

Research on the Improvement of Enterprise Internal Control Mechanism based on Confucian Culture

-- Taking S Company as an Example

Yining Zong*

Dalian University, Dalian, China

*Corresponding Author

Abstract

This paper takes S Group as a case study to study the operation of its internal control mechanism under the influence of Confucian culture. Through the analysis of the five major elements set by COSO internal control, namely internal environment, risk assessment, control activities, information and communication, and internal supervision, it is found that the overall quality of S Group's internal control is good, indicating that under the blessing of Confucian culture, it has played an important role in promoting the operation of the internal control mechanism. However, there are also certain defects. Some Confucian cultural concepts have certain limitations in corporate management. This paper analyzes the existing internal control mechanism of S Group in detail and puts forward relevant improvement suggestions. It is more conducive to the development of the enterprise to take the essence of Confucian culture and remove its dross, and organically combine it with modern forms, so as to provide a cultural reference for other companies in the industry to consolidate their internal control mechanisms.

Keywords

Confucian Culture; Internal Control Mechanism; COSO Five Elements.

1. Introduction

Confucianism was once the mainstream ideology of the Chinese nation, and it still affects daily life as a code of conduct. In the report of the 20th National Congress, General Secretary Xi Jinping made a major deployment of "promoting cultural self-confidence and self-reliance, and creating new glory for socialist culture", and put forward the task requirement of "enhancing the communication and influence of Chinese civilization". Many studies have shown that Confucian culture plays an important role in improving corporate management and can also provide a path for corporate management. The S Group studied in this paper is a large pharmaceutical company. Mainly based on the background of Confucian culture, it analyzes the internal control mechanism of the case company, studies the positive impact of Confucian culture on the internal control mechanism of the enterprise, and discusses whether the problems of the case company are related to Confucianism, and puts forward relevant suggestions to improve the internal control system.

Many scholars have conducted relevant research on the relationship between Confucian culture and internal control. For example, Zhang Xuan conducted an empirical test on the impact of the contemporary value of Confucian culture on the effectiveness of internal control. The results showed that in terms of economic consequences, the contemporary value of Confucian culture can enhance the inhibitory effect of internal control on agency costs and weaken the negative impact of internal control on risk-taking [1]. Cheng Bo pointed out that Confucian culture

affects the quality of internal control from two perspectives: improving the information environment and strengthening contract performance. As the influence of Confucian culture increases, the quality of internal control also improves. This phenomenon is more obvious in companies with high information asymmetry (poor information environment) [2]. Li Zhibin compared the differences in internal control between Japanese and American companies, analyzed the reasons for the differences in internal control from the perspective of the national cultural differences between the two countries, and proposed a Chinese corporate internal control system with the Confucian ethical thought of traditional Chinese culture as the core [3]. Domestic and foreign scholars have also conducted relevant research on the humanistic system implemented by the "people-oriented" concept. Cheng Anlin, Ji Jie and others believe that enterprises should actively establish human-oriented internal control and implement a "hard and soft" internal control model to mobilize employees' enthusiasm, increase their sense of happiness, and promote employee performance [4]. Wang Yanqing believes that the establishment of an enterprise's internal control environment requires attention to the enterprise's human resources work, adhere to the people-centered management concept, and create a corporate culture environment suitable for enterprise development and talent introduction [5]. On this basis, this paper takes S Group as a case study to study the impact of Confucian culture on internal control and puts forward suggestions for improvement.

