

## On Chinese Style Corporate Governance — With the Frictions and Fusion of Business Cultures as a Clue

### DISCUSSION DU TRAITEMENT A LA CHINOISE DES ENTREPRISES – LES INDICES DU FROTTEMENT DE LA CULTURE DU FONCTIONNEMENT ET DU FINANCEMENT

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#### Abstract

Through several decades of legal construction, the legal environment has been greatly improved in recent years. The lack of regulations and systems is not the major cause for business frictions. The major problem for corporate governance at the present stage has become the business frictions caused by differences in cultural values. The article mainly analyzed the cultural features of Chinese corporate governance. When we learn from the western corporate legal systems, we must integrate them with the social, economic and cultural reality in China, try to provide a healthy and harmony environment for business operations, avoid frictions in corporate governance caused by cultural frictions and actively promote localization in order to find out the best practice for corporate cultural governance.

**Key Words:** Corporate governance; Business frictions; Cultural frictions; Cultural convergence

#### Résumé

Après quelques décennies de la construction de la loi, la situation actuelle de la loi chinoise a eut une amélioration extrême, Le manquement de Loi et réformes ne sont plus les éléments de problème de frottement du fonctionnement. Les problèmes de frottement du fonctionnement se présente dans le traitement des entreprises actuelle sont principalement la différence des valeurs culturelle. Le présent texte analyse principalement les caractéristiques de la culture des systèmes des entreprises Chinoise, lors de l'emprunt des réformes de loi des occidentaux, ce dernier doit absolument se combiner avec la culture

économique de la société présente de la Chine, nous devons apporter un environnement saint et complexe pour le fonctionnement des entreprises, afin d'éviter des frottements de fonctionnement dû aux frottement culturelle, il faut promouvoir des originalités locales, afin d'explorer les meilleures pratiques de la culture pour le fonctionnement des entreprises.

**Mots clés:** Traitement de l'entreprise; Frottement du fonctionnement; Fronttement de la Culture; Fusion des cultures

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#### 1. WHERE IS THE WAY: RAISING THE QUESTION

Corporate governance has become a key subject of research in the fields of corporation law and economics both at home and abroad, and the two fields are trying to develop an optimal system of corporate governance from different perspectives. The basic theories of modern corporate governance are the agent theory and the stakeholder theory which has been drawing more and more attention in recent years. Based on the same understanding of the above-mentioned basic theories of modern corporate governance, though different countries have formed different models of governance due to different courses of corporate development, they have quite similar principles for the organization structuring.

“Convergence” has been declared as a phenomenon between the US and the European countries. The legal systems of these countries are regarded as becoming more and more similar and they have formed some sort

of “international best practices” (Kaneko, 2009). Such a process has also provided theoretical basis for the legitimacy of the “transplantation” of the western best practices to other countries and regions. The concept of “maximization of shareholder value” seems to be regarded as the plain and solid basis for Asian “transplantation”. After a long period of exploration, the Chinese corporate governance and reform of the corporate law have already got some achievements. The most important one is of course the Corporate Law of the People’s Republic of China, which was revised and passed in 2005. The revised edition has fully reflected the demand of the market, summarized the practical experience of the Chinese corporate governance in recent years and perfected the structure of corporate governance through absorbing many foreign advanced mature corporate systems, such as strengthening the protection for small and medium shareholders, forming cumulative voting system, derivative action system and disregard of corporate personality system in the form of statute laws, etc.. Though the current corporate law of China has learned from many advanced systems of corporate governance abroad, realized the convergence with the international society in the field of corporate governance, achieved the unification of rules in many areas and built a systematic basis for the transnational operation of the companies, why are there still lots of frictions and disputes in the practice of corporate governance after the unification of theories?

## 2. THE MAZE: BUSINESS FRICTIONS CAUSED BY CULTURAL FRICTIONS

When the legal systems that are effective in the western developed countries were “transplanted” to China, they didn’t lead to the expected results. We should not concentrate our attention to the system itself to look for an answer, but to look at the system along with the business and social environment of the companies. The author thinks that the large amount of business frictions in practice are mainly caused by the differences in cultural values. From the beginning of the reform and opening up of China to the year 2000, “the defective regulations and systems” was the biggest problem for corporate governance. However, nowadays, with the issuance and implementation of a series of laws such as the Corporate Law of the People’s Republic of China, the Securities Law of the People’s Republic of China and the Enterprise Bankruptcy Law of the People’s Republic of China, we can say that the legal environment of China has been greatly improved. Deficiency of regulations and systems is no longer a major problem for the present stage. The major problem for corporate governance at the present stage has changed to the business frictions caused by the differences in cultural values.

