

A Study on the Lack of Independence and Countermeasures of Independent Director System in Chinese Listed Companies

Chen Wenqi

Guizhou University of Finance and Economics, Guiyang, China
wqch2426@163.com

Abstract: *The independence of independent directors is a prerequisite to ensure that the independent directors of listed companies fulfill their functions according to law and effectively play the role of external supervision, however, there is a lack of corresponding norms in the existing laws and regulations to guarantee the independence of independent directors of listed companies. Since the independent director system of listed companies was established in China in 2001, after more than 20 years of improvement and development, the independent director system has become an extremely important part of the governance structure of listed companies. However, hidden worries still exist under the auspiciousness. Factors such as unreasonable nomination and selection system, unclear positioning of independent directors, significantly low remuneration, and mismatch of responsibilities and rights threaten the independence of independent directors of listed companies, leading to the problems of independent directors' interests, role positioning and non-independent performance of their duties. This paper starts from the independence of independent directors of listed companies. This paper analyzes the causes of the lack of independence and puts forward the countermeasures and suggestions to safeguard independence.*

Keywords: *Independent Directors, Independence, Listed Companies, Matching Authority and Responsibility*

1. Introduction

The independent director system originated in the U.S. and has been introduced into China for more than 20 years, and was first introduced in 1997 when the CSRC issued the Guidelines on the Articles of Association of Listed Companies, which stipulated that a company could set up an independent director in accordance with its needs, and at this point in time, as an imported product, the independent director system had not yet been established at the institutional level and made mandatory. In 2001, the China Securities Regulatory Commission (CSRC) issued the "Guidelines on the Establishment of Independent Director System in Listed Companies", which clearly regulated the independent director system, detailed the responsibilities and rights of independent directors from the institutional level, and required that the proportion of independent directors in the board of directors of listed companies should not be less than 1/3, thus establishing the full mandatory implementation of the independent director system in listed companies. The Company Law, which was revised in 2005 and formally came into effect in 2006, stipulates that "independent directors shall be established in listed companies, and the specific methods shall be stipulated by the State Council", and the independent director system of listed companies has thus been formalized from the legal level for the first time.

An independent director is a member of the board of directors who does not hold any position in the company, has no interest in the company's management, and is able to make independent judgments based on his or her knowledge and experience.^[1] That is to say, independence is the most important characteristic of independent directors. Independent directors have identity independence, that is to say, they have no interest in the operation and management of the company, which requires that independent directors have no interest connection with the shareholders, directors and senior management of the company based on their identity and socio-economic relationship, which is sufficient to impede them from performing their duties independently; identity independence guarantees the independence of the independent directors in the performance of their duties.^[2] Independent directors can make independent judgments based on their own knowledge and experience, independently perform the duties conferred by the law, and independently enjoy their rights and fulfill their obligations without being constrained by

the rights of shareholders and other directors and undue interference. The purpose of granting a wide range of powers to the independent directors is to effectively exert their supervisory function over the operation of the listed company and to ensure that the independent directors can fulfill their rights and obligations independently by virtue of their knowledge and experience, without being constrained by the rights and undue interference of shareholders and other directors.^[3] The purpose of granting independent directors a wide range of powers is to effectively fulfill their supervisory function over the operation of listed companies and to ensure that independent directors express independent opinions on major matters of listed companies, thereby safeguarding the legitimate rights and interests of small and medium-sized shareholders, investors and other entities. The professionalism of independent directors enables them to effectively utilize their professional knowledge to make independent judgments in the process of participating in the decision-making of the board of directors, so as to provide more professional and objective recommendations for the company's decision-making.

