Exploring the Significant Differences between Chinese and U.S. Corporations

Tianqi Liao

University at Albany, State University of New York

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Exploring the Significant Differences between Chinese and U.S. Corporations

An honors thesis presented to the
Department of Accounting,
University at Albany, State University Of New York
in partial fulfillment of the requirements
for graduation with Honors in Accounting
and
graduation from The Honors College.

Tianqi Liao
Research Advisor: Raymond Van Ness, Ph.D.
Second Reader: Mark Hughes, Ph.D.

May 2017
Abstract

This thesis explores the significant differences between a Chinese corporation and an American corporation. Their corporate structures, governance, compensation packages, shareholder rights, information transparency, types of disclosure, and government support were assessed. The two similar public companies which were selected included Suning Commerce Group Co., Ltd., the Chinese firm and Best Buy Co., Inc. the American firm. The corporations were compared and contrasted and the advantages and disadvantages of each type of system were explored. A wide range of differences were discovered including the fact that the Chinese firm has two governing boards (Board of Directors and Supervisory Committee) and the American firm has only a board of directors. Further, the ownership in the Chinese firm of the CEO approached fifty percent whereas the American firm the CEO’s ownership was relatively minor.
Acknowledgements

I would like to thank all the people who contributed in some way to the work I completed. First and foremost, I thank Dr. Van Ness for accepting the role as my thesis advisor and always being available and happy to help me. Completion of this thesis would not be possible without the help of him. Next, I want to thank my family for all of their love and encouragement in the past three years of my college life. My parents are behind me every step of the way and support me spiritually throughout my life. My aunt inspires me and gives me the confidence to be the best that I can be.
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1. Introduction

1.1 Introduction to Corporate Governance

The rapid development of globalization has seen the enormous changes in the business world. Corporations not only do business with domestic companies but also have close relationships with foreign companies. China and US are two big countries that play important roles in the world. China is the top of developing country and USA is the top of developed country. The China-U.S. economic and trade relations can be traced back to the eighteenth century when the ship "Empress of China" arrived in China with ginseng, leather and cotton, to exchange for Chinese tea, porcelain and silk. This marked the start of direct trade between China and the U.S.

In 1979, bilateral trade between China and the US was only $2.5 billion. After only 38 years, the amount of China-US trade reached 519.6 billion, which was 207 times more than 1979 (Xinhuanet, 2017). Especially in 2016, the China-US bilateral trade in services was over $100 billion, and two countries have invested more than $170 billion in each other. They have maintained frequent business relationship with each other. Many American companies establish branch offices and factories in china. Likewise, more Chinese companies are beginning to establish a greater presence in the U.S.

The tremendous growth of China-U.S. economic and trade cooperation shows the need for mutual understanding. Chinese companies and American companies can communicate and cooperate more effectively if they get familiar with the corporate governance, business culture and rules of each other.
1.2 Definition

Corporate governance has drawn a lot of attention in public interest because it is important to the growth of a corporation. Corporate governance is a system of ownership and controls in a corporation. It governs the relationship and interests between a variety of stakeholders, including the shareholders, the directors and the management in a corporation.

1.3 Reforms

In China, the recent history of economic reforms and corporate governance has been one of incredible rapid changes, as the country has been moving toward a stronger role for private enterprise and capitalism. As China align itself closely with the international economy, it has also sought to adopt more Western-style oversight mechanisms and legal standard concerning the operations of its corporations. The reform of State-owned enterprise governance in China that gave enterprises more autonomy in management, more decision-making power and the ability to retain some profits, were started in 1978 and has become the top economic reform agenda since then 1984. China passed the company law in 1993 and further revised the law several times which provides a legal framework for the structure of modern enterprises. China passed security law in 1999 for the purpose of regulating the stock market and ensuring the fair practices and transactions and preventing illegal activities such as insider trading. To standardize the operation of listed companies and bring forward the healthy development of the securities market, China Security Regulatory Commission (CSRC) published a Code of Corporate Governance for Listed Companies in 2001 (Kaur, 2014).
The history of U.S. corporate reforms has seen five giant changes in corporate governance. The first reform happened during 1901-1939. The government started to publish laws, such as anti-trust law, to regulate companies. Compared to shareholders, the Board of Directors gained more decision making powers. The Security Act of 1933 and Securities Exchange Act of 1934 require businesses to disclose financial situations and esteem investors. In 1956, companies were required by NYSE to have independent directors. During 1980s, anti-takeover tactics brought the new ideas that the board of directors and management should be responsible for stakeholders. Since 1980s, investors have had significant right to monitor and determine the board of directors and management. However, the collapse of Enron and WorldCom in 2002 pointed out the weakness of corporate governance. Corporate governance in U.S. nowadays is determined primarily by the Sarbanes-Oxley Act of 2002 (SOX) which focuses on the issue of independence, transparency and disclosure, and accountability. SOX required the Security and Exchange Commission (SEC), New York Stock Exchange (NYSE) and NASDAQ to generate specified regulations to control the stock market (Li, 2008).

