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New Measures on Reform of Company Registration System in China

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After promulgation of Notice on Issuance of Reform Plans on Registered Capital Registration System (Guofa<2014>No.7)(the "Notice") and the subsequent amendments to the relevant clauses of China Company Law, the national enforcement of the reform of the company registration system was officially launched on 1st March 2014.

According to the National Market Entities Development Report for April issued recently by the State Administration for Industry and Commerce, the full implementation of the registered capital registration reform is driving the continuous growth explosion in the amount of newly registered companies. Thus we can see that the "dividend" of the reform is being released, especially in respect of the amount of private companies and the strong growth in capital.

The principal changes of the newly amended China Company Law include e.g. changing the paid-in registered capital regime to a subscribed capital regime, lifting the minimum registered capital requirement and simplifying the registration items and documents. Standing at the new starting point of the reform, investors should particularly pay attention to and adapt to the changes and the direction of the company registration system in China.

In addition, the government will also evaluate the credibility of companies by the enterprise credibility information publicity system. Such enterprise information will be considered as the major factor in issue of administrative permits, recognition of qualifications, supervision management, governing procurement, project bidding and grant of state-owned land use right. Support and award will be provided to the trustworthy entities. However, the companies within the list of the enterprises with serious offences and their legal representatives or responsible persons will be restricted or prohibited from market participation. The credibility binding mechanism and the credibility evaluation system, in the long run, will become a long-term mechanism of social significance to regulate the self-regulatory activities of market entities and promote their credibility.

The development of enterprise credit reporting system will further enable the business registration system to align with the practice of the developed countries and areas. The measure of “one offence leading to restrictions everywhere” may not prohibit offences or bubble companies. However such system may provide reference information to the parties of business deals and the credibility will become the foundation of the principle of “Survival of Fittest”. In light of the above, we can see from the aforesaid regulations that other than the administrative penalties, the government will also focus on discovery and record (registration) of bad faith and offences. The measures include, e.g. the local administration for industry and commerce will conduct random check on 3% - 5% of the enterprise publicized information, failure to conduct the required annual reporting or publicize the relevant information or no contact in the registered address (business place) will be recorded as abnormal operations, and the enterprises with uncorrected offence for a certain period time will be stated in the list of enterprises with serious offences.

As a matter of fact, Shenzhen, as the city that is most likely to align with Hong Kong in respect of commerce and trading rules, has provided experience for reference regarding enhancement of post-registration supervision system. Currently Shenzhen has set up the date base for enterprise credibility, which can exchange and share information with Shenzhen Individual Credit Reporting System and the Banking Industry United Credit Reporting System of People’s Bank Shenzhen Branch. Such data base will also play the role of industry association in future. It was reported that after over one year’s implementation of the list of abnormal operations, 22,253 market entities that cannot be reached by their registered addresses or business places have been recorded under the list of abnormal operations and provided to the public by Shenzhen Market Supervision Bureau, which takes 1.6% of the total market entities in Shenzhen. The market entities and the relevant persons under the list of abnormal operations will be recorded into the credit supervision system and restrictions will be imposed in case of e.g. approval of registration, recognition of qualifications and grant of bank loans. Thus the purpose of "one offence leading to restrictions everywhere" has been initially realized.

Principal Reform Measures

The newly amended China Company Law reflects in all respects the principle of easy entry and strict supervision. Specifically, the actual paid-in registered capital will no longer be required to be registered, the requirements of the first capital contribution, i.e. 20% and registered capital verification have been removed, and shareholders will be granted more rights to run their companies according to the articles of association and the shareholders agreement. However the Notice also provides that the subscribed capital regime does not apply to some industries for the time being, including securities companies, fund companies, trust companies, commercial banks, financing leasing companies, financial assets management companies, insurance companies and labour dispatch companies.

One of the opinions is that relaxation of the entry regime will result in registration of many bubble companies. We however take it that such result may only be a temporary dilemma at the initial stage of the reform. Such reform measures, aligning with the international practice, will eventually cause the sensitive relationship between self-management and supervision to be monitored by the market regime and force the market entities to realize the importance of commercial credibility, which will then regulate and rebuild a trustworthy economic market. As a matter of fact, it has already been noticed that, on one hand, the amount of the registered capital, in many respects, cannot represent the true financial strength of a company or its capacity to take civil responsibilities before the reform. On the other hand, the adverse effect resulting from evaluation of the credibility of a company overly depending on its registered capital has become more obvious.

