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Legal Boundaries of Profit Distribution in Chinese Non-state Junior Education

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Abstract. Currently, non-state schools, as important components of China's junior education system, have developed to a considerable scale. Although the Law of the People's Republic of China on Promotion of Private Education and its implementing regulations have preliminarily designed the basic framework of distribution management through the classification based strategy, the current legal framework shows obvious flaws and loopholes. To address this problem, this research proposes a basic orientation: strict supervision and review for for-profit schools, and stress on the public welfare bottom line for non-profit schools. This study employs a combination of literature review and case analysis to systematically examine the current four-level regulatory framework at both central and local levels, and deeply explores the practical challenges faced in implementing the classification management system. The research finds that for-profit schools face a structural conflict between capital-driven profit motives and the public-interest nature of education, while non-profit schools suffer from insufficient development momentum due to the lack of reasonable return mechanisms. In response, this paper proposes the following institutional recommendations: For for-profit schools, establish a "Special Fund for Educational and Teaching Development" and implement a distribution and oversight process involving "Pre-report - After-the-fact Report - Dynamic Adjustment," strengthening financial audits with an emphasis on educational relevance; for non-profit schools, improve dual incentive mechanisms comprising both material and spiritual rewards, and adopt a "negative list and whitelist" approach to manage related-party transactions, thereby enhancing the readability and accountability of information disclosure.

Keywords: Non-state School, Junior Education system, Profit Distribution, Legal Boundaries, Public Interests of Education

1. Introduction

With the further progress of reform and opening up and the rapid development of China's market economy, diverse market entities have been provided with a promising platform. Although the state education in China maintains its leading role, China's non-state schools, especially in junior education, are bursting with new vitality. China adopts a classification based strategy that divides non-state schools into for-profit schools and non-profit ones to better manage and supervise them.

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However, since non-state education in China is still less developed, potential risks are becoming more profound [1]. In response to the current situation, this paper aims to clarify the boundaries of profit distribution in Chinese non-state junior education, addressing to the lack of rules on distribution procedures, proportion limits and information disclosure for for-profit schools, as well as the prevalence of non-profit schools evading the prohibition-on-distribution rule through related-party transactions, disguised fees, high returns and other means. The research comprehensively analyzed related literature and relevant laws and regulations via literature review. At the same time, the paper conducts a detailed analysis of typical cases of profit distribution in non-state schools in China via the research method of case analysis. Next, the paper proposes a series of practical suggestions on balancing between property rights and public welfare attributes, and on filling the gap in the definition of legal boundaries of income distribution in existing research.

The proposed rules are beneficial for regulatory authorities to better identify acts that violate the prohibition-on-distribution rule, and thus simulate the vitality of non-state education capital while maintaining the public welfare bottom line, thereby promoting the legalization and modernization process under the governance system of the non-state education system in China.

2. Main and supplementary regulatory frame-works for profit distribution in China's non-state education sector

2.1. The overall structure of the regulatory framework

The current regulatory framework, from the central to local levels, is mainly structured as a pyramid with four layers. The first layer is fundamental laws, including the Constitution of the People's Republic of China, art.19, para.4; the Education Law of the People's Republic of China, art.26; the Civil Code of the People's Republic of China, arts.76-86 and 87-95. The second layer is the special laws, including the Law of the People's Republic of China on Promotion of Private Education and the Regulations for the Implementation of the Law of the People's Republic of China on Promotion of Private Education. The third layer is the administrative regulations, including the Several Opinions on Encouraging Social Forces to Run Education and Promoting the Healthy Development of Private Education (Guo Fa [2016] No. 81), the Detailed Rules for the Supervision and Administration of For-Profit Private Schools (Jiao Fa [2016] No.20), the Detailed Rules for the Classified Registration of Private Schools (Jiao Fa [2016] No.19), and the Opinions on Regulating the Development of Compulsory Education in Private Schools (Ting Zi [2021] No.15). The fourth layer is local regulations, such as the Regulations of Zhejiang Province on Promotion of Private Education and the Measures of Guangdong Province for Implementing the Law of the People's Republic of China on Promotion of Private Education, etc. The framework reflects the maturity of China's non-state education system and indicates that non-state education is now effectively regulated.

2.2. The classification based management system

The classification based management system is the most important regulatory strategy for non-state schools in China. Under Article 19 of the Law of the People's Republic of China on Promotion of Private Education, the sponsors of private schools can independently choose to establish either non-profit or for-profit private schools. However, for-profit private schools for compulsory education are not allowed to be established [2]. This establishes the foundation of the classification based system. A typical case illustrates the practical application of this system.