2. Corporate Governance: China vs U.S.

The purpose of this thesis is to compare two different types of corporate governance in China and in the U.S. This thesis uses two typical and same-type companies, Suning Commerce Group Co., Ltd. and Best Buy Co., Inc. to further explain and illustrate the differences between corporate governance in two countries. Suning is a successful company that sells consumer electrical appliances and a variety of related merchandise in China, while Best Buy is a successful chain retailer that sells similar products in the U.S. Those two companies sell similar products and provide similar services, but they have different corporate governance.
2.1 Corporate Governance Structure and Board Structure

**China**

According to Company Law of the People’s Republic of China and Securities Law of the People’s Republic of China, in Chinese corporations, shareholders meeting is the most powerful component of a corporation since it has the right to elect and dismiss Board of Directors and make the most important decisions for the company. Chinese corporations use two-tier board structure. One is Board of Directors, a body of elected or appointed members who jointly oversee the activities of the company. They have the responsibility to the Shareholder meeting and are responsible for exerting their business judgment in a way which will act the best interest of the company and shareholders. Besides board of directors, companies are required by law to set up supervisory committee to supervise the activities of board of directors.

The Board of Directors of Suning consists of 9 members, including the CEO of the company. And 3 members of the Board of Directors are independent directors. The laws require that at least 1/3 of Board of Directors are independent directors and they should not have a material relationship with the company. The supervisory committee is composed of 3 members who are high-level staff of management in Sunning. Their job is to supervise the activities of Board of Directors and high-level staff of management. In addition, there is one financial expert. Suning’s board members are allowed to serve on boards and/or committee of other companies and organizations. The Board have the following four committees: Strategy Committee, Nomination Committee, Remuneration Committee, Audit Committee.
U. S.

In the U.S. board structure is single tier since it only consists of Board of Directors. The Board of Directors of Best Buy consists of 10 members. Mr. Joly serves as both the chairman and CEO of the company, since Mr. Anderson, the former CEO of Best Buy, retired in March 2016. All of the directors, other than the CEO, are independent directors. Best Buy’s corporate governance principles require the company to have a lead independent directors who has the responsibilities to ensure independent oversight of management when chairman is not independent. Best Buy has established independence standards consistent with the requirement of the SEC and NYSE. It is determined that a director or director nominee does not have a material relationship with the company.

According to 2015 proxy statement, Best Buy’s board members are allowed to serve on no more than two public company boards. Every year, all the board members stand for election by shareholders to serve on for a one-year term. They are required to retire when they are 75 years old. The Board has four committees including the Audit Committee, the Compensation and Human Resources Committee (the “Compensation Committee”), the Finance and Investment Policy Committee, and the Nominating, Corporate Governance and Public Policy Committee (the “Nominating Committee”). Under the SEC and NYSE rules, all the members of the Audit Committee are qualified as audit committee financial experts and all the members of the Compensation Committee are outside directors.
2.2 Ownership Structure and External Influences

**China**

In Suning’s 2015 annual report, 31.28% of their outstanding shares are owned by individuals, 21.81% by mutual fund. The ownership is not spread out evenly. The top 3 shareholders are Jindong Zhang with 26.44%, Suning Appliance Group Co., Ltd with 14.6% and Suning holding Group Co., Ltd with 4.2%. At the same time, Jindong Zhang owns 48.1% of Suning Appliance Group’s outstanding shares and 100% of Suning holding Group’s outstanding shares. Therefore, Jindong Zhang, the president of Suning, controls 45.24% of outstanding shares, making him controller of the company. Suning has 660,735 shareholders. Their ownership structure is concentrated on a few owners. The concentrated ownership implies that a few individuals can exert significant influence over the operation of Sunning. Suning has lowered their leverage. Suning’s long-term debt decreased by approximately 60.8% since 2014 (CNY914,214,000 in 2014 to CNY357,918,000 in 2015).

