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Innovation and Development of Company Capital System

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Abstract

Globally, the corporate capital system continues to innovate and develop. The transformation of countries with traditional statutory capital systems from statutory capital systems to authorized capital systems, and countries with authorized capital systems to further relax legal regulations on the use of corporate capital is a major challenge. The transformation of countries with traditional statutory capital systems from statutory capital systems to authorized capital systems, and countries with authorized capital systems to further relax legal regulations on corporate capital are two major trends in the world. The transformation of countries with traditional statutory capital systems from statutory capital systems to authorized capital systems, and countries with authorized capital systems to further relax legal regulations on corporate capital are two major trends in the world. To understand why the corporate capital system develops in these two ways, it is necessary to understand the concepts of capital credit and asset credit, as well as the conflict of interest between shareholders and creditors. The development of the corporate capital system is affected by the change in the understanding of corporate credit capabilities and the board-centrism trend of modern corporate governance. Therefore, it is undoubtedly an inevitable choice for the progress of company law to pursue the goals of improving the efficiency Therefore, it is undoubtedly an inevitable choice for the progress of company law to pursue the goals of improving the efficiency of company decision-making and operation, lowering the threshold for company establishment, and reducing excessive idleness and waste of funds.

Keywords: company capital system, statutory capital system, authorized capital system, asset

1. Introduction

The capital system can be said to be a general summary of the legal rules of the company's capital by Chinese scholars, which is a group of rules for the company's capital to be regulated by the law and externalized into the formation and maintenance of capital, with the main basic types being the legal capital system and the authorized capital system. The so-called authorized capital system, refers to the establishment of the company, although the articles of association of the company to determine the total amount of registered capital, but the promoters only need to subscribe to part of the shares, the company can be formally

established, the rest of the shares authorized the board of directors in accordance with the production and operation of the company and the securities market at any time the issue of the company's capital system. [1]In contrast to the authorized capital system, the concept of authorized capital does not exist in the authorized capital system, and there is only a distinction between paid-in and paid-up capital. The promoters of a company are required to contribute or raise the full amount of the registered capital as determined in the articles of association before the company can be established.[2]

In the case of corporations, the granting of limited liability mechanisms, while promoting capital formation, creates investment risks for creditors and leads to "creditor-shareholder" and "shareholder-shareholder" conflicts of interest within the enterprise. The legislator, in the face of the above conflicts of interest, has to choose between the dual interests of "the strong priority of debt financing and the reasonable priority of shareholders' investment", and seeks a balance. Within this framework, the design of the corporate capitalization system evolves into a query: whether, to what extent and in what manner modern company law balances these conflicting interests?

There are two different perceptions and attitudes towards this issue. The first is to pay full attention to the interests of creditors, focusing on creditors' claims to the liquidation of the enterprise's assets and adopting a precautionary, formal and paternalistic "creditor-driven" model of capitalization, i.e., a statutory capital system centered on the three principles of capitalization; the other is to recognize that creditors have a rational self-protection mechanism, and that they are interested not only in the debtor's fixed assets or capital, but also in current and planned rates of return and liquidity of assets. The other attitude is to recognize that creditors have rational self-protection mechanisms and believe that creditors are interested not only in the debtor's fixed assets or capital, but also in the current and planned rate of return and liquidity of the assets. Therefore, most creditors do not need the excessive protection of the law, and company law should be a neutral function in protecting the interests of creditors, and should not be a non-discriminatory care without regard to the category of creditors, but rather a legal protection for the vulnerable creditors who are unable to protect themselves. Therefore, the legislator does not need to set up a priori, preventive and substantive protection, but rather, under the mandatory and strict obligations of the trustee, to arrange for judicial remedies after the fact, that is, the flexible "solvency-based" authorization supported by "asset maintenance". Capitalization arrangements.

