

Protection of Small and Medium Shareholders by Company Law

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Abstract: The protection of shareholder rights and interests is the core issue of corporate governance, and effective protection of the interests of small and medium-sized shareholders is a prerequisite for the fairness and efficiency of the corporate system. Encouraged by the slogan of "mass entrepreneurship and innovation" in our country, more and more people want to participate in such capital markets. These investors often hold small amounts of funds and can only become small and medium-sized investors. The Company Law protects the legitimate rights and interests of these small and medium-sized shareholders, enabling them to actively participate in the capital market. This article will analyze and explain how the law protects the rights and interests of small and medium-sized shareholders, as well as some personal improvement methods.

1. Keyword definitions

1.1 Small and Medium Shareholders

Small and medium-sized investors refer to shareholders other than directors, supervisors, senior management, and shareholders who individually or collectively hold more than 5% of the company's shares. Those who hold more than 5% of the shares are eligible to elect their own personnel to the board of directors to participate in daily business decision-making, while other small and medium-sized shareholders can only exercise their voting rights at the shareholders' meeting. Often, such shareholders find it difficult to interfere with the company's development, and can only exercise their voting rights at the shareholders' meeting when the company faces major issues.

1.2 Protection of Rights and Interests

Article 4 of the Company Law on shareholder rights; Article 20: Prohibited behaviors by shareholders; Article 33 Shareholders have the right to inspect and copy; Article 34: Dividend rights and preemptive subscription rights; Article 42: The voting rights of shareholders are stipulated in the Company Law of the People's Republic of China (2018 Amendment) and Presidential Decree No. 15 of the People's Republic of China. This article will explore some of the rights that cannot be well protected.

2. The antecedents and reasons for protecting the rights and interests of small and medium-sized shareholders

2.1 Precedents

From a legal perspective, every shareholder is equal. In the operation of a company, each shareholder can exercise voting rights based on their own shares, which seems to protect the rights of each shareholder equally. However, major shareholders of a company who hold a large number of shares often rely on the power brought by the large number of shares to intervene in certain major issues of the company, and even "veto" them with one vote. Such behavior seriously damages the rights and interests of small and medium-sized shareholders who hold a small amount of shares. The basic principles of the Company Law require us to ensure that the status and rights of shareholders are not only equal in form, but also in substance.

2.2 Reasons

The development of a company should not rely solely on the decisions of a few people, but should strive for collective thinking and unity. Although small and medium-sized shareholders do not hold much equity, their number is generally greater than that of major shareholders. When protecting these small and medium-sized shareholders, it is also conducive to maintaining the stability of the entire company, allowing the enterprise to develop well, and establishing a good corporate image. In the long run, it is beneficial to the stable development of the entire capital market and even society. The protection of the rights and interests of small and medium-sized shareholders is quite necessary. On the one hand, if the rights and interests of small and medium-sized shareholders are not properly protected, as investors in the capital market, small and medium-sized shareholders will undoubtedly have a negative impact on the development of the capital market, affecting the vitality of the market economy and reducing the enthusiasm of market investors; On the other hand, with the continuous development of China's socialist market economy, the sound and guaranteed legal system not only directly promotes the stable development of China's market economy, but also indirectly guarantees the pace of China's socialist rule of law construction. The protection of the rights and interests of small and medium-sized shareholders is undoubtedly the first step in starting this journey.

3. Insufficient protection of the rights and interests of small and medium-sized shareholders in the past

3.1 The position of small and medium-sized shareholders in the company is too weak

A company seeking development in a market economy inevitably encounters various problems. When facing major issues such as company development and personnel appointments and dismissals, the major shareholders holding the majority of the company's shares often leverage the advantages brought by their own shares to have extremely important influence in the board of directors. This leads to major shareholders of the company often forcing their wishes into voting results in the board of directors and shareholders' meeting. When the wishes of major shareholders are imposed, it will affect the company's decisions. This is unfair to small and medium-sized shareholders, as their voting rights lose their meaning. If the expectations of both parties are inconsistent, the interests of small and medium-sized shareholders may face complete neglect. We can learn about the case of "Haitian Seasoning Group".^[1] Haitian Seasoning conducted an equity buyback in 2012, but its methods were illegal, and during this process, the company forced group employees to return their company shares. In this way, while avoiding paying taxes, Haitian Seasoning has transformed from a state-owned

enterprise to a private enterprise, with the largest controlling shareholder of Haitian Group benefiting the most. This reflects that in a company, once major shareholders want to gain practical benefits by sacrificing the rights and demands of small and medium-sized shareholders, small and medium-sized shareholders often find it difficult to have effective means to resist unreasonable demands.

