Board of Directors System of Limited Liability Companies in China: Realistic Problems and Reform Trend

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Abstract. As an integral part of corporate governance, the system of the board of directors has been improved in China with the development of history. Up against in-depth China's market-oriented reform, there are some problems in the board of directors system of the limited liability company in the Corporate Law. On the one hand, the board of directors of limited liability companies under the Positivist Jurisprudence is faced with defects, including the vague distribution of powers between shareholders and board of directors, power of the board of directors plundered by managers, and serious impact of the legal representative system on the position of the board of directors. On the other hand, due to the contradiction between corporate autonomy and state compulsory force, the system of the board of directors is also facing a huge shock from business practice. In this regard, there are two theoretical solutions, that is, "reservation theory" and "abolition theory". However, both of them have their own imperfections. Limited liability companies should be given the right to choose whether to set up a board of directors and improve the linkage design of the corresponding corporate governance system.

Keywords: Limited Liability Company; Board of Directors System; Corporate Governance.

1. Introduction

Since China's *Corporate Law* has been promulgated in 1993, it has been revised five times. On this basis, a corporate governance structure of "Board of Shareholders + Board of Directors + Board of Supervisors + Managers" has been formed in China. With in-depth China's market-oriented reform and business environment optimization, whether the inherent corporate governance structure can conform to the reform trend has become a hot issue when the national economy has entered a new stage, which has also become unavoidable in the new round of the *Corporate Law* revision. The corporate governance structure is of fundamental significance to the company, and the role of establishing organizational structure lies in the division of labor, grouping, and coordination of tasks. An appropriate governance structure will enable the business activities of the company to be carried out more smoothly, reduce the friction and contradiction in the business of various departments, and improve the operational efficiency of the company. On the contrary, the inappropriate governance structure will hinder the development of the company, greatly damage the vital interests of the company and its closely related entities, and undercut the stability of the company. In the current revision of the *Corporate Law*, the board of directors system of limited liability companies is a hot topic in the reform of corporate governance structure. In fact, the board of directors system of limited liability companies is facing the double challenges of *Positivist Jurisprudence* and practice, which urgently needs reasonable reform to respond.

2. Historical Evolution of the Board of Directors System in China and its Present Situation in Limited Liability Companies

The board of directors tends to be the permanent management decision-making body of Chinese companies. According to the relevant provisions of the current *Corporate Law*, the board of directors is composed of directors, who are in charge of the company's affairs internally and represent the agency of the company's business decision-making and execution externally. The company has a board of directors elected by the board of shareholders or the general board of shareholders. Its establishment can be traced back to Britain and America in the Middle Ages influenced by Christian

culture. Later, the board-centered company was first formed in Europe and became a worldwide corporate governance mode with colonial expansion. [1] Generally speaking, the board of directors' system, as an external product, has experienced a distinct localization process with Chinese characteristics after it was introduced into China. Therefore, the board of directors of limited liability companies has formed a unique position in China's corporate governance structure at present.

2.1 Historical Evolution of the Board of Directors System in China

The beginning and exploration of China's board of directors system concentrated in the late Qing Dynasty and the period of the Republic of China. For example, Rong Hong drafted the *Articles of Association for the Joint Establishment of New Steamship Company* in 1867, which did not stipulate the board of directors in internal governance but adopted a business mode similar to that of Shanxi merchants. In 1873, Li Hongzhang established the Steamship Investment Promotion Bureau, and the so-called "directors" stipulated in its articles of association had no clear roles and functions, which were only privileged shareholders with salaries in a sense. [2] In this period, either a board of directors has not been set up in corporate governance, or is in an embarrassing situation without authority or just with limited practical effect. Later, people gradually realized the importance of the board of directors to the company. Although it was called by different names from all walks of life at that time, according to its functions, it had a preliminary form of the board of directors in modern companies, which was reflected in the *Corporate Law* in the late Qing Dynasty and the *Corporate Law* promulgated by Nanjing Kuomintang Government in the Republic of China. On the premise of determining the basic structure of modern companies, the *Corporate Law* in the late Qing Dynasty separately stipulated the establishment and authority of directors in companies in the fourth section, which was in sharp contrast with the previous practices and reflected the emphasis on the board of directors system, a historic leap of the board of directors system in China. In 1929, Nanjing Kuomintang Government promulgated the *Corporate Law*. After the implementation of this law, the companies established before and after set up corresponding corporate organizations following the provisions of directors and the board of directors in the *Corporate Law*. Some companies have made specific provisions on directors and the board of directors in their articles of association. Besides, some companies have also formulated rules of procedure for the board of directors to refine its functions. [3] The *Corporate Law* of Nanjing Kuomintang Government provides historical experience for the further development of the board of directors in China to a certain extent.