In response to the above disagreement, Professor Manning's analogy is vivid and illustrative: "Bankruptcy in business is not the norm, and comparing it to normal business operations is like a train crash versus normal train operation. It can happen. Then the passenger either buys insurance against it; or simply sits in the center car in the train; and if it is indeed recognized that the train is going to crash, it is not often the case that the passenger is taking any extreme precautions; he can just not ride." [3]How do legislators view the normal operation of commercial business forms, do they assume derailment as the norm and impose prior precautions, or do they view derailment as the exception and allow the space of commercial freedom. This divergence in attitudes directly affects the interests of corporate participants and has given rise to different models of corporate capitalization and subsequently led to different directions in the development of capital systems.

2. Innovative Developments in the Corporate Capitalization System

2.1 New Developments in Authorized Capitalization

2.1.1 Combination of Authorized and Authorized Capital Systems

Professors Ma Renewal and An Zhenlei believe that, based on the reflection on the inherent shortcomings of the legal capital system, the civil law countries represented by Germany and France have started to try to make a certain degree of breakthroughs and adaptations to the legal capital system, and have developed a

[1] Huang Hui. (2012). Corporate Capital System: International Experience and Implications for China, *Commercial Law Journal*, (21), p. 345.

[2] Ma Renewal, An Zhenlei. (2023). Reshaping Capital Formation: The Localized Construction of the Authorized Capital System, *Economic and Trade Law Review*, p. 2.

[3] See, Bayless Manning & James J. Hanks, Jr. (1990). *Legal Capital*, Third Edition, Westbury, New York. p. 5.

permitted capital system with the dual design of a one-time collection of capital and the authorization of the issuance of shares. [1]The innovation of the German Stock Act for the legal capital system is embodied in the introduction of the concept of authorized capital, which allows the issuance of new shares within five years after the registration of the company, but restricts the amount of shares, the issuance procedure and the subject of issuance, etc. If the consent of the supervisory board is required, the company may issue new shares. For example, new shares can only be issued with the consent of the supervisory board, the nominal value of the authorized capital shall not exceed half of the existing capital, and the issuance period is limited to five years. [2]The French Commercial Code, on the other hand, gives the shareholders' meeting or the company's articles of association the right to choose to give the board of directors the authority to issue shares, but there are also necessary procedural restrictions. [3]The common point of the reform of the capital system in Germany and France is that the establishment of the company still follows the principle of determining the capital of the legal capital system, emphasizing the determination of the company's basic capital; however, it can be followed by the agreement of the articles of association and the authorization of the shareholders' general meeting, and the board of directors can resolve to carry out the increase of the capital, i.e., it has absorbed the authorization of the issuance of the capital mechanism for the maintenance of the capital.

A different compromise path to authorized capital system reform was created in the 1950 revision of the Japanese Commercial Code, whereby an upper limit was placed on the authorized shares, stipulating that not less than one quarter of the total number of shares should be issued for the first time, and that the remaining shares could be authorized to be issued at the discretion of the board of directors. [4]In successive revisions of the Companies Act since then, Japanese legislators have still retained the mandatory one-quarter ratio requirement, but there have also been moderating provisions, such as the company's articles of incorporation, which provide for the consent of the board of directors for the transfer of shares, and which can exempt the ratio restriction at the time of the initial issuance. The core feature of the Japanese law's compromise capitalization system lies in the limitations on the total amount that can be issued and the minimum amount of capital to be issued at the time of the initial offering. This reflects its desire to give full play to the systemic value of the authorized capital system in absorbing capital efficiently and flexibly on the one hand, and its skepticism about the safety and stability of the authorized capital system on the other, which is a helpless move under the weighing of interests of many parties, and is suspected of being "extensive but not refined, and superficial".

While adhering to the principle of determining capital in accordance with the legal capital system at the time of the establishment of the company, the above system introduces the rules for the issuance of authorized capital and transfers the decision-making power for the issuance of shares from the shareholders' meeting to the board of directors, which, despite the limitations on the number of years of issuance and the total amount of issuance, enhances to a certain extent the flexibility and high efficiency in corporate fund-raising.