The competition between enterprises in the era of knowledge economy is a kind of comprehensive competition. In the transnational operations, the competition between the companies is not only the competition of the capital strength, but also the competition of the enterprise culture. The enterprise culture itself has no uniform criteria: different industries, different regions, different stages of enterprise development, or even different managers of enterprises might all have different enterprise cultures according to their different situations. However, when a company goes to the outside world and begins to do transnational operations, it should follow the local cultural customs, which means “when in Rome, do as the Romans do”, in order to reduce or avoid the cultural frictions in the corporate operations; otherwise, there might be the “endemic” in the form of business frictions due to the cultural frictions. Therefore, when China is importing the legal systems of the western developed countries, we must pay attention to the cultural features of China as well. The basis of the enterprise culture is the social culture, so all the advanced legal system from the western developed countries will turn out to fail our expectations if they haven’t experienced the process of localization and selective absorption and they are broken off from the reality of social culture. Therefore, all the companies operating in China must fully understand the cultural features of China in order to form their enterprise cultures.

## 3. THE CRUX: THE CULTURAL FEATURES OF THE CHINESE CORPORATE GOVERNANCE

China is an ancient civilization that has thousands of years of cultural history. The Chinese culture is extensive and profound and of long standing. In the process of corporate governance or reform of corporate system, if these cultural elements are neglected, the Chinese corporate governance will never succeed. The traditional Chinese culture is the cultural wellhead of the Chinese corporate governance. After the founding of the People’s Republic of China, the Chinese corporate governance was greatly influenced by the socialist culture. The liberalization of thoughts after the reform and opening up of China has made the Chinese corporate governance absorb and import many concepts and methods in western corporate governance.

(i) The traditional culture is the cultural wellhead of the Chinese corporate governance

The historical culture of China that has been accumulated for thousands of years has constituted the cultural wellhead of the Chinese corporate governance. The Chinese corporate governance will inevitably be disseminated by the Chinese culture. Therefore, the Chinese corporate governance will inevitably have the features of the Chinese culture as well. All the successful

operators in China are masters of Chinese culture with profound understanding of its essence. From the “saint businessman” Tao Zhugong in the Spring and Autumn Period and the official trader Hu Xueyan in late Qing Dynasty, these businessmen achieved great success in business because they fully understood or paid great respect for the traditional culture of China. Chinese culture was their norm of conduct and the “business motto” or rules of business operation. In western corporate governance, the corporate culture focuses more on the abilities, which is a sharp contrast to the Chinese corporate governance. Influenced by the traditional Chinese culture, the latter focuses more on the ethics and their belief is that one’s moral deeds determine one’s destiny.

(ii) The influence of the socialist culture

The socialist culture is the reflection of the socialist ideology. Different from the western emphasis on individualism, China emphasizes on collectivism. According to the requirement of the socialist culture and the nature of the beneficiary bodies, interests are divided into personal interest and national interest; according to different criteria of categorization, interests can be divided into non-fundamental interest and fundamental interest, or immediate interest and long-term interest, etc.. When there are conflicts between different interests, the hierarchy of interests is: personal interest should conform to national interest; immediate interest should be balanced by long-term interest; non-fundamental interest should conform to fundamental interest. Such a hierarchy seems to be contradictory to the concepts of “equality” or “free will” in western society; however, actually, this hierarchy is a kind of moral interpretation for “equality” and “free will” on a higher level. In fact, just as Karl Marx has said, “only in collective can an individual gain full measures to develop his comprehensive abilities, that is, only in collective can there be personal freedom”. Therefore, individual interest must conform to the requirements of the national interest. According to the requirements of the socialist culture, the feature of the Chinese corporate governance is “collective first and personal second”. The social responsibility of a company can also be seen as a reflection of the application of the collective principle in the systemization of a company. In the environment of the Chinese corporate governance, the collective interest is the focus of emphasis.

