Analyzing the Adoption, Features, and Hurdles of VIE Models in the Internet and Finance Sectors

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Abstract. In China in the past few years VIE structure into the Chinese market, in China many foreign country restrictions and their own lack of development in the industry development, at the same time because of foreign investors to let China's relatively backward industries to provide technical and financial support, China's rapid development, but in recent years also exposed some shortcomings, such as tax evasion and legal non-certification and other issues, but also proved that the VIE structure in different industries, both advantages and disadvantages. The following is an analysis of the advantages and disadvantages of using VIE structure in Internet and financial industries. We used to find the leading companies in some industries to make comparisons in order to find out the crisis and opportunities of VIE structure in different industries, and we summarized the crises and opportunities in different industries to find out the similarities and differences, and we put forward our own viewpoints according to their crises.

Keywords: VIE models, Internet, Finance.

1. Introduction

With the rapid development of the Internet and financial industry, many enterprises in China are eager to be listed, the emergence of the VIE architecture provides an opportunity for China's major enterprises to go to the United States listing, it can help Chinese enterprises avoid tax listings, change the listing environment, re-shape the current pattern. But because of its lack of clarity and many other problems, how to solve the management of VIE infrastructure became a new direction of development. This article is mainly aimed at comparing the differences on the internet and financial spheres of VIE architecture, to introduce the use, characteristics and challenges of VII architecture. Finally, through the analysis of phenomena summary, explore the new strategy for VIE management, further clarify the direction of future Chinese enterprise listing efforts, can be provided to lawmakers and relevant management departments reference.

2. Analysis

2.1. Elaboration

2.1.1 VIE in the Internet Sector

According to Fredrik's statistics on Chinese companies listed in the U.S., it was found that out of a total of 230 Chinese companies listed in the U.S., 42% of them used a VIE structure [1]. Among them, VIE structure is especially common among Chinese companies listed on NASDAQ, accounting for as high as 53% [2]. It can be said that without the VIE structure, China's Internet boom would not have been possible. And the VIE structure was first used in 2000, when Sina successfully listed on the NASDAQ for the first time. Since then, a large number of Chinese Internet companies, such as Sohu and Baidu, have been successfully listed abroad in this way [3]. Alibaba is one of the most successful companies in China's Internet industry in the use of VIE structure, the next step is to analyze the model of Alibaba's VIE structure to study the application of VIE structure in the Internet field. From the chart(Figure 1), we can see the overall operation model of VIE structure used by Alibaba. Its attempt to list on the Hong Kong Stock Exchange in 2014 was rejected and then switched to the New York Stock Exchange, after which it became one of the largest IPOs in the U.S. market, with a market capitalization of $288.6 billion at one time [4]. Due to the advantages of the VIE structure, Alibaba attracted many investors at an early stage, and on the basis of sufficient start-up capital, it adopted a perfect management and operation model and invested the funds raised in its own e-commerce industry chain after listing, which enriched Alibaba's own internationalization and won the trust of foreign investors, and ultimately became one of the largest Internet companies in China in today's fast-developing Internet field. Alibaba has become one of the largest Internet companies in China today with the rapid development of the Internet field.

The business model of Internet companies is different from that of traditional companies. They need a lot of capital investment in the early stage, such as burning money on advertising and capturing the market, which makes it almost impossible for them to make a profit, and there is a serious lag in the manifestation of profits. Therefore, this creates a contradiction. Without profit, they cannot go public, and without going public, they cannot continue to expand the market. Compared with the domestic capital market, the U.S. capital market has a hundred years of history and is more mature, so it generally does not overly scrutinize a company's profitability, and as long as the listing materials are sufficient, it can basically be listed. Therefore, most Internet companies choose to go to the United States, where the threshold is lower. For Internet companies, time is life. Judging from the VIE incident, the regulatory path of the overseas financing phenomenon tends to have first-mover timing and financial advantages, which often leads to winner-take-all. However, a delayed IPO could mean a rearrangement of industry rankings. Some industry players in China, such as the Internet and media, may need a lot of financing in the early stage, but the institutional design of China's capital market is hardly able to meet the needs of Internet companies due to poor domestic financing channels, high thresholds for listing on the a-share market, complicated procedures and stringent requirements, and difficulties in raising capital. Comparatively speaking, the capital market of the United States and other western countries is more mature, with simpler listing procedures and faster financing. Therefore, through the construction of VIE framework, a large number of private enterprises in China have been able to successfully go public out of China, so as to obtain financing and realize further development of enterprises [5].

