach, purely quantitative methods are insufficient [40], and qualitative methods of data collection, such as interviews, case studies and fieldwork, are employed. Scholars are encouraged to join in the area of exploration to obtain empirical evidence that could help them understand the human activity under study [37].

Our own research is subjective in that the characteristics of supervisory boards differ

[5] *e.g. Cao, [22]; Ding, [23]; Zhou, [27]*

significantly depending on context, such as legal environment, regulations, and corporate industry and culture. Current circumstances surrounding, and problems faced by, supervisory boards can only be treated as a reaction to the current social environment in China, which may change as the basic context changes. An understanding of the current situation and its problems could not exist without the subjective perception of human beings, as researchers. Therefore, we hold the view that the reality of the research topic is socially constructed and is not independent of the minds of the individuals involved [37]. Also, the process of acquiring evidence is relatively subjective because the data analysis cannot be separated from subjective perception and interpretation. Epistemologically, this paper aims to analyze and interpret the current situation and problems of the supervisory board structure in China, rather than to develop a universal law. Hence the paper has an explanatory, rather than a predictive, function.

3.2 Research Questions

Many researchers have concluded that the Chinese supervisory board is dysfunctional [1,6,35]. Dahya et al. [6] examined the usefulness of the supervisory board report (SBR) in listed companies and suggested that its usefulness depends greatly on the role of the supervisory board in the company. They further found a negative market reaction when SBR disclosure was absent. Xiao et al. [35] found that the supervisory board rarely acts as an independent monitoring body.

Tian [2] suggested that papers written before 2005 indicated a series of deficiencies in the Chinese supervisory board structure, including the 'insubstantiality of power of board of directors, the law and regulations lack of action ability, the lack of incentive for supervision, the low standard for the qualification of supervisors, [and] the asymmetric nature of external supporting system' (p. 161) [41]. On a related theme, Filatotchev et al. [42] provided an interesting conspectus of the particular idiosyncrasies of two-stage boards in Taiwan. This leads us to our first Proposition, as follows:

Proposition 1: Chinese Supervisory Boards are ineffective and redundant, and do not enhance corporate governance.

Previous proposals for fixing issues with supervisory boards typically involved political reform. Given the current political environment in China, we suggest this suggestion is impracticable. However, we may approach this problem from another angle in light of the unique Chinese corporate governance structure. For instance, it may be possible to move away from the insistence on keeping supervisory boards, despite the limitations to their roles, which occur regardless of clear, strict legal regulations. Both Dahya et al. [6] and Xiao et al. [35] hold the view that effective ways to increase the function of the supervisory board include increasing the legal power of supervisors, raising supervisors' technical capacity and reducing political control from CCP and the government. Thus our second proposition is as follows:

Proposition 2: Chinese companies should incorporate the duties of the supervisory board into the responsibilities of independent directors, who are already acting as supervisors in practice.

3.3 Methodology

Both primary and secondary source data are used in this investigation, with qualitative methods of analysis. Five in-depth telephone interviews were undertaken, alongside an additional nine postal questionnaires. At the time of interview, all respondents had positions on either the board of directors or the supervisory board of a listed company. The interview process used in this paper was based on McCracken's [43] four-step inquiry structure. The four steps in the review and discovery process enable the generation of new knowledge through structured interviews. First, the existing literature was reviewed, which provided a high-level lens to guide the interviews and structure the data analysis [43]. The understanding this gave guided the creation of the interview questions, which were then conducted, and which had the potential to challenge previous perceptions and understandings. A semi-structured interview schedule was designed (see Appendix II), based closely on Dahya et al. [1], and administered by either telephone or face-to-face interview.

The initial questions help us to understand PRC company law, as regards specific requirements about supervisory board structures and the numbers of supervisors required. As Tam (1999) and Tian [5] suggested, the focus of Chinese corporate governance should be on the board of directors. Therefore, it is necessary to understand the situation of the board of directors before looking at the supervisory boards. Accordingly, the second set of questions in the

interview focused on the board of directors, with especial focus on the function of independent directors, inspired by the likes of Xu & Lin [13] and Jiaguo [21].

