

## **Some Accounting Consequences of Business Control by Overseas Chinese**

**Joselito Diga**

The Australian National University  
Canberra

**and**

**Russell Craig**

Associate Professor of Accounting  
The Australian National University  
Canberra

### **Abstract**

This paper discusses some of the accounting consequences associated with the control of business enterprises by "overseas Chinese" in the context of five ASEAN countries. Based on extant research, overseas Chinese controlled business enterprises exhibit six characteristics with distinguish them Western multinational companies (MNCs): a family-centric corporate structure; exposure to diverse industries and commercial undertakings; a propensity to source financing "in-house", increasing links with foreign MNCs though joint venture arrangements while attempting to maintain decision-making control locally; attitude towards intangible versus tangible assets; and decision-making which emphasises the use of balance sheets and cash flow statements. These characteristics raise questions regarding the applicability and appropriateness of Western-based accounting standards and regulatory structures in regard to consolidation accounting based on legalistic notions of control, the practice of assigning values to intangible assets, and the decision-usefulness of financial statements which use arbitrary cost allocations. The discussion here suggests that accounting practice in different national settings needs to be understood in terms of unique set of cultural and organisational values.

### **Introduction**

The so-called "bamboo network" of overseas Chinese entrepreneurs is regarded as having been a critically important factor underpinning the dynamic economic growth of ASEAN countries (Hamilton 1991; Sender 1991; Mackie 1992; Weidenbaum and Samuel 1996). Although comprising a relatively small proportion of the population of most ASEAN countries, overseas Chinese exercise very strong

economic influence in each ASEAN country. *The Economist* (1992) estimated that the 50 million ethnic Chinese in East Asia outside China generated a Gross Domestic Product (GDP) of around US\$450 billion, considerably in excess of the combined GDP of ASEAN countries of only US\$395 billion. Overseas Chinese organisations are very active in share trading on ASEAN stock exchanges too. Table 1 reveals that whereas overseas Chinese represent only about 8% of ASEAN's combined population, overseas Chinese entrepreneurs exercise control over the majority of companies listed in each domestic share market in ASEAN.

**Table 1**  
**Ethnic Chinese in ASEAN, 1992**

Country	Number (millions)	% of Total population	% of Total local stock exchange share held
Indonesia	7.2	4%	73%
Malaysia	5.8	32%	61%
Philippines	0.9	1%	50%
Singapore	2.1	78%	81%
Thailand	5.8	10%	81%

Sources: Ch'ng (1993); ABD (1994); EBRI (1994)

Overseas Chinese constitute 86% of ASEAN billionaires and dominate the region's financial capital and retail trade. Ethnic Chinese *taipans* (heads of business empires) in ASEAN include: in Indonesia, Liem Sioe Liong (Salim Group), Mochtar Riady (Eippo Group) and Eka Widjaja (Sinar Mas Group); in Malaysia, Khoo Kay Peng (Hong Leong Group), Lim Goh Ting (Genting) and Robert Kuok (Kerry Group); in the Philippines, Lucio Tan (Philippine Air Lines, Fortune Tobacco), Henry Sy (SM Prime); John Gokongwei (JG Summit); in Singapore, Khoo Teck Puat (Malayan Banking) and Lee Choon Guan (OCBC); and in Thailand, Dhanin Chiravanont (Charoen Pokphand Group), Chin Sophnapanich (Bangkok Bank), Bancha Lamsam (Thai Farmers Bank).

Of the top 300 Indonesian conglomerates, 80% are Indonesian-Chinese controlled (DFAT, 1995). In Malaysia, the Malaysian-Chinese control much of the commercial trade and dominate the professional class, accounting for approximately 60% of all private sector administrative and managerial positions (DFAT, 1995). In the Philippines, Chinese-Filipinos control 50-60% of share capital by market capitalisation, account for about 35% of private sector gross revenues, and own or control 10 out of 26 commercial banks, including the largest bank. In Singapore, which is predominantly a Chinese society, more than 80% of companies whose

shares are listed on the Stock Exchange of Singapore are owned or controlled by ethnic Chinese. In Thailand too, overseas Chinese have strong influence in retail, manufacturing and banking industries (Hewison 1988).

### **Some Characteristics of Overseas Chinese Control of Business**

The business practices of overseas Chinese-owned conglomerates in ASEAN have some significantly different characteristics from those of Western multinational corporation (MNC's). These different characteristics have important implications for accounting policy setting and financial accounting practices (Whitley 1992; Redding and Wong 1993; Chèn 1995). Six characteristics often associated with overseas Chinese control are introduced here. Their potential effects on accounting are discussed briefly.