2. Analysis of the Current Status of Internal Control of S Group under the Influence of Confucian Culture

2.1. Company Profile

S Group was founded in 1994. It puts forward the corporate spirit of "cultivating oneself, managing the family, establishing a career, and helping the world". It is a globalized pharmaceutical and health industry group rooted in China and driven by innovation. Its direct business includes pharmaceuticals, medical devices and medical diagnosis, and medical and health services. It also covers the pharmaceutical business field through its equity participation in Sinopharm Holdings. Due to the influence of factors such as the national pharmaceutical supply-side reform and pharmaceutical policy adjustments, and the 20th National Congress report pointed out that we must adhere to the core position of innovation in the overall modernization of our country, and at the same time emphasized that we must continue to promote the construction of a healthy China and put the protection of people's lives and health in a strategic position of priority development. S Group has also continued to focus on the unmet clinical needs of patients, continued to increase investment in innovation, and promoted the launch of innovative products to improve the accessibility and affordability of drugs. Over the years, the group has continuously strengthened independent research and development and external cooperation, enriched its product pipeline, and included a number of innovative drugs and new indications in the latest version of the National Medical Insurance Drug Catalog, benefiting more domestic patients. In 2022, S Group's holding subsidiary obtained the MPP license to produce and supply two high-quality, affordable oral COVID-19 medicines to low- and middle-income countries in agreed regions around the world. As of 2023, S Group's independently developed innovative antimalarial drugs have saved more than 56 million severe malaria patients worldwide.

2.2. Analysis of the Current Status of Internal Control of S Company

2.2.1. "People-oriented" Internal Environment

The internal environment is the foundation of the internal control system and the guarantee for the effective implementation of internal control. It directly affects the implementation of the company's internal control, the company's business objectives and the realization of the overall

strategic objectives. The internal environment determines the company's overall attitude and is the basis for all other components of internal control. From the perspective of organizational structure, inspired by the Confucian concept of "ritual" order, the group has clarified the establishment and power distribution of various levels of institutions in accordance with laws, regulations and company charters. The general meeting of shareholders has a board of supervisors to supervise the board of directors, and the board of directors has several special committees and standardizes their work processes. This structure enables each level to perform its duties and can be adjusted in time according to market changes, greatly improving decision-making and execution efficiency, and laying a good foundation for internal control. In terms of social responsibility, S Group adheres to the concept of "cultivating oneself, managing the family, governing the country, and pacifying the world" in "The Book of Rites: University" and transforms it into the corporate spirit of "cultivating oneself, managing the family, establishing a career, and helping the world". By establishing a corporate culture working committee, carrying out employee activities, and forming a propaganda team, it guides employees to establish core values and promote the harmonious development of the company. In human resource management, Xunzi's "the king is the boat and the people are the water" thought reflects the importance of talents. S Group practices the talent concept of "attracting people with development, uniting people with career, cultivating people with work, and evaluating people with performance", formulates the "Employee Diversity Policy", protects the equal rights and interests of all types of employees, follows the principle of "equal pay for equal work", and continuously improves the diversity of employees, providing human support for the sustainable development of the enterprise. S Group has formulated the "Employee Diversity Policy" to enable employees to gain a sense of belonging, respect and importance. The policy points out that employees will not be affected by race, skin color, gender, religion, nationality, disability, marital status, retirement status, sexual orientation, gender identity or other legally protected identities. This policy applies not only to formal employees, but also to part-time employees, outsourced personnel and temporary workers. In addition, the policy proposes the principle of "equal pay for equal work" and signs labor contracts with employees in accordance with the law. Among the nearly 40,000 employees, the total number of female employees accounts for nearly 50%, and the proportion of ethnic minority employees is also increasing, from 3.57% in 2019 to 5.49% in 2022.

2.2.2. Risk Assessment

As a pharmaceutical manufacturing company, S Group is involved in pharmaceuticals, medical devices and diagnostic products. These are all special commodities, and their quality issues are one of the key issues of concern to the society. Therefore, for enterprises, risks in product quality management need to be strictly prevented. The company has also made a long-term plan for the next five years (2021-2025), which is mainly divided into three parts: (stable) continue to carry out quality system evaluation and improvement to ensure deep quality compliance, strengthen quality capability growth and quality culture construction; (mature) build a full life cycle quality management system, build a group quality management platform, and promote international quality management; (efficient) build a group digital information system and carry out a quality talent promotion plan. However, even with comprehensive strategic planning, there will still be some adverse events. S Group has also developed a comprehensive approach to the occurrence of adverse events. In addition, S Group has made continuous focus on and testing of drug varieties, and pharmaceutical member companies are also required to regularly summarize and report adverse reports, analyze and evaluate them into written reports, and take corresponding measures to formulate quality management risk plans for the problems, and implement them according to the plans, and then evaluate the benefits and risks. The processes, handling methods and results of these processes must be summarized, analyzed and reported to the headquarters. According to the handling process,