Since the promulgation of China's *Corporate Law* in 1993, the board of directors system has entered a period of formation and perfection in China. In essence, Modern Chinese *Corporate Law* has the obvious characteristic of legal transplantation. For example, the "single-head system" in Northeast China, the introduction of the Soviet enterprise model in 1945, and the "modern enterprise system reform" promoted from top to bottom after 1992 all have evident institutional reference, [4] which is rooted in the development model of compulsory system change of *Corporate Law* in China and the objective fact that *Corporate Law* started late with a poor foundation. This legal transplantation has played an important role in guiding the rapid and orderly development of Chinese companies after the reform and opening up, but it also has obvious historical limitations. In particular, the Chinese board system that is mixed with the German monistic board system and American dual board system has left hidden dangers for the follow-up improvement of Chinese *Corporate Law*. In 1993, China's first *Corporate Law* established the basic model of the board of directors system and constructed the basic direction of the future Chinese board of directors on this basis. Then, in the first revision of the *Corporate Law* in 1999, it perfected the supervision mechanism of the power exercise of the board of directors through the provisions of "supervisors attending the board meeting as nonvoting delegates" and "directors, managers, and financial leaders shall not concurrently serve as supervisors", reflecting the tendency of state intervention in the board system. In the third revision of the *Corporate Law* in 2005, the provisions of "the qualifications and obligations of directors, supervisors, and senior managers of the company" were added in the sixth chapter, which improved the division of functions and powers between the board of directors and other organizations of the

company to provide institutional guarantee for the protection of shareholders' rights and interests. After that, several revisions of the *Corporate Law* only took advantage of the former law. On the issue of the board of directors system, it still firmly maintains the original model, but this is contrary to the current social and economic development as well as the appeal of the majority of companies.

2.2 Present Situation of the Board of Directors System of Limited Liability Companies in China

The Corporate *Law* of our country divides the company into the limited liability company and the joint stock limited company. Because of the different positions, the problem of these two types of companies cannot be generalized. This article focuses on the problem of the board of directors system of the limited liability company. The reason is that people's focus on joint stock limited companies with strong openness tends to be unified, typically the listed companies and large-scale joint stock limited companies. In other words, under the economic integration and mass economies when the company expands and the company structure continuously develops from U-type to M-type, the three orientation modes of the board of directors are the board of directors as strategic management, the board of directors as strategic management and relationship investor power alliance, and the board of directors as a supervisor and system maintainer.[5] As for some less open joint-stock limited companies, they generally refer to the arrangements of other joint-stock limited companies. However, for a limited liability company with strong closure, there are great divides in the academia regarding the regulation of its board of directors in the current *Corporate Law*. The corporate governance structure of limited liability companies in China is usually in the form of three main bodies, that is, the board of shareholders (authority organization), the board of directors (management decision-making and business execution organization), and the board of supervisors (supervision organization). The board of directors in China is the executive body in power distribution and the decision-making in daily functional operations. However, the current *Corporate Law* is blind to how to ensure the normal operation of the power of the company manager, that is, the board of directors, and how to solve the conflicts between the board of directors and the power of other corporate organizations. This situation is particularly prominent from the perspective of limited liability companies, which is embodied in two aspects. On the one hand, the power distribution between the board of directors, the board of shareholders, and the board of managers of limited liability companies are vague under the *Positivist Jurisprudence.* Meanwhile, the board of directors and the legal representative system are actively conflicted. On the other hand, the board of directors of limited liability companies with strong closeness in commercial practice has some defects, such as low efficiency, waste of resources, false organization, etc., which conflicts with the positioning of limited liability companies that pay more attention to corporate autonomy and operating efficiency. Therefore, with the further in-depth market-oriented reform in the post-epidemic era, it is imperative to reform the board of directors system of limited liability companies in China.

3. Problems Faced by the Board of Directors System of Limited Liability Companies under the Positivist Jurisprudence

As far as the board of directors system is concerned, China not only defines the nature of the board of directors vaguely, but also exposes many deficiencies in its independence, specific function setting, and authority distribution with other corporate organizations. Because the establishment of the board of directors of open companies has certain commonness from the perspective of *Comparative Law*, its contradiction is relatively moderate. But as for the closed limited liability company, its board of directors system in the following three aspects of the problems need to be solved.