3.2 Non standardized information disclosure leads to infringement of the right to know of small and medium-sized shareholders

Shareholders have the right to know about the company's financial system, operating status, and other aspects, and can access information. This is the most basic right of a shareholder and also the basis for their participation in the company's management. Only by understanding the internal situation of the company can they make correct judgments on the company's future development direction. In the process of company operation, if small and medium-sized shareholders want to access information, major shareholders can fully use their power to restrict the behavior of small and medium-sized shareholders. If major shareholders want to tamper with and forge company accounts and documents, it is also possible, while small and medium-sized shareholders may lose some of their interests because they cannot access these documents. Taking the case of Shanghai Chaori Sun Technology Co., Ltd. as an example, from 2011 to 2012, Chaori Sun revised its annual net profit and performance forecast five times, transforming from an initial large profit to a huge loss. The company did not timely and truthfully disclose its operating conditions to the public, which greatly affected the investment enthusiasm of investors. Under such non-standard information disclosure, small and medium-sized shareholders find it difficult to understand the actual financial situation of the enterprise based on the disclosed information. Such cases should not be limited to just one or two cases. Most listed companies use false information disclosure to avoid commercial risks or seek actual benefits, but in such cases, it is often achieved on the basis of the damage to the rights and interests of small and medium-sized shareholders. The financial fraud incident of Luckin Coffee is also a typical case of disclosing false information. Muddy Waters (a short selling agency) publicly released an anonymous short selling report, accusing Luckin Coffee of financial fraud and exaggerating net income from sales, selling prices, advertising fees, and other factors. At that time, Luckin denied all claims, but later faced class action lawsuits from some investors, financial disclosure seasons, and changes in independent directors. Unable to withstand the pressure, Luckin exploded. The rapid rise and decline of such "star companies" will have a huge impact on domestic and foreign venture capital, not to mention those small and medium-sized investors. In such events, small and medium-sized investors often find it difficult to know the truth, and only react after the investment fails and causes actual economic losses. However, by that time, the dust has settled and they can only suffer losses.

3.3 Regarding equity repurchase issues

Equity repurchase refers to a company buying back shares that have already been issued to the public at a certain price. In the original Company Law, it was stipulated that shareholders could transfer their equity to each other. Sometimes, companies engage in equity repurchases, which actually protects the rights and interests of some shareholders. Currently, there are relatively few legal provisions for equity repurchases in China, mainly based on Article 74 of the Company Law.^[2] However, in complex and ever-changing business practices, the existing situation of equity repurchases is difficult to encompass the needs of practice.

3.4 Company profits without dividends

Article 37, Paragraph 6 of the Company Law stipulates: "The shareholders' meeting shall exercise the power to review and approve the company's profit distribution plan and loss compensation plan." In other words, the specific situation of the company's dividends shall be decided by the shareholders' meeting. In other words, shareholders have the voting power to decide whether to distribute the company's dividends, and can decide whether to distribute or not to distribute profits. However, in practical life, many companies may delay dividend matters under the pretext of "poor company profits", and small and medium-sized shareholders often face this almost "rogue" situation and are helpless.

4. Issues of small and medium-sized shareholders themselves

Most small and medium-sized shareholders themselves may not have a high level of participation in corporate governance due to their small shareholding. Compared to corporate governance, they are more concerned about the benefits and income that their shares can bring to them, lacking enthusiasm and willingness for corporate governance. In this way, some small and medium-sized shareholders who want to participate in corporate governance will be covered up by the majority who only focus on interests.^[3]

5. Legal basis for protecting the rights and interests of small and medium-sized shareholders

5.1 Right to Information

Article 33 and Article 97 of the Company Law clearly stipulate the right of shareholders to be informed of the company's operating conditions and other related information. If the major shareholder engages in behavior that harms the minority shareholders during the normal operation of the company, the minority shareholders have the right and knowledge of the company's dynamics. For example, the major shareholder who holds decision-making power in the company may issue new shares in order to gain control over the entire company and dilute the equity of small and medium-sized shareholders. In this situation, if small and medium-sized shareholders can timely check the company's dynamic situation, discover the actual situation of the company's operation and equity changes, they can make timely responses to protect their legitimate rights and interests.

5.2 Cumulative voting system

5.2.1 Voting system in the old law

In the old Company Law, companies adopted the principle of capital majority voting when making decisions, where one share is equal to one vote. Under this mechanism, shareholders who own the majority of the company's shares have greater say, and whoever speaks has more weight, of course, who has control. Small and medium-sized shareholders own fewer shares, and although there are many, they cannot have a significant say in the company's business decisions.

5.2.2 Voting system in the new law

Article 105 of the new Company Law stipulates that in the election of directors and supervisors by the shareholders' meeting, a cumulative voting system may be implemented in accordance with the provisions of the company's articles of association or the resolutions of the shareholders' meeting. The cumulative voting system referred to in this Law means that when the shareholders' meeting

elects directors or supervisors, each share has the same voting rights as the number of directors or supervisors to be elected, and the voting rights held by shareholders can be used collectively. The proposal of this cumulative voting system can encourage more small and medium-sized shareholders to participate in the voting system and give them more say.

