



Coordination and Perfection between Independent Director and Supervisor's Council

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Abstract

Inside supervision exists in the name only and is severe lack in Chinese Listed Company. The authority of supervisors' council is strengthened in the new Company Law and definitely regulate that the Listed Company should introduce independent director system. The two are different corporation inside supervision modes in unitary and binary Corporate Governance Structure. If introduce the two of them in one country's corporate law, supervisors' council will inevitably conflict with independent director in legal status and function design and etc. The two systems have different characters in exercising supervisory power, they are also complementary. This article tries to explain the realistic predicament of supervisors' council system and independent director system and to coordinate their relationship, which will benefit further to perfect inside supervision system of our Chinese corporation.

Keywords: Independent director, Supervisors' council, Inside supervise, Coordinate, Perfect

The new Company Law which is implemented on January 1, 2006 definitely provide that listed company should establish independent director, which will benefit to perfect our Corporate Governance Structure, protect and maximize investors and corporations' interest. But there is much discordance between the independent director system which originate from unitary Corporate Governance Structure and current Corporate Governance Structure in China. The discordance of the two systems must be changed. But the new Company Law simply provided that independent directors should be established in listed companies and specific should be procedures specified by the State Council. So when designing the new system we must think how to realize seamless access of the independent director's supervision function into current Corporate Governance Structure in China, coordinate the relationship between independent director and supervisor's council, strengthen their supervision function and avoid the embarrassment of their function conflict or no one to be responsible for the supervision. Otherwise, listed companies adopt both supervisory board system and independent director system which forms a parallel system of internal supervision mechanism and only increase supervision cost and reduce supervision efficiency.

1. The conflict between independent director system and supervisors' council system

1.1 There is great difference in the legal status of independent director and of supervisors' council.

The independent director system originated from America. The corporate governance structure of America is unitary and its corporate organizational includes only shareholder meeting and board of directors who exercises supervision function, and no board of supervisors which exercises specially supervision function. Because of insider control increasingly fierce, board of directors' supervision function has been weakened. And just because of the fact of insider control, America set up independent director system. Insider control refers to, on the modern corporation whose ownership is separated from management right, senior managers master the corporate control in fact or legally, and their interests will be reflected abundantly in corporate strategic decision. Public company's equity is very dispersed in America, and no one shareholder can control a company effectively, which leads to insider control at last. And independent director system is set up for avoiding this by board of directors (internal organization of the corporation) proper externalizing, and external independent director introduced will supervise and restrict to insiders. In the unitary corporate governance structure, independent director who hasn't higher authorities than board of directors, is equal director and attend board of directors and say no for supervising insider director.

Supervisors' council system originated from Germany. The German corporate governance structure is binary and vertical structure, which is composed of general meeting of shareholders, supervisors' council and board of director. Shareholders and workers representatives elect to generate supervisors, and Supervisors' council appoints members of board of director and supervises it to perform business. The most important character of German supervisors' council system is that supervisors' council and board of director aren't parallel organs, but board of director is supervisors' council's inferior organs, which is an excellent creation of company system. Commercial Law of Japan accepted

Germany mode from enacted in 1899, and corporate governance of Japan took binary structure as Germany's. According to Company Law of Japan, the ownership is separated from management right, shareholder meeting is the highest authority, board of director and supervisor are parallel organs and all belonging to shareholder meeting, which is different from German vertical structure in which supervisors' council leads board of director, and different from England and America unitary structure in which board of director has function of execution and supervision.

In a word, the Legal Policy target which the two systems pursue is the same and homogeneity, but their Law Technology structure is different. In corporate governance structure of England and America, general meeting of shareholders elects board of director, board of director elects and dismisses managers. In order to supervise and restrict managers, the measure is to insure directors' (especially independent directors') externality and independent identity to set up a higher strategy organ than manager. And doing specific labor division in the organ, electing persons who are wisdom, giving them rich salary and definite liability, and supervising managers by nomination mechanism beforehand, compensation mechanism and audit mechanism. The corporate governance character in the civil law, however, is binary structure. Supervisor's council and board of director are equal and their function is respectively business supervision and service execution, both of them obey general meeting of shareholders (at least in the form). Endowing supervisor's council with a strong position ensures it to perform its supervision function to business and finance without pinning from board of director and manager tier. Germany is a typical.

