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BOOK REVIEW

Venture Capital Law in China

by Lin Lin, Cambridge University Press, 2021. 356 pp. Hardcover: £ 85.00

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Despite having a relatively short history as compared to its western counterparts,[1] China's venture capital (VC) market witnessed an impressive growth in recent years. With 29.4 per cent of global VC injected into Chinese start-ups in 2018, China's VC market has become the second largest in the world in terms of deal value, attracting both domestic and foreign investors with immense opportunities and ever-increasing technological innovation.[2] However, the law and practice of VC in China has not been sufficiently examined in academic writings despite its size and significance as well as the immense potential for legal research. There was a lack of discussion from a legal perspective as to how the Chinese government played a role in engineering its domestic VC market. In this regard, as a valuable and timely contribution to the scarce scholarship on the Chinese VC industry, *Venture Capital Law in China* fills the gap in the literature with sophisticated and systematic case studies of China. Through an in-depth comparative analysis of the VC markets in China and the United States (US), the author highlights the distinctive legal features observed in the creation and the development of the Chinese VC market, thus providing VC scholars, policy makers, and practitioners with insights into this significant yet poorly understood sector.

Structurally, the book begins with a useful and pertinent introduction to the VC market in China (p 1–43). Chronologically dividing the historical development of the Chinese VC market into five periods, the author argues that the Chinese government has adopted a top-down approach characterized by a regulatory framework consisting mainly of piecemeal interim regulation to ensure the simultaneous availability of investment capital, specialized financial intermediaries, and entrepreneurs – the three essential factors presented in Ronald Gilson's 'simultaneity problem' in the engineering of a VC market.[3]

The following chapters of the book provide a detailed examination of the main stages of a standard VC life cycle including fundraising (p 44–142), investment (p 143–212), and exit (p 213–304) through the lens of the VC market in China. Unique features that exist in VC practice in China have been identified and analyzed in each of the stages. For example, the author includes an in-depth account of the prevalence of the valuation adjustment mechanism ('VAM') agreements in VC contracting in China, which is one of the many peculiar characteristics that distinguishes it from its international counterparts (p 177–185). The author further discusses the reasons for the prevalence of this special contractual design as well as the associated problems (p 186–207) in the context of

[1]See Josh Lerner, *Boulevard of Broken Dreams: Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed – And What to Do About It* (Princeton University Press 2009) ch 3.

[2]Pitchbook Data, 'China Became Second Largest Venture Capital Market by Total Capital Invested in 2018, According to PitchBook Report' (Pitchbook, 19 Mar 2019) <https://pitchbook.com/media/press-releases/china-became-second-largest-venture-capital-market-by-total-capital-invested-in-2018-according-to-pitchbook-report> accessed 4 Jun 2021.

[3]Ronald J Gilson, 'Engineering a venture capital market: lessons from the American experience' (2003) 55 Stanford Law Review 1067–1103.

China. In addition, these chapters are successful in critically examining the current legal landscape for the Chinese VC sector and highlighting the specific issues and shortcomings found in the existing regulatory framework. Accordingly, suggestions for legal reforms are proposed by the author to address these concerns to facilitate the future development of VC in China in light of the evolving demands and challenges of the market.

The book concludes with an interesting and insightful discussion of the factors contributing to China's success in creating a rapid-growing VC market within a relatively short time frame in spite of various limitations on the country's legal and financial systems (p 305–311). While emphasizing that engineering a VC market is highly context-specific and must be tailored to the varied circumstances of each country, the author also extracts lessons of general applicability from the Chinese experience (p 311–316), and explores the ways forward for China's VC market in the form of law and policy reforms (p 316–322).

An informative, insightful, and stimulating work, *Venture Capital Law in China* significantly contributes to the academic literature concerning VC and Chinese law in three unique and meaningful ways.

First, the book offers a unique perspective by critically analyzing the role that law and governmental intervention plays in the creation and the development of a VC market in the context of China, which sets it apart from existing books and articles that focus on other jurisdictions and those that are written from an economic perspective. In particular, the author provides a balanced view by evaluating both the positive and negative impacts of the VC market brought on by the evolving role of the Chinese government in different periods of time. On the one hand, the success of China's VC market can be largely attributed to the effective and timely policies issued by the central government followed by corresponding actions taken by regulatory authorities at all levels. Moreover, the author is the first to offer a theoretical defense of the thesis that, contrary to general international opinion, China has offered strong legal protection for investors as a necessary and pivotal support in creating a conducive environment for the development of the Chinese VC industry, and this has boosted its explosive expansion in the last decade. The book shows that the top-down approach taken by the Chinese government allowed the swift establishment of a solid foundation of institutional and legislative infrastructure through relatively effective and continuous law and policy reforms. On the other hand, the author warns against the detriment of simplistic and excessive governmental interventions when the key VC market infrastructure is already in place. Very often the government's implementation of a one-size-fits-all approach unduly hinders the organic development of the Chinese VC market. This pitfall has been clearly illustrated by the undesirable effects caused by the tightening of licensing for fund managers and the restrictions imposed on initial public offerings (IPOs) by the authorities on VC fundraising and exit in China. In view of this, the author highlights the importance of promptly adjusting the level of government intervention as a country progresses through different stages of economic development. Given the current state of the Chinese VC market, it is sensible for the government to gradually place greater reliance on market forces in the allocation of capital and to refrain from heavy-handed interventionism in the decision-making of market players in the VC sector. Drawing from China's experience, the author thus provides valuable observations and guidance for other jurisdictions wishing to create or further develop their VC markets through appropriate government intervention while harnessing the power of market forces.