2.1.2 Further Liberalization of the Authorized Capital Regime

The second path of development is the further relaxation of legal restrictions on authorized capital, represented by the concept of "stated capital" created in the United Kingdom and Australia. As a result of the strengthening of board-centrism in corporate governance and the criticism of the limitations on the amount of authorized capital, the UK Companies Act 2006 abolished the "total authorized capital" limit and created the "stated capital" rule. Under this rule, the board of directors of a company enjoys a higher degree of freedom in the issuance of shares, and the law no longer mandates the company to set out in the articles of association the upper limit of the authorized capital, but empowers the board of directors to declare the actual capital issued in accordance with the company's actual operational needs and business operation considerations, which can be

[1] Supra note 3, Ma Renewal and An Zhenlei, pp. 6, 7.

[2] Translated by Hu Xiaojing and Yang Daixiong. (2014). *German Commercial Company Law*, 2014 edition, Law Press, p. 163.

[3] Translated by Luo Jiezhen. (2015). *French Commercial Code*, 2015 edition, Peking University Press, p. 287.

[4] Lu Ning. (2017). Ruminating on the Reform and Development of the Corporate Capital Formation System — Taking the Characterization of the "Contribution System" as a Starting Point, *Legal Studies*, (3), p. 116.

regarded as the system that gives the directors the greatest freedom at this stage. In conjunction with this, in order to prevent the board of directors from abusing its power of issue and causing damage to the interests of shareholders of the company, the company law of the United Kingdom gives the shareholders of the company the opportunity to protect their own rights and interests by exerting stronger control over the company's charter, supplemented by the mature market mechanism and the deep-rooted fiduciary concept in order to maximize the security of the transaction. [1]It is easy to see that the emergence of the "declared capital" rule is an inevitable trend of further relaxation of corporate capital control, the board of directors in the process of raising corporate capital is increasingly expanding the authority of the board of directors, but also with the development trend of the board of directors of the corporate governance of the eugenics of the development trend of the interaction between corporate governance and the company's capital more and more benign maturity. At the same time, it should also be recognized that the absolute trust and high degree of empowerment of the board of directors under the stated capital is the result of continuous exploration and application on the basis of the extremely mature authorized capital system, which relies on the protection of judicial remedy procedures and mature market mechanisms. Therefore, for countries with a deep-rooted authorized capital system and a lack of supporting systems for a highly liberal economy, it is not appropriate to blindly carry out such a highly liberalized reform of the corporate capital system, and it should be followed with caution.

2.2 Logic Behind the Development Path

2.2.1 Capital Credit and Asset Credit

As the modern corporation has shifted from a "partnership of persons" to a "partnership of capital", the understanding of corporate credit has shifted to the ability to fulfill obligations and repay debts based on the assets of the corporation, and has been divided into capital credit and asset credit according to the degree of understanding of "capital".

According to the degree of understanding of "capital", there are two types of understanding: capital credit and asset credit. Capital credit is to lay down the company's operation ability and responsibility ability with the company's capital, and to use the company's capital as the basic guarantee for the interests of the company's creditors. [2] The corporate system of the traditional civil law system emphasizes the role of capital credit in guaranteeing the security of transactions. Based on this concept, the legal capital system enshrines the three principles of capital, and capital credit becomes the main criterion for the identification of company credit under this model. "In the capital-credit context, capital is accorded the deified status of signaling a company's ability to be responsible." [3]The design of the system has also been influenced by this philosophy. The idea behind the design of the legal capital system is to equate a company's registered capital with its solvency. The registered capital of a company is the most practical and fixed, it is the lower limit of the foundation of the company's capital. It can represent the actual capital of the company, so it must also reflect its solvency. However, this concept also has shortcomings, that is, ignoring the paid-in program. The pitfalls of the degree of performance, and the importance of asset structure and asset value, performance lacks attention to factors other than the amount of capital on the books that are more indicative of a company's true solvency.