The questions then moved on to focus on supervisory boards per se, asking for he names, backgrounds and positions of supervisors within the company.[6] This detailed investigation allows us to assess the individuals' ability to do their jobs (see Dahya et al., [1]; Tian, [2]). It is also helpful in identifying any cross-office situations. According to Dahya et al. [1], supervisors sometime act as Party officials, and this phenomenon leads to confusion about roles and responsibilities. In the interviews, more specific characteristics of supervisory boards were sought, such as frequency of supervisory board meetings, the different functions of independent directors and supervisors, supervisory board reports and access to information.

Some additional questions were incorporated on the influence of the Communist Party and the Trade Union on corporate governance. These questions were not emphasized because of the sensitivity of such issues and the political environment in China. Indeed, not all interviewees responded positively to these questions or answered clearly and directly. At the end of the interview, however, some interviewees did offer possible resolutions to the current problems from a practical standpoint.

The five in-depth interviews were conducted by telephone with Respondents A, B, C, D and E. Respondent A is a general manager in an State-Owned non listed company, and acts as member of the board of directors in a state-owned, listed company, and also has previous supervisory experience in listed companies. Respondents B and C are chairmen of a supervisory board in a Chinese listed company. D is the secretary of a board of directors in a listed company, and E is acting as an independent director in a company listed in Hong Kong. In addition, we sent out nine questionnaires to individuals other than the original five respondents. One auditor was also interviewed via text messages, and this individual was very familiar with the internal control environment within her clients' companies. The specific backgrounds of interviewees are shown in Table 1.

[6] *To preserve confidentiality we do not divulge any individual details here.*

4. RESULTS AND DISCUSSION

Chinese legal decisions have allowed supervisors to walk away unscathed, even if they did not fulfil their roles satisfactorily. In financial fraud cases, members of the supervisory boards of listed companies should bear concrete administrative responsibility in the form of warnings and fines [44]. This was clearly borne out in the case of Shanxi Tian Neng Technology Co. Ltd (ST Ltd).[7] Between 2011 and 2012, this company's financial statements showed an inflated income of CNY 900 million (£104 million) and inflated costs of CNY 500 million (GBP 58 million), which led to inflated profits of CNY 400 (GBP 47 million). When ST Ltd submitted applications for share issuance to the China Securities Regulatory Commission (CSRC), the company included false financial statements from the end of 2011. The CSRC, however, found the deception and immediately penalized all directors and supervisors who had signed their names to the April 2012 prospectus. One of the supervisors, Yongping Wang, received a warning and a fine of CNY 0.1 million (GBP 0.012 million) but refused to accept the punishment from the CSRC. He sued the CSRC in the Beijing First Intermediate People's Court to request a cancellation of the punishment decision. The court supported the CSRC's penalty decision and rejected Wang's request in 2014. The written judgement suggests that all corporate supervisors have the responsibility to ensure authenticity and reliability in the disclosure of financial information according to the Company Law of the People's Republic of China and the Securities Act.

4.1 Civil Liability

Regarding the civil liabilities of members of supervisory boards, where false statements arise from a listed company, regulations exist in the provisions of article 23 of *Stipulations Concerning Civil Compensation Cases Owing to False Statements in the Securities Market*, issued by the Chinese Supreme People's Court (2002).[8] Further provisions exist in article 28 of

[7] *We gained access to recent cases and prejudications through the Global Law Office in Beijing. These recent cases and legal decisions indicate that supervisors are required to carry out their responsibilities according to company law and relevant regulations*

[8] *Consortia of underwriters and securities listing sponsors shall bear the compensation liability for the loss of investors caused by false statement, with the exception where there is non-fault evidence. Responsible directors, supervisors, managers and other senior management staff shall bear joint*

Stipulations Concerning the Trial of Civil Compensation Cases Owing to False Statements in the Security Market, issued by the Chinese Supreme People's Court (2002).[9]

These two regulations are clearly referred to in the *First-Instance Civil Judgment on False Statement Liability Disputes of the Case Zhou Li Against Yunnan Yuntou Ecological Environment Technology Co., Ltd., He Xueqin and Jiang Kaixi*. In this case, Zhou Li was one of the shareholders of Yuntou Company, which falsified statements in 2007. The false statements were prepared by management and signed by all directors and supervisors. This falsification was identified by the CSRC in 2010 and led to a large slump in the company's share price. Zhou Li sued the company and two senior managers for civil compensation. The court supported Zhou Li's request, and the written judgement indicates that the three defendants needed to compensate Zhou for part of his loss in the share price slump.

