SMEs in China: Policy Environment Report

July 2019 Update
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1. Abstract

In recent years, the policy environment for small and medium-sized enterprises (SMEs) in the People’s Republic of China (PRC) has undergone a significant transformation. The present report sets out to provide an overview of the most significant developments affecting SMEs operating in the country. The structure of the report consists of an introduction to SMEs in China, an analysis of the current policy environment of SMEs in China in various areas and a conclusion.

2. Introduction to SMEs in China

2.1 Definition and classification of SMEs in China

SMEs in China are defined, according to the Law of the People’s Republic of China on the Promotion of Small and Medium-sized Enterprises (2017) (SME Promotion Law), as companies that “have a relatively small size in personnel and scope of business”. The standards for classifying small and medium enterprises are formulated by the relevant departments of the State Council, and the identification of a company as a micro, small or medium-sized enterprise is dependent on a series of variables such as the industry it belongs to, its operating income, its total assets and its number of employees.

SMEs constitute an overwhelming majority of the enterprises in China and are key to its economic development, as they represent 99.6 per cent of China’s companies, offer more than 80 per cent of the job positions and hold more than 70 per cent of the patents. They also represent more than 60 per cent of the gross domestic product (GDP) and contribute more than 50 per cent of the taxes.

2.2 European definition and classification of SMEs

While in China the identification of a company as a micro, small or medium-sized enterprise is subject to variables such as the industry it belongs to, its operating income, its total assets and its number of employees, the European definition and classification of what constitutes an SME is more simplified.

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European Commission review of the definition of SMEs

On 6th February 2018, the Commission launched a public consultation on the review of what the definition of an SME should be, which closed on May 5th of that same year. On 4th July 2018, the European Parliament voted and approved a resolution stating, among other things, that while the 2003 definition of SMEs should be preserved, more attention should be paid to the different types of structure encompassed within the definition (e.g. start-ups, micro enterprises etc.), as well as to start-up and scale-up initiatives and to structures such as Midcaps, which do not quite fit into the SME definition. The Commission, which on 11th November 2018 provided a response to the Parliament’s resolution, has yet to adopt a final decision.

According to the European Commission, the classification of micro, small and medium-sized enterprises is determined through staff headcount and financial ceiling. Thus, an SME by European definition is an enterprise that employs less than 250 persons and has an annual turnover not exceeding EUR 50 million or total assets of EUR 43 million.

Similar to China, SMEs are also the backbone of the EU’s economy. In the non-financial business sector, they account for 99.8 per cent of the total number of businesses throughout the EU and 66.4 per cent of its employment, and they generate 56.8 per cent of value added. Furthermore, 93.1 per cent of SMEs are micro SMEs.

The information presented above shows that SMEs are key contributors to economic growth and development both in China and in the EU. However, in terms of definition and classification, the tools used to determine the type of SME for each category are different for the EU and China (in accordance, on the other hand, to each actor’s size of economy and number of population). Thus, some companies considered as SMEs in China would not have this denomination in Europe due to their larger size in terms of employees and/or annual turnover.

2.3 Challenges that European SMEs face in China

SMEs in China face a number of challenges, in many cases due to their size and relatively limited resources. The most important are related to financing, administrative burden, talent acquisition and retention, shortage of key technologies and management skills, and standard-setting and public procurement.

These challenges are further exacerbated in the case of foreign SMEs due to a series of added difficulties these companies encounter when entering the Chinese market.

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The European Business in China Business Confidence Survey (BCS 2019) surveyed 585 European companies based in China, with SMEs constituting the largest group of respondents at 52 per cent of the total. Analysis of the responses shows that at 39 per cent, SMEs are the least likely group to see meaningful opening in their respective industries, and also that half of the SME respondents are more likely to perceive unfavourable treatment by the Chinese government.8

Figure 66: Twice as many SMEs have seen revenues decrease compared to large companies

How did your company’s total 2018 revenue in Mainland China evolve compared to 2017?1)

Graph 1: Business Confidence Survey 2019

3. Analysis of the current policy environment of SMEs in China

The past years have seen an increased government focus on SME growth that has been translated into important developments in SME legislation and regulations. One of the key pieces of legislation issued in recent years is the new SME Promotion Law, which came into force on 1st January 2018. Throughout 2018 and 2019, events like the economic slowdown and the trade tensions with the US prompted an increased push for supporting private enterprises, encouraging foreign investment and improving the business environment in China.