In view of the above, the government is attempting to gradually build and improve, by legislation, a company supervision system based on the credit reporting system. The first step of the reform of China Company Law is to replace the annual inspection system by the annual reporting system. The government is in the process of issuing the relevant laws and regulations, including e.g. the Regulation on Publicity of Enterprise

Information, Measures on Random Check on Publicized Enterprise Information and Measures on Management of List of Abnormal Operations, which indicates that the formalized annual inspection system will be replaced by the annual reporting system with more openness and transparency. Further, companies will have to publicize the information on its operation conditions, which on one hand will raise a higher requirement on the financial management, arrangement of policies and overall operation of companies, and on the other hand will enable the public to evaluate the credibility and financial strength of companies by the publicized information.

Impact on Foreign Investment by "Easy Entry and Strict Supervision"

As the amendment of China Company Law has just been completed, transitional arrangement will have to be made for registration with the industry and commerce administration. For foreign investors in particular, as the "Laws on Foreign Invested Companies" is still effective outside the Free Trade Zone, of which the clauses inconsistent with the new Company Law and the business registration system are still subject to further amendments and improvement.

However, at the internal level of a company, under the reform of company registration system, the valid agreement between the shareholders on the articles of association or the shareholders agreement on equity or cooperative joint venture will become exceptionally important. We are still waiting for the detailed policies and explanations from the relevant authorities in this respect. For instance, the new law has lifted the requirement on the paid-in registered capital and the minimum registered capital. However, the requirement on approval of foreign investment has not been removed completely, therefore, how can the feasibility study report of a foreign investment project justify the agreement between the shareholders on the amount of capital contribution and the timeframe thereof? To some extent, though "1RMB Company" is already a possible option, the amount of the registered capital and the total investment in line with the scale of the investment is still one of the primary criteria to be considered for company establishment by foreign investors who will make investments with cross-border capital flow.

The new policy of "One Window All Services" was announced by Shanghai Pudong New District at the end of March 2014, under which the entry approval system has been changed to the notification and undertaking system, material examination has been replaced by formality examination, and the official time required for establishment and change of a foreign investment project has been shortened to 2 working days. In addition, the five licenses, i.e. approval, business license, organization code certificate, tax registration certificate and pre-registration food permit will be processed jointly. Pudong Market Supervision Bureau has set up a window for "One Window All Services". Promulgation of the Measures indicates that China will gradually provide national treatment to foreign investment in respect of entry management. The Measures further align with the Measures on Management of Investment subject to Government Approval (National Development and Reform Committee Order No. 11), i.e. the requirements on the application documents, approval conditions and procedures of foreign investment will be generally same as those for domestic projects.

Furthermore, the Measures have also greatly simplified the conditions for approval and record of foreign investment projects. The requirement on review of the market prospect, economic benefits and product technologies which should be decided by companies has been lifted. The market will play a decisive role in resource allocation. Companies will be given a free hand in investment. Thus efforts will be taken to provide more convenience to foreign investment.

What worth mentioning is in Shanghai, the district "Negative List" of Huangpu District has been first issued and the district policy of the CBD of Jinan District is also ready to be issued. It is understood that the Negative List of Huangpu District principally applies to the tertiary industry e.g. financial services, professional services, commerce and trade industry, cultural and creative services, transportation and logistics services. The approval procedures will be simplified in some pilot industries，and then formality examination will be implemented step by step to speed up the approval process for company establishment within the district. District “Negative List” like this will have profound impact to investors in their decision-making of choosing registration domain.
It can been foreseen that the convenience and friendly new policies implemented in Shanghai for foreign investment will set an example in this respect in China, gathering valuable experience for further reform of the relevant laws and regulations regarding foreign investment.

At the closing of this article, we find the Ministry of Commerce (“MOFCOM”) has issued a Notice of Eliminating Requirement of First Paid-in Capital and Minimum Registered Capital for Foreign-invested Enterprises. We believe this is just the beginning of new wave of regulatory reform to the foreign investment regime which is under the jurisdiction of MOFCOM. Coupled with the deepening of a series of measures driving by the central government in respect to promoting fair competition and maintaining regular market activities, more registration reform measures on both domestic and foreign investment will been seen. It is therefore advisable for every investor to keep abreast of all updates in this respect to survive in the competitive marketplace.

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