3.1 Vague Power Distribution Between the Board of Shareholders and the Board of Directors

The board of directors in a limited liability company, as a legal decision-making body, should have considerable independent decision-making power on the strategic management, risk control, and

business plan of the company. However, because the promulgation of the *Corporate Law* of China was born up against the reform of state-owned enterprises, although it was nominally transformed into a corporate form over a long period, a large number of state-owned units still exercised dominant power, which leads to the prevalence of shareholder centralism in China to a certain extent. Thus, shareholders tend to regard the company as their property, and the separation of ownership and management rights is not clear in corporate governance, especially in limited liability companies with a strong combination of human resources and capital. At the same time, there is no specific response to this problem in several amendments to China's *Corporate Law*. In the *Positivist Jurisprudence*, the functions and powers of the board of shareholders and the board of directors of limited liability companies are vague, thus the existing space of the board of directors in the system is almost invaded.

Articles 37 and 46 of the current *Corporate Law* stipulate the terms of reference of the board of shareholders and the board of directors of a limited liability company, with specific provisions shown in Table 1.

Table 1. Terms of Reference of the Board of Shareholders and the Board of Directors

Content of Authority	Board of Shareholders	Board of Directors
Corporate operating policy and investment plan	Decision Making	
Corporate operation plan and investment plan		Decision Making
Annual corporate plan of financial budget and final accounts	Consideration and Approval	Formulate
Corporate plan of profit distribution and loss compensation	Consideration and Approval	Formulate
Corporate increases or decreases its registered capital	Resolution Making	Plan Making
Issue corporate bonds	Resolution Making	Plan Making
Merger, division, dissolution, liquidation, or change of corporate form of the company	Resolution Making	Plan Making
Residual general power	Other functions and powers stipulated in the articles of association of the company	Other functions and powers stipulated in the articles of association of the company

It can be seen from the above table that the board of directors in the current *Corporate Law* has almost no exclusive power over the distribution of powers between the board of shareholders and the board of directors, which only plays some procedural roles. The characteristics of human cooperation in limited liability companies further enlarge this problem.

On the one hand, the board of directors has no independent authority. The current *Corporate Law* endows the management and investment power of the company to the board of shareholders and the board of directors, which leads to the fact that the board of directors makes a difference in the procedural participation of the board of shareholders. However, it does the same thing as the board of shareholders, which will lead to low efficiency and waste of resources. Even though *Corporate Law* uses two pairs of terms to highlight their difference in company management and investment, including "business policy and business plan" and "investment plan and investment scheme", it still cannot make it clearer. As for a joint stock limited company, it is difficult to distinguish their functional boundaries, let alone a limited liability company with highly overlapping shareholder status and director status. In addition, "'Policy, Plan' and 'Plan, Scheme' may be various for corporate legislators and theoretical researchers, but for corporate managers who are exposed to the rapidly changing market competition environment, they may be alienated into reasons for rash advance or excuses for dereliction of duty." [6] As for the corporate annual plan of financial budget and final accounts in the corporate daily operation and management, the board of directors only has the power to make preliminary plans for the corporate profit distribution, loss compensation, and the increase or decrease of the corporate registered capital, so does the issuance of corporate bonds, the merger,

division, dissolution, liquidation, or the change of company form. The final decision-making power (i.e., the right to review and approve) is all concentrated on the board of shareholders. What the board of directors does can be done by the board of shareholders and the board of directors has no independent authority. Thus, its status is easy to be questioned. The current *Corporate Law* also transfers the residual general power of the company to the board of shareholders. Although the scope of residual power is not clearly defined in the legislation, it only stipulates that both of them enjoy other powers stipulated in the articles of association. However, the fundamental principle that the articles of association are formulated by the board of shareholders actually gives the board of shareholders the possibility of expanding its power.

On the other hand, the procedural role of the board of directors is weak. The board of directors can only exercise its functions and powers in the initial stage. When the plan is submitted to the board of shareholders, the mission of the board of directors can be described as complete. Procedurally, the board of directors is only the front body for the board of shareholders to review the plan without the right to speak for the final introduction of the plan. The serious imbalance between the power and responsibility of the board of shareholders and the board of directors leads to greater responsibility than the power of the board of directors with excessive criticism. Eventually, the board of directors gives the controlling shareholder the right to make the major decisions of the company, which makes the board of directors become a tool of the board of shareholders and loses its procedural independence. In a word, the vague distribution of the functions and powers of the board of shareholders and the board of directors in the current *Corporate Law* undercuts the functions and powers of the board of directors, and then shakes the necessary foundation for the existence of the board of directors as an independent part of the company.

