4.6.Corporate Social Credit System

Introduction

Corporate Compliance to laws and regulations plays an important role in any country your business is active in. Pretty unique to China is the Corporate Social Credit System being implemented in China currently though, which enables authorities to exchange their information and data between each other, leading to a simple fact: If you screw up in one area, other authorities might additionally punish you or increase their checks on you. If you screw up really hard, you can even lose your ability to supply to government projects or be blacklisted completely until the problem is rectified.
Therefore you should ensure the compliance in all areas.
In general, multi-national corporations should be prepared already quite well for this due to internal compliance and management systems.
In many areas in China there is a general trend away from pre-approvals towards regular checks after implementation, this trend also manifests with this credit system: New investment projects require less regulatory approval beforehand but the compliance will be measured continuously afterwards.
Please keep in mind: This chapter is last updated in January 2020 and recent developments might not be considered.

Scope and development

The scope of the Corporate Social Credit System is mostly domestic single entities, therefore it should not be understood as a systematical method to discriminate against foreign-invested companies: While both get rated, foreign-owned companies do not play the major role.
The process itself is a simple cycle of formulation of requirements by the government, monitoring and rating the company behavior and compliance regarding the requirements with possible rewards and sanctions afterwards.
As mentioned, the scope is currently strictly by legal entities, there are currently no spill-over effects to other legal entities within one enterprise group or within the supply chain. Even while this might change in the future, there is currently no evidence for suggesting this. Spill-over effects might occur due to key-personnel though, e.g. if the CEO or legal person has an individual bad rating regarding income tax, the company can also be rated negatively.
Even while the development of the systems is driven by the National Development Reform Commission and the People´s Bank of China, so far the development state is pretty spotty nationwide and not yet necessarily connected between different regions and provinces: While some provinces are comparably far ahead in their development, some others are still behind. Involved companies are e.g. Huawei, Ali Baba and Tencent.

Exemplary impact in 2018

According to an analysis of the company Sinolytics, in the year 2018 the scoring system had the following impact in China, all numbers rounded:

- 12400 entities blacklisted
- 13,55 Million people blacklisted by the courts
- Around 1 Million entities forbidden from biddings
- 12800 entities forbidden from public procurement
- 19200 entities have been jointly sanctioned
- 2,2 Mio entities have successfully rehabilitated from blacklists in 2018

Considering the sheer market size of China and the amount of companies and people, this impact can still be seen as comparably small.

Rating Criteria and Scoring System

The rating criteria is intended to be objective and non-discriminatory, but sometimes “vagueness” leaves room for interpretation. The Core Ratings are often based on keeping deadlines and the accuracy of reports in areas that are valid for all companies, e.g. tax filings, but specific ratings for certain industries, types of operations or also locations exist.
In general, the Scoring system does not implement new requirements, it mostly just enables the exchange of data between different authorities that implemented their scoring already before. This non-central approach of rating criteria definition but centralized reporting and data exchange can make it pretty hard to find the actual requirements since they are distributed amongst different authorities, laws and regulations. Additionally, not every relevant regulation mentions clearly that it can have an impact on the rating itself.
Additionally, public sentiment towards a company will become part of the evaluation.

The scoring regarding the fulfillment of the criteria is not unified between the different authorities: While some authorities use a gamification-approach in which points are deducted for misbehavior and additional points are rewarded for good behavior, others use absolute ratings like “A” for a very good rating and “D” for a bad rating, with the standard rating being “N” as “not rated yet”. A consolidated rating, that uses all the single rating in a final score, is under development.

Data sources, data Exchange between authorities and Joint rewards and punishments

Companies in China often share quite an amount of information with the Chinese authorities, e.g. via tax filings or with statistical information required by the government. Most of the ratings will be calculated based on this data. External information sources can be verified complaints from third parties on central complaint-platforms or from private Rating agencies. Next to the increased data exchange, defined by respective bilateral memorandums of understandings between ministries, the main new key component of this corporate social credit system is the introduction of joint rewards and punishments. The rewards and punishments have a pretty broad range, e.g. increased or decreased frequency of checks regarding imported goods or taxation issues, simplified methods for bureaucratic processes for positively rated companies or even a direct impact on the price of utilities like electricity.
For serious misbehavior of the company, a blacklisting can occur. At the same time, repair mechanisms do exist, e.g. commitment letters to rectify a situation after a minimum wait time can remove the company from the blacklist. This also has the advantage that formerly unclear processes become public and more structured for affected companies.

Publicity of rating data

Quite some data about companies is available to the general public, even while scoring tends not to be published in all detail – mostly it can only be checked for “very good” or “very bad rating” or effective blacklisting.
Some examples, where you can find data about your own or other companies, would be:

- Credit Score Website: http://www.creditchina.gov.cn
  Here you can check administrative licenses, awards, administrative penalties, risk warnings and other related data
- National Enterprise Credit Information: http://www.gsxt.gov.cn
  This includes amongst others administrative penalties
- Import & Export Rating: http://credit.customs.gov.cn
- Tax Rating: http://hd.chinatax.gov.cn
- Private company Tianyancha, www.tianyancha.com , with information like staff in key positions, registered capital, etc.

5. Financial Management

Financial Management brings its very own challenges, especially if you are used to financial issues in combined currency areas like the European Union. The most common challenges within financial management can be attributed to the following areas:

- Chinese accounting principles probably are different in some areas compared to the accounting principles used in your group.
- China is a controlled currency area, meaning that the "State Administration for Foreign Exchange" (SAFE) is checking all inbound and outbound foreign currency transactions for validity;
- China has a special invoice system based on "Fapiao" that have to be purchased and have a high risk of being faked;
- Taxation is a subject that is always changing and can be challenging;
- Transfer pricing is a hot topic: The tax authorities will try to prevent "unfair" transfer of profits out of China, and
- If you are not used to Cross-Border Business, you might be unfamiliar with implications by changing exchange rates.

If you are taking over a management position in China, it might be your first one: The chapter about Budgeting and Controlling should be helpful if you have the first time the task to create a budget for your area of responsibility.