Therefore, although the authorized capital system attaches great importance to the protection of creditors at the institutional level, it fails to achieve the desired effect due to the inherent flaws in the understanding of capital credit. In reality, the legal capital system countries also often have large enterprises insolvent and bankrupt, authorized capital system of large enterprises credit is not worse than the legal capital system countries. Therefore, one cannot help but reflect on whether the credit brought by capital can provide real and effective protection for creditors. The shortcoming of capital credit lies in the fact that companies often rely on assets rather than capital to assume responsibility or fulfill their obligations to the outside world. The company's operation will always have profit and

[1] See Ge Weijun. (2022). UK Company Law Reform and Its Implications for China, *Finance and Economics Law*, (2), pp. 44-49.

[2] Zhao Xudong. (2003). From Capital Credit to Asset Credit, *Legal Studies*, (5), pp. 109-111.

[3] Wang Yan and Li Yuzhuo. (2022). Criticism of the Logic of Capital Credit and Reshaping the Protection Mechanism for Corporate Creditors, *Business Research*, *4*(4), p. 110.

loss, that is, changes in the value of assets, the company's external liability will also have leverage rather than mechanical book capital limit, so the company's capital and total assets, net assets will inevitably exist between the difference. The legislation only regulates the abstract registered capital, but can do nothing to reflect the actual operation of the company's asset status. [1]Therefore, the company's capital can only be used as a reference for solvency, while the real assets it actually owns is the real basis for reflecting the solvency. The company's assets are always in flux, reflecting the company's profit or loss, and the company's tangible or intangible depreciation, which can always reflect the changes of the company's solvency in a timely and intuitive manner, and the change from the credit of capital to the credit of assets is a rational choice made on the basis of the scientific analysis of the credit of the company, and it is a historical necessity for the development of the company law.[2]

Acceptance of the idea of credit for the assets of a company will inevitably weaken the focus on the capital of the company. For example, the question of whether the registered capital of a company is issued in a lump sum or in batches at the time of its incorporation, and the question of paid-in versus paid-out contributions, are simply normal commercial acts of the company. The law treats this as a business judgment based on internal decision-making, thus giving full autonomy to the company rather than paternalistic control. Thus, instead of overly reinforcing the front-end protection of creditors, it is better to block than to loosen. For example, fully trusting the subjective initiative of creditors and allowing companies and creditors to participate freely in business activities. The role of law should be changed from parent to helper, reducing paternalistic front-end protection to after-the-fact relief protection or assisting creditors to make rational behavior, such as strengthening the construction of corporate integrity system and information transparency. At the same time, the authorized capital system model based on asset credit theory can also improve the efficiency of corporate financing, lower the threshold of company establishment, and reduce the excessive idle and waste of funds, which is undoubtedly an inevitable choice for the progress of company law.

2.2.2 Shareholders and Creditors

One of the important roles of the law is to settle disputes. One of the important issues to be resolved by the legal system of capital lies in harmonizing and balancing the conflicting interests of shareholders and creditors of a company, which is one of the most conflicting and antagonistic issues in the field of commercial affairs. For internal capital, creditors will hope that the more the better, the more fixed the better, so as to stabilize the debtor company's solvency, to protect its claim interests not to be damaged, while shareholders will hope that a higher leverage, to seek low-cost high-yield; while in the external investment, creditors will be more conservative, hope that the company's assets stay in the company as much as possible as a security for the settlement of its debts, while the company's shareholders will be more aggressive, wanting as much of the company's assets to flow out as possible to create value, and then reap the benefits through dividends, return of earnings, and so on. "The different interests weighed in favor of protection is the fundamental idea underlying the division of capital system, and the different system of different system divisions thus began." [3]The distinction between the legal capital system and the authorized capital system lies in the different trade-offs on the question of which priority should be given to the protection of the interests of creditors or shareholders, and which should be the primary consideration, which leads to the differences between the two legal systems in the design of the capital system.

