

# **The Current Situation of the Director Remuneration Disclosure in China's State-Owned Listed Companies and Accountability of Problem Pay**

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**Abstract:** With the reform of economic system, corresponding changes have taken place in the remuneration system of directors of state-owned listed companies in China. Objectively speaking, China's remuneration reform in recent years has made some achievements, and initially established the system framework of the remuneration management of directors of state-owned listed companies. However, , there are still some problems in the system of director remuneration, such as supervision and management, incentive and restraint, main body responsibility, disclosure mechanism, etc. Moreover, the reform system itself has certain time lag, and the implementation situation needs to be observed. It can be said that the reform of the remuneration system of the directors of the state-owned listed companies in China is far from reaching its due strength and depth, especially the issue of remuneration disclosure. This paper discusses the status quo of remuneration disclosure, the path selection and the accountability of director's problem pay in order to build a more standardized and reasonable remuneration system. The remuneration disclosure system of the state-owned listed companies can better regulate the legal behavior of the state-owned listed companies and play an important role in the development of national economy.

## **1. Introduction**

In order to ensure the legalization and rationalization of director remuneration design, supervision is a necessary way, and extensive supervision is an effective way to solve the problem of power abuse, slack work and reduce costs. The fundamental purpose of securities supervision is to protect the legitimate rights and interests of investors[1]. The requirement of disclosing directors' remuneration is also an effective means to protect investors' interests. Extensive supervision should start from several aspects: from the aspect of government supervision, the CSRC, the stock exchange and the tax authorities should issue the detailed rules for the supervision and management of the remuneration of the company's directors; from the aspect of intermediary supervision, the audit institutions and other intermediary institutions need to strictly check the statements provided by the company, make use of their own professional knowledge, find out the loopholes, and timely put forward amendments to the company and report to the government regulatory authorities; from the aspect of self-regulation, the remuneration committee must take the responsibility of supervision and keep the first pass; from the aspect of media and public supervision, the media and the public should be responsible for the authenticity of the information provided, and it is not allowed to compile false information and maliciously attack others. The media and the public can question the information of director remuneration on the basis of evidence, and make a supplement to the careless omission.

## **2. The Current Situation of Director Remuneration Disclosure in Listed Companies**

At present, the state-owned listed companies in China have the following characteristics in their director remuneration: firstly, most of the executive directors do not get remuneration from the listed companies; secondly, non-executive directors usually receive fixed remuneration, which cannot reflect their contribution to the company; thirdly, if the executive directors get remuneration from the listed companies, the amount is relatively high, compared with other directors without any

remuneration, differentials of director remuneration are too large, but in the annual report of listed companies, there are no reasons for this huge difference. In addition, the disclosure of director remuneration of listed companies in China at present is limited to the disclosure of total amount of remuneration and share holding, without any details.

In order to make the payment of director remuneration quantifiable and comparable with the listed companies in the same industry, the composition of director remuneration should be clear, reasonable and easy to understand. The disclosure of director remuneration should include the following details: 1) Basic remuneration. It should be set at a level that reflects responsibility, tenure and the highest value that has been created for the company in the past. The basic remuneration paid to directors should be comparable to that of their peers, and the Remuneration Committee should publicly disclose the reasons why directors and other highly paid persons are paid more than the median wage of their peers; 2) Annual incentive remuneration. An annual short-term cash incentive remuneration plan should be designed to reward outstanding performance that meets or exceeds the stated performance objectives, and to align the directors' interests with the company's objectives and strategic objectives; 3) Long term remuneration. It is designed to achieve several long-term goals, including maintaining efficient and qualified directors, making directors' financial interests consistent with shareholders and promoting and rewarding excellent long-term performance; 4) Equity grant and stock options. Agency theory shows that when the equity level of managers in the company is close to a high level, it can provide incentives, so that the management can coordinate their own interests with shareholders; Stock options are considered as long-term incentive plans granted to directors to attract and retain talented directors and reward outstanding performance; 5) Resignation and replacement fee. The company's remuneration committee must fully disclose the content, term and conditions of the employment contract, as well as other arrangements and reasons for directors and managers, and the total amount involved. The Remuneration Committee shall disclose the new manager's contract or the amendment to the existing contract in the above statement; 6) Retirement arrangements. Retirement arrangements include deferred remuneration plans, supplementary director retirement plans, and other retirement arrangements for directors.

