Proposals on prc's company classification by the comparative method

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Abstract. With the constant development of companies in our country, we still classify companies exclusively on the ground of person cooperation or capital integrity since the promulgation of the PRC’s Company Law (CCL) in 1993. Classificatory standard like this lagged far behind and exposed many problems, which includes the loopholes in the corporation regulations, state-funded companies types are excluded in this standard, and always not conducive to the boosting domestic company competitiveness among the fierce international competition. By comparing experiences of other countries and judicial districts, this article discusses the improved approaches: Adopting the company classification standard based on shares publicly offered and transferred, making specific classified pathways of existing companies, which means revising the Company Law and the Securities Law jointly.

Keywords: Limited Liability Company, Joint-Stock Company, Company Classification, Draft Company Law

1. Analysis of chinese company types classification

1.1 Regulatory Arbitrage Issues

The simple dichotomy management system design, classifying all their Co., Ltd into Limited Liability Company (hereinafter, “LLC”) and Company Limited by Shares (usually known as a joint-stock company, JSC), can lead to regulatory arbitrage problems and managerial discretion problems. Firstly, the original design intention of the LLC system is for thriving development of small and medium-sized enterprises with fewer shareholders and stronger close interpersonal relationship. The flexible company have great autonomic power, which brings cost-friendly governance, an easier approach to developing into large-scale ones.¹ It is ubiquitous that this type of company has more capital profits and a large number of employees such as Huawei in China and other typical companies in Italy, South Korea, etc. These countries’ company laws do not limit the scale of LLC. In practice, because such large-scale LLCs cannot raise capital by issuing shares publicly, they choose to raise funds internally from employee or make the shares be held by the company's trade union or shareholding association to circumvent the regulation that a limited company should have no more than 50 shareholders.² What’s more, anonymous shareholders are created by signing an equity nominee holding agreement with hidden shareholders in public documents such as the articles of association, the register of shareholders, and the industrial and commercial registration to avoid above regulations.³ These cases are all taking advantage of loopholes in the CCL to circumvent the stricter management of the share LLC system that their companies should abide by. Secondly, it is also the improper classification of company types, which had generally made the border between LLC and JSC fuzzier, led to a large number of managerial discretion in the court. Judges can easily rule the opposite result with their discretionary power because it is difficult to distinguish the nature of a company’s behavior and it is further difficult to clarify what rules the big-scale LLC and small-scale JSCs should follow when there are too many similar management systems between the two.
1.2 Classification Issues of State-Funded Companies

Although the concepts of state-funded companies overlap with the concepts of LLC and JSC, these companies are still served as an exception to the traditional company type classification design. We can see the latest draft revision of CCL is still based on the traditional logic mode, classifying companies with person cooperation or capital integrity. But a new chapter 6 “Special Provisions for State-funded Companies” has been added, broadening the state-funded company concept scope from the past wholly state-owned limited liability companies to state-controlled limited liability companies and companies limited by shares. Nevertheless, according to the traditional classification, wholly state-owned company should belong to LLC, but how do we determine the state-holding LLC and state-holding JSC? Do they belong to the superior or inferior concept of LLC and JSC? Or are they still should be regarded as the exception to the traditional dichotomy? What kind of specific regulatory rules should those companies abide by? Any case is incompatible with the logic of dichotomy, which reflects the logical flaws of this classification way.

1.3 International Competitive Deficiency of Domestic Company Types

At present, three new types of companies have been developed with the domestic capital market flourishing and also in urgent need of being recognized by CCL. First is the listed JSCs, which achieve fund-raising by listing and transferring their shares publicly on the securities exchanges. Second is the unlisted JSCs characterizing the same interpersonal relationship as LLC with fund-raising internally, but they still should apply the same system as the listed JSCs, which led to many questions, for example, costly organization, little autonomy of shareholders, and difficulties in transferring equity, and so forth.[1] The third type is NEEQ-listed (National Equities Exchange and Quotations) companies. Chinese unlisted SMEs can transfer their equities and raise funds publicly after listing on the NEEQ which is not only a system innovation in China’s capital market but also an essential stepping stone for SMEs to promote to list on the GEM, SME, and Main Board.[4] The NEEQ-listed company structure will be more facilitate to the international competition because SMEs no longer need to go public to raise large amounts of capital. At the same time, it is also necessary to clarify its definition in the CCL.

2. External jurisdictions compared

2.1 Classification Based on The Public and Private Capital Raising

In the UK, US, Japan, and other Bri-Ame System countries, companies are classified into two types, the Private Company and the Public Company. Adopting the public-private classification standard means classifying on the ground of whether the company shares are publicly raised and transferred in the securities market. To be specific, there are two types of companies in UK, named public-company and private-company, and two of them constitute a complete extensible category of company types together. The former type are always larger companies with dispersed, passive investors, exchange-traded stock, and a company secretary to ensure their information disclosure. While the latter refers to companies that is not included in public companies, subject to the rules of consideration, and has stronger capital maintenance norms.[5] In US, there are public-corporation and close-corporation. The former “go public” type has to take on substantial disclosure burdens, due to mass public shareholders and a large number of information asymmetries, but they were given the exclusive right to raise capital from the general public. While the latter is a purely private company, characterized mostly by small, owner-managed companies with illiquid shares, and without a large number of information asymmetries.