Under the system design of the authorized capital system, the shareholders of a company, as the internal management and control personnel of the company, are in control of the actual operation of the company and enjoy the protection of limited liability of the shareholders. It bears a small risk but can seek high profits that do not correspond to it, while the external creditors of the company have to bear the potential risk of not being able to fully pay off the debts after the company's failure to operate and go bankrupt without mastering the information of the company's internal operation and management. In order to improve this

[1] Zhao Xudong. (2004). *Research on the Reform of the Corporate Capital System*, 2004 edition, Law Press, p. 7.

[2] Supra note 3, Ma Renewal and An Zhenlei, p. 4.

[3] Li Jianwei. (2021). The Integration of Authorized Capital Issue System and Contribution System — Changes in the Corporate Capital System and Options for Revision of the Company Law, *Modern Law, 6*(6), p. 109.

extreme situation of inequality, the legislator strictly limits the company's capital within the company through strict capital regulation system, such as capital formation regulation, capital determination regulation, capital outflow regulation, etc., and severely cracks down on the behavior of damaging the company's share capital such as capital evasion, so as to safeguard the interests of the creditors, compress the profit space of the shareholders, and achieve the balance of interests and risks. In the authorized capital system, the company's own interests are maximized in favor of the interests of all parties, including shareholders, creditors, shareholders as a residual claimant of the company's assets, power of the residual controller, the most incentive to improve the company's operations to maximize the company's assets, so the law through the improvement of the investor protection mechanism to achieve the greatest possible capital raising, operation and distribution of flexibility and convenience, will be able to achieve the maximum growth of corporate interests, and to achieve the maximum growth of corporate interests. Can realize the maximum growth of the company's interests, and through the expansion of the company's interests to protect the possibility of future claims of creditors, and then realize the win-win situation for all parties. It is easy to see that the protection of creditors under the legal capital system has a strong color of legal paternalism, which is guaranteed through external constraints for fear that the interests of creditors may be damaged, while the authorized capital system gives full freedom to commercial operations, avoids excessive interference in corporate governance and capital operation, and respects commercial autonomy and the enthusiasm of commercial subjects.

However, it should be seen that the design of the legal system should take into account the different possibilities of the company's practice. For a long time, the design of China's legal system has been showing a clear tendency to protect creditors, and the protection of creditors' interests is regarded as the key to the design of the capital system, which is often due to the concern for the extreme scenarios of the company's bankruptcy or insolvency, and ignores the capital contribution relationship between the shareholders and the company, as well as the principle of the equality of the shareholders. The principle of equality of shareholders is ignored. [1]However, in the vast array of commercial transactions, the protection of creditors' interests is often the key to the design of the capital system. In easy practice, how many such extreme scenarios are there, whether the proportion they occupy can support them to obtain such a high degree of attention, and whether the highly skewed legislative protection is comparable to the measurement of the interests behind them? The answers to this series of questions warrant a fresh look at the current institutional design. Excessive front-loading of creditor protection will greatly dampen the incentive of shareholders of a company to improve corporate governance and promote corporate development. When the most motivated shareholders, who are the first and foremost responsible for the operation of the company, no longer expect the company to develop in the long run, how can the assets of the company be increased and the vitality of the commercial affairs be stimulated? To take a step back, the authorized capital system, with the concept of asset credit as the cornerstone, pays attention to the actual assets in the company's operation and takes the company's continuous good management ability as the basis of the company's debt repayment, so that the creditors' judgment of the company's solvency is always based on the real and objective assets of the company, which is in fact more conducive to the protection of the creditors. Is the protection of external creditors better served by a fixed amount of capital at the time of the company's establishment, or by an efficiently run company with a promising future and full of vitality? The answer is self-evident. The shift from a statutory capital system to an authorized capital system is not a trade-off between creditor protection and incentives for shareholders, but rather a reversal of the overly tilted legislative concept of creditor protection, so that the balance between the two ends of the capital system design can be truly returned to equilibrium.