### **3. The Practical Problems and Path Choice in the Information Disclosure of Director Remuneration**

At present, there are still some problems to be solved in the disclosure of director remuneration of listed companies in China, such as the obvious violation of information disclosure, the lack of relevant civil laws and regulations, the lack of synergy in the regulatory system, and the imperfect third-party supervision mechanism. The disclosure of director remuneration in China's state-owned listed companies should be reformed on the basis of full reference, analysis and judgment, and go out of the development path in line with national conditions.

The securities market of western developed countries is the result of market breeding, gradual development and perfection, while the securities market of our country comes from "airborne" driven by the government. From the perspective of equity structure of listed companies, according to statistics of Shanghai Stock Exchange, by the end of 2005, the total number of shares of Listed Companies in Shanghai Stock Exchange was 540.806 billion yuan, of which 346.184 billion yuan was outstanding shares, accounting for 64.013% of the total shares of listed companies; 194.622 billion yuan was outstanding shares, accounting for 35.987% of the total shares of listed companies. About 2 / 3 of the shares do not participate in the market circulation, the ownership structure of "the dominance of state-owned shares", highly stable shareholder structure and status, all of which determine the serious lack of motivation for the listed companies to voluntarily disclose the company's information. As far as the educational background structure of investors is concerned, by the end of 2005, 37.88% of the individual investors opened accounts in Shanghai Stock Exchange, 26.94% of them have secondary school education, 22.15% of them have junior college education, 9% of them have undergraduate education, and 4.03% of them have master's degree or above. It can be seen from the above situation that the cultural level of Chinese investors is still low, and investors

cannot search, analyze and sort out information alone in the complex and changing market changes. In order to obtain information accurately, more cost and energy must be paid, which will also lead to a larger total cost of our society. Therefore, if we want to adopt voluntary disclosure in our country as the leading mode of information disclosure will make individuals and the whole society pay social costs that cannot be borne.

In China, the market intermediaries such as accounting firms, securities companies, law firms, and asset appraisal firms generally have the problems of poor audit independence and low professional ethics, which are caused by their short development time, unclear property rights and responsibilities, and poor professional competence. If we compare our country's accounting firms with foreign ones, we can find that our country's accounting firms are small in scale, have weak independence and low audit quality. In the information disclosure, the problems of purchase audit and audit fraud are especially serious. In 2001, the year of China Securities Regulatory, the state audit office conducted a sampling inspection on 32 audit reports issued by 16 accounting firms with the qualification of annual report audit of listed companies. As a result, 14 registered accounting firms (87.5%) issued 23 audit reports that were seriously untrue, involving 42 certified public accountants.

Based on the weak development of intermediary agencies in China, it is impossible to use non market forces to force the establishment of intermediary agencies. Of course, after the implementation of the mandatory information disclosure system in China, the listed companies are often not satisfied with the situation. Executives make use of improper means to disclose false information, use the trust of the public, damage the interests of investors, and make the trust of the listed companies overdrawn, so that the development of the securities market in our country is very difficult. We should establish a Chinese style information disclosure model of director remuneration, which is dominated by mandatory information disclosure model and assisted by other disclosure models.

In terms of the specific content of remuneration disclosure, the developed countries in Europe require listed companies to disclose the remuneration policy and the specific composition of director remuneration[2], while China does not require disclosing the composition of director remuneration at present. According to the annual report of listed companies, the majority of listed companies did not disclose the composition of director remuneration in their annual report. In the process of the reform of director remuneration, it is worthy of our attention and needs to be improved.

#### **4. Accountability of Directors' Problem Pay in Listed Companies**

The problems in director remuneration often reflect the confusion of corporate governance structure. Achieving an appropriate mix between authority and accountability is a daunting, but necessary task[3]. At present, the judicial review of remuneration in various countries is mainly limited to the level of procedural review. In western developed countries, shareholders of listed companies have little chance to succeed in bringing a lawsuit on the reasonableness of director remuneration. Although the court does not like the “waste” caused by excessive pay, the judges are not willing to judge that the pay is too high or unreasonable. They prefer corporate autonomy. As long as the listed companies fully disclose the remuneration of directors in accordance with relevant agency rules, such remuneration payment will not be revoked by the court. This shows the importance of information disclosure for directors' remuneration arrangement.