It is important to emphasize that the supervisors in these cases received penalties and warnings from the CRSC, but avoided any civil liability; although the court refers to regulations that indicate supervisors need not bear any such liability. The regulations regarding supervisors' civil responsibilities are clear despite the lack of real prejudication until recently.

4.2 Criminal Liability

When a listed company commits a crime, member liability depends on whether the individual was a direct supervisor or another person with direct liabilities in relation to the crime. In cases where the person in question is the decision-maker, organizer or leader of the crime, or plays a major role in the crime, the member is considered to be in charge of direct liability and shall bear criminal liability. In the case of the *Second-Instance Civil Judgement on ZhongShan MingTian Electronic Technology Co., Ltd., Chen Ruofei Defraud,* Chen Ruofei, a shareholder of MingTian Co., Ltd., was acting as the supervisor of the company and was sentenced for contract fraud after creating phony business contracts.

The case of Hainan Minyuan Modern Agricultural Development Co. Ltd [6] is very similar to that of ST Ltd, which conducted itself fraudulently in 2011 during the process of share issuance. The major differences between the two scenarios is that all supervisors at ST Ltd. were penalized in 2011, although only through warnings and administrative penalties. It also should be highlighted that the court uses clear references to laws and regulations to support the CSRC's punishment decision, including: the Initial Public Offering and Listing Management Approach (published in 2006); The Securities law of PRC (revised in 2005); the Administrative Penalties Law (published in 2005) and the company law of PRC (2005). All of these regulations and laws were published or revised after 2005. In fact, evidence suggests that many supervisors have received penalty decisions from the CSRC. The general form of punishment includes fines and warnings. As mentioned above, supervisors also need to bear civil and/or even criminal liability, depending on the situation.

4.3 Interview Evidence

The role of supervisors has some resemblance to the function of independent directors in Chinese company law. Independent directors monitor the directors and executives to ensure they are acting in the interests of shareholders and to protect the interests of minority shareholders, challenge directors if necessary and offer independent advice about management decisions. Legally, these two definitions overlap significantly. Discussions with interviewees suggested that the majority of the monitoring role that should belong to supervisors is being fulfilled by independent directors. Interviewees indicated that supervisory boards primarily conduct legality reviews. This is illustrated particularly well in the statement by respondent B, who has acted as a chairman of a supervisory board for a listed company for 15 years and currently serves simultaneously as a supervisor in two other listed companies:

Most of the monitoring job is always done by independent directors. They have voting power on the board of directors, and lots of them are experts in law and accounting fields. We are just

liability for compensation liability of the consortium of underwriters and securities listing sponsors.

[9] *In the case of any of the following circumstances concerning issuers, listed companies, consortium of underwriters, securities listing sponsors, responsible directors, supervisors, managers and other senior management staff, it shall be deemed as joint false statements, where joint liability shall be borne by issuers, listed companies, consortium of underwriters and securities listing sponsors for loss of investors: (1) participating in false statements; (2) knowing or ought to know about the false statements without expressly expressing objection; (3) other cases that liability shall be borne.*

Table 1. Background of respondents

Code	Industry	Exchange[a]	Ownership[b]		Role of participant[c]	Mode of interview		
			SOC	FOC		Phone	Email	Text
A	Finance	n/a	✓		BOD member; general manager; strong supervisory work experience	✓		
B	Electronics information	SHZ(A)	✓		Chairman, SB; secretary, party committee	✓		
C	Electronics	HK/SHZ(A)	✓		Chairman, SB; chief accountant of company	✓		
D	Environmental protection	SSE(A)	✓		SB supervisor	✓		
E	Electronics	HKEX		✓	Independent director on BOD	✓		
F	Electronics information	SSE(A)	✓		BOD member		✓	
G	Electricity	n/a	✓		SB supervisor		✓	
H	Variety	SHZ(A/B)	✓		Vice secretary, party committee; SB supervisor		✓	
I	Electronics	n/a	✓		BOD secretary		✓	
J	Manufacturing	SHZ(A)	✓		Vice president, BOD		✓	
K	Electronics	SHZ(A)	✓		BOD member		✓	
L	Manufacturing	n/a	✓		BOD president		✓	
M	Computer software	SHZ(A)	✓		BOD secretary		✓	
AUD	Auditing	n/a	-	-	Senior auditor assistant in Big 4; familiar with internal control and governance structure of client	Message by Wechat		✓

