

Microcosmic Analysis on the Formation of the Professional Moral Hazard of the China's Central Enterprises Operators*

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Abstract: How to recognize and prevent the professional moral hazard of the central enterprises operators has been a major problem in deepening state-owned enterprise reform. Scientific solution to this problem has great theoretical and practical significance. From the perspective of risk management, this paper uses a combination research method of standardized research and case study to explore the connotation of the professional moral hazard of the central enterprises operators and analysis its characterization, damage and evolution paths. On this basis, from two aspect of establishing scientific and reasonable incentive mechanism and complete supervision and restriction mechanism, some feasible policy recommendations to prevent the professional moral hazard of the central enterprises operators have been proposed. This will provide a theoretical reference for state-owned assets management department.

Keywords: Central enterprises operators; Professional moral hazard; Risk; Evolution path

1 Introduction

As the further development of state-owned enterprises reform, the problem of the professional moral hazard of the central enterprises operators is emerging day by day, such as “the event of Chen Tonghai”, “Zhang Chunjiang corruption case” and the “real estate speculation scandal” of China National Petroleum Corporation (CNPC) and so on. How on earth does the professional moral hazard of the central enterprises operators form? How can we prevent the professional moral hazard of the central enterprises operators? Central enterprises operators, as the core of the leadership, are responsible for a series of paramount decisions which include strategic management, thus the operation and management decisions of the enterprises will be inevitably affected by the professional moral hazard of the central enterprises operators, even mistakes of management decisions will emerge so that they bring enormous operating risks to the central enterprises. So it has great practical significance for deepening the reformation state-owned enterprises that how to prevent the professional moral hazard of the central enterprises operators.

In recent years, the problem of the professional moral hazard has become the hot issue in academia, but there seldom are systematic research achievements about the professional moral hazard of the central enterprises operators. In 1963, Kenneth J. Arrow, professor of Stanford University and the Nobel Price winner in 1972, published an article named *Uncertainty and the Welfare Economics of Medical Care* in the journal of *The American Economic Review*, which has accelerated the reborn of the study on professional moral hazard, and it made moral hazard spread from the fields of ethics and economics to other ones^{[1][2]}. In domestic, scholars explore the problem of moral hazard mainly in the industry of insurance in the field of economics^[3]. Looked from the object of study, they pay more attention to the professional moral hazard of assurers, doctors, teachers and so on but seldom to that of enterprise operators, especially those central enterprise operators; looked from the study methods, either standardized research method or case study method are often used in order to study the professional moral hazard, but not the combination of both.

From the perspective of risk management, this paper uses a combination research method of standardized research method and case study method first to define the connotation of the professional moral hazard of the central enterprises operators and analyze its characterization, damage and evolution paths, thus feasible policy can be raised according to the evolution mechanism, which will further provide a theoretical reference for state-owned assets management department.

2 The Connotation of the Professional Moral Hazard of Central Enterprises Operators

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In central enterprises, enterprises operators refer to those general state-owned individual charged and managed by SASAC (State-owned Assets Supervision and Administration Commission) subordinate to the State Council as the contributor, and general managers, deputy general managers and general accountants in state-owned individual proprietorships without boards as well as board chairmen, vice board chairmen, general managers, deputy general managers and general accounts in state-owned individual proprietorships with boards and designated by state-owned stock representatives in state-owned holding companies.

The study of moral hazard was initiated in Adam Smith's *The Wealth of Nations*^[4]. Since 1990s the theory of moral hazard was introduced in domestic, people popularly believed that it was caused by invisible factors related to human moral, that is to say, it is one's nonfeasance, dishonesty and illegal purpose that contribute to the hazard accidents and do harm to social property or others' property and lives^{[3][5]}.

The professional moral hazard derives from moral hazard, the study of which is mainly reflected in the profession of accounting. It can be understood as the potential factors causing tangible or intangible loss in the process of the employees' working due to the individual's deviation from professional rules.

