

On Independent Director's Resignation Behavior and Values of Listed Companies—Analysis on Independent Directors' Exodus Caused by "Kangmei Pharmaceutical Case"

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Abstract: The independent director system plays a vital role in corporate governance. Under the background of independent directors' exodus caused by "Kangmei Pharmaceutical Case", Shanghai and Shenzhen A-share listed companies from December 31, 2021 to March 31, 2023 are chosen as the samples in this paper, in order to explore the possible influences of independent director's resignation behavior on the values of listed companies. It has been found that listed companies with independent directors having resigned are less capable of creating values, compared with those whose independent directors are in office, which proves that the independent directors' resignation behavior in listed companies negatively affects corporate values. It further proves that if listed companies manage to improve internal control quality and guarantee independent directors fully exercise power to lower the possibility of independent directors' resignation, these companies will create higher values.

Keywords: Independent Directors; Corporate Values; Resignation

1. Introduction

As a crucial part of corporate governance, the independent director system means independent directors on behalf of minority stockholders supervise board of directors so as to enhance corporate operating efficiency and protect stockholders' rights and interests. According to the *Guidance on the Establishment of Independent Director System in Listed Companies* issued by China Securities Regulatory Commission in 2001, listed companies are required to establish independent directors. The introduction of independent director system has not only strengthened the internal execution and supervision of the board of directors but also protected investors' rights and interests. Nevertheless, independent directors are often regarded as being neither "independent" nor "professional" in practice. Quite a few independent directors in listed companies of China fail to fulfill duties because of insufficient time, energy and practical experience, so they are neither professional nor independent. Therefore, lots of independent directors are called "Eye Candy". In the financial fraud case of Kangmei Pharmaceutical which was once called "White Horse Stock", this corporate wangled accounts because of the independent directors' neglect of duties. Therefore, according to the outcome of judgment, five independent directors whose surnames are Zhang, Jiang and Li are sentenced to assuming associated liabilities for compensation from 5 percent to 10 percent respectively, with the compensation amount of being as high as 245.9 million yuan. However, the annual pay of the five independent directors is only about 100 thousand yuan.

It is the first that that independent directors has assumed associated liabilities in the "Kangmei Pharmaceutical Case". It has become a civil dispute case of listed company with the most plaintiffs and the highest amount of claim for compensation. Afterwards, the "exodus" of independent directors in A-share listed companies appeared. According to the announcement disclosed by cinfo, there has been 39 A-share listed companies that announce the resignation of independent directors for 42 times from November 12 to 30 in 2021. A total of 43 independent directors resigned. It is worth considering whether the independent directors' resignation will reduce the corporate values. Therefore, under the background of independent directors' exodus caused by "Kangmei Pharmaceutical Case",

the possible affects of independent directors' resignation on values of listed companies are explored in this paper.

2. Literature Review

In order to improve the structure of corporate governance and protect the interests of minority stockholders, independent directors as a system innovation in corporate governance have been studied for many years. However, did those independent directors really play roles? When it comes to this, scholars' opinions vary. Starting from independent directors' supervision function, Weisbach (1988) holds that the independent directors' independence is positively correlated with their supervision effectiveness^[1]. However, Shivdasani and Yermack (1999) point out that not all the independent directors can effectively supervise the management of companies, because those management personnel may interfere in the salary and recruitment process of independent directors^[2].

In China, opinions have been divided on whether the independent director system can positively affect corporate values since the issue of the *Guidance on the Establishment of Independent Director System in Listed Companies* by China Securities Regulatory Commission. From the perspectives of independent directors' salary, reputation and background of studying abroad, Hu Chen (2018) and Xiang Huiling (2019) prove that the establishment and effective implementation of the independent director system are beneficial to the improvement of enterprise market value and the growth of enterprises^[3-4]. Besides, starting from the announcement of independent directors' resignation, Shen Weitao (2012) observes that independent directors' independence is conducive to improving corporate values^[5].