On August 8, 2006, six ministries and commissions, including the Ministry of Commerce, the Securities Regulatory Commission and the State Administration of Taxation, jointly issued the "Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors" ("Decree No. 10"), in which the provisions relating to "connected mergers and acquisitions" were The provisions on "connected mergers and acquisitions" are seen by the industry as a tightening of the approval of indirect overseas listings by domestic Chinese enterprises (connected mergers and acquisitions are a common transaction structure used by domestic Chinese enterprises to raise funds overseas). The regulations stipulate that if a special purpose company set up or controlled by a Chinese enterprise or natural person in China acquires a Chinese enterprise with which it has a connected relationship, it is required to submit a report on the merger to the Ministry of Commerce for approval [3].

On September 28, 2009, the General Administration of Press and Publication (GAPP), the State Copyright Administration (SCPA) and the Office of the National Working Group on Combating Pornography and Illegality (OWGCP) jointly promulgated the "Regulations on Implementing the State Council's “Three Provisions” and the Relevant Explanations of the Central Office of the People's Government in Further Strengthening the Approval of Online Games". The Circular on Implementing the State Council's “Three Provisions”and the Central Editorial Office's Relevant Interpretations, and Further Strengthening the Management of Online Game Approval and Imported Online Game Batches", Xinjiaolian No. 13 ("Circular No. 13"), which prohibits foreign investors from engaging in the operation of online games in China by way of sole proprietorship, joint venture, or cooperation, and explicitly stipulates that foreigners shall not actually control and participate in the operation of online games by way of signing related agreements or providing It also clearly stipulates that foreign investors shall not actually control and participate in the online game operation business of domestic enterprises through signing relevant agreements or providing technical support and other indirect means. This is the first time that the Chinese government has prohibited foreign investors from investing in a domestic sector through a VIE structure by way of laws and regulations [3].

In June 2010, the Central Bank issued the Measures for the Administration of Payment Services for Non-Financial Institutions (hereinafter referred to as "Order No. 2"), which stipulates that enterprises engaged in third-party payments must be domestic legal entities, and that the State Council needs to approve the license applications of enterprises with foreign capital components separately. In the second half of 2010, Jack Ma first transferred Alipay's business, which was 100% owned by the Alibaba Group, to Alibaba Hangzhou in two separate transactions, paying a total of $332 million in consideration. After these two transactions, Alipay remained under the control of the agreement. However, in the first quarter of 2011, the central bank sent a letter requesting Alipay to make a written statement about the control agreement. Ma unilaterally terminated the control agreement in May 2011 in order to prevent Alipay from encountering unnecessary risks due to its foreign background when seeking financial licenses issued by the relevant domestic institutions. Jack Ma informed shareholders such as Yahoo and Softbank about the incident the next day and subsequently initiated compensation negotiations. Yahoo's stock fell in response to the news, with a cumulative drop of 28% in the three months following the incident. From the perspective of the VIE structure itself, the case mainly reflects several major risks of the VIE structure: First, policy risk. The central bank issued a non-financial enterprise payment license is required to grant the object of the domestic legal person company, a foreign background or the existence of agreement control situation need to declare for approval, and ultimately by the State Council to decide whether to issue a payment license. At the same time, the agreement-controlled company should also conduct a substantive review before deciding whether to issue a payment license. Second, risk control. Jack Ma was able to successfully complete the transfer of shares of Alipay and interrupt its agreement control with WFOE by adopting a "first cut, then play" approach. Jack Ma interrupted the agreement control between VIE and WFOE on the previous day, and only notified Yahoo and Softbank on the next day, reflecting the limited control of the real shareholders of listed companies with VIE structure over the VIE. Founder Jack Ma did not propose to convene a board of directors' meeting or a shareholders' meeting, and easily bypassed the two major shareholders, Yahoo and Softbank, to persuade the management of Alibaba Hangzhou to interrupt the control of the agreement with WFOE. It can be seen that investors do not have enough control over the interest entities behind the "shell companies" in which they invest [6].

