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Research on Legal Regulation of Performance Commitment Compensation in Major Asset Reorganization of Listed Companies

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Abstract

The purpose of performance promise compensation is to compensate for the uncertainty of the value of the underlying assets in major asset reorganization, which exists dependent on the asset reorganization relationship and includes two major elements, performance promise and performance compensation, which are complementary to each other. Due to improper intervention of administrative power, inadequate information disclosure system, imbalance of regulatory objectives of M&A and restructuring, and poor functioning of intermediaries, supervisory companies have difficulties in the process of M&A such as prominent contradiction of management rights, distortion of M&A and restructuring market, and "de-realization to deficiency". In response to these dilemmas, the existing system needs to update the regulatory concept, diversify the configuration of performance indicators, appropriately adopt profitability payment plans and rationally set up compensation methods, so as to give full play to the institutional function of performance commitment compensation.

Key words

Major Asset Reorganization; Performance Commitment Compensation; Betting Agreement; Profitability Payment Plan

Introduction

With the continuous improvement of China's capital market, major asset reorganization activities of listed companies have become more and more frequent, and major asset reorganization has become an important way for listed companies to achieve strategic goals and integrate resources. However, the asset restructuring activities of listed companies will greatly affect the interests of listed companies, target companies and their shareholders, especially the small and medium shareholders of listed companies, and the transaction price and future profit level of the target assets in asset restructuring become important factors to balance multiple interests. The objective information asymmetry between the parties to the asset restructuring makes it likely that the target company will irrationally make aggressive judgment and description under the trend of interests, resulting in the listing of a larger restructuring risk, and then transferring the risk to the small and medium investors. Based on the practical needs, the "betting agreement" usually applied in the field of private equity is gradually used in the field of major asset reorganization of listed companies on a large scale, in

which the "betting agreement" is manifested in another form, i.e. performance commitment compensation. The performance promise compensation system with typical gaming can play the role of restraining the restructuring parties, and if asset restructuring in the capital market is an important means to promote economic restructuring and industrial upgrading, then the performance promise compensation is given the function of lubricant by the system designer. However, in recent years, the improper application of performance promise compensation has brought about a series of negative effects, and there are cases where the subject company has difficulties in failing to complete the high performance promise and thus dragging down the listed company. In order to better play the institutional effect of performance promise compensation, there is an urgent need to systematically correct its dysfunctional operation.

Basic structure of performance commitment compensation for major asset reorganization

In the process of major asset restructuring, the purpose of performance promise compensation is to compensate for the uncertainty of the value of the underlying assets. When discussing the transaction structure of performance promise compensation, what should not be ignored is the asset restructuring relationship as the basis. As one of the auxiliary mechanisms of major asset reorganization, performance promise compensation has two levels of legal relationship, one is the asset reorganization relationship as the basis, and the other is the performance promise compensation relationship as the derivative mechanism. In order to overcome the negative impact caused by the uncertainty of the value of the underlying assets in the process of asset restructuring, which is a process of re-integration of internal and external business resources, performance promise compensation is created. From the viewpoint of generating relationship, asset restructuring is the cause and performance promise compensation is the result; from the viewpoint of functional relationship, performance promise compensation is the means and asset restructuring is the purpose, which are interdependent and reflect each other, and the transaction structure of performance promise compensation should take major asset restructuring as the starting point.

On the basis of the asset restructuring contract, the performance promise compensation includes both performance promise and performance compensation. Performance commitment is a guarantee for the future performance target of the subject company when the listed company conducts M&A and restructuring activities. The performance forecast number is the core content of the performance commitment, which is a forecast made by the transferor for the operating income and profit level of the subject enterprise within the commitment period according to the operation condition and future development of the M&A subject. Performance commitment is the premise of performance compensation and is the core provision of performance compensation. The achievement of the performance target is the condition for triggering performance compensation, and the existence of performance commitment as a premise makes the implementation of performance compensation based on the evidence.