Key: [a]Stock Exchange: SHZ (Shenzen Stock Exchange); SSE (Shanghai Stock Exchange); HKEX (Hong Kong Stock Exchange); A share market = Mainland currency Renminbi; B share market = foreign currency ($US or $HK)

[b]Ownership Structure: SOC (State-owned company); FOC (Foreign-owned company)

[c]BOD (Board of Directors); SB (Supervisory Board)

responsible for reviewing whether the decision-making by executives complies with the relevant law, regulations and internal articles of our company.[10]

This is consistent with the statistical results from Xu and Lin [13], who found that independent directors of listed companies generally come from three backgrounds: academic, accounting and legal. Discussions with other respondents also suggested that, although there is an overlap in function between independent directors and supervisors in China's corporate law, in practice the monitoring role of supervisors is reduced to checking legality and compliance of material activities within the company based on relevant laws, regulations and internal company articles. The monitoring based on shareholders' interests is always performed by independent directors. Respondent B said:

We attend the meetings of the board of directors as non-voting delegates. Sometimes, we speak directly and express opinions if the report prepared by management includes apparent irregularities or illegal acts. However, it has seldom happened in my working experience. We

[10] *Where interviews were conducted in Chinese, as here. responses have been translated into English by the authors.*

do not consider the rationality of the decision-making by the executives and directors according to the interests of shareholders. What we focus on is the compliance and legality.

This argument was supported by several other interviewees, such as E, an independent director at a company listed in Hong Kong:

According to laws and regulations of the listing rules, the independent directors and supervisors have different duties and rights in our company. Other independent directors and I give professional advice in the meeting of the board of directors for a position outside the company. The aim for us is to protect shareholders' interests and challenge the decision-making by executives and other directors based on the interests of shareholders. The supervisors attend the meeting of board of directors; however, they focus on whether the proceedings of the meeting are organized according to the articles of association. They are also responsible for reviewing the behavior of the company to identify any illegal behavior according to the law and regulations, although they have never identified anything since I came to this company.

Company law requires supervisors to check company accounts. In practice, however, this duty is performed by the internal audit committee, which belongs to the board of directors. One audit manager from a Beijing office of one of the big four accounting firms made the following remarks based on her auditing experience with different Chinese listed companies:

For most of my clients, the job of checking book accounts is done by the internal audit department, especially relating to the procedure of preparing accounts and other internal control measures. I have heard some cases of the mistakes in financial statements having been found by the internal audit department. Besides, I have experience in which the members of the audit committee wanted to communicate with us and were familiar with potential mistakes in the financial statements. We report our audit opinion to the audit committee directly, and we do not have any contact with supervisory boards.

The role of supervisory boards in Chinese listed companies appears therefore mainly to involve checking the compliance and legality of particular behavior or a decision made by executives and directors. The supervisors perform this check in three ways. First, they attend meetings as non-voting delegates and speak directly to the board of directors. Second, the supervisory board holds a meeting at which members receive reports about management performance, and members can express any disagreement via the supervisory report that is submitted to the meeting of shareholders. Third, supervisors can contact directors and executives directly if there are doubts about their behavior.

However, the function of checking compliance and legality is meaningless in many listed companies because lawbreaking behavior does not always occurr and may be difficult to detect even if it is happening. Therefore, the position of the supervisor involves little work and has become a formality. Respondent B commented:

We just need to sign our names on the clean supervisory report, which was already prepared by the Office of the Board of Directors and Supervisors (the Office of Two Boards). Sometimes, we don't even meet, and the Office of Two Boards will then be responsible for passing the unqualified report to every supervisor's office. We sign our names in the report accordingly. Actually, I don't really care what it says in the supervisory report because it is always the same thing. In my 15 years of working experience, I have never seen any statement of the supervisory board disagreeing or even heard any disagreement expressed in the meeting of the supervisory board.