2.1.2 VIE in the financial sector

The Hongkong and Shanghai Banking Corporation (HSBC) was founded in 1866 to provide credit to windows engaged in trade between China and the West. Today, the Hongkong and Shanghai Banking Corporation (HSBC), together with its subsidiaries and affiliates, is one of the world's largest and wealthiest banking groups, with consolidated assets in excess of US$4.2 billion as at the end of 1987; shareholders' funds amount to nearly US$4.2 billion. As at the end of 1987, the Group's consolidated assets exceeded US$4.2 billion; shareholders' funds amounted to nearly US$4.2 billion HSBC has 1,300 branches and offices in more than 50 countries and employs more than 50,000 people around the world HSBC, based in Hong Kong, is the world's number one banking group headquartered in Asia (except Japan) HSBC is ranked among the world's 30 largest banks on the international stage. HSBC's Hong Kong-based China Business Company Limited, part of the Hong Kong and Shanghai Banking Corporation Group, also specializes in consulting services HSBC has long been recognized as an expert in import/export credit, documentary credits and remittances Today, HSBC's specialized China Trade Services program has added new dimensions, such as consulting and assistance with trade practices, correspondence and market conditions The HSBC Group also publishes publications on economic and business statistics and industrial surveys. The HSBC Group also publishes publications on economic and business statistics, industry surveys and newsletters. In addition, HSBC's branches in New York, London, UK and Singapore have opened China Liaison Offices to provide these specialized services to clients in the region [7].

In recent years, with the successive advancement of a number of reform measures, such as interest rate marketization, RMB internationalization, the construction of the Free Trade Zone and the "One

Belt, One Road" strategy, HSBC China, which maintains a leading position among foreign-funded banks in a number of areas, has also ushered in a new opportunity for development. Ms. Brenda Wong said, "China is a strategic market for the HSBC Group. Looking to the future, HSBC will continue to steadily push forward the development of its business in China and leverage its international service expertise to further support China's financial reform and market opening, and to serve the sustainable development of the real economy. HSBC maintains a close business relationship with our strategic partner Bank of Communications, leveraging our respective strengths in China and abroad to provide financial support to Chinese enterprises going global through a wide range of services such as syndicated lending, bond financing, fund management and asset custody." In the future, HSBC will assist in the development of overseas investment and custodian business in the Chinese market," said Ms. Wong. For example, we will help overseas investors to participate in the bond market of the Chinese banking sector." (Continued from page 9O) development concept, the Bank of Import and Export will be based on its own functions and missions, focusing on the promotion of international economic cooperation and support for the transformation and upgrading of the open economy in two major areas, to provide enterprises with more targeted and adaptive policy-based green financial services, and to truly let the green financial concepts to achieve green development. In the field of promoting international economic cooperation, the Exim Bank will further focus its business on supporting the development of foreign trade and cross-border investment, promoting the green "import" and green "export" of enterprises, products and services, and focusing its support on promoting the transformation and upgrading of foreign trade, and optimizing the development of rough and high-market economy. We will focus our support on promoting the transformation and upgrading of foreign trade, optimizing the rough and high-emission trade structure, and proactively coordinating the relationship between trade, investment development and environmental protection. In the area of supporting the transformation and upgrading of the open economy, the import banks will further extend their support chain to the whole chain of research and development, manufacturing, and services related to the enhancement of value-addedness, technological content, and energy-efficiency and environmental protection standards of exported products and "go-go" projects, and make efforts to improve the economic structure adjustment, transformation and upgrading, scientific and technological innovation, and green development, especially in the supply-side structural reform. In particular, we will provide financial products and services in such areas as supply-side structural reform [8].