Second, the book is probably the first to examine, from a comparative legal perspective, the similarities and differences between China and the US, the two largest VC markets in the world. For example, the author points out that although the limited partnership has been the preferred business form for VC funds in both China and the US, Chinese limited partnership-type funds differ from their US counterparts in the high degree of activism among their limited partners (LPs), the double-general partners (GPs) regime, and the presence of an alternative method of calculating GP compensation (p 45–92). It is important to recognize – as the author does – that law does not exist in a vacuum but 'sits within a culture'.[4] Built on the author's rich professional experiences in China and the US, the book goes beyond a simple textual comparison of the VC laws of the two jurisdictions and explores the underlying cultural, political, economic, and societal factors that led to the differences between the two countries. For instance, the author suggests that Chinese VC investors' preference for IPOs over mergers and acquisitions (M&A) as an exit option, which is a stark contrast to their counterparts in the US, can be attributed to two factors: economically, the high returns given by the exits of VC investments via IPOs in the Chinese stock exchanges, and culturally, an older generation of Chinese entrepreneurs' aversion to relinquish control of their VC-backed start-ups through M&A (p 217–221). Therefore, the book serves to heighten the awareness among its readers of the nuances of the Chinese VC market as compared to VC markets in other countries.

Third, presenting the most thorough and systematic case studies of the Chinese VC market so far, *Venture Capital Law in China* leads the body of academic commentaries in this field of legal study by its remarkably comprehensive and up-to-date empirical research. Arguments made in the book are well-supported by qualitative and quantitative data meticulously hand-collected and examined by the author. These examinations include (i) Chinese-based investment agreements concluded between 2017 and 2019; (ii) interviews with a wide range of key market participants such as lawyers, venture capitalists, fund managers, founders of start-ups, large technology or e-commerce companies, individual investors, and representatives of institutional investors; (iii) judgments of Chinese courts on disputes relating to VC investments; (iv) data and reports published by leading law firms and service providers; and (v) model contractual agreements used in the American VC market (p 145). The abundance of data in the book is extremely helpful for two reasons. First, it effectively addresses the lack of understanding of the Chinese VC market caused by the difficulty of accessing source materials in Chinese and a general unfamiliarity with Chinese bureaucracy. Second, it allows its readers to keep up with the fast pace of regulatory change and market development in China by equipping them with the latest state of the Chinese law on VC as of 1 June 2020. In particular, Chapter 4 of this book provides in-depth analysis on the recently introduced dual-class share structure on the Shanghai Science and Technology Innovation Board ('STAR Market'). The comparison between the dual-class share structure on the STAR Market and its counterparts in Hong Kong and Singapore is extremely insightful and informative, and would be of great importance to the policy makers who are searching for ways to facilitate VC-backed exits or to reform their stock markets. This chapter also provides a thought-provoking discussion by identifying the importance of bankruptcy laws in encouraging entrepreneurship and advocates the adoption of a debtor-friendly bankruptcy regime in China. As China lacks a nation-wide personal bankruptcy regime, it will be interesting to see how the area of bankruptcy law evolves in China in the coming future.

In conclusion, *Venture Capital Law in China* powerfully illustrates the engineering of the Chinese VC market with insightful theoretical, empirical, and comparative legal analysis. The role of the Chinese government in the development of the country's VC sector has been masterfully examined. Furthermore, the author's study of the Chinese VC market has become even more meaningful in light of the COVID-19 situation around the world. Despite being hit the hardest globally by the pandemic with a sharp drop in both the volume and value of VC deals in the first two months of 2020,[5] China's VC sector has quickly bounced back as the country's

[4] Edward J Eberle, 'The method and role of comparative law' (2009) 8 Washington University Global Studies Law Review 451, 452.

[5] Preqin, 'China's PEVC Fund Managers See Deal Activity Recovering as its Coronavirus Cases Diminish' (Preqin, 19 Mar 2020) <https://www.preqin.com/insights/research/blogs/chinas-pevc-fund-managers-see-deal-activity-recovering-as-its-coronavirus-cases-diminish> accessed 25 May 2021.

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economy recovers after the outbreak came under control.[6] In March 2020, VC fundraising in China rebounded to almost the same level as 2019 with a sixfold rise from February.[7] Meanwhile, new opportunities have been identified in the Chinese VC market as the market has shown outstanding performance of VC deals in sectors such as educational technology (Edtech) and biotechnology.[8] Given the market turmoil and new challenges brought by COVID-19, the rebound of the Chinese VC market provides hope to the global VC scene and the Chinese VC lessons highlighted in this book serve as useful guidance for those countries seeking to boost their VC markets amidst global uncertainties.

[6] Alison Tudor-Ackroyd, 'China venture capital deal-making shows green shoots of recovery as funds hunt for bargains among coronavirus hit start-ups' *South China Morning Post* (9 Apr 2020) <www.scmp.com/business/banking-finance/article/3079271/china-venture-capital-deal-making-shows-green-shoots> accessed 25 May 2021.

[7] James Thorne, 'China's VC industry bounces back after coronavirus-induced winter' (Pitchbook, 2 Apr 2020) <https://pitchbook.com/news/articles/chinas-vc-industry-bounces-back-after-coronavirus-induced-winter> accessed 25 May 2021.

[8] Mercedes Ruehl and Ryan McMorrow, 'China's venture capital funding rallies after coronavirus lockdown' *The Financial Times* (14 Apr 2020) <www.ft.com/content/60359c79-0161-46e2-bed5-a30d372834b7> accessed 25 May 2021.