Thus this essay holds it that the professional moral hazard of the central enterprises operators refers to the phenomenon that the central enterprises operators violate individual's morality and maximize their utility at the cost of sacrificing the benefits of the country and other investors and do wrongs to maximize the deviation from the value of the enterprises.

3 The Analysis of the Professional Moral Hazard of Central Enterprises Operators

3.1 The characterization of the professional moral hazard of the central enterprises operators

By summing up those moral events of central enterprises operators, the characterizations of the professional moral hazard of the central enterprises operators in our country are mainly five kinds of behaviors as follows:

3.1.1 Be arbitrary

It is that central enterprises operators do things completely according to their own willing regardless of the ideas of the investors and other operators. The typical one is "the case of Chen Tonghai", which happened during 1999 and June, 2007 when Chen held the post of the general manager and deputy general manager of China Petrochemical Group Company and the vice president and chairman of China Petroleum and Chemical Corporation Limited Company, he made decisions arbitrarily and made "the biggest corruption case of central enterprises".

3.1.2 Be planted

It means that in order to pursuit their own benefits, the central enterprises operators transfer the enterprises' assets and profits out thus it violates the interests of minority stockholders and people out of the enterprises. During the reforming period of central enterprises there was few this kind of behavior. But as the reform completes this behavior is emerging day by day, which is mainly reflected as the behavior of interests conveying of enterprises operators with the typical case of "real estate speculation scandal" of CNPC in 2009. The operators of CNPC took out 20 billion RMB from the enterprise to buy 1480 commodity houses 1/3 below market price at the golden place of the third-ring in Beijing, which is claimed as the employees' individual buying behavior but in reality done by upper levels in the enterprise. This is regarded as a serious interests conveying behavior.

3.1.3 Excessive post consumption

Excessive post consumption refers to the consumption which should be used necessarily and reasonably for performing duties but actually was used by the operators by taking advantage of their positions for gaining legitimate and nonpublic interests for themselves and others. Meanwhile, this is a kind of behavior not purely related to their own needs but to jobbery. Chen Tonghai was mentioned here again, who flooded away 40,000 RMB per day when he was in his position; Zhang Enzhao, the ex-president of CCB, spent 1,150,000 RMB for holding one party. And his hobbies were from tennis, golf to luxury yacht; one decade ago when the State Electricity Company held internal meetings, the general manager Gao Yan was offered 60 thousand RMB super suite and the president suite cost 8000yuan per day for noontime break in which all things from furniture to closes tool are custom made.

3.1.4 Illegality and exceeding authority

It means that the operators of the enterprises do wrongs which violate the rules of the country and the enterprises or do the issues which are out of their duties. Jiang Xinsheng case is a typical one. In the

inviting tenders project of nuclear power plant of Zhejiang and Guangdong, Jiang, the ex-president of China National Technical Import and Export Corporation, was suspected of leaking state secret and bribery. The ex-deputy general manager of CGNPC Shen Rugang and another 20 people in the company were affected; the similar case happened in 2009 in which 10 central enterprises were involved “CCI’s suspecting of broad bribery”.

3.1.5 Job Burnout

Job Burnout refers to the individual’s tired and exhaust state under pressure of working, the main expressions of which are losing passion of work, always tired, inclining to evaluate oneself negatively and regarding working as a boring thing and he /she cannot develop his/her ability in it. The Investigation Report of 2008 China Workplace Personage Job Burnout Situation published by China Human Resources Development Net showed that the proportion of Job Burnout in state-owned enterprises was 16.2% which was just following three-capital enterprises (18.5%) and governments or institutions(16.6%) , and was followed by private enterprises(15.8%) . Although these enterprises have different attributes, the percentage of Job Burnout is all above 15% and the possibility of Job Burnout in every job is quite high. So the passive effect of Job Burnout among central enterprises operators should be highly noticed by governments and academic circle².