As a matter of fact, along with more than twenty years of implementation and improvement, the independent director system has become an extremely important part of the governance structure of listed companies, playing an important role in improving the corporate governance structure, promoting standardized operation and protecting the legitimate rights and interests of small and medium-sized investors.^[4] In recent years, the rapid development of the capital market has also given rise to financial fraud, connected transactions, abuse of shareholders' rights by major shareholders to infringe on the interests of small and medium-sized shareholders and investors and other chaotic phenomena, which have disturbed the order of the capital market. Compared with supervisory bodies such as supervisory boards which are independent of the board of directors and the general meeting of shareholders, the independent directors participate in the decision-making of the board of directors in the capacity of directors, and strengthen the supervision of the other directors and the senior management personnel, so as to better fulfill the role of prior and interim supervision. As the comprehensive deepening of the capital market reform continues to advance, the positioning of independent directors is not clear, the responsibilities and rights are not equal, the means of supervision is not enough, and the performance of the duty is not enough protection and other systemic problems need to be solved. How to clarify the status of independent directors and ensure their independence, so as to ensure that they perform their duties in accordance with the law and play an active role, has become a key concern in the reform of independent directors.^[5]

2. Analysis of the Lack of Independence of Independent Directors in Chinese Listed Companies and Its Causes

2.1. Lack of independence of interest and its causes

2.1.1. Non-independence of Interests

Independence of interest is a prerequisite to ensure that independent directors can perform their duties independently. Directors can be categorized into internal directors and external directors. Internal directors are the main part of the company's internal governance, engaging in the day-to-day operation and management of the company internally, fulfilling the authority in accordance with the provisions of the law and the articles of association of the company, being responsible for the company's production, management and operation, appointing and removing senior management personnel, and having the obligation of loyalty and diligence to the company.^[6] According to whether they have substantial interests with the company, its shareholders, directors and executives, outside directors can be classified into outside directors with affiliation and outside directors without affiliation. In order to ensure the independence and supervisory effectiveness of independent directors so that they can make independent and objective judgments, the independent directors should be outside directors without affiliation, i.e., in addition to their status as independent directors, they do not have any substantial interests or contractual relationships with the company, and do not serve as a member of the company's Board of Directors or a member of the Board of Directors.^[7] However, in reality, due to the fact that independent directors are often appointed by listed companies and paid performance allowances, independent directors are inevitably attached to listed companies and major shareholders with a high proportion of shares, resulting in the situation of "human director", which makes the independence of independent directors difficult to be fully guaranteed, and the interest relationship is not independent.

2.1.2. Causes of non-independence of interests

2.1.2.1. Unreasonable subject of nomination and selection of directors

The lack of independence of independent directors' interests basically comes from the unreasonable system of nomination and selection of independent directors. The nominating body directly affects the appointment and selection of the final independent directors, and the nominating body tends to select the person who has a stake in or is favorable to itself as the nominated body, and the nominated body is more likely to be influenced by the nominating body when it votes on the relevant matters, especially in this humane society of China, this situation is more prominent.^[8] According to the relevant provisions of laws and regulations, the nomination subjects of independent directors include the board of directors, the supervisory board and shareholders who individually or collectively hold more than 1% of the company's shares. In practice, most of the independent directors in China are recommended by major shareholders, acquaintances or intermediaries, or are introduced in the course of the company's IPO, and then voted by the shareholders' meeting. The above selection and appointment methods make the independent directors mostly nominated by the controlling shareholders or the directors sent by the controlling shareholders, representing the interests of the major shareholders and actually manipulated by them, and it is difficult to guarantee their independence in terms of their identities, and the existence of the interest connection makes it difficult to guarantee the independence of the relationship of interest of the independent directors, and thus it is difficult to ensure their independence from the source.

2.1.2.2. Significantly low remuneration packages

To ensure the independence of independent directors, it is necessary to ensure that independent directors do not have interests and conflicts of interest with the companies they work for, but at present, our country still implements a fixed remuneration system for independent directors, which lacks specific incentives, and the allowances for independent directors are formulated by the board of directors and approved by the shareholders' meeting. The remuneration package of independent directors in China is obviously on the low side.^[9] According to statistical data, including the inland region and Hong Kong, a total of 3607 A-share listed companies in various industries, the inland region and Hong Kong region, there is a significant difference in the average level of remuneration of independent directors. In Hong Kong, it is 200,000 to 500,000 Hong Kong dollars, and the mainland average is 80,000 yuan, of which the financial industry is the highest 178,000. The remuneration of independent directors in China has not changed much in general in recent years, and it is obviously lower than the salary level in Hong Kong. The obviously low remuneration package has directly dampened the motivation of independent directors, making it more likely that they will become a mere formality in the course of performing their duties and making it difficult for them to fulfill their multiple functions of checks and balances, decision-making and advising.

