Watch out your manager for your China business

Description

Just recently a client of mine, a foreign company that has a subsidiary business presence in China, approached me for a service to investigate some suspicious dealings that were made by one of his senior manager in Shanghai subsidiary.

The foreign parent company apparently discerned something fishy from a decline in profits of the subsidiary company and commenced an audit on the business operation in the past a few years. It found out that there are some invoices from a certain company that have been dealing with the subsidiary in the name of consultancy. At that point, they realized that there may be something wrong there.

So the client got me to check on the suspected company. So we first went to local company registration authority to obtain all the incorporation documents among which we can come to know who are the shareholders of the company. With the shareholder identity information, we can further trace their respective family members. By this way, we discovered that the suspected company was set up by the parents of a senior manager of the Shanghai subsidiary and there had increasingly been dealings worth millions of RMB with the Shanghai subsidiary. With such self-dealings going on, no wonder has there been a perceivable decline in profits.

Also not long ago, another company invested by foreign investors engaged in moving services for expats in Shanghai asked me about advice on his manager tunneling business opportunities to another competitors in return for commissions.

Well, this is never something new instead cliche story that has been spoken about by many people, foreign investors or domestic ones. I have written another post in the past regarding this kind of business issues. However there are still many such stories happening in real world.

So how could a foreign investor do to address the problem? Or what kind of institutions should the investor build into their China business in order to reduce or weed out such malpractices?

1. Preventive Measures

there could be a number of measures that can be employed to reduce and diminish the possibility of such illegal practice.

(1). Do background check on the senior manager before making your valid offer to him or her;

there are agencies in the market that can offer such kind of services to client to check on one's credilbity from their past.

(2). Penalties and adverse consequences to deter such malpractices.

Here we talk about putting in place penalties that will befall the wrongdoers by writing up good employment contract and corporate bylaws that are binding on the employees.

For senior managers such as general manager or financial chief officers or other high-ranking officers (as designated by the araticles of association of the company), a review of corporate articles of association shall be necessary to stipulate particular clauses addressing such issues.

(3). Regular auditing

Blind trust is often the factor to blame for the happening of such self-dealings. Trust is important between shareholders or board of directors and their subordinate managers, but the lack of active supervision or sheer centralization of managerial powers in one hand can easily breed the guts on the part of managers to engage in self-interesting activities.

It is advisable to build a culture of periodical auditing of corporate business from both financial and legal perspectives to diagnose and check out any problems.

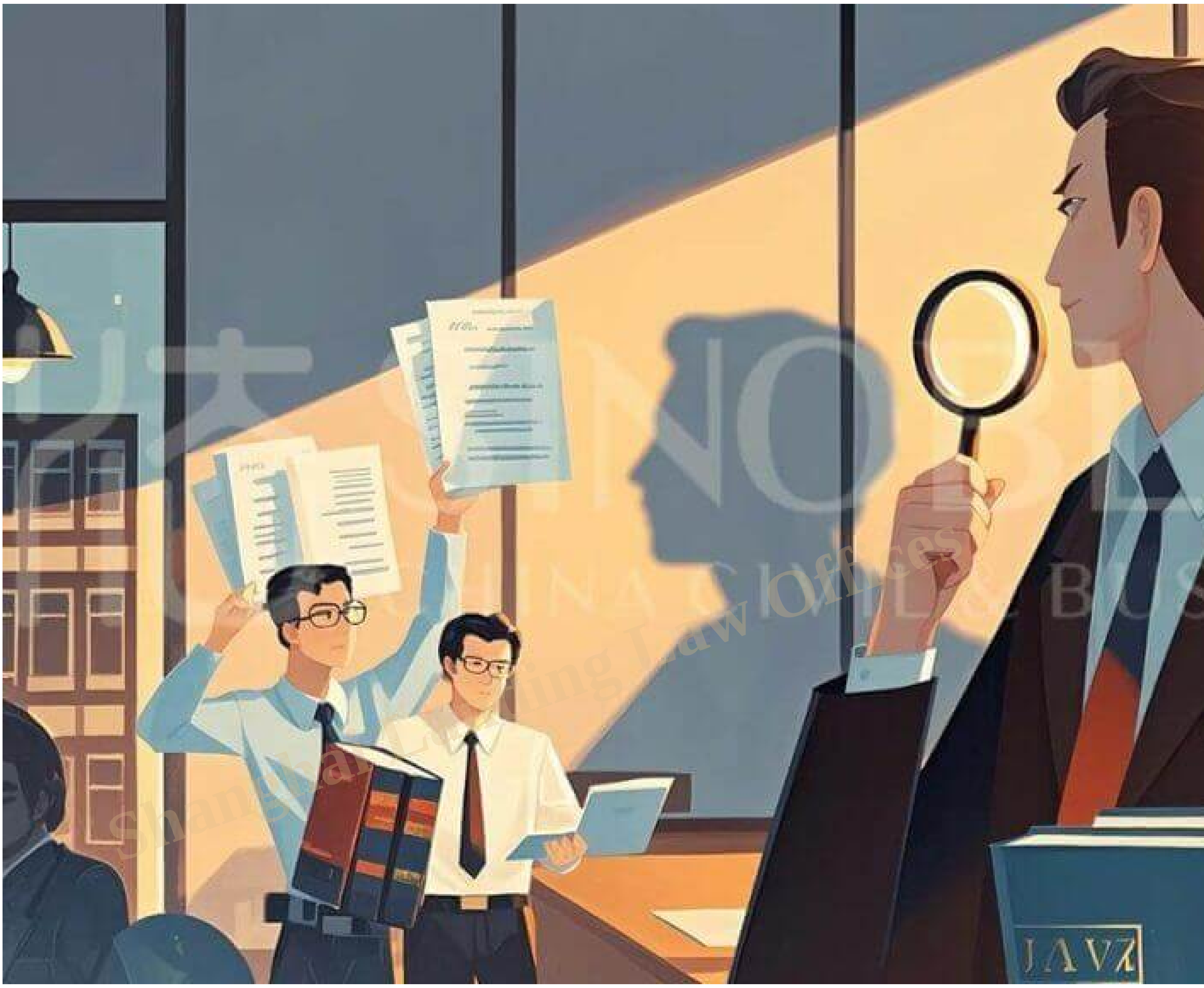
Shareholders shall duly exercise the power of appointing auditing firm as granted by China Company Law to make sure the auditors won't be bought by the management of the company.

2. Positive Alignment of Interest between Shareholder and Management

My understanding of the reasons why the manager of the client's Shanghai subsidiary would ever try to do such illegal and unethical activities is that the manager felt that he, receiving relatively good fixed salary, was not justly compensated for his excellent work that has brought about conspicuous growth of the the company's business over years. That sense of imbalance between contribution and compensation spawned the seed of dishonesty and betrayal.

Thus preventive measures alone may not be able to effectively weed out or avoid those problems, and it may be equally important, in a long run, to align the interests of the management in line with the interests of the company they serve. To achieve that goal of alignment, the effective way is to set up an equity-based incentive scheme where the management will be entitled to more benefits as they grow corporate revenue and profits, cultivating a sense of partnership instead of employment.

In a commercial world, it is more advisable to acknowledge that every human individual has the propensity to do something dishonest to benefit themselves.



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