The performance compensation as the result of performance commitment contains both subject and object, and the subject of performance compensation is the legal subject who undertakes the compensation obligation in the legal relationship of performance commitment compensation. The performance promise compensation

occurs between two parties of M&A transaction, the party who makes the performance promise and undertakes the compensation obligation is the party who transfers the subject assets, generally the shareholders, the actual controller and the management of the target company; however, under special circumstances, the performance promise party in the same or non-identical control holding merger transaction may also be the controlling shareholder of the listed company. The object of performance promise compensation is the payout behavior of the promisor, i.e., paying certain cash or shares to the listed company in accordance with the performance promise compensation when the agreed performance target is not achieved, according to which, the payout behavior of the promisor is generally cash compensation and share compensation or a combination of such compensation. Cash compensation is the compensation in the form of paying a certain amount of cash to the M&A party for the difference of profit and related loss as the performance failure when the actual operating performance of the target company does not reach the promised target within the performance promise period, and share compensation is the compensation in the form of paying a certain number of shares to the listed company by the promisor in accordance with the performance promise when the target company does not reach the target performance within the promise period. Mixed compensation is an agreement in performance promise compensation to compensate in cash and shares according to the difference between actual performance and target performance.

Analysis of the dilemma of performance commitment compensation in major asset restructuring

Institutional dilemma of performance promise compensation

A.The gas pedal of "de-realization to deficiency

From the operation effect of performance promise compensation in practice, it is easy to lead to high promise and high premium, and also easy to lead listed companies to "de-realize to virtualize", i.e. investors gradually shift their investment preference from real economy with slower return to virtual economy in order to pursue more economic return, resulting in the company's gain through financial channels The share of financial income in the total profit of the company and the share of financial capital in the asset allocation of the company are increasing. The phenomenon of "de-realization" of listed companies is mainly reflected in the initial M&A restructuring and after the completion of the M&A restructuring, in terms of the initial M&A restructuring, the industry structure and industrial integration direction of the M&A restructuring can largely reflect the "de-realization" of the M&A restructuring. The industry structure and direction of industrial integration of M&A restructuring can largely reflect the "de-realization" of M&A restructuring. After the completion of the M&A restructuring, the performance patchwork behaviors such as surprise M&A and surplus manipulation to fulfill the performance commitment of listed companies reflect the "de-realization to deficiency" of listed companies. In addition, the application of leveraged M&A in M&A restructuring is also an important manifestation of listed companies' "de-realization", and the irrational and speculative M&A motives behind leveraged M&A will not only lead to operational risks, but also to financing risks and systemic risks.

B.The contradiction of management rights is prominent

Generally speaking, whether performance compensation plays its preset function depends on whether the compensation agreement can be effectively implemented when the performance does not meet the target. In the field of M&A restructuring, the purpose of M&A restructuring by the listed company as an investor is to improve the quality of the listed company and promote product upgrading, so it will access the operation and management of the target company to varying degrees, for example, by controlling the board of directors, supervisory board and general manager of the target company to fully or partially control the operation and management of the target company, and when a performance compensation dispute occurs, the original shareholders of the target company will use the reason of The original shareholders of the target company will not fulfill the performance compensation agreement for the reason that "the listed company interferes with the operation and management of the target company, which makes it difficult to achieve the performance target of the target company".For example, in the case of dispute over capital increase between Kehua Hengsheng Co. and the defendants Sun Jiafeng and Meng Xiaopei, and the third party Shanghai Chenyi Network Technology Co., Ltd, The court of first instance held that the appointment of the executive vice president of Chenyi by Kehua after the completion of the M&A caused changes in the operation of the target company, and therefore Chenyi was not required to fulfill its compensation obligations to Kehua. It can be seen that in practice, there is a significant contradiction between the implementation of performance compensation and the right to operate and manage.

C.Distorting the M&A restructuring market

Compared with the performance compensation regulation in the field of private equity investment, there is a tendency to distort the trading market in the field of M&A and restructuring of listed companies. For example, in terms of transaction subject and transaction structure, the major reorganization of listed companies is more of a "single" regulation, from the perspective of transaction subject, the counterparty of private equity investment is a high-growth and high-risk financier, if there is no clean performance compensation agreement, it will face the risk of being denied listing, while in the field of M&A of listed companies The subject company is a mature enterprise that can improve the quality of listed companies and promote industrial upgrading, with growth and low risk. As the basis for the M&A and restructuring of listed companies, the "Measures for the Administration of Major Assets Reorganization" does not provide for the qualifications and thresholds that the target company should have, which is more of a "one-way" regulation for listed companies. From the perspective of transaction structure, the private equity field can sign compensation agreements with both the target company and the original shareholders of the target company. After the "First Case of Betting Agreement", especially the release of the "Minutes of the National Court Civil and Commercial Trial Work Conference", the court's trial mindset has gradually shifted from effectiveness deterrence to performance control. With a double protection effect, but in the field of listed M&A restructuring listed companies usually sign with the original shareholders of the subject company, and there is only a single layer of protection mechanism, which makes the performance compensation system more difficult to implement and cannot guarantee the landing of high-quality M&A restructuring. Besides, the transaction results of listed restructuring also reflect the distortion of performance compensation for the M&A restructuring market, specifically in that the cognitive bias of transaction subjects who are overconfident about the subject assets and overly optimistic

about the industry prospects distort the M&A restructuring transaction results, leading to the M&A restructuring transaction market failure.