2.2. Lack of independence of roles and its causes

2.2.1. Lack of independence in role positioning

Clarifying the role of independent directors is a prerequisite for ensuring their independence and enabling them to perform their duties correctly. In practice, different listed companies are often not clear about the role of independent directors, some believe that the role of independent directors as unaffiliated outside directors is to play the role of monitoring the effectiveness of the independent directors should be used as a separate monitoring force, then the independence of the independent directors puts forward higher requirements; there are some people believe that the independent directors should give full play to the effectiveness of the expert advice, to provide expert advice for the decision-making of the listed company.^[10] It is also believed that independent directors should give full play to the effectiveness of expert advice and provide expert advice for the decision-making of listed companies; there are even subjects who believe that independent directors should act as external managers of the company, focusing on enhancing the image of the company and adding color to the company. It is because the practice of independent directors often both supervision and expert advice and other roles, its role positioning is not clear. It is Imagined that a company relies on its independent directors to express opinions in accounting or legal and other relevant areas of expertise in the process of forming decisions, and how can the independent directors express different opinions on the decision when the board votes? This is undoubtedly to question their own professional ability and authority in the field of expertise, in this case, it is precisely because of the lack of independence of the role of independent directors, making it difficult to effectively play the role of independent directors in monitoring the effectiveness.

2.2.2. Causes of non-independent role positioning

Based on the role orientation of independent directors, it can be seen that independent directors of listed companies often exercise the functions of participating in the decision-making of the board of directors, supervising and checking the internal directors, and providing professional advice on the decision-making of the company.^[11] According to China's current independent director system, the independent directors of listed companies should include at least one accounting professional, which is clearly stipulated in China's Securities Law, i.e., the independent directors of listed companies should have certain professional requirements. However, it is this requirement for professionalism that to a certain extent blurs the positioning of the duties of independent directors. According to the legislative intent, the independent director should be as an unaffiliated outside director, with its independent supervision power and the supervisory board to form a supervisory synergy, and jointly play a supervisory and checks and balances, but the professionalism of the independent director makes the independent director in practice often both the role of an expert and a consultant, for the formation of the company's decision-making to provide professional advice, this multiple role positioning essentially leads to the independent director resides in different roles of conflict of interest, therefore, the independent director should have a high degree of professional ability and level. This multiple role positioning essentially leads to the conflict of interest when independent directors reside in different roles, therefore, it is the key direction of the reform of independent directors to clarify the positioning of the duties of independent directors and to ensure their supervisory efficacy, and the requirements for their professionalism should be limited to the process and procedure of supervisory efficacy, such as relying on professionalism and objective judgment to express independent opinions, rather than excessive involvement in the process of decision-making.^[12]

2.3. Lack of independence in the performance of duties by the sole director and its causes

2.3.1. Uncertainty about the distinction between the powers of internal and external directors

In the previous analysis, the independent directors have been recognized as unaffiliated outside directors, and the identity of the independence is to ensure the independence of independent directors to perform their duties as a prerequisite for the independent directors, only to clearly delineate the powers and functions of the independent directors and the internal directors, in order to ensure that they play the role of supervision and checks and balances. Compared with the internal directors who are elected by the general meeting of shareholders, and even some of them have the identity and qualification of shareholders, and have equity ties, selection and appointment relationships and other interests with the listed company and its shareholders, the external directors emphasize more on their transcendence and objectivity in the middle, and do not participate in the actual operation and management of the listed company, but only play a supervisory role.^[13] However, in practice, the whole process of independent directors' performance has been completely internalized. This is mainly due to the fact that the law gives independent directors the basic obligations and rights of internal directors of listed companies, and at the same time also gives six other powers and corresponding obligations exclusively belonging to the independent directors, which makes the independent directors essentially required to become the existence of "power directors", that is, they should not only undertake the rights and obligations of internal directors, but also to fulfill the duties of internal directors, and to fulfill the duties of internal directors. This requirement is obviously lacking in practicality and contradictory. Besides, since independent directors often work part-time in several listed companies and are engaged in their main business respectively, they are essentially unable to participate in the daily operation and management of the company and lack understanding of the production and operation activities of the company, they can only become "seconders" when attending the board of directors. The unclear distinction between the functions and powers of internal and external directors leads to the independence of independent directors becoming a mere formality and makes it difficult to realize the institutional value of the independent director system.^[14]