5.2.3 Significance

From this point, it can be seen that China attaches great importance to the balance of shareholder power. In the future, companies can actually give more rights to small and medium-sized shareholders, so as to better constrain and balance power within the company, making company decisions more reasonable and scientific.

5.3 Equity Repurchase

In Judicial Interpretation 5 of the Company Law of 2019, it is stipulated that when the people's court hears cases involving significant differences among shareholders of limited liability companies, attention should be paid to mediation. Under legal and mutually agreed circumstances, the people's court should support the company in repurchasing the shares of some shareholders. The provisions of the Supreme People's Court on Several Issues Concerning the Application of the Company Law of the People's Republic of China (V), Fa Shi [2019] No. 7. In the past, the scope of adaptation for equity repurchases was narrow and could not effectively protect the rights and interests of small and medium-sized shareholders. After this judicial interpretation, more comprehensive conditions for allowing repurchases were established, which played an important role in protecting the legitimate rights and interests of small and medium-sized shareholders. Shareholders who are unwilling to accept major changes in the company can withdraw from the company after receiving reasonable compensation, better protecting the rights and interests of investors.^[4]

5.4 Litigation remedies for non-dividend companies

According to Article 74 of the Company Law, if a company fails to distribute profits to shareholders for five consecutive years and meets the conditions for profit distribution stipulated in this Law, shareholders who vote against the non-dividend resolution of the shareholders meeting may request the company to purchase its shares at a reasonable price. Within 60 days from the date of passing the resolution at the shareholders' meeting, if a shareholder and the company cannot reach an equity acquisition agreement, the shareholder may file a lawsuit with the people's court within 90 days from the date of passing the resolution at the shareholders' meeting.

Corporate dividends were originally within the scope of corporate autonomy, but due to the excessive abuse of rights by major shareholders in judicial practice, there have been cases of disguised embezzlement, concealment, or transfer of company profits. China has implemented legal constraints and regulations in this regard. In this way, the rights and interests of small and medium-sized shareholders can be better protected by law, becoming a legal basis, and at the same time, companies can achieve fairness and justice in dividend distribution.^[5]

6. Countermeasures and suggestions

Here are some personal improvement ideas for the current Company Law.

6.1 Establishing a sound legal system

The law is not perfect enough in some details, such as whether it is possible to view the original documents in the relevant provisions on the right to information. If small and medium-sized shareholders cannot see the original documents, the authenticity of the documents they see and the authenticity of the company's operating conditions they understand also need to be discussed. Meanwhile, if small and medium-sized shareholders are restricted by the threshold set by major shareholders, how should they protect their right to know? This includes regulating the stock market, reducing the impact of malicious listing (referring to investors purchasing more than 5% or multiples of the total share capital of the stock in the securities market) on other shareholders of the company, and improving compensation mechanisms.

6.2 Establish a sound system for shareholder meetings and set constraints

The highest authority of a company is the shareholder meeting. If we can improve the shareholder meeting system, we can more effectively protect the rights and interests of small and medium-sized shareholders. Dilution of equity can be used to reduce the shareholding ratio of major shareholders, control the shareholding ratio of major shareholders within a certain range, and prevent the occurrence of a "one man talk". In some companies, there may be restrictions on the speaking time of shareholders during shareholder meetings. Although this improves the efficiency of meetings, it also makes it difficult for small and medium-sized shareholders to fully express their demands. Establishing a sound system is to establish a balance mechanism between small and medium-sized shareholders and major shareholders, so as to realize the demands of both parties and improve the rationality of company decision-making without harming their legitimate rights and interests.

6.3 Improving Supervision Institutions

In the board of directors, the supervisory function is undertaken by the supervisory board, so the role of supervision should also be emphasized in addressing the abuse of shareholder rights. Supervisory agencies should have sufficient supervisory power to effectively control the occurrence of abuse of rights, and strong checks and balances can effectively protect the interests of shareholders. We can establish a separate supervisory body composed of small and medium-sized shareholders, which has the right to supervise the decisions made by the shareholders' meeting, the right to know and the right to question, and to supervise the operation and operation of the company.

6.4 Improving management awareness among small and medium-sized shareholders themselves

There are many small and medium-sized shareholders, and it is difficult to achieve complete unity of opinions when managing the company. Some small and medium-sized shareholders even focus only on the realization of interests and do not care about the management of the company. If small and medium-sized shareholders wish to have a certain say in the company's business decision-making, they should have an understanding and realization of their rights. The company should strengthen one's own management and legal awareness, improve decision-making participation enthusiasm, and actively participate in management and supervision.^[6]

7. Conclusion

After several revisions of the Company Law, the imbalance between the management and

operation of companies still exists, and how to achieve equal rights between major shareholders and small and medium-sized shareholders is still a practical problem in front of us. The early Company Law did not make a large number of relevant provisions on this, and the new law has not been implemented yet. It still needs to be continuously developed and improved. To solve such problems, a dual guarantee of internal improvement and external supervision should be done, and the protection of the rights and interests of small and medium-sized shareholders still has a long way to go.

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