100% of adverse events have been reported and responded to in recent years. In recent years, there have been no adverse reactions caused by drug quality defects and group adverse events in the company's medical device production member companies, which fully demonstrates that S Group has achieved good results in handling and prevention in this regard.

2.2.3. Control Activities of “Correcting Oneself before Correcting Others”

Confucius's idea of "correcting oneself before correcting others" has important implications for business operations. If an enterprise wants to consolidate its market position, it must first regulate itself and control risks. Under the influence of Confucian culture, S Group actively practices this concept in its control activities. In terms of internal audit, S Group has formulated detailed rules and regulations and processes to fully control daily business activities and strive to control various risks within an acceptable range. At the same time, the audit department is required to conduct internal control effectiveness tests on the headquarters and subordinate units. Some control processes must be tested every year, and all control processes must be tested at least once every three years to avoid tests being concentrated in the same year. For important, high-risk or major change processes, the number of tests should be appropriately increased according to their importance, and testing methods such as inquiry, observation, review and inspection of control execution evidence, and re-execution should be adopted. The test process must prepare working papers, which should be prepared by the self-assessment personnel of the subordinate units and then submitted to the Group Audit Department for review. The review content includes internal control deficiencies and the degree of impact. Major or important deficiencies need to be judged after full communication. In response to the internal control deficiencies found during the review, the audit department completes the "Control Defect Correction Plan", and the company or its subordinate units make corrections accordingly. If there are difficulties in correcting major deficiencies, they will be reported to the Audit Committee of the Board of Directors in a timely manner. Subsequent testing will be carried out after the correction to ensure that the control operation after the correction is effective.

2.2.4. Information and Communication on “Loving Others and Being Kind”

Under the influence of the Confucian culture of "loving people and being close to benevolence", S Group has achieved remarkable results in internal information and communication. Internal information and communication aims to allow the board of directors and other committees to fully communicate so as to effectively perform their supervisory duties. S Group adheres to the "people-oriented" concept, breaking through the limitation of the lack of voice of the people in the traditional "people-oriented" concept, and gives employees voice through the employee stock ownership plan to ensure that employees clearly understand their responsibilities and the relationship with others' work, so as to better integrate into internal control. At the senior management meeting, the board of directors and other committees are held on time, and the internal management plan is decided by voting. Except for the Environmental, Social and Governance Committee in 2019, which was not established and had no meeting records, the senior management participation rate has reached 100% in recent years, and the online + offline combination mode is adopted during the epidemic. At the reporting level, S Group is highly transparent, regularly summarizes the operating and financial status, and discloses it to the public on a quarterly, semi-annual and annual basis, so that all parties inside and outside the company can grasp the dynamics of business development in a timely manner, release positive signals and attract potential investors. At the employee level, S Group attaches great importance to occupational health and safety and actively organizes EHS training. The duration and frequency of employee training have increased year by year. In 2022, the average duration per person was 15 hours and the average frequency per person was 9 times. From management

to employees, information communication is smooth, and the company's situation is fully understood, laying a solid foundation for the company's long-term development.

2.2.5. Internal Supervision of "A Gentleman Seeks within Himself"

Confucian culture emphasizes the use of morality to regulate people, and also attaches importance to supervision, such as "governing people with morality, regulating people with propriety, and having a sense of shame and standards", as well as the tradition of supervision of imperial power. Influenced by this, S Group attaches great importance to internal supervision and has established a comprehensive supervision system. The main supervisory body of S Group is the Audit Committee, which is responsible for reviewing financial information, supervising financial reporting, risk management and internal monitoring systems, and conducting internal audits and internal control evaluations. The internal control evaluation report disclosed every year shows that there have been no major and significant defects in the group's internal control in recent years.