3.2 Power of the Board of Directors Plundered by Managers

Article 49 of the current *Corporate Law* stipulates the functions and powers of the manager of a limited liability company, which overlaps with that of the board of directors to a certain extent. The specific provisions are shown in Table 2.

Table 2. Terms of Reference of the Manager and Board of Directors

Content of Authority	Manager	Board of Directors
Annual business plan and investment plan of the company	Plan Implementation	Decision Making
Production, operation, and management of the company	Presiding	
Setting scheme of internal management organization of the company	Drafting	Decision Making
The basic management system of the company	Drafting	Decision Making
Specific rules and regulations of the company	Formulate	
Personnel appointment and dismissal	Request the appointment or dismissal of the deputy manager and financial officer of the company; Decide on the appointment or dismissal of management personnel other than those to be appointed or dismissed by the Board of Directors	Decide on the appointment or dismissal of the corporate managers and their remuneration, and decide on the appointment or dismissal of the corporate deputy managers, financial officers, and their remuneration upon the nomination of the managers

It is not difficult to see from the above table that while the decision-making function of the board of directors is gradually weakened, the rising managers also challenge the executive function of the board of directors. As for corporate personnel management, production, and operation affairs, the

managers grasp the power of presiding over, implementing, drawing up, etc. on their own, leaving only the board of directors with the power to decide. At the same time, in terms of personnel management, managers skip the board of directors and have the right to appoint or dismiss other responsible management personnel of the company. This makes the board of directors more unable to control the company and further subject to the managers. "As the executive organ of the company, the manager has the legal power, which is not conducive to the centralized management of the board of directors." [7] After the power of basic management systems such as strategic management of the board of directors was transferred to the managers, that is, after the managers plundered the power of the board of directors, the board of directors further became a virtual institution between the board of shareholders and the managers.

3.3 Legal Representative System Seriously Impacts the Status of the Board of Directors

A legal representative refers to the person in charge who exercises his functions and powers on behalf of a legal person according to the law or the articles of association of a legal person. As a basic system in civil and commercial laws, the legal representative system is widely adopted all over the world. The provisions of the legal representative system of a company in China are mainly reflected in Article 81 of the *Civil Code* and Article 13 of the *Corporate Law*. Article 13 of the *Corporate Law* stipulates that "the legal representative of the company shall be the chairman, executive director, or manager in accordance with the provisions of the articles of association of the company, and shall be registered according to law", limiting the scope of a legal representative in Chinese companies to the chairman, executive director, or manager. The legal representative represents the company to the outside world, which provides convenience for the operation and management of the company as well as the trial execution of the court in the early stage of the company. However, with the development of the times, its drawbacks are gradually revealed, especially in limited liability companies.

"If the board of directors is to be at the center of corporate governance, the key is to have the power to represent the company externally and internally". [8] In other words, when there is a statutory or regulatory system in the company that damages the overall power of the board of directors to represent the company externally or internally, its operating mechanism and independent foundation will be infringed. The legal representative of a limited liability company not only has an impact on the position of the board of directors in the company, but also replaces its external representation. Specifically, the internally legal representative of a limited liability company damages the basic principle that the board of directors adopts the mode of co-management and collegiality. "The legal representative who bears extensive external responsibilities and occupies the first position cannot have the same actual status as other directors who only participate in collegiality, which leads to the imbalance of the position in the collegiality of the board of directors." [9] At the same time, when the board of directors has to obtain the external business information and internal management control of the company through the legal representative, it will weaken the function of the board of directors in centralized management of the company, thus making the legal representative system have a serious impact on the internal position of the board of directors. Externally, the legal representative is independent of other institutions of the company, whose power of business decision-making and implementation does not come from the authorization of the board of directors, but is expressly stipulated by law, impacting the overall position of the board of directors on behalf of the company. The legal representative independently engages in foreign civil and commercial activities in the name of the company. Its scope covers a series of important matters in the process of production and operation of the company, which causes the third party to only pay attention to the legal representative of the company and ignore the board of directors. Besides, it produces a series of problems such as whether the legal representative of the company has the effect of an unauthorized guarantee. As a result, the legal representative of the company encroaches on the independent external status of the board of directors, which makes the board of directors seem dispensable under the impact of the legal representative system.