3.2 The analysis of the motivation of the professional moral hazard of central enterprises operators

Human behaviors are dominated by the motivation which is caused by the need. Without the need the motivation will not appear. The central enterprises operators’ needs are at multiple levels from the basic physiological needs to self-realize demands. Due to the difference of professional development and values of the enterprises operators, there will be different oriented demands during different periods. Meanwhile, as the central enterprises operators, they hold certain dominating right of the enterprises resources, when this demand points to certain goals and displays the possibilities to reach the goals which are against the interests of the enterprises and do not agree with the central enterprises targets, there will form the central enterprises operators professional moral hazard crime motivations.

The motivations of central enterprises operators’ professional moral hazard can be divided into three kinds: the motivations for money, desire and power(see Table 1). These moral hazard motives do not exist solely but coexist, which will bring risks in one aspect as well as another in other aspects.

Table 1 The Motivations of Central Enterprises Operators’ Professional Moral Hazard

Motive	Definition	Characteristics
Money (power-for-money deal)	seizing money by power	Corruption and embezzlement, commercial bribery and so on.
Desire (power-for-desire deal)	Meeting self desire by power	Squandering public funds, power-for-sex deal and so on
Power (power-for-power deal)	Seizing political asset, pursuing promotion in official career by power	Selling offices and bartering ranks, malpractice and malfeasance

3.3 The forming paths of the of the central enterprises operators

The operators who hold management permissions of the central enterprises will produce the professional moral hazard crime motives due to the different levels of personal goals and disagreement with central enterprises’ interests and goals. And under the disadvantage and the leak of management deficiency in state supervision departments, law deficiency out of enterprises and low morality of operators in the enterprises, unreasonable incentive system, information asymmetry incomplete contract and imperfection of company management and internal operation these motives will shift to the behaviors of being arbitrary, being planted, excessive post consumption, illegality and exceeding authority and Job Burnout so that they could do harm to the operators and the interests and fame of central enterprises and further bring social honesty risk and obstacle to the development of the market-oriented economy as well as weaken social economic benefits.

The disadvantage and the leak of the professional moral hazard of the central enterprises operators are reflected in two aspects: in and out of enterprises, that is saying, internal and external(see Figure 1).

² The web of Human Resource Development in China. Survey on the Situation of Job Burnout in the Working Group[EB/OL], <http://www.chinahrd.net/news/info/34714> (In Chinese)

External: (1) Management deficiency in state supervision departments. The government's supervision needs certain social costs, the work that should be managed by higher government departments such as quality supervision administration, consumer association will bring difficulties to relevant national authorities due to lack of necessary basic executive resources.(2)The deficiency of national related law. After the producing of moral hazard of the operators, judicial investigation and litigation should be launched, but because of the loose restraint and insufficient depth and width and dreadful execution to the central enterprises operators, they are fueling the enterprises operators' moral crime psychology.

Internal: (1) Lower morality of operators. In our country, a part of central enterprises operators lack professional responsibility and professional dedication, even money worship, hedonism, egoism also exist in every one of them, therefore in dealing with the relationships between individuals, groups and social benefits there will be a dislocation of value orientation.(2) Unreasonable incentive system.

The central enterprises operators' salary and other treatment are seriously low which will make them fail to get the reasonable compensation for their labor and their labor is in disproportion to values, so the central enterprises operators are likely to seek a balance and compensation in another way and other methods which will bring moral hazard.(3) Information asymmetry and incomplete contract. As agents, the central enterprises operators hold the most abundant and timely market information for making all sorts of decisions. But as the client, the owners could not get to completely understand the information. In addition some of the operators' behaviors are covert and cannot be noticed and bewared of accurately so there emerging information asymmetry. At the same time, the central enterprises' "principal-agent relationship is a contractual one"^[6]. Because there is a lot of uncertainty in reality, they may not sign a complete contract to restrain the behavior of agents who may do harm to the client's interests behavior without being discovered by the principal. (4) Imperfection of company management and internal operation. Because of the distortion of central enterprises governance structure in our China, on the one hand, the board, as internal supervision department lack of supervision power, and the board of supervisors are answerable to general manager so they cannot exercise supervision; On the other hand, in central enterprises the chairman of the board often serve concurrently as the general manager, and the chairman of the board, the general manager and the board of supervisors are nominated by higher party organization which causes "internal control" and further causes imbalance of power in the enterprises.