##### **4.1 The Emergence of Directors' Problem Pay**

It's natural for directors to work and get paid in the company. Directors with strong working capacity are indeed scarce resources with special endowment, and it is no doubt that directors enjoy high salary. However, in reality, director remuneration tends to be higher and higher, no matter the company's performance is good or bad, they will get rich remuneration, even in the cases of company deficit, directors still enjoy high salaries, which is worthy of our in-depth thinking and analysis.

As far as the listed companies in China are concerned, specifically, through the inquiry of the annual report of the listed companies, in the earlier years, director remuneration of many companies also surprised people very much. In 2008, the main business income and net profit of HUAFI increased by 60.6% and 81.6% respectively, while the total remuneration of directors increased by 334%. The annual salary of the chairman of HUAFI increased to 7.23 million yuan from 1.44 million yuan in 2007, an increase of 404%. What's more, Sinopec's net profit attributable to the parent company in 2008 was 29.69 billion yuan, declined 47.5%, but the remuneration of the company's president increased from 825,000 yuan in 2007 to 844,000 yuan, and that of the two vice presidents increased from 789,000 yuan to 808,000 yuan. In 2007, China Insurance International made a profit of more than HK \$1.5 billion, an executive chairman made an annual salary of 4.14 million yuan, and the company lost nearly HK \$300 million in 2008, however, his salary did not seem to be affected at all. Although he left office in November 2008, the annual salary was still as high as HK \$3.3 million. The rising of director remuneration and the bleak business performance have become two hot spots. The financial crisis has put director remuneration in the spotlight, which has triggered the public's criticism.

But this situation is not only a problem of China, the United States and other developed countries are no exception. Wall Street cowboys, after the financial crisis, still don't forget the high salaries. On the one hand, the Wall Street tycoons received huge assistance from the Ministry of Finance and survived the crisis. On the other hand, they were greedy. The total year-end bonus in 2008 was up to \$18.4 billion, 44% less than that in 2007, but it was still similar to the peak of Wall Street in 2004, the sixth highest in history. Former US President Barack Obama denounced "extreme irresponsibility" and "shame" at the top of Wall Street, he said, "That is the high irresponsibility, it is shameful, focus on Wall Street, who are asking for help, to show some restraint, to show some discipline and to show some responsibility.[4]" And it is also unacceptable for the public.

Through the above situations at home and abroad, we need to think about the logic behind the high salaries of directors. Do their efforts really match the salary? Maybe the board of directors should respond to these questions and reprimands, and they think it is legal and compliant to take these salaries. The implication is that the remuneration is not set by the directors themselves, but is approved by the Remuneration Committee led by independent directors or composed of independent directors. There are many problems in the process of independent directors' consideration of director remuneration and the objectivity and independence of director remuneration decision-making. In a sense, such decision-making is not completely trustworthy. Due to the existence of interest relationship, the decision-making mechanism of director's remuneration, which is led by independent directors, is also vulnerable to the influence of directors. Therefore, it is necessary to prevent the decision-making of favoritism through judicial review.

#### **4.2 Judicial Review of Directors' Problem Pay**

In view of the problems existing in the decision-making of director remuneration, the use of appropriate judicial review is an effective way to determine the private preference motivation in the directors' relationship. The intensity of judicial review is related to the degree of conflict of interest within the company. If there is a big conflict of interest, we should strengthen judicial review. In the aspect of directors' remuneration decision-making, the strength of judicial review mainly considers several factors.

Firstly, the strength of judicial review depends on the degree of independence of directors' decision-making. The more independent a director's decision is, the more likely he is to make the right decision. On the contrary, the more the director's decision is controlled by others, the stronger the review should be. Due to the professionalism and complexity of director remuneration, the company may host and develop remuneration plans by employing remuneration consultants. However, based on the market competitiveness of remuneration consulting business and the possible conflicts of interest between remuneration consultants and the company, remuneration consultants also tend to director's interests. In this way, the remuneration plan may become not objective, so we should strengthen the judicial review of the remuneration decision-making of the

board of directors at this time.