#### *1. Family-centric corporate structure*

Most overseas Chinese conglomerates are a unique blend of family ownership and control on the one hand, professional managerial expertise on the other. *Strategic* decisions are made usually by key family members who have been identified by the group's patriarch or matriarch as having the requisite entrepreneurial competence to do so. Simultaneously, decisions relating to *operational* aspects of the business are devolved to hired professional managers. While such practices appear to be similar to arrangements in Western firms, a key difference with overseas Chinese is their emphasis on long-term reciprocity between employers and employees. Long-term loyalty is fostered by highly paternalistic practices, including promotion of employees according to seniority; by commitment to secure job tenure even during economic downturns; and by remuneration of employees with a basic wage supplemented by large bonuses to reward good financial performance. Significant social sanctions based on notions of "shame" and "loss of face" discourage short-term opportunism in the labour market by either employer or employee (Redding and Wong, 1993). Although Chinese-owned conglomerates often are controlled by single family, there are significant interrelationships between conglomerates caused by cross-shareholdings, intercompany directorships, joint ventures, and inter-family marriages. Business and trading relationship are much more personalised than in the West, including circumstances where national boundaries need to be crossed to transact business effectively. It would not be uncommon behaviour for an overseas Chinese entrepreneur in Malaysia to return a favour by introducing new business to an associate in Indonesia (or any other part of the world) (Hamilton *et al.* 1990; Hamilton 1991; Kao 1993).

The ubiquity, continuity and informality of the family-centric structure of an overseas Chinese business organisation calls into question the propriety of applying consolidated accounting rules based on a formal, legal, definable notion of "control". "Economic control" in Western-based consolidation accounting standards is often defined in terms of extent of share ownership or capacity to exercise dominant influence in making operating and/or financing decisions. This does not sit comfortably with the notion of "control" as interpreted and exercised in an overseas Chinese business, where, more realistically, it likely to emerge from the operation of an informal, often subtle and discreet, network of filial and personal linkages. In such circumstances, "control" is very difficult to ascertain. Even if an attempt were made to do so, this might possibly be a forlorn task, easily overlooked, underplayed or thwarted by the sheer imprecise, ill-defined abstractness of "control" in overseas Chinese business. Part of the problem stems from many overseas Chinese entrepreneurs disliking legal contracts and preferring instead to rely on informal memorandums of understanding and verbal agreements. Contracts, even when signed, are seldom the "iron-clad" agreements they are in most Western countries. Accordingly, the family-centric characteristic of overseas Chinese controlled business may vitiate attempts to introduce consolidated financial reporting based on Western notion of "control" of an economic entity.

## 2. *Diverse Industrial and commercial exposure*

Overseas Chinese-owned enterprises generally are very highly diversified conglomerates engaging in both *financial* activities (principally merchant banking and commercial banking) and *non-financial* activities (mainly property development, retail trade and manufacturing). examples include the business empires established by Liem Sioe Liong (Indonesia), Robert Kuok (Malaysia), Lucio Tan (Philippines), Lee Choon Guan (Singapore) and Dhanin Chiravanont (Thailand). These conglomerates do not conform to the ideal Western model of a firm highly focused on a few "core competencies" (Hamel and Phahalad 1990).

The diverse array of economic activity of overseas Chinese-owned conglomerates has further implications for consolidated accounting. The propriety and relevance of consolidating the accounts of entities engaged in such highly diverse activities seems questionable. Combining the financial accounts of highly desegregated conglomerate with business interests in commercial banking, manufacturing, and property development, appears more likely to muddle the financial picture rather than produce financial information which will lead to better economic decisions. The appropriate evolution of each sub-entity, in each industry through application of different commercial criteria and performance benchmarks. Industry through application of different commercial criteria and performance

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<sup>1</sup> For a discussion of similar problems in Japan, see McKinnon (1984).

benchmarks. Industry-based reporting, rather than consolidated reporting seems likely to be a more useful outcome of the accounting process than consolidated financial reports. Whilst the degree of co-ordination exercised by the parent company on group subsidiaries and affiliates is an important issue, with consequences in terms of industry competition and concentration policy, nonetheless many entities in a highly diverse overseas owned Chinese conglomerate are evaluation as such, using appropriate accounting measurement and reporting devices to do so.

### *3. Preferred financing sources*

During the early stages of their growth, overseas Chinese-owned enterprises rely strongly on internal finance and loans from family, friends, and clan-members. At more mature stages of development, capital still tend to be sought from a financial institution that is part of the corporate group (Limlingan 1986; Kunio 1988; Redding 1990). This practice of “in-house” financing helps sustain a high level of secrecy over the affairs of overseas Chinese-owned enterprises.

Large overseas Chinese controlled conglomerates in ASEAN are participating increasingly in both domestic and internal capital markets. This participation, supposedly, ought to increase the level of transparency of those conglomerates. Yet, they appear able to maintain a high level of secrecy relative to Western companies. They appear adept because of cultural and political preferences in limiting disclosures to the minimum necessary to comply with securities law and stock exchange regulations. But, more importantly, stock exchange listing requirements in ASEAN appear to suit overseas Chinese conglomerates because they emphasise disclosures by particular companies in a group. Large overseas Chinese conglomerates usually adopt a “squat pyramid format”, with a private holding company at the top. A second tier of companies consists of prized assets which are held privately, and a third tier consists of publicly-listed companies (DFAT, 1995). Such a structure helps conceal the extent of assets controlled by the group. Clearly, consolidated accounting requirements in ASEAN could ameliorate this problem by instituting consolidation requirements which addressed the unique organisational and operational features of overseas Chinese groups and introduced a more relevant and operable notion of “economic control”.