4. Challenges of the Board of Directors System of Limited Liability Company under Commercial Practice

Articles 44 and 50 of the current *Corporate Law* stipulate that a limited liability company has a board of directors with three to thirteen members. However, a limited liability company with a small number of shareholders or a small company may have an executive director instead of a board of directors. Compared with the initial legislation of *Corporate Law*, the state gradually liberalized the board of directors system of limited liability companies to achieve the expected ideal governance effect through autonomy according to their conditions and circumstances. But on the whole, the board of directors or executive directors is necessary for the legislation in the governance of limited liability companies.

4.1 Theoretical Root of the Realistic Conflict of the Board of Directors System: Contradiction Between Company Autonomy and State Compulsory

The attribute of *Corporate Law* determines that it contains two kinds of system values, including autonomy and compulsory, so it needs to realize a kind of value balance. In fact, according to the "autonomy of private law" and "company contract theory", a company, as an enterprise in the form of an organization established by mutual investment among shareholders, is formed for profit, meeting the needs of the market economy, and socialized mass production. It is allowed to give full play to private law autonomy instead of imposing too much intervention. Company autonomy pursues efficiency, freedom, and the autonomy of will, which is the necessary condition for the survival and development of a company. Corporate autonomy can realize the rational allocation of resources, and its main body can satisfy its own purpose by chasing personal interests, indirectly enhancing social wealth, and promoting economic development. [10] However, as an economic entity based on autonomy, unlimited autonomy will make the company bear greater risks. Although modern companies have set up the board of directors, managers, and other institutions as "think tanks" to guide the rational development of the company and protect the expected and existing interests of shareholders from being damaged. But people's rationality is fundamentally limited, and it is inevitable to make wrong decisions in the face of social and economic turmoil. When a company has an internal or external failure, it is not enough to solve the problem of company failure only by market mechanism or moral concept. For example, the Great Depression of the United States in 1929 was a lesson from the past. It was under the laissez-faire of "liberalism" that the inherent defects of the market economy were exposed through problems such as company failure, which eventually caused the economic crisis. Therefore, it is necessary to rationalize the autonomy of the company through state compulsory at an appropriate time to realize the coordinated development of the company itself and the social economy.

As far as the board of directors system is concerned, the rigid requirements of the current *Corporate Law* are largely the embodiment of national coercion, which requires the board of directors system of limited liability companies and its bottom line to set up an executive director. Even a one-person limited liability company needs the existence of an executive director. In most cases, it is often concurrently held by the investor shareholders of the company. The compulsory requirements of the state for the system of the corporate board of directors are subject to the specific situation of the emergence and development of our *Corporate Law*. First of all, "China's existing *Corporate Law* is actually the product of taking into account foreign company legislation experience and China's national conditions". [11] As an exotic product, the board of directors' system was completely accepted in the process of legal transplantation in China, which made the board of directors' system in China mixed with the German unitary board of directors' system and the American dual board of directors' system, causing many problems. Secondly, the legislative thought of legal paternalism [12] is particularly obvious under China's *Corporate Law*. The reason is that the *Corporate Law* of China is not spontaneous development without going through the stage of social exploration, but the product of social reform from top to bottom. After the establishment of the socialist market economic system

in 1992, China quickly changed from a planned economy to a market economy, which emphasized breaking old ideas and concepts. Therefore, the background of the *Corporate Law* issued in 1993 is not only to serve the reform and opening up, but also to guide some market players to transform into corporate enterprises stably and effectively, so as to ensure the smooth progress of the reform of the market economic system. Finally, the reform of state-owned enterprises began in 1993, which made state-owned enterprises eager to connect with the international community. Because of the particularity of state-owned enterprises, the board of directors is indispensable. On the one hand, the board of directors plays a complementary and alternative role to the original "factory director responsibility system", which helps state-owned enterprises to improve quality and efficiency; On the other hand, the public nature of state-owned enterprises determines that they need a more perfect governance structure, so the necessity of the board of directors system is deeply embedded in the specific historical environment at that time.