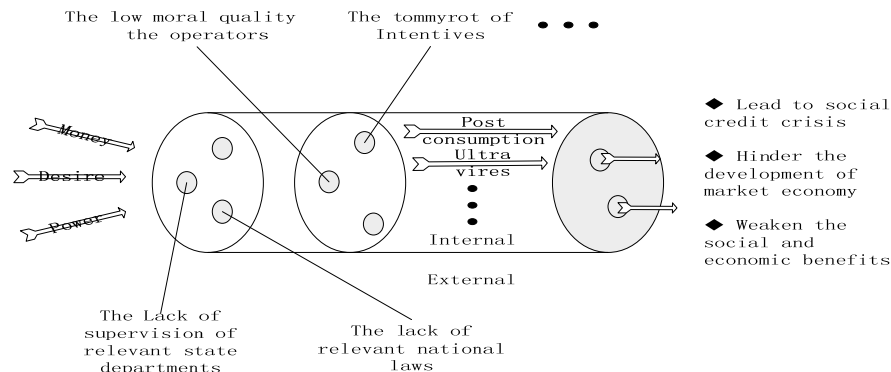


Figure 1 The Formation Path of the Professional Moral Hazard of the Central Enterprises Operators

4 The Preventative Measures to the Professional Moral Hazard of the Central Enterprises Operators

The enterprises without incentive system and restraint system are inevitably going corrupted. For the prevention of the professional moral hazard of the central enterprises operators, both incentive and restraint systems should be established in order to form a combination two aspects.

4.1 Establishing scientific and reasonable incentive system

For the central enterprises operators' incentive mechanism, scientific and attractive incentive system should be designed to let then share enterprises' operation results and encourage them to take the action with the maximization of enterprise value. It can be concretely carried out as follows:

4.1.1 Compensation incentive mechanism

It is an important mechanism to coordinate interests between enterprise owners and operators. Scientific and reasonable compensation incentive mechanism can not only makes the contribution to the evaluation and return which the enterprises operators deserve but also improves operators' opportunity

cost of moral hazard behaviors which reduces the benefits of the central enterprises operators' moral hazard behavior. Compensation incentive mechanism not only should have sufficient data to support but also have reasonable structure and provide incentives with the guidance of interests to the operators who have made decisions the owners prefer at the lowest possible cost. For instance, in enterprises after profitability improves or stock price increases manager researchers will be given cash or stock awards, etc.

4.1.2 Fame and honor mechanism

The demand of the central enterprises operators is changing, they should be guided by the correct moral and ideology to make them abide professional ethics, honesty and self-discipline and pay attention to their personal reputation so that they can restrict their opportunism behavior and maintain the interests of the enterprises. Both material and spiritual incentive should be given to the operators so that comprehensive incentive will be realized. For example it gives political honor and social status to the successful central enterprises operators, gives publicity and recognition to their dedication and innovation, arouses their pride and encourages them to put the central enterprise management as a lifelong career and to devote themselves to the development and expansion of the enterprises.