However, some scholars think oppositely through empirical study. For example, from the perspectives of independent directors' attendance and financial and management background, Chang Rui (2009)^[6] consider there is no correlation in terms of meaning between the independent director system and corporate values. Further improvements are required to ensure the independent director system plays a corresponding role. Similarly, Gao Minghua (2002) express that the independent director system is not significantly correlated with corporate performance^[7]. For one thing, it is because the independent director system in China starts relatively late. For another, conflicts sometimes exist in independent directors' performance of duties, leading to the fact that the overall corporate performance has nothing to do with the independent director system.

According to the above literature, the existing researches mainly focus on the independent directors' independence and supervisory role and explore the relationship between independent director system and corporate values. There are few researches on the possible effects of independent directors' resignation behavior on values of listed companies. Under the background of the hot topic of "the exodus of independent directors caused by Kangmei Pharmaceutical", this paper employs added value to measure the values of listed companies and explore the influence of independent directors' exodus on values of listed companies.

3. Research Hypothesis and Research Design

3.1 Research Hypothesis

Normally, independent directors won't resign easily if the listed companies run well and have sound internal control systems. However, when problems appear in the internal governance of listed companies, independent directors will resign to avoid liabilities, which reflects that the independent directors' resignation often manifests the existence of great defects inside enterprises. At the meantime, researches have shown that reputation mechanism plays a vital role in independent directors' performance of supervision function. The higher the independent directors' reputation, the better they can stifle the violations of listed companies^[8]. As is known to all, independent directors cannot easily get a good reputation which requires long-term accumulation, but it may lose overnight. Therefore, independent directors' good reputation can bring listed companies interests and at the same time they will choose to resign if their personal reputation is negatively affected because of the internal governance problems inside the listed companies. On the other hand, the market is inclined to react negatively to the independent directors' resignation, the manifestation of which is that the cumulative abnormal returns of listed companies decline sharply after the independent directors' resignation^[9].

On the basis of the above research results, this paper proposes the hypothesis: independent directors' resignation behavior has negative effects on values of listed companies.

3.2 Research Design

3.2.1 Sample Selection and Data Sources

To explore whether independent directors' resignation behavior will influence values of listed companies after the exodus of independent directors caused by the "Kangmei Pharmaceutical Case", this paper chooses the financial data of A-share listed companies from December 31, 2021 to March 31, 2023 as the samples. The data of independent directors' exodus come from Wind database and cninfo while the financial data come from CSMAR. To ensure the data selected are comprehensive and accurate, the samples should be screened or processed as follows: (1) remove samples with ST and *ST status because these companies have abnormal conditions regarding finance or other aspects, so they have no reference value. (2) remove samples that have no or abnormal major variables. (3) remove samples with suspension of stock trading. (4) remove samples of companies in financial and insurance industries. A total of 4472 observed values are obtained at last.

3.2.2 Definitions of Variables

(1) Explained variable -- value added (VA)

Value added refers to the total added value of a company jointly created by stakeholders of the enterprise. The higher value added means a better performance of the company. According to the calculation method of value added used by Wang Danli (2021)^[10] in empirical research, value added is quantified as the sum of cash dividends, interest expense, employees' salary, taxes and dues as well as retained earnings of enterprises.

(2) Explanatory variable -- independent directors' resignation(Quit)

The variable is set as 1 if independent directors resign from the enterprise during this period; other wise, it is set as 0.

(3) Control variable

Company size(size): the natural logarithm of the company's year-end total assets.

Asset-liability ratio(Lev): the ratio of the company's year-end total liabilities to total assets.

Sales growth rate(Growth): the ratio of the company's sales of this year to its sales of previous year.

Duality(Dual): dummy variable. It is set as 1 when one person serves as the chairman and general manager; otherwise, it is set as 0.