With our society entering a new era, corporate governance and development will surely enter a new stage, the existing foundation of the original board of directors system being questioned. To build a socialist market economy with Chinese characteristics, it is imperative to localize the legal system, and the reference to foreign company legislation experience in the original legislation should be properly discarded. Nowadays, *Corporate Law* pays more and more attention to corporate autonomy, and the board of directors system should start from the perspective of corporate autonomy. After the reform and opening up, the modern company system has developed in China for 30 years and the domestic market has already accumulated a lot of experience in commercial activities. If we continue to restrict the structure and mode of corporate governance mechanically, it will do more harm than good. The *Corporate Law* has completely broken away from the background of state-owned enterprise reform and its main purpose of serving state-owned enterprises has ceased to exist, which has become a law serving general market subjects, instead of being used as the general and universal basis for the existence of the board of directors. Getting rid of the shackles of the past, the government simplifies administration, decentralizes power, and gives more choices to market players to decide for themselves, which is the ideal trend of the future board of directors system.

4.2 Concrete Manifestation of the Actual Conflict of the Board of Directors of a Limited Liability Company at Present

It is precisely based on the contradiction between corporate autonomy and state compulsory in the board of directors system of limited liability companies in the current *Corporate Law* that leads to two conflicts in the board of directors system in reality. Firstly, the composition of the board of shareholders and the board of directors is highly competitive. Secondly, the value of the existence of the fact of the board of directors is weakened by the phenomenon that Chinese social culture enhances the human nature of limited liability companies.

First of all, in practice, the board of shareholders and the board of directors of limited liability companies often have one team with two systems. Although the current *Corporate Law* stipulates the board of directors system of limited liability companies, for some limited liability companies with weak openness in practice, its owner or the shareholders of the company has a high degree of intervention in the company's operation and management. Besides, the separation of the two rights is not clear, which leads to the fact that the business practice tends to be the opposite of legislation in the setting of its board system. Specifically, it either evades the setting of directors or only sets up an executive director but is held by major shareholders without introducing external managers. Or even if the board of directors is set up, the position of chairman is held in the hands of major shareholders. Major shareholders put forward plans as executive directors or chairman of the board of directors through their controlling position, and then approve them as shareholders. They rarely hold the board of directors meetings and cannot form effective resolutions, thus overhead the power of the board of directors of limited liability companies, resulting in the nominal board of directors in their companies.

In recent years, more and more attention has been paid to the disputes arising from this and some scholars have done considerable research on it. From a practical point of view, under the current

market economy conditions in China, most limited liability companies are not large in scale. From the perspective of the cost of corporate governance, major shareholders are sensitive to the cost preference of corporate governance, because excessive governance costs will reduce the profit distribution of shareholders. And in order to ensure their control over the company, major shareholders are more willing to hold the position of the board of directors or executive director in their own hands. Meanwhile, most of them directly serve as directors, managers, supervisors, and other management positions. The decision-making power of the company is directly in the hands of shareholders, with shareholders and directors highly overlapping. In China's limited liability companies, more than 90% of shareholders serve as directors, managers, and other senior executives. [13] An empirical study on the governance of limited liability companies in Quanzhou, Fujian Province shows that among the 46 limited liability companies surveyed, 32 companies have no board of directors, accounting for 69.6%. There are 46 companies whose directors are all shareholders, accounting for 100%. [14] Under this commercial practice, the composition of the board of shareholders and the board of directors of limited liability companies are highly competitive, which makes a series of plans such as the company's business plan nominally proposed by the executive director or board of directors and approved by the board of shareholders. However, it is in fact handled by the major shareholder who is also the executive director or chairman.

Secondly, under the social culture of attaching importance to human communication in China, the localization of *Corporate Law* highlights the human nature of limited liability companies, and the value of the board of directors is weakened. As a new system introduced in the reform of legalization of companies in China, under the general practice that the popularity of shareholders in limited liability companies is higher than the awareness of rules, it is naturally difficult to realize collective power without a standardized decision-making procedure in the board meeting, which leads to the ineffective operation of the board of directors. It can be embodied in the secular life order of the Chinese board of directors, where emotion often repels rationality and directors identify others to shield themselves for the sake of avoiding mistakes and repaying gratitude. Then it leads to the ritualization and empty shell of the board of directors meeting. Most of the board of directors' meetings have many topics with very short-lasting time, which are often unanimously passed by a high vote as a common ritual. [15] It can be said that at this time the value of the factual board of directors is no less than nothing and the board of directors' system of limited liability companies has become a mere formality.