2.3.2. Mismatch between the powers and responsibilities of independent directors

The independent directors in the Kangmei case were sentenced to hundreds of millions of dollars of liability, which broke the tone of the system of independent directors' "no merit, but no fault", and directly affected the wave of resignation of more than 300 independent directors in 2019, based on which the issue of mismatch between the powers and responsibilities of independent directors once again triggered heated discussions. Liability constraint is an important measure to urge independent directors to maintain the independence of their duties, out of the consideration of the unfavorable legal consequences that should be borne by the improper performance of their duties, independent directors tend to be more

conscientious in the performance of their duties to ensure the independence of their duties, so as to avoid the unfavorable legal liability for the improper performance of their duties caused by the lack of independence.^[15] However, in China's current legal system, the company law stipulates that the director fails to perform his duties in accordance with the law as "violation of laws, administrative regulations and the articles of association", and the securities law will be held jointly and severally liable for the directors of the standard limited to fault. Although independent directors have the same rights and obligations as internal directors in law, and even enjoy the special powers conferred by the status of independent directors, objectively speaking, independent directors are mostly part-time. For the limited participation in the company's affairs, the dependence of decision-making information on the right to know provided by the company in accordance with the law, it is difficult to obtain reasonable protection, and even the lack of professional knowledge, the characteristics of externality even affect the play of their right to speak. Such objective restrictions all lead to the inability of independent directors to truly exercise these rights. But in essence, it bears the same obligation of "signing and punishing". Therefore, when faced with such strict standards for determining responsibility, independent directors often adopt a safer approach, keeping in step with the company's major shareholders and decision-making management, rather than actively exercising the rights of independent directors to make independent opinions and vote independently, or simply adopt the "active hedging" method of directly voting against the agreement and refusing to sign, or even directly resigning to avoid future problems. It can be said that it is precisely because of the mismatch of power and responsibility that the independence of independent directors is hindered in essence, leading to the dilemma that independent directors are not independent in performing their duties.

3. Suggestions for Improvement of China's Independent Director System

3.1. Clarify the division of authority between internal and external directors

The most important thing to solve the problem of unclear positioning and mismatch of power and responsibility of independent directors is to clarify the division of power and authority between internal and external directors, so as to define the power and authority of independent directors and provide them with matching obligations and responsibility mechanisms. Independent directors are not the main body involved in the daily operation and management of the company, their objective ability to perform their duties and the depth of their participation in the company's affairs directly determines the independent directors can not realize a full range of understanding of the company's production and operation, investment guarantees, mergers and acquisitions, separation, personnel appointments and dismissals and other major decisions, and the actual operation of the company depends on the disclosure of the company's information and notification to safeguard their right to know. Therefore, the requirement for independent directors to have the authority of internal directors will only lead to the exercise of authority as a formality, and even lead to a mismatch of authority and responsibility affecting the independence of independent directors. As the members of the Board of supervisors of a company are far more involved in the company's daily affairs than independent directors and have a better understanding of the company's operating conditions, they should still assume the regular internal supervision responsibilities of the Board of Supervisors, instead of punishing independent directors to assume the overall internal supervision functions. Such cross-functional functions are not conducive to effectively exerting the supervision and check and balance functions of the Board of supervisors. Moreover, it is not conducive to forming internal and external supervision force through functional division with independent directors.