(iii) The liberalization of thoughts after the reform and opening up of China

When talking about the legal development and the cultural features of the society in China at present, we must analyze the influence of the liberalization of thoughts after the reform and opening up of China, because to a certain extent, the liberalization of thoughts after the reform and opening up of China has brought us onto the road of institutionalization and has greatly accelerated the legal construction of China. Due to the influence of the

liberalization of thoughts after the reform and opening up of China, corporate governance has finally realized systematic scientific governance. After the reform of the economic system and the opening up of China, China absorbed and imported many corporate governance experiences of western developed countries and systems and methods in corporate governance, which has definitely influenced the cultural governance in Chinese companies. For instance, under the derivative action system, when entities such as director, supervisor and senior managers infringe upon the company’s rights and interests and the company is reluctant to affix their responsibilities, a shareholder that complies with the legal conditions may institute a proceeding on behalf of the company (Zhao, 2006, p.309). The disregard of the corporate personality system in the Corporate Law of China, which was revised in 2005, was learnt from the “piercing the corporate veil” system of the United States. As the limited liability has enlarged the possibility of failure to clear off the creditor’s rights, the shareholders of a company usually take risky operations to gain interests; however, they need not to undertake all the costs and part of the risk is imputed to creditors of the company, which has encouraged the shareholders to take risky actions. This moral hazard has long been criticized by the critics of limited liabilities, which is also one of the reasons to improve the principles of limited liabilities (Christopher, 1980, p.65-76). Therefore, in order to prevent the abuse of the independent company personality, for specific facts in certain legal relationships, the independent company personality and limited liabilities of the shareholders can be denied, and the shareholders of the company are ordered to undertake direct responsibilities for the creditors of the company and the public interests.

The above three cultural features influenced and affected each other in the practice of Chinese corporate governance, and finally they have formed the cultural features that are different from the corporate governance of other countries. This is the Chinese corporate governance with unique cultural features.

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#### 4. THE INEVITABLE ROAD: CULTURAL CONVERGENCE

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The cultural features of the Chinese society are the basis of formation of enterprise culture as well as the premise for importing the experiences of corporate governance of western developed countries during the process of corporate governance. In the process of the modernization of the Chinese legal system, many legal systems have learned from and imported the legal systems of the western developed countries. However, the effectiveness of these legal systems is based on whether these systems have been absorbed in a truly local way and integrated into the social culture of China.

Through analyzing the successes and failures of reform of corporate governance by other countries in Asia, we may come to some inspirational conclusions. During the process of resuscitation from the Asian financial crisis, many countries had to design their Corporate Law under the pressure of the restrictions of IMF and the World Bank (Gan & Lou, 2009, p.79). All the Asian countries reformed their corporate governance on different levels. Thailand, Indonesia and some other countries were very submissive to the above-mentioned restrictions, lacking thorough research into the reform schemes and profound analysis of the social environment and social culture of the nation. Due to the negligence of the difference between the local environment and the transplanted reform scheme, the final reform of corporate governance didn't receive very good results. South Korea's response to the restrictions was different from these countries, and its reform scheme of corporate governance covered a wider range and its extent was also more profound. During the process of corporate governance reform, with a good combination with the local social, economic and cultural environment, South Korea found its own road and a better way to reform, which made it the fastest to recover from the Asian financial crisis. Through the comparison of these countries, we may see that different attitudes towards the same reform scheme of corporate governance may lead to completely different results. For the countries that accepted the scheme due to the pressures, such as Thailand and Indonesia, the reform scheme was only a simple copying of the original one without active local absorption, so there were few achievements of the reform. But Korea has successfully combined the reform scheme of corporate governance and the local social, economic

and cultural environment. That's why the result was quite positive. In all, the key to the success of a reform scheme are the local absorption and the cultural integration.

With the gradual perfection of the market economy of China and the constant development of the economic globalization, the Chinese enterprises need to go to the outside world. Of course, we also welcome foreign companies to come to China. However, during the process of communication with the developed economies in the world, we should not only pay our attention to the study of the technical regulations when importing the legal systems, but also constantly promote and do research about the convergence between the imported legal systems and the actual social economy and culture of China, try our best to provide a healthy and harmony environment for the operations of the companies, avoid frictions in the operations and governance due to cultural frictions and actively promote localization in order to find out the best practice for corporate culture governance.

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