5. Concrete Path of the Reform of the Board of Directors System of Limited Liability Companies

5.1 Comments on Existing Schemes: "Abolition Theory" and "Reservation Theory"

Given the problems existing in the board of directors system of limited liability companies in China at present, academia has put forward many suggestions, which can be roughly summarized into two schemes, including "abolition theory" and "reservation theory". The main point of "reservation theory" is that for small and medium-sized enterprises, the board of directors can provide resources for the development of the company, so its establishment is necessary for the company. Besides, both limited liability companies and joint stock limited companies should take this as the principle. In addition, the "reservation theory" holds that the restrictions on the functions and powers of shareholders, managers, and legal representatives are enough to fill the loopholes in the current board of directors system of limited liability companies, so there is no need to abolish them. On the contrary, the "abolition theory" holds that the current high-cost and low-efficiency deliberation mode of the board of directors is in a dilemma between the board of shareholders and the managers. To abolish the board of directors once and for all, we should give full play to the characteristics of human cooperation of limited liability companies and make them more flexible in the system. Furthermore, we should encourage limited liability companies to give full play to the potential of corporate autonomy and better respond to the problems existing in their board of directors at present.

As far as the "abolition theory" is concerned, its advantage lies in abolishing the board system in limited liability companies, which is conducive to giving direct support to the majority of limited liability companies at the legislative level, and then encouraging them to seek autonomy, improve efficiency, and meet practical needs. On the one hand, under the *Positivist Jurisprudence*, the abolition of the board of directors system of limited liability companies is conducive to solving the conflict of authority between the board of directors and the board of shareholders, managers, and legal representatives in the original legislation, optimizing the corporate governance structure and improving the operational efficiency of the company. On the other hand, in commercial practice, abolishing the board of directors system can make shareholders directly control the company and improve the efficiency of capital utilization. However, its drawback lies in the thorough abolition of the board of directors system of limited liability companies, which may be counterproductive to some limited liability companies. In fact, there are also problems in abolishing the board of directors system directly and emphasizing the human cooperation of limited liability companies blindly. For example, although a wholly state-owned company belongs to the sequence of limited liability companies, its special status determines its special needs. For example, State Grid Co., Ltd., which is related to the lifeline of the national economy and national energy security, requires it to have a more standardized corporate governance structure due to its important social and industrial status. Wholly state-owned companies have abundant funds and huge scale, but also need to bear social responsibility, which requires them to adopt more perfect practices in governance mode, otherwise, it will deviate from its positioning and reality, unfavorable to the socialist market economy. In addition, abolishing blindly is going to another extreme of compulsory. If the board of directors of limited liability companies is completely banned by legislation, it will become a disguised restriction on corporate autonomy.

As far as reservation theory is concerned, its advantage lies in that the board of directors, as a part of the company, still has certain interests for limited liability companies in terms of its actual effect, even though there have been some obstacles. The board of directors supervises and manages the operation of the company on behalf of shareholders as well as supervises the strategic decision-making and implementation of the company. When there are problems in the management of the company, the intervention of the board of directors can reverse the situation in time. If a company wants to grow and develop, a professional board of directors is essential in the long run. However, its drawback lies in that although its system is expected to be very perfect, the positions of executive directors or board members of limited liability companies with weak openness in commercial practice are often divided by shareholders, with the board of directors being a virtual institution. At this time, it is unrealistic to abide by the principle that the board of directors must be set up.

5.2 The Third Way: Board of Directors with Optional Settings

Based on the advantages and disadvantages of the above two schemes, combined with the general situation of the development of limited liability companies at present, the author thinks that we can consider giving limited liability companies the power to set up the board system selectively, that is, whether to set up the board of directors or not is up to the company itself. *Corporate Law* only provides the "model rules" of the board of directors system for selection.

"The system design of each company should not only adapt to the complex and ever-changing economic and social environment, but also meet the different needs of different transaction types." [16] From this point of view, the starting point of corporate system design should be the actual demand of the market. Based on legal economics and company contract theory, commercial organization law has obvious model law attributes, which can provide a cooperation template and compensation mechanism to fill contract loopholes, allowing the parties to be autonomous in private law. [17] Companies meet their production needs through continuous contracting to the outside world, and it is natural to allow them to choose their organizational structure through contracting within the company. Therefore, it is an urgent need for the reform of *Corporate Law* to set up corresponding mechanisms, so that China's limited liability companies can independently choose whether the board of directors is set up or not. When the systems of shareholders, managers, and legal representatives

in a limited liability company impact the authority of the board of directors and the majority of limited liability companies exclude the establishment of the board of directors under commercial practice, especially the necessary remedial measures cannot be exercised, allowing limited liability companies to make selective modifications to the establishment of their board of directors system in the form of articles of association will not only help solve the conflict between law and practice, but also help limited liability companies get rid of bondage and tackle problems easily.