In terms of anti-fraud, the Board of Directors has set up an Integrity Supervision Department, which is responsible for anti-corruption publicity, consultation, clue acceptance and investigation, and supervision and inspection. The Group has issued 8 basic documents, including the "Anti-Corruption Regulations", to ensure clean management from the institutional level. When new employees join the company, all employees are required to sign the "Employee Integrity Commitment Letter". In recent years, the Integrity Supervision Department has held nearly 50 integrity training and lectures, updated more than 100 anti-corruption cases and laws and regulations in the OA Integrity column, and promoted it in the headquarters and member companies through posters, trifolds, etc., to enhance employees' anti-corruption awareness. The Integrity Supervision Department continues to expand the scope of supervision. Since 2021, it has supervised the bidding and opening of the group's projects to stop non-compliant behaviors in a timely manner. The number of clues received by the group has increased year by year, indicating that employees' awareness of anti-fraud has increased. According to investigations, the company has recovered more than 30 million losses in recent years, and the internal supervision has achieved remarkable results.

3. Limitations of S Group's Internal Control under the Influence of Confucian Culture

3.1. "Emphasis on Morality and Harmony" Leads to Procurement Defects

The Confucian culture of "seeing profit and thinking of righteousness" and "valuing righteousness over profit" has positive significance in shaping human nature, but in corporate management, this moralistic view of righteousness and profit and the concept of "harmony is the most precious" may limit the company's consideration of its own interests. In terms of quality risk control, S Group has formulated a detailed process covering risk identification, assessment, classification and processing summary. However, the production links of the pharmaceutical industry are complex, and the procurement, production, transportation and other links of raw materials are prone to quality problems. Before 2019, influenced by Confucian culture, S Group focused on reducing costs and improving efficiency during centralized procurement, had low sensitivity to procurement risks, and did not strictly screen suppliers. In 2019, S Group realized the importance of procurement management risks, connected procurement with auditing and integrity lines, promoted the construction of a digital procurement business platform, and made the procurement process more transparent and traceable. After strengthening management, supplier violations were gradually exposed, 79 cases were handled within two years, and 41 cases were handled in 2022. Procurement risk control is still the focus. In the actual operation process, there will also be related operating entities that have not strictly complied with relevant laws and regulations due to poor

management and other reasons and have been punished. In 2022, 45 people violated relevant regulations and 7 people were subject to compulsory measures for criminal violations. In addition, the medical service business faces the risk of medical accidents or disputes, such as surgical errors, misdiagnosis, equipment accidents, etc. Once a major medical accident occurs, the company will face compensation, performance damage and reputation crisis.

3.2. “Focusing on Stability Over Change” Hinders the Development of Information Integration

Confucianism was born in a relatively stable social environment. "Agriculture is important and commerce is suppressed" reflects its concept of "stability is important and change is not important", and it tends to be simple. This concept also exposes its drawbacks in the human resource integration of S Group. At a time when digitalization has become the mainstream, enterprise information dataization and resource integration are crucial. Although S Group has a relatively complete reporting and employee training management system, its human resource system has defects. The group has 85 branches and subsidiaries, which mostly used manual offline processing methods before 2020, which was inefficient. At the beginning of 2020, the digitalization of human resources began to be promoted. However, as many as 16 systems were selected by the headquarters and branches and subsidiaries, and they were not unified. This made the policies and processes of each branch and subsidiary independent, making it difficult for the group to coordinate management, and the cross-company management efficiency was low. The headquarters' statistical data still relied on traditional forms to summarize, making it difficult for managers to make effective decisions. After introducing digitalization, S Group unified the recruitment channels, realized the automation and paperless recruitment process, improved efficiency, and optimized the employee information input link. However, due to the short system construction time and the epidemic, as a pharmaceutical company, S Group needed to quickly form a vaccine team, which resulted in a large increase in staff, frequent changes in organizational structure and reporting relationships, and a large turnover of personnel under the matrix management model. Although the most difficult period of the epidemic has passed, the impact of business changes is still there, and S Group's human resources system still faces severe challenges.

