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Is It a Good Time To Consider a Joint Stock Company?

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When setting up a company in China, an investor needs to consider the corporate form in which this company should be established. In practice, most investors prefer to set up a limited liability company (LLC). Given the amendment to the PRC Company Law adopted by the Standing Committee of the National People's Congress on December 29, 2023 (New Law) coming into effect from July 1, 2024, is it now a good time to consider a joint stock company (JSC)? This article compares the differences between LLCs and JSCs in certain major respects under the New Law to provide investors with information that may be useful to answer this question.

1. Restrictions on Number and Domiciles of Shareholders

An LLC must be established by not less than one but not more than 50 shareholders. For a JSC, the New Law removed the requirement of having at least two promoters (i.e., founders), allowing the establishment of a sole-shareholder JSC. The number of promoters of a JSC, however, must not exceed 200.

Notably, at least half of the promoters of a JSC must have their domiciles within China. Therefore, a foreign company is not permitted to directly set up a wholly foreign owned enterprise (WFOE) in the form of a JSC, but it may do so through one of its Chinese subsidiaries, e.g., a holding company incorporated in China. A foreign investor may also set up a joint venture with a Chinese partner in the form of a JSC.

2. Capital Contribution

Under the New Law, whereas shareholders of an LLC must contribute their subscribed capital in full within five years of the establishment of the company, promoters of a JSC are required to contribute their subscribed capital in full before the establishment of the company. Where the initial subscribed capital of a JSC is not excessive, such requirement of a full contribution upon the establishment appears to be manageable. Pursuant to a draft regulation released by the State Administration for Market Regulation (SAMR) for public comments, any new share issued by a JSC for the increase of its registered capital may have to be fully paid up prior to the registration of such capital increase with SAMR or its local counterparts.

Notably, the obligations of the board of directors (BOD) of an LLC to verify its shareholders' capital contributions, and the potential risk that a shareholder's equity interest that relates to its overdue capital contribution may be forfeited, are applicable to a JSC as well. For details, please refer to our article "Key Considerations for Amending AoAs Under the New Company Law."

3. Authorized Capital

Under the New Law, in principle, the BOD of a JSC may issue, within a period of three years, new shares of up to 50% of the shares that have already been issued, if so authorized under the articles of association (AoA) of such JSC or by its shareholders. Without such authorization, the issuance of new shares would require the approval of a shareholders' meeting, which might be time consuming to obtain, especially where a JSC has a large number of shareholders. As such, an authorized capital mechanism may improve the efficiency of a JSC's equity financing.

The authorized capital mechanism does not apply to an LLC. If an LLC needs to increase its registered capital, it must obtain a supermajority approval of its shareholders. As an LLC typically has limited number of shareholders and they are usually closely connected with each other, the burden of obtaining a shareholders' resolution approving an LLC's capital increase for fund-raising may not be so heavy as it appears to be.

4. Classified Shares

Under the current law, a JSC may issue preferred shares only if conditions required by the State Council are satisfied. As a matter of practice, most JSCs that have issued preferred shares are those listed on the Shanghai Stock Exchange or Shenzhen Stock Exchange. The New Law generally allows any JSC to issue different classes of shares with varied rights and restrictions with respect to the distribution of profits or liquidation proceeds (e.g., preferred shares), weighted voting rights, and transfer of shares (e.g., restricted shares), with certain exceptions.

It is not unusual that Chinese companies seeking to be listed in an overseas market establish an offshore corporate structure to allow the issuance of preferred shares and the grant of weighted voting rights. Given the change under the New Law, a JSC incorporated in China with classified shares might become an appealing alternative to an offshore listing vehicle.

Special rights and restrictions of classified shares will need to be set out in a JSC's AoA. Any amendment to a JSC's AoA and any increase of a JSC's registered capital will be subject to the affirmative votes of not only a two-thirds supermajority of all the shareholders present at a meeting of shareholders, but a two-thirds supermajority of the shareholders of classified shares present at a meeting of such shareholders. The rights and restrictions attached to classified shares are, therefore, generally stable and transparent, which could improve the efficiency and certainty of transactions.

Classified shares are not applicable to LLCs. Voting rights are granted, and dividends are distributed, to shareholders of an LLC in proportion to their respective capital contributions, unless otherwise provided in an LLC's AoA or agreed upon by its shareholders. In practice, a contractual arrangement that is inconsistent with the default rules applicable to an LLC under the law, e.g., distribution of dividends to foreign shareholders disproportionate to their capital contributions, might be challenging to implement.

5. No-par Value Shares

Currently, a JSC is only allowed to issue shares with a par value (usually CN¥1), and the purchase price for each share must not be lower than the par value. The New Law, for the first time, allows a JSC to issue shares without any par value, in which event at least 50% of the proceeds from the issuance of such shares must be credited to the JSC's registered capital. No-par-value shares may be converted into par-value shares, and vice versa.

With no-par-value shares being permitted, a JSC may issue shares at a discount, allowing founders or investors to acquire a majority of a JSC's shares for a small capital investment. In the event of LLCs, founders and investors may always subscribe to an LLC's registered capital at different prices.

6. Transfer of Shares

The transfer of equity interest of an LLC to a third party will no longer require the consent of any nontransferring shareholder under the New Law, but a nontransferring shareholder still has the right of first refusal to acquire the equity interest being transferred, unless otherwise provided in the LLC's AoA.

The transfer of shares of a JSC is not subject to the consent or right of first refusal of any other shareholder, under both the current law and the New Law. In addition, the New Law removes the statutory restriction under the current law that promoters of a JSC are prohibited from transferring any of their shares within one year from the establishment of the JSC. Meanwhile, the New Law explicitly allows the AoA of a JSC to impose restrictions on the transfer of shares. Such changes leave a greater deal of autonomy for JSCs to decide their rules on share transfer, which will narrow the differences between an LLC and a JSC in terms of transfer of equity interest or shares.

7. Corporate Governance

The corporate governance structures of an LLC and a JSC are generally similar under the New Law, with a JSC being subject to more statutory requirements, including the following:

- Whereas an LLC is not subject to any annual meeting requirement, an annual shareholders' meeting must be held every year for a JSC. Similarly, only the BOD of a JSC is required to convene at least two meetings each year.
- For an LLC, if all the shareholders unanimously agree in writing on the matters that would otherwise need to be discussed at a shareholders' meeting, a written resolution may be adopted without such a meeting. In the event of a JSC, a shareholders' meeting must be convened to discuss and vote on the matters under deliberation.
- A 20-day (or 15-day in the event of an interim meeting) prior notice must be sent to a JSC's shareholders for a shareholders' meeting, and, in principle, a 10-day prior notice must be sent to a JSC's directors for a meeting of the BOD.
- In principle, a JSC's register of shareholders is not allowed to be updated within a period of 20 days prior to the date of a shareholders' meeting or five days prior to the benchmark date for the declaration of dividends.
- Whereas an LLC of a small scale may not need to have a board of supervisors (or any individual supervisor) upon the unanimous approvals of all its shareholders, a JSC must have one supervisor or a board of supervisors, unless it establishes an audit committee within the BOD.

8. Public Financing

Under both the current law and the New Law, a JSC remains the only corporate form that a company seeking to be listed on any stock exchange in China may take. An LLC must be converted into a JSC in order to be listed.

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