On this issue, Article 70 of the new round of *Corporate Law* (Revised Draft) stipulates, "A small-scale limited liability company may have a director or manager without a board of directors to exercise the functions and powers of the board of directors as stipulated in this Law". This clause provides the possibility of assigning the original authority of the board of directors to the managers, which has achieved a certain breakthrough based on the existing legislation, but it still needs to be further expanded and improved. The author thinks that the option of setting the board of directors system of a limited liability company can be completely handed over to its owner shareholders, and it is not limited by the "relatively small scale" in the *Corporate Law* (Revised Draft). The reason why it is not restricted by the "relatively smaller scale" is that it is not a mature concept in *Corporate Law* and lacks legal system interpretation without traces in the existing judicial interpretation, which is too subjective. After deleting the restriction of "relatively smaller scale", a limited liability company can choose to set up a board of directors as a general rule. However, choosing to set up a board of directors does not mean that the original relevant provisions on the establishment of the board of directors system should be deleted, but should be retained to provide model rules for a limited liability company that chooses to set up a board of directors. Meanwhile, this kind of limited liability company can choose according to its wishes regardless of its size, which will also produce questions. For example, some limited liability companies with special status and large scale will not meet the practical needs by canceling the establishment of the board of directors. The author thinks that everyone is the biggest defender of his/her own interests. As for limited liability companies, their owners and shareholders can't turn a blind eye to the damage to their interests, and their choice of corporate governance structure will depend on the actual operation and profit effect of the company. As for special forms such as wholly state-owned companies, it may be a more appropriate model to stipulate that wholly state-owned companies need to set up specific rules of the board of directors through laws other than *Corporate Law*. In addition, it has enough foundation in our country to leave the option of setting the board of directors system to the company itself. Since the implementation of *Corporate Law*, investors in the market have acquired certain awareness and ability to face and bear market risks alone. This concern in *Corporate Law* is also the manifestation of paternalism, which goes against the current market spirit of encouraging autonomy. However, although the shareholders of a limited liability company will choose a scheme that fits the market based on their responsibilities, it also needs certain restrictions, while the restrictions on individuals should be lighter. Therefore, when handing over the option to the company, we should also pay attention to the matching of the corresponding compensation mechanism. When the autonomy and efficiency of a limited liability company are improved, the ways to supervise and solve its problems need to be improved. It is worth paying attention to whether a limited liability company without a board of directors needs to set up a board of supervisors or an audit committee, and whether it needs to strengthen its role.

In a word, the limited liability company whose board of directors does more harm than good because for various reasons can completely cancel the board of directors through the provisions of the articles of association, so as to form a triangular governance structure of the board of shareholders, managers, and board of supervisors within the company. As for the limited liability company which is inclined to set up the board of directors, it reserves the right to continue to set up the board of directors. That is to say, on this issue, *Corporate Law* gives full play to its role as a model law, providing a model for the majority of limited liability companies, but the choice is in the hands of each company itself. It should be noted that not all limited liability companies are small and medium-sized with strong closeness, it is still necessary to set up the board of directors for wholly state-owned companies or limited liability companies with strong openness to a certain extent. Thus, the

establishment of the board of directors should be decided by themselves rather than simply canceled in legislation.

6. Conclusion

Nowadays, the establishment of the board of directors of limited liability companies is not only facing the impact of the system in Positivist *Jurisprudence*, but also has a distinct conflict with commercial practice. It is not feasible for the law to require the establishment of the board of directors or executive directors of limited liability companies. There are still some problems in the inherent solutions, such as treating the symptoms but not the root causes, and it is difficult to meet the actual needs of the majority of limited liability companies. In the new round of *Corporate Law* reform, we should give the company the right to choose whether to set up the board of directors of a limited liability company and clarify the model law attributes of relevant provisions of the *Corporate Law*. For a limited liability company that needs to set up a board of directors, it shall continue to be implemented in accordance with its original provisions. For limited liability companies that choose not to set up a board of directors, it can be stipulated in the articles of association that there is no board of directors and then a triangular governance structure of the board of shareholders−managers−board of supervisors can be formed, so as to help optimize the national business environment and flourish the socialist market economy by improving the internal governance structure of limited liability companies.

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