Interviewee A, a general manager in a state-owned company, expressed a similar opinion:

We have regulations specifying that all supervisors could contact me or other members of management directly if they have any doubts about our behavior. However, I have never received such communication from supervisors since I came to this company in 2013.

Therefore, it is reasonable to argue that although the company law implemented in 2005 details the roles and responsibilities of supervisors in a listed company, the conflict of function among supervisors, independent directors and internal audit departments has led to a phenomenon in which the monitoring function of the supervisory boards only includes checking compliance and legality. Based on the few compliance problems that have occurred and the fact that most of the problems could have been found by managers and directors, the role of the supervisory board is limited and has shifted away from the functions specified in company law.

4.4 The status of Supervisors

According to company law (2005), the supervisory board exists at the same organizational hierarchical level as the board of directors. Given that it acts as a monitoring body, supervisors need to maintain their independence in practice to make objective judgements. The lack of independence and the low status of supervisory boards has been mentioned in previous research (see Dahya et al., [1]; Xu and Lin, [13]), especially in Chinese literature. Unfortunately, few of these scholars explain why this phenomenon occurs and what are the consequences of a lack of independence among supervisors.

As a monitoring body in the corporate governance structure, the supervisory board has a duty to check financial statements, question illegal moves made by directors and challenge decision-making by executives and directors with the aim of promoting the interests of shareholders. Therefore, the supervisory board should be independent of any external forces in carrying out their duties and making objective judgements [1].

Nevertheless, most supervisory boards in Chinese listed companies are not independent for two reasons. First, given that most listed companies are state-owned or have a state-owned background [12], the status of their supervisory boards is highly influenced by the Communist Party. In all state-owned companies discussed in our interviews, at least one-third of the members of the supervisory board were from the Communist Party Committee. More importantly, most of them served as secretaries of these committees or the Committee for Discipline Inspection. In this role, they can take part in the company's decision-making process. Respondent A, who acts both as a general manager in a state-owned company and as a member of the board of directors in a parent company that has more than 10 subsidiary listed companies, described the power of CCP in his company as follows:

The Communist Party has significant influence in most aspects of corporate governance in our companies. All senior-level employees should have good political backgrounds (such as being a member of the Communist Party). The Communist Party takes part in our talent selection and promotion processes. A few months ago, our company made a new regulation that all senior management should be recommended by the Communist Party Committee. The secretary of the Communist Party in my company has power to take part in general manager office meetings, [11] and sometimes we have different opinions about how to manage our company. There are no good methods for dealing with the problems of disagreement between us. I have to consider or even compromise his ideas sometimes before making decisions. The Secretary of the Communist Party is also Chairman of the supervisory board in my company.

Similar opinions were expressed by respondent C, a chairman of the supervisory board in a listed company:

The Communist Party Committee acts as the core of leadership and is a political nucleus. They need to ensure that the central policy decisions have been practiced in the practical field. In our company, the secretary sometimes even has more power than the general manager in the management of the company. Actually, we call the secretary of the Communist Party Committee 'general manager' and other senior managers in our company a 'leading group'. All business in our company is managed by them together.

Chinese central government has already declared that the Communist Party Committee needs to take part in the decision-making processes of state-owned companies, when the decision is important to the development of the company or includes important matters of human resources, projects and large amounts of money (CCG, 2010). These specifications suggest that the Communist Party has significant influence and participant power in the decision-making processes of SOEs. Apparently, the independence of supervisors cannot be guaranteed given that most chairmen also act as secretaries of the Communist Party Committee and have power to intervene in the decision-making process. If the secretary of CCP Committee is required to monitor his own major decisions, the monitoring activity is merely a self-check and a formality.

Further, the extant 2005 company law requires at least one-third of the supervisors to be staff representatives from the company. This

[11] *The general manager office meeting is the highest decision-making institution in a state-owned company. It does not use the voting system; however, all participants can express their opinions. The general manager makes the final decisions.*

requirement imitates the German system, in which the Trade Union and employees have great power in the corporate governance structure. Trade Unions in China are weak and, based on discussions with interviewees, they work primarily to organize entertainment activities for employees. Thus, staff representatives are just a formality in China because their monitoring targets are the executives and directors who are their superiors. One staff representative supervisor in interview stated:

The people on the board of directors are all my superiors. They have the power to fire me. Actually, I just attend the meeting of the board of directors and the meeting of the supervisory boards, according to the articles of association, but I seldom make any statement. I know if I say something wrong in some kind of occasion like meetings of the board of directors, the superiors may have a bad impression of me. Therefore, keeping silent is the smartest way to fulfil the job of supervisor.