1.2 The area of authority of independent director and that of supervisor's council exist cross and overlap.

Independent director in common law and supervisor's council in civil law are two different modes of company interior surveillance. The former is interior supervising of the board of director, the latter is supervision of special supervisory organs exterior the board of director. The objective of all the two modes is to reduce cost of corporate governance and solve the problem of corporate governance to ensure to realize and maximize interest of investors and corporate. The pursuing goal's consistency determines the similar and overlap in their area of authority is inevitable.

2. Agree with independent director system and supervisor's council system

Independent director system and supervisor's council system are two interior supervising systems in different corporate governance structure and each of them has merits and demerits in practice. So it is incorrect to undue emphasis any of the systems. In fact, with the enhancement of the international tendency of capital market, countries are drawing lesson of success from other supervising modes, which show the two supervision systems have joint supervising goal and are complementary, and can draw merits from each other to reform self- system.

2.1 The two systems have joint goal.

Though independent director system and supervisor's council system are different modes of listed company interior supervising, their goals are all to supervise managers' behavior, and to ensure investors' interest not being impaired because of managers abusing power, and to reduce corporate governance cost, and also to give consideration to stakeholders' interest. The independent director is a necessary complement to our current company interior supervising system, and can change present situation that supervisor's council exists in the name only.

2.2 Two of them have very strong complementary.

Board of director is the highest power authorities of decision making, however, independent director is an important part of decision level, and they participate in the whole process of making important policy including plan in advance important decision, determination and issue at last and etc. So the independent director's supervision function has the character of close combination with supervising in advance, inside supervising and supervising of the decision making. In contrast, supervisor's council as the special supervisory organ interior company, learns the specific conditions about company daily operating and can obtain company's the most direct and authentic information and can understand timely manager tier's execution to the decision of general meeting of shareholders and board of director. Independent director participate in the whole process of decision, but its daily working time is not able to full guarantee, and its supervising to execution of decision and effect evaluation also can not be in time and accurate. After company important decision made, supervisor's council can began daily tracking supervision. So the character of supervisor's council supervising is supervision afterwards, outside supervision and supervision without participation in decision making, which can remedy the defect of independent director system. The supervision afterwards of supervisor's council includes all kinds of functions such as inspection, implementation, evaluation, feedback, and etc, which is an important complement to the supervision function of independent director, and is also an important basis for general meeting of shareholders to evaluate the decision level and management.

2.3 The combination of independent director system and supervisor's council system is beneficial to perfect Internal Supervision System of Companies.

On the one hand, our members of supervisor's council used to come from union chairmen and worker representatives, which leads to the truth of inequality between independent director and supervisor's council, and brings difficulty to the

two organs' communication. The combination of independent director system and supervisor's council system makes communication between independent director (as members of board of director) and supervisor's council and has changed their communication way. On the other hand, supervisor's council has the right to supervise work of independent directors as members of board of director. In point of the independent director's investigation to supervisor's council daily work and its professional ability, independent director also can supervise supervisor's council, so as to push supervisor's council to work fairly and effectively.

3. The coordination and improvement perfection between independent director system and supervisor's council system

3.1 The coordination between independent director and supervisor's council

3.1.1 The function orientation between them

Defining purview between independent director and supervisor's council can not deviate from their role orientation. First, the nature of independent director's supervision right is different from that of board of supervisor. In binary corporate governance structure, independent director is also director (belongs to company's service execution organ in nature), and its function can not transcend board of director's authority. Their existence, on the one hand, makes company decision making more democratic and scientific; on the other hand, apart from independent director's supervision function can strengthen board of director's supervision to managers and mutual restriction internal board of director. The role of supervisor's council in nature is to supervise work of executive organ of corporate business. Second, defining function of independent director and supervisor's council, the authority of independent director is mainly to supervise whether all the important decision what board of director has done is impartial and scientific, however, the authority of supervisor's council is mainly to supervise the legitimacy of corporate finance and business action of directors and managers.