**U. S.**

Best Buy has diluted ownership concentration. Best Buy’s 2015 annual report indicates that the entire 87.5% of the company is owned by a total of 522 different institutions. The top three investors are FMR LLC with 14.2%, Vanguard Group Inc. with 10.38%, and JPMorgan Chase & Co with 8.99%. Best Buy has dispersed ownership structure on more owners. This diluted concentration indicates that no one individual or institution is able to exert significant influence over the operation of Best Buy. Best Buy’s long-term debt increased by approximately 9.6% from 2015 to 2016 ($1,217,000,000 in May 2, 2015 to $1,334,000,000 in April 30, 2016).
2.3 Executive and Director Compensation

**China**

All the directors of Suning are compensated. The remuneration Committee considers and determines the directors’ compensation. Besides giving the base salary, Suning pays executives and directors based on operating performance. In 2014 Suning initiated employee stock ownership plans (ESOP), a long-term incentive that allows employees who are managers and directors to purchase company’s stocks at lower price (Sunning Commerce Group Co., Ltd., 2016).

**U. S.**

Best Buy’s Compensation Committee determines, approves and oversees executive compensation. The compensation Committee’s independent compensation consultant reviews the recommendation of management with Compensation Committee. CEO creates and presents recommendation and offers his view to the Compensation Committee with respect to executive officer compensation. Human resources and finance provide the Compensation Committee with market analytics and financial analytics (Best Buy Co., Inc., 2016).

In Best Buy, all the board members get compensation for their service in board. Executives and CEO compensation consists of five components: base salary, short-term incentive (STI), long-term incentive (LTI), health, retirement and other benefits, and executive benefits. Besides base salary, Best Buy pays executives and CEO compensation in cash and long-term equity compensation (e.g., performance share awards, stock option and time-based restricted shares) based on their performance, operating performance and financial metrics in order to create a
strong incentive and responsibility for working harder and achieving or exceeding company goal. In addition, executives and CEO get health benefits from company. CEO’s pay mix consists of salary 10%, STI 20%, LTI 70%. Executive ‘s pay mix consists of salary 20%, STI 25%, LTI 55% (Best Buy Co., Inc., 2016).

2.4 Information Transparency and Disclosure

China

The CSRC Code Chapter 7 (2001) clearly states that information disclosure is an ongoing responsibility of listed corporations. In addition to disclosing mandatory information, companies shall also voluntarily and timely disclose all other information that may have a material effect on the decision of shareholders and stakeholders. A listed company shall include information regarding its corporate governance, including the composition of the board of directors and supervisory board; attendance records; establishment of functional subcommittee and their operating details; independent directors’ opinions on related-party transactions; controlling shareholders’ interests; executive appointments and removals and etc.

U. S.

All the public companies in the U.S. are required to disclose the initial registration statement that they file with the SEC. In addition, Companies must inform their shareholders regularly by filing following periodic reports with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements. Any additional disclosures also must be filed. These include proposed mergers, acquired and tender offers;
securities transparency by company insiders, and beneficial ownership by a person or group that reaches or exceeds five percent of the company’s outstanding shares.

2.5 Government Support

**China**

In China, the government plays an important role in the business development. The government made huge efforts in transforming state-owned enterprises (SOEs) to the corporate form of private business. Corporatization could largely reduce the control and intervention of government to business companies. However, half of the listed companies are SOEs or partially controlled by government, still. Although the listed companies like Suning are not SOEs, the business is still able to get support from government in different aspects. Since 2015, Suning has signed co-operation agreement with over 10 province government. Cooperating with government, Suning seizes the opportunity of expanding the new market and getting fast development.

**U. S.**

In the U.S. the government doesn’t intervene with a corporation’s growth as much as Chinese government does. 70 percent of U.S. corporations are publicly-owned. Usually, it is more possible that mid-size and small-size companies get support from American government. Large companies like Best Buy is generally more independent. The only connection between Best Buy and government is indicated in the advocacy and government affairs claiming that the company works with policymakers on issues impacting their customers, employees, businesses shareholders and communities. Best Buy supports policies involved with financial services,
cybersecurity and data privacy, competitive work place, supply chain, energy & environment and emerging technologies.