4. Research on the Improvement of Internal Control Mechanism of Enterprises under the Influence of Confucian Culture

4.1. Strengthening Fraud Supervision

As market competition becomes increasingly fierce, the procurement process has gradually become a disaster area for fraud. Due to loopholes in procurement control activities, S Group has seen many violations in recent years. To resolve this problem, a multi-pronged approach is needed. In terms of supplier management, when developing suppliers, carefully screen and establish a list of qualified suppliers to avoid dependence on a single or a few suppliers. Engineers who develop the supply chain are arranged to be responsible for product procurement selection and comprehensive quality review of qualified suppliers. The final authority to finalize the supplier is handed over to the procurement management team formed by various departments, so as to form a situation of mutual checks and balances and reduce procurement risks. At the personnel supervision level, the internal control and audit departments regularly check project stakeholders to see if there are any violations by fund mobilization personnel. At the same time, they regularly visit suppliers to understand their evaluation of project personnel. Once fraud signs are detected, the relevant personnel will be punished and transferred from their positions immediately to deter employees. In terms of anti-fraud measures, given that S Group has formulated anti-fraud measures and systems but

fraud is still rampant, it is necessary to strengthen anti-fraud work from the dimensions of employee guidance, organizational structure improvement, and business review. During recruitment, we strictly conduct background checks, select employees who are consistent with the corporate values, vigorously carry out positive value training and publicity, and the management takes the lead; continue to improve the organizational structure, strengthen the construction of internal control mechanisms, and strive to reduce the "human factors" in the business process; regularly and irregularly review business activities, promptly discover and correct problems, evaluate and respond to potential fraud risks, and severely deal with violations. In addition, in view of the supplier risks in the procurement process, we should also build a supplier evaluation and assessment system, regularly evaluate suppliers in terms of product quality, delivery time, price, service, etc., flexibly adjust the cooperation strategy based on the evaluation results, and sign a legally binding contract with the supplier to clarify the rights and obligations of both parties and the responsibilities for violations, and use legal means to constrain the behavior of suppliers, effectively reducing the risks caused by the supplier's dishonesty or poor ability.

4.2. Improving Enterprise Informatization Development

In view of the defects in the human resources system of S Group, S Group should formulate a unified human resources system selection standard, integrate or replace the existing 16 systems, and ensure that the headquarters and 85 branches and subsidiaries use the same platform. A special project team should be set up within the company to be responsible for the planning and implementation of system switching, formulate a detailed timetable, and promote the system unification work in stages to reduce the management difficulties caused by system differences and enhance the group's overall management capabilities. S Group needs to reorganize the cross-company management process, combine a unified human resources system, design standardized operating procedures, clarify the responsibilities and powers of each branch and subsidiary in personnel deployment, performance appraisal, etc., reduce process conflicts, and improve cross-company management efficiency. At the same time, actively establish an automatic data collection and analysis mechanism to replace the traditional form summary method, provide managers with real-time and accurate data support, and help effective decision-making. In view of the frequent business changes and the large personnel turnover under the matrix management model, S Group needs to establish a complete talent reserve pool to identify and cultivate key position talents in advance. Develop personalized training plans for employees at different levels and positions to improve their adaptability to new systems and business changes, and ensure that employees can quickly adapt to new work requirements when the organizational structure is frequently adjusted. At the same time, S Group needs to increase its technical investment in the human resources system and regularly upgrade and optimize the system to adapt to changing business needs. It should also establish a professional technical maintenance team to promptly resolve problems that arise during system operation and ensure the stability and security of the system. At the same time, strengthen cooperation with system suppliers to obtain the latest technical support and industry solutions to enhance the competitiveness of the system.

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