3.1.2 The coordination of two systems

As mentioned above, the character of independent director's supervision is close combination with supervision in advance, internal supervision and supervision of decision making, however, the character of supervisor's council supervision is supervision afterwards, outside supervision and supervision without participating in decision making. The character of the two supervision modes is opposite, which constructs for us a tridimensional supervision system in corporate governance structure. If constructing a coordination system between them, we can change their function overlap into multi-line defense of supervision and improve supervision effect. The one, we should construct sharing system of information and resources between independent director and supervisor's council, and hold regularly conferences which can be participated in only independent directors and supervisors to exchange information, circulate situation with each other. Independent director may review and use financial auditing report of supervisor's council, and supervisor's council will hear Independent director's suggestion, when it exercises its supervision function. The two, negotiation system between independent director and supervisor's council should be constructed. They can negotiate with each other about some special problems, and suggest the other party to take relevant supervision measures to strengthen supervision effect. The three, independent director and supervisor's council can joint to investigate special problems and form composition forces of supervision.

In a word, we must coordinate the two systems, define their function according to their different characters on supervision function, and make them having definitely function division and positive interaction to create a Chinese-featured company supervision mode in which independent director system can do harmonious coexistence with supervisor's council system.

3.2 The perfection of independent director and supervisor's council

3.2.1 The perfection of supervisor's council

A. Change supervisory board members' structure and quality and removal mechanism to improve its supervision efficiency and strength. One of the important reasons that our current supervisory board can not exert its function effectively is supervisory board members' structure and quality and removal mechanism exist serious problems. According to the questionnaire investigation about Listed Company Governance which Shanghai Stock Exchange has done in 1999, there are there obvious characters about member structure of Listed Company supervisor's council: the one, most of members of supervisor's council are employee supervisors. 73.4 percent effective sample companies' chairmen of supervisor's council are promoted from internal companies and the appointment of most of vice chairmen of supervisor's council and other supervisors is so, too. The two, supervisors are mostly come from political cadres and model workers, and their salary and position is basically decided by management which leads to supervisors to be not able to keep their independence. The three, supervisors' educational background and professional knowledge are lower obviously than directors'. More than half of chairmen, vice chairmen and supervisors hold junior college, however, most of directors hold undergraduate which leads to supervisor's council being in disadvantage position and can not supervise board of director effectively. While other researchers think that our supervisor's council has defects below:

supervisors are non-independent and scarce capacity; the legal provisions about this have defectiveness. Obviously, we can not ask supervisor's council like that to perform its duty effectively. In order to change this present condition, we must reform supervisor's council member structure. The one, introducing outside supervisors which can be appointed directly by Listed Company and can also be delegated by Accounting Firm or Auditing Firm who has no business connection or finance connection with The Listed Company. The two, electing persons with high professional quality as members of supervisor's council, such as experts, scholars, advanced professional persons of accounting and finance with professional certificates and professional dedication. The concrete methods to elect supervisors can study ways to elect independent directors. The three, outside supervisors must also have independence, and the criterion to judge the independence can refer to that of independent director.

B. Giving supervisor's council all kinds of specific procedural rights, such as inquiry right, veto power and etc, to ensure certainty of supervision. Another important reason that our current supervisor's council can not exert its function effectively is that we have not an effective procedure to ensure certainty of supervision. For example, there are regulations about supervisory board's right to supervise company finance and directors' deed in our Company Law, but there are no specific measures to ensure the right, which leads to supervisor's council no effective measures to correct illegal behaviors when they find that. So we should give supervisor's council all kinds of procedural rights by legislation in order to assure supervisory board's substantive rights realized and restrict effectively internal rights in Corporate Governance Structure.