The following sections will be dedicated to analysing the recent SME policy developments in China in the areas of finance and reduction of the financial burden, SME market development, administrative procedures and protection of the rights of SMEs.

3.1 Financing and reduction of financial burden

3.1.1 Financing

Along with major national policies such as the documents derived from the 13th Five Year Plan (13FYP) or China Manufacturing 2025 (CM2025), The SME Promotion Law provides a legal basis for the support of SME public and private financing through a series of articles and measures in chapters 2 and 3. These measures have been further detailed and developed in subsequent documents.

Public financing

Public financing is to be provided by the government at all levels through the establishment of special funds for SME development, which will have a focus on micro and small enterprises. These funds will be supervised and evaluated in order to ensure their proper and legal use. This type of multi-level SME financing is also provided for in the *Five-Year Action Plan for Promoting the International Development of SMEs* and CM2025.

Private financing

Private financing is as a rule not easy to obtain for SMEs in China, as they are usually seen as a high-risk and low-return investment, and Chinese authorities are well aware of this issue. Thus, the revised SME Promotion Law encourages direct and indirect financing of SMEs by financial institutions and includes some new provisions in order to facilitate this type of financing.

Regarding direct financing, article 18 of the SME Promotion Law provides for the development of a multi-level capital market system and the promotion of bond market and equity financing as channels for SME funding. SMEs can access this type of financing through the National Equities Exchange and Quotation (NEEQ) – also known as the New Third Board. In order to improve SME direct financing, the State Council’s *Guiding Opinions on Promoting the Healthy Development of Small and Medium-sized Enterprises* announced measures like the fast-tracking of SME initial public offerings and encouraging the listing of SMEs on the NEEQ. These measures come as a much-needed government reaction to phenomena such as the decrease in newly listed companies that the NEEQ suffered in the past years. While this push towards encouraging direct financing for SMEs might in the end improve the overall situation in China, it is unlikely to have

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What is the NEEQ?

The NEEQ is a national securities trading market that – thanks to its less stringent and lower capital threshold requirements for listing – provides an alternative financing method for Chinese SMEs that cannot list on the Main Board market. In 2018, the equity transfer system added 577 newly listed companies and raised CNY 60.8 billion, a sharp decrease compared to 2017’s 2,176 newly listed companies and CNY 133.6 billion (which in turn had also decreased compared to 2016).^9^

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any significant impact on European small businesses.

On indirect financing, the SME Promotion Law allows for the usage of movable property and accounts receivable as collaterals for chattel secured financing,\(^\text{11}\) and also provides for the encouragement of credit guarantee issuance. The promotion of usage of movable property as a financing channel for SMEs had previously been mentioned in documents such as the *Guiding Opinions on Further Promoting the Informatisation of Small and Medium Enterprises*, and the *Work Plan for the Task Force of Accounts Receivable Financing of Micro and Small Enterprises (2017-2019)*.\(^\text{12}\)

Throughout 2018 and 2019 further moves to improve SME financing were discussed. During the 2019 ‘Two Sessions’,\(^\text{13}\) one of the measures announced was the implementation of targeted cuts to required reserve ratios (RRR) for medium and small banks, the released funds of which would be lent to private enterprises and small and micro businesses. Also, the work report set a target of a 30 per cent increase in loans granted to small and micro businesses by state-owned commercial banks.\(^\text{14}\) These measures were echoed in the State Council’s *Guiding Opinions on Promoting the Healthy Development of Small and Medium-sized Enterprises*, as well as other specific provisions to improve access to financing for SMEs such as expanding the scope of refinancing policies or increasing the tolerance for non-performing loans.\(^\text{15}\) On a State Council meeting on 17\(^\text{th}\) April 2019, among other things it was announced that a proper policy framework for applying low RRRs for small and medium-sized banks would be established.\(^\text{16}\) On 24\(^\text{th}\) June 2019, People’s Bank of China (PBOC) Deputy Director Zou Wei announced that loans to SMEs during the first five months of 2019 had experienced a y-o-y increase by 21 per cent and now amounted to CNY 10.3 trillion.\(^\text{17}\) These positive development are also supported


\(^\text{11}\) Also known as chattel mortgage: A type of financing using movable personal property rather than real estate as security.