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In September 2022, the Zhangzhou Municipal Education Bureau approved the classification registration of Zhangzhou Experimental Middle School, designating its senior high school division as a for-profit private institution while retaining its compulsory education stage as a non-profit non-state school. This approval indicates that although the school's sponsor, Fujian Dongsheng Group Co., Ltd., has invested educational resources in the junior high school segment, the approving authority strictly adhered to Article 19 of the Law on the Promotion of Private Education and did not permit the compulsory education phase to become for-profit. The binding force of legal provisions was thus affirmed [3].

3. Legal difficulties of China's non-state schools under the current regulation system

3.1. Common problems

The current regulations on profit distribution of non-state schools are facing several common problems that remain to be solved. Initially, some sponsors of non-state schools are taking advantage of the independent property of the school corporation [4]. This phenomenon will create instability for additional investments used for upgrading educational facilities and, teaching resources, and for improving the quality of education, which may potentially threaten the public welfare of education. At the same time, the regulations on the institutional differences between for-profit and non-profit schools are not detailed, the legal status of the two types of schools is not clearly defined, and the bylaws are incomplete [5]. For example, current legal regulations mainly focus on restricting the organizers, while neglecting aspects such as the salaries of staff members, the educational rights of students, and the efficiency of the use of financial funds, which are all related to the public welfare guarantees. As a result, it is becoming increasingly difficult to guarantee educational efficiency. Moreover, there is conflict between parties involved in non-state education, such as sponsors, teachers,students, and their parents. Due to their different needs and interests, the current regulatory system fails to ensure and balance legal interests between parties.

3.2. Specific problems of for-profit schools

The Company Law encourages companies to aim for maximizing the interests of shareholders. The essence of education is to cultivate individuals. Scholars have pointed out that when the capital market demands high growth and high dividends, schools may face the failure of educational principle under the pressure of capital. Besides, for-profit schools must first cover their losses and set aside the statutory reserve funds before they can distribute dividends. Besides, the contradiction between the long-term nature of educational services and the short-sightedness of the capital market makes it difficult for financial statements to truly reflect the school's ability to continue operating.

3.3. Specific problems of non-profit schools

Non-profit school founders do not receive any economic returns. Their continuous investment relies on moral self-awareness or reputation incentives. Although current laws allow for "compensation or rewards" upon termination, this right is uncertain and delayed, making it difficult to form a stable long-term investment expectation, thereby restricting the development of high-quality non-profit schools.

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4. Suggestions for legal boundaries of profit distribution

4.1. For-profit schools

In order to better balance capital interests and educational public welfare, we suggest that a "Special Fund for Educational and Teaching Development" project be carried out. This means that after making up for losses and extracting the statutory reserve fund, for-profit schools must first allocate a certain percentage of their distributable profits as the "Special Fund for Educational and Teaching Development". This fund is independent of the daily operating funds and is exclusively used for teacher training, curriculum development, facility upgrades, and other substantive construction. It must not be used for dividends or to repay shareholder debts.

Besides setting up the fund, the whole distribution process should be operated under three fundamental principles as follows. First is "Pre-report". Before the schools begin to distribute their profit, they must report their profit distribution plan to the local educational authorities, and schools can only distribute the profit after approval by the review process. After distributing the profit, the school must report its fund flow and be subject to a second review. That is what we call the "After-the-fact Report" The third principle is "Dynamic Adjustment". The funding ratio is not fixed. It can be adjusted dynamically based on the actual situation of the school and after review by the regulatory authorities.

To improve the responsibility and supervision system, we also suggest enhancing the "educational attribute" review of financial audits to consolidate the responsibility and supervision system.

4.2. Non-profit schools

Given the current strict regulations for non-profit schools, in order to better stimulate the enthusiasm for running the school, we hope to improve the incentive mechanism. On the material level, we need to ensure reasonable salaries and welfare. On the spiritual level, we can appropriately offer reputation incentives (such as honorary titles) and governance incentives (providing greater internal authority to those who are efficient in governance).

For non-profit schools, it is essential to ensure their public nature, and therefore a complete chain of supervision must be established. To achieve this goal, implementing the "negative list and whitelist" management system for "related party transactions" and enhancing the "readability" and "accountability" of information disclosure are of great significance at this stage [6].

5. Conclusion

Education is a public issue that concerns the fundamental interests of the public. Therefore, public welfare is always the bottom line of non-state education. At the same time, to encourage non-state junior education to thrive, a reasonable distribution system should be established. The key is allowing non-state educational capital to grow under a comprehensive regulatory system. A legal atmosphere should be built in which the benefits of abiding by the regulatory system outweigh the risk of illegal distribution. Only in this way can we better satisfy people's aspirations for a better life.

Still, there are many aspects that were not addressed in this paper. For further study, we will focus more on developing a more comprehensive and quantitative scheme. A detailed legislative project and timetable also need to be designed in the future. Meanwhile, all the theories raised by the paper need to be tested by practice to prove their validity and sustainability.

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