The basic objective of the independent director system is to monitor and limit private interests under the control of management. This means that independent directors do not need to intervene in the daily operation and management process of the company and intervene excessively in the daily affairs of the company in which they work, which belong to the authority of the internal directors rather than that of the independent directors. To solve the problem of "internal directorship" of the independent directors, we need to ensure their independence and externality, and to rule out the self-supervision function of the internal directors, so as to realize the "weak directorship" and "strong independence" of independent directors. To solve the "internal directorization" of independent directors, it is necessary to ensure their independence and externality, exclude the self-supervision function of internal directors, and realize the "weak directorship" and "strong independence" of independent directors. Based on this, independent directors should perform their duties as an external supervisory mechanism, without assuming the general obligations and responsibilities of internal directors, and their functions should be limited to attending the board of directors and the shareholders' meeting, and in the process of attending the meeting, they should find out whether there are any cases in which the shareholders of the company or the actual

controllers of the company have abused the rights of the shareholders to seek private interests to the detriment of the company or the interests of the investors, and supervise the situation in this regard. The professionalism of the sole director should also be limited to the ability to identify "shareholders, de facto controllers, directors and executives of the company and other subjects whether there is abuse of power for personal gain", rather than demanding the professional competence of intermediaries such as auditing, lawyers or accounting firms employed by the company in general, which can also deal with the lack of independence due to the overlap of roles assumed by the directors. Information belongs to the company's mandatory obligations, independent directors for the information provided by the company should be general duty of care to determine that it is true, if the legal consequences arising from the failure to protect the right to know the company and its directly responsible personnel should be held accountable, and can not be determined that the independent directors have not fulfilled the duty of loyalty and diligence, so as to impose severe legal liability.

3.2. Establishment of a self-regulatory organization for independent directors

To deal with the dilemma of the lack of independence of independent directors of listed companies, the establishment of a self-regulatory organization of independent directors can be used to deal with the problems of irrational selection and recruitment mechanisms, low remuneration and the lack of professionalism of independent directors. Self-regulatory organizations, as social groups, are a bridge between the government and the market. They can be entrusted with matters that should not be managed by the government but need to be managed from the perspective of the needs of the enterprises and the society, such as the standard of remuneration and professional training of independent directors, which are needed by the enterprises but cannot be done by the enterprises individually, or even if they can be done, they need to pay a high cost. All these matters can be managed by the self-regulatory organization of independent directors.

The reasons for the lack of independence of the interests of independent directors mentioned above include the irrational system of nomination and selection of independent directors and the obviously low remuneration. Self-regulatory organizations of independent directors can take the lead in establishing an expert pool of independent directors, and based on the performance data of existing or retired independent directors and the qualification standards of independent directors, distinguish qualified independent directors based on background conditions such as profession, industry, region, professional experience, performance evaluation, and other people who are willing to serve as independent directors of listed companies and have the qualification to serve as independent directors can also join the expert pool of independent directors. Therefore, the requirement for independent directors to have the authority of internal directors will only lead to the exercise of authority as a formality, and even lead to a mismatch of authority and responsibility affecting the independence of independent directors. As the members of the Board of supervisors of a company are far more involved in the company's daily affairs than independent directors and have a better understanding of the company's operating conditions, they should still assume the regular internal supervision responsibilities of the Board of Supervisors, instead of punishing independent directors to assume the overall internal supervision functions. Such cross-functional functions are not conducive to effectively exerting the supervision and check and balance functions of the Board of supervisors. Moreover, it is not conducive to forming internal and external supervision force through functional division with independent directors.

With regard to the issue that the remuneration package is obviously low and affects the independence of independent directors, the independent directors' self-regulatory organization can formulate a uniform and reasonable standard for the remuneration package of independent directors in accordance with the size of the listed company, the region, the industry, the assessment of risk and other factors, taking into account the different types of independent directors, and in light of the different positions of independent directors on the board of directors of the listed company and other factors, formulating unified and reasonable compensation standards for independent directors. It should include both fixed remuneration and incentive mechanism; it should ensure that the remuneration of independent directors is not so low that it does not match with the risks they bear, the professional ability they possess and the time and energy they should invest, which will make them lose their motivation to perform their duties, thus making the independent directors become a mere formality; and it should also ensure that the remuneration of independent directors is not so high that they take into account the favors of the person who nominates them and the person who selects and appoints them, and become attached to the major shareholders or the person who is in actual control, thus leading to the lack of independence of the interests. This will lead to the problem of non-independence of interests and affect the independence of independent directors in performing their duties.