\(^\text{13}\) The annual meetings of the National People’s Congress and the Chinese People’s Political Consultative Conference.


by research at the local level, although that same research suggests that the government’s efforts towards encouraging lending for SMEs have not been met with enough appetite from businesses themselves due to the uncertain economic situation.\\(^{18}\)

**Chinese credit conditions ease**

![Graph 2: FT Confidential Research](image)

When it comes to cross-border transactions, on 29\(^{th}\) April 2016, the PBOC issued the *Notice on Nationwide Implementation of Macro Prudential Management of Cross Border Financing*, which constituted an important change in the regulation on cross-border debt by Chinese enterprises and FIEs, as they use net asset value instead of registered capital to determine the headroom for foreign debt (although foreign debt will still be restricted for FIEs under the new regime).\\(^{19}\)

Notwithstanding the recent developments at the national level, a recurring issue raised by European small businesses is that there is still considerable room for improvement when it comes to ensuring that both domestic and foreign SMEs have equal access to financing in China. According to the *BCS 2019*, lack of financing is one of the key factors affecting the net profit margin of SMEs and Midcaps.\\(^{20}\)

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\(^{18}\) *China’s Cheap Loans find Few Takers Among Small Firms*, Financial Times, 11\(^{th}\) June 2019, viewed 26\(^{th}\) June 2019, [https://www.ft.com/content/76e58290-8872-11e9-a028-86cea8523dc2](https://www.ft.com/content/76e58290-8872-11e9-a028-86cea8523dc2)


In this regard, a point to consider is that in Europe access to financing is not a big issue for SMEs. In fact, according to The Survey on the Access to Finance of Enterprises, only seven per cent of surveyed companies listed access to financing as an issue, thus making it the least of the respondents’ concerns. While the European and Chinese systems each have their particularities, continuing exchanges on good practices could eventually contribute to an improvement in the situation in China.

The EU SME Centre reports that – due to their unique position within the system – European SMEs seeking financing channels in China experience additional obstacles that prevent them from obtaining it. This issue is clearly exemplified in the following case study, which was originally presented in the Inter-Chamber SME Working Group Position Paper 2018/2019.

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A successful European SME in the services sector doing business in China tried to apply for a loan in order to cover cash flow. However, it encountered a series of difficulties that ultimately made it impossible to be granted any credit from financial institutions, both Chinese and foreign.

The process followed by this SME was to first look for financing from Chinese banking institutions. However, due to the small size of the company vis-à-vis a Chinese SME, it was not able to meet the financial requirements the Chinese banks had established in order to provide a loan. The next step the company took was to try to obtain assistance from a financial institution in its home country. The issue in this case was that the SME’s holding was not based in the home country and consequently the SME did not have any relationship with the financial institutions there. Given the fact that foreign banking institutions in China can grant loans only through their local partners, therefore ensuring the financial coverage in the home country, it was impossible to grant the loan. This cannot happen if the holding is not based in the mother country and has a financial history with the foreign bank there.

According to that SME, the only avenues for financing it was left with were to ask its shareholders for a capital injection, to look for a Chinese partner providing the capital or to work with accelerators and incubators that would provide financing on a project-by-project basis. The third procedure is a possibility that remains to be further explored, as such a system tends to focus on products and not on services.

3.1.2 Reduction of financial burden

Article 11 of the SME Promotion Law provides for the creation of favourable tax policies for SMEs. Some of the taxes where reduction or exemption is going to be applied are corporate income tax or value-added tax (VAT) among others. On 20th October 2017, the State Administration of Taxation announced that, in order to support micro and small enterprises, businesses with a monthly sales volume of between CNY 20,000 and CNY 30,000 would be exempted from VAT from 1st January 2018 to 31st December 2020. This threshold was increased to CNY 100,000 in a January 2019 announcement by the State Council. During that same meeting, the State Council also announced that for SMEs with taxable income below CNY 1 million/year, only 25 per cent of income would be considered taxable. The intention to further implement preferential tax policies for smaller enterprises was reaffirmed on the 2019 Work Report and later regulations. Further regimes of preferential tax policies have been rolled out for different sectors so as to encourage entrepreneurship and innovation (see point 2.3.2.).