C. Giving supervisors definite responsibility and improving supervisors' salary to assure their diligence. The responsibility is restricting measure, however, the salary is incentive measure, and ideal mode to assure supervisors' diligence is to simultaneous use the two measures. The incentive and restricting system should be established in which risk and income are symmetric. Because independent supervisors' income comes from allowance, so there are two problems for attaching incentive effect: one is how much allowance should be given. Supervisors undertake a great deal of responsibility of supervising and decision making, and so the responsibility and the salary will be asymmetric if the allowance is too small, which will effect their enthusiasm to take part in company business; if the allowance is too much, independent supervisor will too care their allowance to keep their independence. And so, proper allowance is a problem worth studying. According to current reform thinking, we should think whether introducing stock option system and increasing an article about independent supervisor in Company Law, so as to independent supervisor can transfer freely their stock when they resign from their post. Two is who decide the standard of reward. We think independent director or shareholders who are not appointed as directors can evaluate independent supervisors' work and decide their reward. Independent supervisors should responsible for their negligence such as breaking articles of corporation, administrative regulations and law by public opinion supervision, administrative punishment and legal penalty. The author thinks this is also suitable for general directors.

3.2.2 The perfect of independent director

We achieved some achievement on practicing independent director system in the past few years. But there is much deficiency in our legislation and specific operation for many reasons, which all need further perfect. The author will discuss mainly some points as follow.

A. Strengthen legislation about independent director. Because independent director's responsibility isn't definite in our current law, which makes company lack supervision, and so three aspects as follow should be thought in the future legislation: the one, proportion of independent director in board of directors and right, obligation, responsibility and function of independent director should be nailed down in correlation laws; the two, making further explicit stipulation of independent director's qualifications, producing procedure, their allowance and etc in correlation laws and making principle specification of independent director's fault liability; the three, making independent director's responsibility more definite in legislation.

B. Establishing professional Human Resources Market of independent director. Now independent director is hired or fired by Listed Company in China, their allowance is given also by Listed Company. And so the practice of independent director's supervision function will be restricted by ownership structure and outside supervision system. In order to assure independent director to work independently, we require establishing the self-regulative professional organization such as Independent Director Association and Independent Director Firm and etc. On the one hand, independent directors can only come from the organization to guarantee the appointment of independent director; on the other hand, evaluation and assessment independent director regularly. The independent director who is unqualified or illegal will be denounced publicly and probably be canceled the qualification. If independent director's work mistake leads to shareholders' loss, he will be hold joint liability in law.

C. Restrict independent director to do part-time job to insure the practice of their function. Chinese Listed Company puts their fame and prestige and social influence in primary position when appointing independent director, and subordinate whether they play their role in company management and operation and neglect independent director's rational structure and their working time. In order to assure independent director to serve diligently, they are not suitable

to part-time excessively, and 2 to 3 companies suitable in general.

D. Establish liability system of independent director, in which their liability, power and benefits are unified. On the one hand, independent director should undertake corresponding liability for their positive action and negative action within their function and power. Compared to foreign codes, complete Responsibility Confirmation Rule for independent director has not been formed in China, the responsibility consciousness of most of independent directors is not strong. Aiming at this fact, we can draw advanced experiences from other countries and impose strict restriction upon legal liability of independent director to perfect corporation governance and protect minority shareholder's rights. On the other hand, we can establish Liability Insurance for Independent Directors. Independent director faces more risk than other directors and managers because of its special position. When independent director performs its duty, its personal experience, judgment and ability deficiencies, what it knows about company is inadequacy, and there is asymmetric at acquisition company information aspects, which all can cause fault. Establishing Liability Insurance for Independent Directors can reduce furthest risk of the position, descend career issues of independent director and make their decision more effective.

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