At the same time, the US manages its capital market with the basic concept of “information disclosure plus strict liability”. In this way, they can not only easily keep the openness of the capital market, clear the liability of both types of companies, but also give convenience to investors to choose their investment objectives and helps organize market effectively. The classification method in UK and US ensure the market’s stable operation since its inception, which shows the rationality that public-private classification absolutely meets the needs of investors and the capital market.

2.2 Classification Based on The Credit

In civil law countries, companies are classified into personal corporations, capital corporations, and personal-capital corporations, on the ground of the company credit rate, which has a long history but no clear boundaries among these types of companies. With the increasing boom of the stock market and securities trading, JSCs are classified into listed and unlisted companies, and the regulatory arbitrage problems caused by the small distinction between unlisted JSCs and LLCs have already been discussed before. Therefore, countries that used this classification criterion revised their native laws in order to solve these problems. For example, Japan revised its company law in 2005 and classified companies on the standard of capital raising publicly or privately. Then Japan revised the company again in 2014 to the standard whether the company shares are freely transferable regardless of being listed or not, thus classifying the company types into public and non-public companies.[6]
Taiwan province also amended the company law in 2018 and adopted the one-dimensional system of the company classification model, integrating all the closed company types, which means governing the LLCs, the unlisted JSCs, and other non-public companies in the rules of closed companies.

2.3 Other Classification Criteria
Besides the above classification standards, there are still existing other criteria. Firstly, based on the company's shareholding structure and shareholder status, the companies are classified into state-owned companies and non-state-owned companies, which can be further classified into wholly state-owned companies and state-holding companies according to the shareholding ratio in the company, while the former should be separately regulated according to special laws and the latter can still follow the public-private regular standard. Secondly, there is a specific classification standard used in the jurisdictions that do not apply the public-private classification and usually classify companies on the ground of company credit. This criterion is always used to classify listed or unlisted companies, depending on the number of shareholders whether reaches a certain amount, such as 200 or else, which could not be uniformed.

3. Classified standard selection and reconfiguration approach of company classification

3.1 Standard Selection
By comparing classification standards of different judicial districts and analyzing the development of the domestic market, it can be concluded that the public-private classification standard is our best fit. Both the results of various classified standards above-mentioned and the history of Japanese and Taiwan’s modified company law tells that classifying companies depending on whether the company shares are publicly transferred is the most in line with the international development trend for the company types classification. China's capital market has gradually developed into a multi-level mature system. Listed JSCs, unlisted JSCs, and NEEQ-listed companies are the three new-formed company types with the development of the capital market and rising drive of investors. Faced the new market situation, we should reviewed the collected comments on the outdated person cooperation or capital integrity standard that does not meet the market development needs. In brief, the public-private standard is not only easier to manage entities in the market, but also boosts the appeal of China's market to domestic and foreign investors by giving more freedom to the shareholders and investors. It is necessary to take this standard as the main direction of consideration during this CCL amendment.

3.2 Reconfiguration Approach
What is the specific approach to classifying such three new types of domestic companies and amending securities law jointly? Firstly we could classify the existing companies into public companies and non-public companies based on the standard of whether the company shares are raised and transferred publicly and then regulate them separately in two chapters of CCL. The former includes all the companies raising capital and transferring shares publicly, namely listed JSCs and the NEEQ-listed companies. The latter includes both LLCs and unlisted JSCs.[7] Secondly, China Securities Regulatory Commission (CSRC) has already defined the concept of unlisted public companies in 2012 in the Measures for the Supervision and Administration of Unlisted Public Companies and later issued a series of departmental regulations to supervise unlisted public companies, which left room the development of these companies. Therefore, we can directly integrate the three types of company provisions into the Securities Law as a timely response to the judicial practice.

4. Conduction
Chinese current company type classification model is not only lagged behind the capital market and international trends, but has already exposed regulatory arbitrage issues and other legal loopholes. This article finds that the public-private standard meets our country’s needs best by comparing different criteria of other judicial districts, and if the CCL is amended on the public-private standard, the domestic market will thrive. Meanwhile, if the securities law is amended jointly through consolidating securities sector regulations, the harmonization of laws will be greatly promoted. This paper is only a theoretical proposal on one part of CCL for the company classification. For the practical of company law, there will be more challenges, such as the slow growth of conceptual understanding in the market, the cost of restructuring a new company’s manageable system, etc. which will require to be unraveled by more relevant policies.

References