Secondly, the close relationship between directors will also have an impact on the formulation of remuneration. "There is also a public perception that a determined board is able to pretty well ignore protestations from shareholders and others, as long as it remains united. The UK government seems set to utilize the current review of company law to introduce a measure of regulation into the behavior of British boards in setting director remuneration.[5]" The intensity of the review is also closely related to the closeness of this relationship. Social psychology research found that the mutual attraction of directors in work is influenced by personal characteristics, similarity, familiarity, complementarity and proximity. It can be seen that the longer a director holds office, the easier it is to form a culture of mutual recognition in the company[6]. this time, it is necessary to strengthen the review and eliminate the problem pay caused by the company's poor culture.

Thirdly, we should pay attention to the influence of group thinking on the director remuneration. There is often such a phenomenon that the longer people work together, the more likely they are to have a group thinking, follow the crowd and follow suit. At this time, we should strengthen the examination. In particular, when a manager is in charge of everything, and the selection and appointment of independent directors are manipulated by directors or CEOs, and their salaries may be higher. In turn, independent directors are grateful for the appreciation of the chairman or CEO, which greatly loses the responsibility of independent directors to make decisions independently, and forms tacit mutual protection behavior. If such a situation takes place, more efforts should be made to review.

### **4.3 Internal Accountability of Directors' Problem Pay**

#### **4.3.1 Personal Responsibilities of Directors**

Directors, entrusted by investors, should be loyal to the interests of the company and give priority to the interests of the company. The interests of the individual are subordinate to the overall interests of the company and do not harm the long-term interests of the company. In case of any conflict between personal interests and company interests, the directors shall disclose relevant situations to the board of directors, the board of supervisors, the general meeting of shareholders and other institutions. If there is no disclosure or the disclosure violates the relevant regulations, the transaction may be withdrawn. The disclosure shall be made within a reasonable period of time. Generally, from the time when the directors know or should know the transaction that will produce a conflict of interest, they shall explain it at the next shareholders' meeting, or the next meeting of the board of directors or the board of supervisors. All the interests obtained by the directors from the company shall be disclosed so that the board of supervisors and the shareholders can know whether the interests are reasonable or not.

First of all, directors should be held responsible for the disclosure of director remuneration information flaws. No one is clearer about the benefits he has obtained than the director himself. When the information is omitted, if the director intentionally conceals it, he shall recover the benefits of the undisclosed part; if the director is negligent, he shall timely supplement the disclosure, and the reasonable part of the salary supplement disclosure shall be paid normally, and the unreasonable part shall be recovered; if the director provides all the information of the benefits to the information disclosure obligor, and the obligor has omissions, the director is obliged to remind the obligor to make corrections after finding problems. The part of director remuneration that is not disclosed on time should be the focus of the supervision agencies.

#### **4.3.2 Liability of Information Disclosure Obligor**

The liability of information disclosure obligors needs to distinguish different situations to define whether there is fault or whether they should bear corresponding legal liability.

Firstly, if the information disclosure obligor participates in making false information or intentionally omitted information disclosure documents, the obligor shall bear legal liability.

Secondly, if the information disclosure obligors only know that the disclosure of documents have defects, the obligors should check and correct them as soon as possible.

Thirdly, the information disclosure obligors are not clear about the defects of the documents, the key issue of whether to pursue his legal liability is to judge whether he has fulfilled his duty of care. After investigation, if the obligor is able to fulfill his duty, it cannot be held liable. Otherwise, if he fails to fulfill his duty, he ought to bear corresponding legal liabilities.

Finally, the information disclosure obligors have the obligation to correct and disclose relevant information to the public in time after discovering information defects.

## **5. Conclusion**

The purpose of requiring director remuneration to be disclosed is to receive extensive supervision, to let the media and the public participate in it, and to avoid their unwarranted suspicions, which will have a negative impact on the company's credit and make the supervision organization more responsible. Therefore, the design of remuneration disclosure requires details and clarity. On the premise of disclosing the total amount of remuneration package, it should also include basic salary, annual incentive remuneration, long-term remuneration plan, equity grant and stock option incentive, retirement arrangement, etc. The directors' problem pay shall be recovered and the relevant responsible person shall be held accountable.

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