It is very interesting that the lack of supervisory independence was acknowledged by most interviewees, but considered important by only a few. For instance, respondent A stated:

I don't think the independence of supervisors is an important thing. I think the thing which could make sense is cooperation. I need to cooperate with my colleagues and then let our company be better. I seldom focus on their independence or objectivity. If we have some problem with compliance or legality, I can deal with it and correct it with my colleagues. Institutional independence is not important.

This argument was also supported by respondent H, a supervisor in a listed company:

The Communist Party, senior management and supervisors have the same objective, which is to keep the enterprise developing in a continuous and healthy way, and making rewards for stakeholders. This is consistent with the corporate governance institution. The institution in terms of independence is important, but moving forward, and dealing with the problems on timely basis is more important.

It is easy to understand this point of view given that Chinese people as a whole emphasize collectivism and communism. If they believe that they have the same objectives and that they can deal with the problems they face, a clear organizational hierarchy may not be important in terms of independence in the monitoring role. Most managers, directors and supervisors understand the importance of independence, but very few consider it important given that many problems can be dealt with in a collective and informal way. This finding confirms the conclusion by Goodall and Warner [28] who suggest that informal connections are more important than independence in dealing with the problems faced in practice in China.

In short, the current supervisory boards in Chinese listed companies have no independent authority to act as a monitoring body within the corporate governance structure. The three main reasons for this are: the cross-office situation involving officials who are on both the CCP Committee and the supervisory board; the legal status of staff supervisors; and the unique Chinese collectivist culture.

4.5 The Power of Supervisors

One obstacle for the supervisory board is the lack of power, particularly with regard to the information shortage mentioned in previous literature (see Dahya et al., [1]; Ding et al., [10]; Tian, [2]). This literature argues that supervisors should have the same power as executives and directors to access information on operating activities because this information is original material that is necessary for supervisors to make judgements and fulfil monitoring duties. Company law in PRC (2005) does authorize supervisors to obtain this information and conduct independent investigations based on their judgement.

Most interviewees could identify a specific department responsible for informing directors and supervisors, and were aware that they had the power to ask for more information if necessary. Dahya et al. [1] found that only a few supervisors could receive such information and that it would be fragmented. This situation has improved in the past 15 years, as is well-illustrated by the following statement from Respondent A:

In our group, we have a mechanism that the report on operational information about the company needs to be prepared by executives. The comprehensive department (or two board office based on different subsidiaries) then sends the information to all directors and supervisors at

the end of every month. The report, the report of the completion of financial indicators and the financial statements are sent to all directors' and supervisors' mailboxes. No single supervisor will be intentionally omitted because the omission is easy to find.

This statement suggests that supervisors can obtain information in two ways: first, they can receive the information from the board office or the comprehensive department on a regular basis; second, they can attend the meeting of the board of directors and listen to the executive reports. Ignoring the insider factor, therefore, it could be argued that the directors and supervisors receive the same information. But note that, although supervisors could receive complete information, in practice, they never doubted the information they received or asked for further information.

4.6 Technical Competence

Technical incompetence is an issue highlighted by previous scholars. Dahya et al. [1] find that in most of the state-owned listed company, the position of supervisor is given to fading political figures and retired or retiring cadres to enjoy. This situation still exists, given that at least every third member on the supervisory board is also an official on the CCP Committee, according to our fieldwork evidence. However, they typically also have financial or legal professional backgrounds. According to the interviewees, most company shareholders have a sound policy for selecting and appointing supervisors. Respondent A commented:

We do not have a clear standard in nominating supervisors for our subsidiary company; however, we are always concerned about two aspects for the candidate. The first one is their specialized knowledge. The candidate who has an accounting and auditing background will be considered first. Secondly, we prefer that the candidate has a good political background.