3.2.3 Econometric Model

The basic empirical analysis model of this paper is as follows:

$$VA=\alpha_1+\alpha_2Quit+\alpha_3Control+\varepsilon$$

4. Empirical Analysis and Results

4.1 Descriptive Statistical Analysis

To analyze and master the selected sample data more effectively, this paper uses spss data analysis software to carry out descriptive statistical analysis on samples regarding the influence of independent directors' resignation on corporate values. As is shown in the descriptive statistical results in tables 1 and 2, the average value added of listed companies whose independent directors are in office is 1.98e⁹ yuan, while the average value added of listed companies whose independent directors have resigned is 1.62e⁹ yuan, which shows the listed companies whose independent directors have resigned are less capable of creating values than those whose independent directors are in office. What's more, it is noteworthy that the average sales growth rate of listed companies whose independent directors are in office is 1.1305, while the average sales growth rate of listed companies whose independent directors have resigned is 1.1057, which represents the listed companies whose independent directors have resigned are less capable of making profit than those whose independent directors are in office. Therefore, the preliminary result is that the independent directors' resignation behavior negatively affects the values of listed companies.

Table 1 Descriptive statistics on the impact of the departure of independent directors on the value of listed companies

Variable	Sample size	Minimum	Maximum	Average value	Standard deviation
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VA	2121	-6.01e ¹⁰	8.72e ¹¹	1.62e ⁹	6.90e ⁹
Quit	2121	1	1	1	0
Size	2121	8.2879	12.1794	9.7037	0.5616
Lev	2121	0.0240	2.3773	0.4149	0.2065
Growth	2121	0.0001	14.1584	1.1057	0.5664
Dual	2121	0	1	0.34	0.47

Table 2 Descriptive statistics on the impact of non-resignation of independent directors on the value of listed companies

Variable	Sample size	Minimum	Maximum	Average value	Standard deviation
VA	2351	-1.20e ¹⁰	9.86e ¹⁰	1.98e ⁹	6.31e ⁹
QUIT	2351	0	0	0.00	0.00
Size	2351	8.0037	12.0171	9.6569	0.5555
Lev	2351	0.0156	1.0885	0.3881	0.2041
Growth	2351	0.1751	57.8675	1.1305	1.2653
Dual	2351	0	1	0.38	0.48

4.2 Regression Analysis

Regression analysis on the independent directors' resignation and the values of listed companies has been conducted in table 3. Explanatory variables and control variables are shown in the far left. The regression results without adding control variables are shown in column (1) and the result shows that the independent directors' resignation will reduce the values of listed companies at a significance level of 5%. The regression results of adding company size (Size), asset-liability ratio (Lev), sales growth rate (Growth) and duality (Dual) are shown in column (2). The coefficient of the explanatory variable is -0.011, with a significant negative correlation at the level of 1%. It shows that the independent directors' resignation will inhibit the values of listed companies, no matter control variables are added or not, which has proved the hypothesis of this paper to some extent, that is to say, the independent directors' resignation behavior has a negative effect on the values of listed companies.

Table 3 Regression analysis of the impact of the departure of independent directors on the value of listed companies

Variable	(1)	(2)
	VA	VA
Quit	-0.007**	-0.011***
	(-0.448)	(-0.882)
Size		0.619**
		-44.585
Lev		-0.115***
		(-8,378)
Growth		0.007***
		(0.600)
Dual		-0.027**
		(-2.140)
R ²	0.103	0.328
Adjusted_R ²	0.101	0.327

5. Conclusion

Under the background of independent directors' exodus caused by "Kangmei Pharmaceutical Case", Shanghai and Shenzhen A-share listed companies from December 31, 2021 to March 31, 2023 are chosen as the samples in this paper, in order to explore the influence of independent director's resignation behavior on the values of listed companies. On the basis of theoretical research and data

analysis, the following conclusion has been drawn: it is indicated in the empirical results that listed companies whose independent directors have resigned are less capable of creating values and making profits, compared with those whose independent directors are in office. Therefore, it has proved that the resignation behavior of independent directors in listed companies negatively affects corporate values.

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