Analysis of the causes of the dilemma of the performance promise compensation system

A.Undue interference of administrative power under major asset restructuring

Improper intervention of administrative power in M&A and restructuring of listed companies is one of the important reasons why the performance promise compensation system is in trouble, including both lack of intervention and excessive intervention. The lack of intervention is reflected in the failure of the regulatory authorities to play their due role in reviewing and supervising the market failure of the M&A restructuring market, resulting in the use of performance compensation to accelerate the market failure again. In the era of "decentralization", more emphasis has been placed on the decisive role of the market, but based on the special characteristics of the listed M&A and restructuring field, such as its public nature and the huge amount of assets involved, it is more likely to lead to market failure, and it is impossible for the government to be absent and not intervene. After the revision of the Measures, the SFC is not required to review major asset reorganization of listed companies with cash payment. Although the relaxation of approval by the SFC has stimulated the market dynamics, there are also negative effects of lower performance and impairment of goodwill after reorganization, which is a reflection of the relaxation and lack of intervention by the executive power. In addition, excessive government intervention refers to the administrative power replacing the role of the market in M&A restructuring transactions. The Administrative Measures on Major Asset Reorganization promulgated in 2008 stipulates the mandatory requirement of signing performance compensation agreements for major asset reorganization of listed companies, replacing the free choice of the market with the mandatory requirement of legislation, making the "price discovery" and "signaling" functions of the performance commitment compensation system The "price discovery" function and the "signaling" function of the performance commitment compensation system are weakened or even alienated.

B.Imbalance in regulatory objectives for major asset restructuring

The alienation and irregularities in the application of performance promise compensation in practice are closely related to the imbalance in the regulatory objectives of M&A restructuring in China. The performance promise compensation aims to promote the conclusion of M&A and restructuring transactions of listed companies and should serve the objectives of securities regulation. Article 1 of the Measures for the Administration of Major Assets Reorganization emphasizes "promoting the quality improvement of listed companies", but this objective is not specific and uncertain. For example, the performance promise compensation may improve the quality of listed companies in the short term, but in the medium and long term, it not only does not improve the quality of listed companies, but also may lay hidden dangers for the development of listed companies. Whether the quality of listed companies is improved after the completion of M&A should take into account the development of the company, industry integration, industrial upgrading, economic restructuring and other factors. From the current M&A and restructuring practice in China, there is no doubt that the performance compensation system has promoted the efficiency of M&A objectives, but the effectiveness has

not been realized, which is related to the imbalance of M&A and restructuring regulatory objectives in China.

C.Inadequate disclosure system for performance promise compensation

Capital markets have significant information-driven characteristics, and the effective transmission of information is one of the important prerequisites for giving full play to the resource allocation function of capital markets.[See Mao Xinshu, Wang Bin, Lin Changquan, and Wang Nan, "Information Disseminators and Capital Market Efficiency", in Economic Research, 2013, No. 10.]Disclosure of information on M&A and restructuring of listed companies occurs after the listing of the company's securities and discloses the relevant information of listed companies to specific subjects or the public. However, in practice, the information related to major asset restructuring is not fully disclosed and the quality of the disclosed information is not high, for example, the disclosure of asset valuation information closely related to the performance promise compensation is its embodiment, and examples of inadequate disclosure of asset evaluation or asset valuation information are very common. Since 2014, securities regulators have started to monitor the compliance operation of information disclosure of listed companies by disclosing inquiry letters of listed companies. Although some studies have shown that the regulatory approach of disclosure inquiry letters can play a positive role in prompting disclosure obligors to improve the quality of information disclosure and improve corporate governance, the inquiry letters, as a non-punitive regulatory measure, lack the protection of mandatory legal liability and exist in practice for a long time, so there is still a need to continuously improve the information disclosure system of listed companies.