### *4. Links with foreign capital: Joint Venture Accounting*

Ethnic Chinese-owned conglomerates in ASEAN increasingly are establishing links with foreign, non - ASEAN MNCs to facilitate access to new technology , marketing expertise or well-recognised international brand names (Lassere and Schütte, 1995). Such links offer foreign MNCs access to the growing domestic market in ASEAN and to the use of the organisational and networking advantages of an overseas Chinese conglomerate. The task of monitoring the

financial success of joint ventures between Western MNC's and overseas Chinese conglomerates is often difficult, complex one because of different culturally-based attitudes to information gathering and sharing.

the emphasis of many Western firms on financial and budgeting controls is incompatible with the more personalised and informal approach to control in overseas Chinese-owned enterprises. Where joint venture arrangements are in place, these are often associated with pressure to standardise the financial reporting systems of the partners. Often, a mutually acceptable compromise is reached on the need to comply with accounting regulators in trying to requirements in each partner's country. But a critical challenge confronts domestic accounting regulators in trying to reconcile the competing outlooks of the joint venturers. One striking example of the challenge arises from the reluctance of many overseas Chinese companies to assign values to any form of intangible asset. Overseas Chinese entrepreneurs are disinclined to embrace Western-based accounting standards which require intangible to be valued separately in the balance sheet. This matter is addresses below briefly.

##### *5. Treatment of "tangible" and "intangible" assets*

Chinese entrepreneurs appear to prefer not to attach any value to "intangibles" such as goodwill, research and development and deferred tax, despite the Western-based financial accounting standards in ASEAN countries often insisting that these items be valued and reported separately. Many ethnic Chinese entrepreneurs appear to have a strong preference for investment in real estate assets. These are viewed unequivocally as good, salable assets, highly acceptable as collateral when raising additional capital, and highly regarded as an attractive form of investment because of rapid appreciation of property values in ASEAN. But, in contrast to the importance they attach to tangible assets, Ethnic Chinese entrepreneurs are inclined to discount the worth of services and intangibles (DFAT 1995). In general, they appear keen to minimise outside payments for legal, accounting, research and development, intellectual property and other intangible services. Many overseas Chinese companies appear to prefer to provide these services in-house or simply to forego them wherever possible.

In contrast to much recommended Western-based accounting practice, expenditures incurred for these types of services are often routinely changed as expenses. Whether some consideration should be given to their "capitalisation", in order to "match" costs and revenues, or to recognise the expiration of service potentials, is not a matter for deliberation. The balance sheet is seen principally as a listing of tangible assets (especially cash and property) less any net debts owed.

### 6. *Emphasis on balance sheet and cash flows*

Decision-making within many overseas Chinese enterprises depends much less the information contained in profit and loss statements than on balance sheets and cash flow statements. Quite often, overseas Chinese enterprises emphasise a low profit margin/high turnover strategy to gain market share, and consequently, losses are incurred deliberately in early stages of the business to gain customer following. Much greater importance attached to managing inventory properly (to avoid obsolescence) and to ensuring sufficient cash is on hand to take advantage of the business opportunities which arise periodically (Limlingan 1986; Chen 1995). Operational results are evaluated commonly in terms of how quickly inventory is turned over and on the net amount of cash generated. This environment emphasises short-term adaptability. However, Western-based accrual systems of accounting, arising from the IAS-based accounting standards adopted by ASEAN countries, are characterised by arbitrary allocation methods and an emphasis on reporting periodic profit. For overseas Chinese conglomerates the accounting which emerges has very limited decision usefulness for them. And, as indicated earlier, is not conducive to assessing the span of control or financial performance of overseas Chinese-owned conglomerates. Perhaps it is time for a rethink by financial regulators in ASEAN.

### Conclusions

Overseas Chinese business enterprises are an important element of the economic development and success of ASEAN countries. These enterprises exhibit a unique set of characteristics based on the cultural propensities of the Overseas Chinese. In turn, these unique organisational characteristics and values raise questions regarding the applicability and appropriateness of Western-based accounting standards and regulatory mechanisms.

If accounting is remain relevant in these societies, it is important that accounting concepts and practices consider the particular economic and cultural characteristics of the societies in which they exist. The wholesale transplantation of foreign accounting concepts and regulatory structures appears to be inappropriate to be inappropriate if these do not contribute to better decision-making for domestic internal and external users of information. In particular, the use of consolidation accounting based on legalistic notions of control does not consider the subtle, yet powerful, networks that characterise "economic control" among overseas Chinese-owned and controlled business enterprises. Also, insistence is using arbitrary cost allocation methods to arrive at balance sheet and profit and loss figures appears to diminish the decision-usefulness of financial statements, particularly to internal users of such enterprises.

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