4. Conclusion

The independence of independent directors is a prerequisite for independent directors to perform their functions in accordance with the law and effectively play the role of external supervision, however, there is a lack of corresponding normative protection in the existing laws and regulations to ensure the independence of independent directors in listed companies. Therefore, this paper puts forward a proposal to address the lack of independence of independent directors under the current system from the aspects of improving the system of independence of independent directors of listed companies, establishing a self-regulatory organization of independent directors to solve the problem of nomination and selection of independent directors, and clarifying the division of powers and responsibilities between independent and non-independent internal directors to ensure the matching of powers and responsibilities between independent directors and non-independent internal directors. The proposal to address the lack of "independence" of independent directors under the current system is put forward in the following aspects. Along with the advancement of the reform task of independent directors, in 2022, the SEC revised the Guidance Opinions into the Rules for Independent Directors of Listed Companies in its regulatory consolidation work to further clarify the positioning of the duties of independent directors of listed companies, release the supervisory potential of the independent directors, and enable them to play their roles better. 2023, with the consent of the CPC Central Committee and the State Council, the General Office of the State Council issued the Opinions on the Reform of Independent Director System of Listed Companies. The Opinions on the Reform of the Independent Director System of Listed Companies" was issued by the General Office of the State Council with the consent of the CPC Central Committee and the State Council, which defines the positioning of the duties of the independent directors and gives full play to the roles of the independent directors in decision-making, supervision and consulting; optimizes the way of performance of the independent directors and improves the mechanism of the special committees of the board of directors; strengthens the cognitive management of the independent directors and establishes the qualification system of independent directors; improves the system of the selection of independent directors and establishes the mechanism of the nomination avoidance; and strengthens the guarantee for the performance of the independent directors. Listed companies have the responsibility to provide necessary conditions for independent directors to ensure that they perform their duties. They strictly supervise the performance of independent directors, and establish a reputation incentive and restraint mechanism to improve their performance, improving the responsibility restraint mechanism of independent directors, and increasing the accountability of independent directors who fail to perform their duties or fulfill their duties, improving the internal and external supervision system to form a stronger supervision synergy, including coordinated and efficient reform tasks. In the same period, the CSRC solicited public opinions on the "Measures for the Management of Independent Directors of Listed Companies (Draft for Comments)", and the reform goal of the next stage urgently needs to further improve the independent director system of listed companies from the level of laws and regulations. With the effective guarantee of independent directors' independence and the effective play of independent directors' supervision effectiveness, the improvement of the independent governance level of listed companies and the high-quality development of the capital market will be expected soon.

The independence of independent directors is a prerequisite for ensuring that independent directors perform their functions in accordance with the law and effectively play the utility of external supervision. However, there is a lack of corresponding normative guarantees in existing laws and regulations to ensure the independence of independent directors of listed companies. Therefore, this paper puts forward the "independence" of independent directors under the current system from the aspects of improving the "independence" system of independent directors of listed companies, establishing a self-discipline organization for independent directors to solve the problem of nomination and recruitment of independent directors, and clarifying the division of powers between independent directors and non-independent internal directors to ensure the matching of the rights and responsibilities of independent directors. Missing suggestions. With the promotion of the reform of independent directors, in 2022, the CSRC revised the Guiding Opinions to the Rules for Independent Directors of Listed Companies in the integration of laws and regulations to further clarify the positioning of the responsibilities of independent directors of listed companies and release the potential of independent directors' supervision, so that they can better play a role. In 2023, with the consent of the Party Central Committee and the State Council, the General Office of the State Council issued the Opinions on the Reform of the Independent Director System of Listed Companies, which determined the responsibilities of independent directors, give full play to the decision-making, supervision and consulting role of independent directors; optimize the performance of independent directors, and improve the special members of the board of directors. Meeting mechanism; strengthen the cognitive management of independent directors and establish an independent director qualification system; improve the selection system of independent directors and

establish a nomination avoidance mechanism; strengthen the guarantee for independent directors to perform their duties, and make it clear that listed companies should provide the necessary conditions for independent directors to perform their duties; strictly supervise and manage the performance of independent directors and establish a reputation. Incentive and restraint mechanism; improve the responsibility and restraint mechanism of independent directors, and increase the accountability of independent directors for non-performance and responsibilities; improve the coordinated and efficient internal and external supervision system, and form an eight-way reform task of strong supervision and synergy.

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