3. Summary

With the enactment of the draft company law, the discussion on the company capitalization system has been revitalized. From a worldwide perspective, many countries with traditional

[1] Liu Yan. (2014). The Logic and Path of the Reform of the Capital System of the Company Law—Observation Based on the Perspective of Business Practice, *Legal Studies*, (5), p. 36.

statutory capital systems are shifting to authorized capital systems, while the authorized capital system itself is also undergoing continuous innovation and development. To sum up, there are two main paths for the development of authorized capital system, one of which is the integration on the basis of statutory capital system, represented by the approved capital system represented by Germany and France and the compromise capital system represented by Japan; the second path of development is the further deregulation on the basis of authorized capital system, represented by the "statement capital system" represented by Britain and Australia. The second development path is the further deregulation based on the authorized capital system, represented by the "stated capital system" of Britain and Australia. With regard to the first path, the Statement Capital System and the Compromise Capital System are in fact similar in nature, and they are both reforms in traditional countries with a statutory capital system that introduce the features and concepts of the Authorized Capital System on the basis of the statutory capital system. This reflects the reflection of the traditional statutory capital system countries on the inherent shortcomings of the statutory capital system, and began to try to make a certain degree of breakthroughs and adaptations to it. For example, in Germany and France, the company capital system, through the dual design of raising capital once and authorizing the issuance of shares, transfers the decision-making power of the issuance of shares from the shareholders' meeting to the board of directors, and imposes limitations on the number of years of issuance and the total amount of issuance, which, to a certain extent, enhances the flexibility and high efficiency of the company's fund-raising. Regarding the second path, there are two views in the academic circle: the first view is that the proposal of "declared capital" abandons the concept of "authorized capital", so it should be a new type of capital system different from the authorized capital system, that is, "declared capital system". The second view is that "stated capital" is only a new concept and term developed on the basis of the authorized capital system, and the essence of the system is still to authorize the board of directors to issue shares, so it has not jumped out of the scope of the authorized capital system, and is only a new development of the authorized capital system. It is only a new development of the authorized capital system, and cannot stand on its own as a brand new capital system. We look at the typical UK Companies Act 2006, which abolished the restriction of "total authorized capital" and created the rule of "declared capital", but in fact, the law still allows the board of directors to be authorized by the articles of association or the shareholders' meeting to issue shares. The difference is only that the law no longer compels a company to state the maximum amount of authorized capital in its articles of association, but leaves it to the board of directors to state the actual amount of capital issued in accordance with the company's actual operational needs and business operation considerations. Therefore, the essence is still "authorization", but due to the strengthening of the centrality of the board of directors in corporate governance, the "unnecessary" limitation on the amount of authorized capital has been abolished. Under this rule, the board of directors of a company enjoys a higher degree of freedom to issue shares, which is arguably the greatest freedom granted to directors at this stage.

The reason why the corporate capital system has developed in such two ways is actually based on the consideration of three sets of concepts and conflicts: one is the progress in understanding from capital credit to asset credit, whereby the understanding of corporate credit has shifted from fixed capital to the ability to fulfill obligations and pay debts based on the company's assets. This advancement in understanding has changed the role of the law from that of a grandparent to that of a supporter, reducing paternalistic front-end protection to post-facto remedial protection or assisting creditors to act rationally, such as by strengthening the construction of a corporate integrity system and transparency of information. As a result, the design of the capital system model based on this theory can improve the efficiency of corporate financing, lower the threshold of company establishment, reduce excessive idle and waste of funds, which is undoubtedly an inevitable choice for the progress of company law. The second is the consideration of coordinating and balancing the conflict of interests between shareholders and creditors of the company. From the legal capital system to the authorized capital system, it is not to make an either/or trade-off between the

protection of creditors and the incentive of shareholders' interests, but to reverse the overly tilted legislative concepts for the protection of creditors' safety in the past, so that the two ends of the scale of capital system design can be returned to a real balance.

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