Major asset restructuring performance commitment compensation system improvement path

Update of regulatory concept

The performance promise compensation system does not fully achieve the purpose of M&A restructuring implementation regulation, and the protection of investors' interests cannot be solved, and even the situation of infringing investors' interests is presented in different stages of the whole implementation process. In this context, vigorously promoting the market discipline mechanism can help compensate for the information distortion generated by administrative regulation, and the M&A restructuring regulatory system should no longer be limited to the traditional goal of protecting minority shareholders, but should instead strive to achieve the binding incentive effect of performance promise compensation, synergize both parties to the M&A to a common business goal, and allow both parties to profit from the transaction activity in the long run. The institutional assumption behind performance-based compensation that securities transactions are "sure-fire" is not consistent with the fundamental attributes of a market economy of self-determination and self-responsibility, and open-box M&A activities can provide opportunities for value discovery and management of prudent investments. Therefore, it is necessary to further weaken the application of the system of mandatory performance promise compensation, and give full play to the information transmission function of performance promise compensation and the function of market resource allocation.

Multiple configuration of performance indicators

The "performance" of performance commitment mainly refers to the difference between the "actual profit of relevant assets" and the "profit forecast", and the voluntary performance commitment agreement also takes a single financial indicator as its mainstream. The voluntary performance commitment agreements also use a single financial indicator as their mainstream option, and the indicator of "net profit" accounts for the largest proportion. [See Wang Jingyi, "Research on the Design and Effectiveness of Performance Commitment Contracts of Listed Companies", Doctoral dissertation, Southwest University of Finance and Economics, 2022, p. 50]. At present, the single performance indicator and financial attributes have always been popular options for major asset restructuring of listed companies. Although the financial indicator of "net profit" as the reference system for performance betting has the significant advantage of being observable and easy to compare, the single performance assessment indicator is likely to cause the short-sighted behavior of the subject company, which tries to The attempt to use net profit as the basis for performance evaluation once and for all is counterproductive and creates a potential risk of M&A failure. For this reason, instead of reminding the fear afterwards, it is better to adopt a more diversified performance target beforehand to eliminate the soil of financial fraud, and the design of the terms of non-financial indicators is also conducive to the M&A restructuring purpose of resource integration, and the indicators of core technology breakthroughs, expansion of important customer groups and other indicators that enhance the intrinsic value of enterprises should also be used as indicators of performance commitment, which is conducive to the fulfillment of performance commitment compensation.

Appropriate application of profitability payment plan

The so-called "profitability payment plan" is a contractual method in which the buyer of an M&A transaction does not pay a one-time price or determine a specific acquisition price in advance, but pays/deducts the remaining price to the seller of the M&A transaction in stages according to the completion of the target company's future revenue or other performance indicators. In essence, it is an M&A scheme directly linked to the performance promise compensation, and due to the uncertainty caused by the information asymmetry between the two parties of the M&A restructuring, it is difficult to be solved by the "autonomy" and "entrepreneurship" of both parties. The profitability payment plan becomes an important institutional tool to resolve the knots and doubts of both parties. In practice, a profitability payment plan implies a waiver of the benefit of a realistic period of time to receive payment of the consideration and, instead, an incentive clause designed to allow the seller to demand an accelerated payment obligation if the buyer violates the agreement or the principle of good faith. Therefore, in order to better balance the interests of both parties to the M&A, especially to set feasible incentive terms for the management of the target company, profitability payment plans often set incentive terms for the seller of the M&A transaction, in addition to the agreement on deferred payment of the equity transfer price. In general, profitability payment plans have their advantages, although they have negative effects such as complicated clause design and clause enforcement that may constitute a deterrent to the purpose of the M&A transaction, but such defects are not unique to profitability payment plans, so we do not have to reject their use, which is perhaps a more desirable attitude.

Rational setting of compensation method

The compensation methods of performance commitment mainly include cash, shares, and "cash + shares", and there are divergent views in academic circles regarding the actual effect of such compensation methods, with some views that share compensation has more incentive effect than cash compensation, and some views suggesting that share compensation does not affect M&A performance. For cash compensation, it is argued that if cash compensation occurs too early in the performance commitment period, it will affect the subsequent financing or liquidation ability of the target company and should be taken with caution. In fact, the cash compensation's ability to deliver is always limited by its mechanism itself, while the share compensation is similar to the equity incentive plan, which is intended to tie the counterparty's interests to the listed company. Empirical studies have shown that the incentive effect of performance promise compensation on the management of the target company is not clear, regardless of whether the compensation is in the form of shares or cash. Thus, it can be seen that the multi-dimensional and diversified compensation methods ultimately belong to the negotiation game of the parties to the M&A market transaction, so there is a need for legislative proposals such as the menu type, which should give more freedom of choice to the parties to set the compensation methods rationally on their own according to the corporate strategy, negotiation position, etc.

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