Risk management system is not yet well organized the risk management department of the Bank of China is in fact a relatively low ranking department, which is subordinate to the business department. Therefore, the warnings given by the risk control department have not been given enough attention. For example, our four major commercial banks all have risk management committees but judging from the soaring Renminbi credit in the first quarter of 2009, the internal risk control departments of the banks may not be able to play much of a role. Moreover, some of the commercial banks in China do not have sufficient awareness of risk, and they have issued a large number of non-performing loans, blindly expanding their business, whereas financial institutions are characterized by a wide range of business, unscientific business processes, high comprehensiveness and complexity, etc. These characteristics are different from the current situation. These characteristics, combined with the actual economic environment, could easily give rise to a large number of financial risks. There is no systematic and scientific performance evaluation policy within banks, making it difficult to prevent moral risks. 3.2 Risk Management Techniques Lack Scientific and Rigorousness At present, risk management of commercial banks in China only relies on the credit officers and supervisors' rough understanding of the industry and enterprises to make subjective judgment and is mainly based on qualitative analysis. Mathematical models for sophisticated risk measurement, such as VaR, have just been introduced into China and their applicability is still in the groping stage. As for the historical data required by quantitative analysis models, commercial banks in China have not paid much attention to them. In the past, banks in China lacked experience and paid much attention to the collection, collation and accumulation of credit data, financial data, default records, loss ratios, etc.

of enterprises and institutions, which resulted in an extreme scarcity of historical data, which is not systematic, and which could not support the establishment of mathematical models and the estimation of the relevant parameters, thus directly restricting the establishment of a risk management model of banks. This directly limits the establishment of a risk management model for banks. 3.3 Single Financial Products and Insufficient Financial Innovation of Chinese Banks Due to the constraints of the current interest rate control and other factors, the direction of financial innovation of Chinese banks mainly focuses on asset business and intermediate business, with intermediate business being the most important one, and the amount of innovation in liability business lags behind the other two types of business. There is a lack of innovative products with the bank's own characteristics and unique advantages; there are more imitative innovations and fewer independent innovations; the support of core technologies for innovative activities is weak; the technical and service contents of products are low; and there is a serious phenomenon of homogenization. 3.4 China's banks have limited means of risk avoidance International commercial banks generally hedge, avoid and transfer systematic risks such as interest rates and exchange rates by buying and selling derivative financial instruments. In China, domestic commercial banks are the main force in the trading of derivative financial products, mainly engaging in self-operated derivative financial instruments business and derivative financial instruments business on behalf of customers, with business varieties including forwards, futures, options, swaps and structured products. At present, China's commercial banks have many restrictions and strict entry requirements, and the trading time of their derivative financial instruments is short, the amount is small and the varieties are few. 3.5 Lack of Risk Management Talents in China Risk management of banks involves highly specialized businesses, products, risk management methods and models, which need to be engaged and managed by a large number of professionals. However, at present, the number of risk managers in the domestic commercial banking market is relatively small, and there is a lack of professionals who are well versed in risk management theories and risk measurement techniques, thus failing to form a professional risk management workforce. 4 Implications and Suggestions for the Establishment of a Risk Management System in Chinese Banks [9]. In the past, once a dispute arises, the only remedy that an investor can obtain is to file a lawsuit and investigate the other party’s liability for breach of contract. However, the VIE model that has been swimming in the legal gray area is very likely to face a situation that is not recognized by the court. In the meantime, the value of investors in overseas companies is short-selled, their interests will be harmed and even basic rights and interests will not be guaranteed by law. So far, there are no public precedents in the domestic courts that directly involve the VIE structure. However, the VIE disputes that were previously decided by arbitration and the jurisprudence that the Supreme Court concluded at the end of 2012, which is very similar to the VIE model, have placed the VIE model very passive position [10].