3. Advantages and Disadvantages

The comparison between Suning and Best Buy can clearly indicate the differences between the corporate governance of modern Chinese companies and U.S. companies. These two models of corporate governance have both advantages and disadvantages. In some aspects, one’s merits are the other one’s demerits.

3.1 Single-tier vs Two-tier

Only one-tier board exists in U.S. under U.S. law. The single-tier board in the U.S. has three major advantages. First of all, it can have a superior flow of information. Different from a two-tier board, a single-tier board gives every member in the board chance to get involved and participate in the companies’ meetings and decision making process, thus fully utilizing a wide array of knowledge of the managers and monitors. As all of the board and managers participate in the decision making process, they are stimulated and given enormous incentives and passion to devote themselves.

Also, the single-tier board improves the efficiency of decision-making. Since the management and supervisory board are merged together in one tier, no separate agreement is necessary. They can have more meetings, have more frequent communication and make more decisions more thoroughly and quickly.
The disadvantages of sing-tier board are, however, the advantages of the two-tier board. Unlike single-tier board that concurrently serves on the functions of making and monitoring the same decision, the two-tier board separate the responsibilities and ensure more independence and equality. The separation between management and supervisory is more efficient in preventing the board member from acting for their own profits and protecting shareholders’ equity.

However, being kept out from business operation process and given less chance to meet managers, it may be more difficult for the supervisory board to do their job with inadequate information of business. In addition, the supervisor committee is structured to make decision-making process more complicated and bureaucratic, thus largely decreasing freedom.

3.2 Shareholders Right and Decision Making

A key issue in China concerns the ownership structure of listing corporations. The standard model of a listed company in the OCED setting is one that the management and the ownership of the firm are separate. Large shareholders often hold executive or directorship positions in the company. As it can be found in Suning, Jingdong Zhang is not only CEO but also the largest shareholder of the company. Even though such a model may be easier for shareholders to make decisions more quickly, it may not be favorable for other shareholders to express their ideas and have real effects on decision-making process. The worst scenario can be that the major shareholder become autocratic and make all the decisions by himself and don’t listen to others. As a result, the company may make the wrong choices.
However, American corporations have extremely high liquidity. Shareholders earn money by purchasing and selling stocks, thus they don’t really care about how companies develop in long term. However, in some extent, such a model is favorable for voting and choosing the competent management fairly. The dispersed shareholding structure also makes it less possible for individual shareholders to have control of the company that they invested. Only through the stock market they vote with the feet (to sell the company’s stock they held and to choose other companies’ stock) to constrain the company’s behavior. The active market for corporate control puts strong pressure on management from the market for good performance and increase in shareholder value. Incentive and compensation system link long term company performance with the performance of the management and cause the problem of extensive use of stock options and other stock-based compensation scheme. Once the management fails to manage the company effectively, they may be taken over by other people.

4. Conclusion

China and U.S. are widely seen as the world’s two important economic parties, yet the modes of corporate governance in the two countries are drastically different. Chinese corporations use two-tier structure that consists of board of directors and supervisory committee, but U.S. corporations use one-tier structure which is composed of only board of directors. The ownership of Chinese corporations is more concentrated, that is, one or a few individuals are dominant in the company’s operation process. The ownership of U.S. corporations, however, diluted over a very large number of people. Numerous individuals have ownership of the company by investing in different financial institutions, so none of them have the significant decision-making power in operation.
Chinese corporations do not provide high-quality disclosure and understandable information as U.S. corporations do. But considering that China has much shorter history of corporate governance, I believe that China has a large potential to develop and will perform better in information transparency and disclosure. Chinese companies generally have more government support than U.S. companies due to the fact that China is a socialist state. Corporations in China and U.S. have similar ways to compensate executives and directors-i.e., STI and LTI.

Despite the differences between the corporate governance system, Chinese and U.S. companies can still maintain good business relationship based on respect and mutual understanding. They can even learn different management rules and corporate cultures from each other and improve their own effectiveness and efficiency. We will see a friendlier, closer and mutually beneficial business relationship between the two countries.
References