This idea is supported by the backgrounds of the supervisor interviewees, most of whom have the relevant history in accounting and law; some also are senior certified public accountants.[12] Also, every company discussed here includes at least one accountant in its supervisory board. Previous literature has suggested that supervisors cannot understand financial statements and, therefore, cannot monitor these statements according to the requirements of corporate law. This argument seems unreasonable in light of the evidence. Therefore, this paper suggests that the technical competence of supervisors has improved during the last 15 years.

Although the legal environment has improved since the publication of the New Company Law in 2005, in practice, the function of the supervisory board is limited and has shifted away from the functions specified in the Company Law. We find that the functions of supervisory boards in listed companies include only checking compliance and legality of the behavior of members of the boards of directors and executives. This shift in the function of supervisory boards is a consequence of the conflict in function between supervisors, independent directors and internal audit departments. Highlighting this gap between regulation and practice is a new insight arising from our work. In addition, the findings presented in this study indicate the lack of independent status among supervisory boards, which could weaken their monitoring role in practice.

The evidence indicates that the power and competence of supervisors has improved in recent years. Most of our respondents indicated that supervisors could access the same information as the directors; furthermore, most know that the Company law of PRC has authorized supervisors to make independent investigations. This power and competence, however, have no place given the declining role and lack of independence faced by supervisory boards.

4.7 Implications

The responsibilities of supervisors are more strictly defined and upheld within the legal environment in China compared to a decade ago, especially given that requirements and regulations have become clearer since 2005. China's originally lenient legal environment [1] and unclear regulations in terms of supervisor liabilities have improved over the last decade. In the current Chinese legal environment, supervisors are expected to bear specific liabilities if they failed to fulfil their monitoring duties. Today's supervisors need to acknowledge administrative, civil and even criminal liabilities according to the specific situation. Supervisors cannot always walk away unscathed in China's current legal environment. However, the

[12] *The senior certified accountant is a senior professional and a technical title in China.*

phenomenon of escaping without charge still exists, especially with regard to civil liability. We suggest that this phenomenon is legally complicated because the plaintiff in a civil case always treats the whole company as an independent legal entity rather than suing all responsible individuals.

Previous literature has often referred to the somewhat lenient legal environment in China and the ambiguity of supervisory responsibilities (e.g. Dahya et al., [1]). This paper, however, suggests that the problems faced by Chinese supervisory boards are not caused by leniency or unclear responsibility requirements. On the contrary, we suggest that the current regulations in China are sufficient to allow supervisors to fulfil their jobs. Based on the results from the interviews, this paper suggests that the main problems faced by supervisory boards in practice include a decline in the supervisory role and a lack of independence caused by conflicting functions among organizational agents and the Chinese cultural context.

With the rapid development in China, the responsibilities of supervisory boards in Chinese listed companies have been clearly described over the past 15 years in light of the enactment of a series of relevant laws and regulations. The strict legal regulations in terms of supervisors' responsibilities mean that most supervisors who fail to carry out their monitoring responsibilities within the corporate governance structure will be punished by either the CRSC or the People's Court depending upon their behavior. Currently, most supervisors in listed companies have sufficient power and professional knowledge to fulfil their responsibilities.

In practice, however, the work of the supervisory board is limited to checking compliance and legality of behavior of the board of directors and executives. This practical role diverges significantly from the requirements of relevant regulations. We suggest that the limited role of the supervisory board is a consequence of conflicts among too many monitoring parties in the corporate governance structure. Besides, the lack of independence also limits supervisors' monitoring functions. Dual membership of both the CCP Committee and the supervisory board, in addition to the low status of staff representatives, mean that supervisory work is effectively a formality. Furthermore, the collectivism of Chinese culture makes directors and supervisors less concerned about building a strict monitoring body.

5. CONCLUSIONS

There is an old Chinese saying that equates to 'too many cooks spoil the broth'; things become disorderly if too many rules are introduced. The problems facing supervisory boards result not from a lack of clarity about the responsibilities of supervisors, as mentioned in previous literature, but rather from too many monitoring responsibilities allocated to different monitoring agencies. The three monitoring bodies in Chinese listed companies cannot be effective at same time. Therefore, this paper suggests that China's two-tiered board structure may require changes in the future. Whilst acknowledging the limitations of our study, in terms of the small size of our sample, we do believe that the insights offered through both interview and legal case evidence offer a novel take on the case of Chinese supervisory boards. Future studies might wish to explore larger samples and quantitative evidence to support our findings.