2.2. Comparison

The common feature of these two industries is that they are listed abroad and can be listed and traded quickly by avoiding the complicated procedures at home. Secondly, China was relatively backward in terms of technology and capital at that time, and the use of the VIE structure could quickly help China to develop the relevant industries, while foreign investors provided capital and technology to learn from. Third, comparatively speaking, the capital markets of the United States and other western countries are more mature, with simpler listing procedures and faster financing. Therefore, through the construction of VIE framework, a large number of Chinese private enterprises have been able to successfully go out of the country for listing, so as to obtain financing and realize further development of enterprises. Fourthly, foreign markets are relatively developed and can be traded a lot, allowing industries to profit quickly.

The Internet industry needs a lot of scientific and technological support, which means that it needs a lot of top talents and capital investment, financial need to look at the exchange rate of the two countries and the international environment, the need to make a relatively reasonable judgment to make the industry profitable. The Internet needs the permission of the Chinese domestic government and must keep the corresponding information confidential, while the financial industry needs to make the information as open as possible and needs to face the pressure of other banks such as China Merchants Bank and Bank of China, and many banks can also carry out foreign exchange, etc., and the background of the Bank of China is the Chinese government, and people will also look at foreign exchange fees to choose the bank, and at the same time, the bank will have a long-term rate of return on investment will be different from bank to bank, and people will choose a bank with a high rate of return. People will choose the bank with high return rate. Internet in China may have some industry famous such as Alibaba, but in foreign countries it is relatively small proportion of the industry, the majority of which is Amazon, so its popularity is relatively small(figure 1).

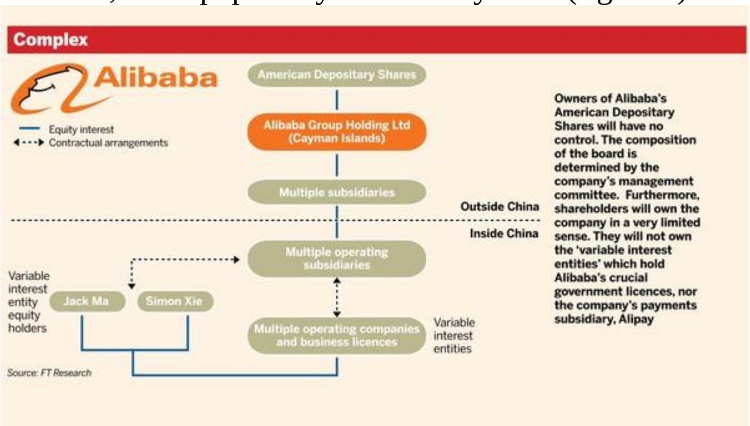

Fig. 1 Case study of Alibaba

3. Conclusion

By comparing the use, characteristics and challenges faced by VIEs in the Internet industry and the financial sector, the author believes that the two industries have the same objectives. At the same time, their listing conditions and background are different. In response to the above results, the author will give the following recommendations. First, integrate strategic management into the tactical implementation. Enhance system inclusive, support enterprise development needs, relax foreign enterprise fundraising restrictions, etc., actively guide overseas listed enterprises into the Chinese financial market, solve the issue of adopting VIE architecture enterprises, give advantage conditions and facilitate program; Second, to integrate the advantages of subsequent developments into the practice of precise positioning. Clear listing standards. For enterprises that are partly threatening the country's financial markets or the existence of equity disputes, do not issue listing abroad, establish domestic enterprises overseas listing supervision and coordination mechanism, strengthen joint supervision, for listing files and security supervision mechanisms to be well linked, and to oversee the supervisory department of oversea securities companies cooperation. Third, clear legal responsibilities, for violations of the procedure of listing to be clear, and strengthen the penalty level, increase the cost of violations. The research results and conclusions can provide relevant legislation developers, domestic and foreign enterprises listing managers and shareholders with reference and recommendation, which is conducive to regulating the listing of Chinese enterprises. However, the study is still unilateral in analysing the common points and differences of the two industries and thinking about the response policy, thinking insufficient depth, and addressing the shortcomings, to propose future development directions: first, to expand the scope of literature research and conduct more in-depth research; second, to refine the research theme; third, to contrast the study of domestic and foreign literature; and fourth, to focus on the combination of theory and practice, conduct experimental simulation analysis, optimize improvement policy.

Authors Contribution

All the authors contributed equally and their names were listed in alphabetical order.

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