4.2 Establishing complete supervision and restraint mechanism

The supervision and restriction mechanism to the central enterprises managers should be established combining with the characteristics of central enterprises. It can be concretely carried out as follows:

4.2.1 Supervision and restraint mechanism of marketing competition

Introduce competition mechanism of professional managers, get rid of the existing outdated management mode in which the enterprises operators are investigated by the enterprise department, administrated by the personnel department and appointed by the government, and cut off the administrative personnel relationship between the government departments and the enterprises thus realize the transformation from the personnel administrating of the central enterprises operators' selection, appointment and management to marketing so that it makes the competent and responsible operators in the central enterprises gain better salary and promotion but the incompetent and lazy ones the lower salary and demotion even dismissing their posts. Therefore, fully competitive market of professional managers will make the central enterprises operators enhance the enterprise economic benefit, consolidate their position and improve their own reputation in order to ensure themselves not eliminated and obtain higher pay.

4.2.2 Supervision and restraint mechanism of law and administration

It has obvious restraint to the central enterprises operators. Although the SASAC has published *The Guiding Opinion on Post Consumption for Standardizing the Central Enterprises Principal*, the penalty is still soft and the executive power is not enough, so need to be further refined related laws, improve the law enforcement, therefore the related law should be further refined to strengthen the executive power of the law. At the same time it must perfect the company law as soon as possible and increase the laws and rules on standardizing the main body of interests within the enterprises as well as make clear-cut legal norm for the status and behaviors of all kinds of interests body including the operators in the enterprises. In addition, the government should strengthen the authority of the supervision institutions to form strong administrative restriction mechanism, including the supervision and restriction of financial department, accounting offices, audit institutions to the operators.

4.2.3 Supervision and restriction mechanism of internal management in the enterprises

First, the central enterprises board chairman, the general manager and the secretary of the party committee should not be centralized in one person, but be set up according to provisions to prevent excessively concentrated power which would be abused. Second, the company governance structure is essentially a contract system, the enterprise should formulate reasonable articles of association and sign effective contract to make clear rights and duties of the principals and agents to which both sides do things according. At the same time, it should make the behavior standards and management responsibility for the operators, make internal enterprises management system, show the responsibility and rules as well as regulations of the operators and form internal supervision and restriction mechanism of the operators behavior. Finally, further standardize, strengthen and carry out the functions of the board of directors and the board of supervisors, stress that the important decisions of the enterprises must go through the employee representative meeting and the shareholders' conference, and strengthen the supervision function of the two organizations.

4.2.4 Supervision and restriction mechanism of the operators' ideological and moral education

In our country the operation moral, business ethics and other aspects of the education and training are often ignored in the process of the personnel training. Therefore, the central enterprises must strengthen ideological and moral education in the training of the operators, and form their own supervision and restraint mechanism. On the one hand, the enterprises should strengthen the operators' values and moral beliefs guidance to make them set up the common ideal for constructing socialism with Chinese characteristics and the collectivism thought of devoting themselves to the enterprises, and set up responsible, professional, dedicated professional moral sentiment. On the other hand, they should resolutely resist and put an end to the corruption thoughts of money worship, right worship, hedonism and extreme individualism to prevent the spreading of these thoughts in the central enterprises.

5 Conclusion

This paper explains the definition, the motivation and the forming paths of the professional moral hazard of the central enterprises operators in details. Due to the different levels of personal goals and disagreement with central enterprises' interests and goals the operators form the motivations towards money, desire and power. Under internal and external conditions and the leaks of all kinds of enterprises the motivations transferred to the behaviors of the professional moral hazard which damage the benefit and reputation of the enterprises and finally cause social credit crisis, hinder the development of the market economy, weaken the social economic benefits. Thus the state should begin with changing internal and external conditions and blocking the leaks to set up scientific and reasonable incentive mechanism and complete supervision and restriction mechanism to the central enterprises operators.

This paper uses a method of standardized research and case study to study the characterization, the motivation and the preventive measures of the professional moral hazard of the central enterprises operators. In the future the method of empirical approach will be adopted and the universality of the study achievement will be perfected so as to better understand and prevent the behavior of professional moral hazard and further deepen the process of state-owned enterprises reform.

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