Our work agrees with Tam [4] and Tian [5] that supervisory boards are relatively ineffective, and is also confirmatory of Goodall & Warner's [28] finding that informal interaction works better. It further supports the work of Dahya et al. [1] and Liao et al. [29] that supervisors are not afforded the power to do their jobs effectively. We therefore suggest that reform in the corporate governance structure is useless unless policy-makers are clear about functional conflicts. The theory behind the practice of introducing institutional arrangements from developed countries was sound, but such arrangements may not be sit well within Chinese organizations. The supervisory board, regarded as a combination of Anglo-American countries' one-tiered model, Germany's compulsory supervisory board model and Japan's corporate auditors' system [10], is currently redundant within Chinese listed companies. Thus, this paper recommends the removal of the supervisory board from the current corporate governance structure, with supervisory duties being transferred effectively to independent directors. Easing up on the regulatory requirements, rather than tightening the rules, should facilitate functionality in corporate governance practice.

DISCLAIMER

The products used for this research are commonly and predominantly use products in our area of research and country. There is absolutely

no conflict of interest between the authors and producers of the products because we do not intend to use these products as an avenue for any litigation but for the advancement of knowledge. Also, the research was not funded by the producing company rather it was funded by personal efforts of the authors.

CONSENT

As per international standard or university standard, participant's written consent has been collected and preserved by the author(s).

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COMPETING INTERESTS

Authors have declared that no competing interests exist.

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APPENDIX I: LIST OF IMPORTANT LAWS AND REGULATIONS

中华人民共和国公司法 [Company Law of the People's Republic of China, the Standing Committee of National People's Congress, Dec. 29, 1993; revised on Aug. 28, 2004; Oct. 27, 2005; and Dec. 28, 2013]

股份制公司暂行规定: 股份有限公司规范意见; 有限责任公司规范意见[Provisional Regulations of Shareholding Enterprises: Opinions on Standards for the Companies Limited by Share; Opinions on Standards for Limited Companies and the Like, the National Reform Committee of People's Congress, May 15, 1992]

关于在上市公司建立独立董事制度的指导意见[Independent Director Guidelines in Listed Companies, China Securities Regulatory Commission, Aug. 16, 2001]

最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定[Stipulations Concerning Civil Compensation Cases Owing to False Statements in the Securities Market, Chinese Supreme People's Court, Dec. 26, 2002]

关于进一步推进国有企业贯彻落实"三重一大"决策制度的意见[Guidelines on Further Advancing the State-Owned Enterprises' and the implementation of the 'Three Importances and One Large Decision-Making System, the general office of Chinese central government, Jun. 5, 2010]

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APPENDIX II: SEMI-STRUCTURED INTERVIEW SCHEDULE

1. Background information

(1) Industry
(2) History
(3) Types of shares (A, B or H)
(4) Shareholding structure
(5) Largest shareholder

2. Boards of directors (BODs)

(1) How many directors are there in the BOD?
(2) Who is on the BOD?
(3) How does the BOD work?
(4) What does the BOD do?
(5) Is there any dominant influence within the BOD?
(6) Who are the independent directors?
(7) What does the independent director do?

3. Supervisory board (SB)

(1) How many supervisors are in the SB?
(2) Who is on the SB?
(3) How does the SB work?

Do the members of the supervisory board receive company information on a timely basis?

Do the members of the supervisory board take part in the meetings of the board of directors?

The frequency of supervisory board meeting.

(4) What does the SB do? Who arranges the agenda of supervisory board meetings?
(5) How do you describe the relationship between the SB and the BOD, and that between the SB and the AGM?
(6) How do you describe the relationship between the SB and independent directors? what is the difference between them?
(7) How is the SB report prepared? Who drafts it? Is it handed in to AGM directly, or is it first handed in to the board of directors' meeting?

4. What are the roles of the Communist Party, the Trade Union and employees' council in corporate governance?

5. What methods do you think could be used to improve the effectiveness of supervisory boards in your company?

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