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The reduction of administrative charges, provided for in article 12 of the SME Promotion Law, is another way of cutting down costs for SMEs. According to State Councillor Wang Yong, who joined the NPC enquiry, by June 2019 21 provinces had already implemented a policy of ‘zero charges’ to their local fees, thus reducing the burden of enterprises by more than CNY 40 billion. The next step was to reduce or eliminate the 41 administrative fees at the central level.

3.2 Administrative procedures

Regulatory costs and barriers have traditionally been one of the main obstacles for SME development in China. Aside from measures such as reducing administrative charges, in recent years there has been progress in the reform of the entrepreneurial approval system. Articles 27 and 31 of the SME Promotion Law already provide for the simplification and streamlining of the entrepreneurship approval and deregistration processes. In 2018 both the State Council at the national level and local governments of cities like Beijing and Shanghai rolled out policies to simplify administrative procedures and reduce the time for setting up a business. These measures prompted China’s rise in ranks in the World Bank’s index on ease of doing business. The commitment to continue this development trend was renewed throughout the 2019 ‘Two Sessions’. Some of the measures envisioned include reducing and simplifying approval procedures, making it easier to obtain licenses, developing online services and establishing a government service evaluation system. The intention to reduce the timeline for starting a business was recently further echoed in the new Opinions on Further Compressing the Time for Starting a Business, issued by five ministries including the State Administration for Market Regulation (SAMR) on 12th April 2019.

From the perspective of European SMEs, feedback regarding these policies has been generally mixed. Although European small businesses report that in the past years there has undeniably been an improvement in terms of reduction of red tape and shortening of the time required to start up a business, they still perceive a gap between the policy and its implementation, and indicate that times for setting a foreign business are still considerably longer than the 2018 national targets (not to mention the 2019 ones), and above the World Bank’s average for the country (9 days in 2018). Notwithstanding internal issues such as the speed in which businesses manage to collect the necessary documents for registration,

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the general feedback is that processes for foreign companies are still longer than for Chinese and that further measures could be taken to bridge this gap.

### 3.3 SME market development

#### 3.3.1 Talent acquisition and retention

Employment in China is a pressing issue. In 2019 the number of college graduates is expected to reach 8.34 million – a record high number.\(^{33}\) In this respect, the Chinese leadership is aware of the key roles of micro and small enterprises as the largest recipients of employment, and thus of the importance of supporting these enterprises in order to boost employment. Accordingly, Article 37 of the SME Promotion Law states that the relevant governmental departments at county level and above shall guide college graduates to obtain employment in SMEs and induce innovative talents into SMEs by subsidizing or training. Prior to the issuance of the SME Promotion Law, other regulations supporting talent acquisition for smaller enterprises had been set in place such as the *Opinions of the State Council on Further Efforts Relating to Employment and Business Start-up under the New Conditions.*\(^{34}\) The *Opinions of the State Council on Effectively Ensuring Employment and Entrepreneurship at Current and Future Periods* also encourages talent attraction for start-ups and smaller enterprises through measures like encouraging graduate students to seek employment in SMEs with incentives such as tuition compensation or student loan subsidies.\(^{35}\)

Regarding the access of foreign professionals to the Chinese work market, the Human Resources Working Group of the European Union Chamber of Commerce in China highlights the implementation of the *Notice on the Implementation of the Foreigners’ Work Permit System in China* from 1\(^{st}\) April 2017.\(^{36}\) Furthermore, at the local level – for instance in Shanghai – some actions have been taken to facilitate the obtention of visas or resident permits to foreign graduates or professionals, such as the development of entrepreneurship visas. While the working group considers these measures a positive development, it also stresses that there are still significant obstacles for attracting senior and technical talents, as well as foreign interns.\(^{37}\)

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\(^{34}\) *Opinions of the State Council on Further Efforts Relating to Employment and Business Start-up under the New Conditions*, State Council, 1\(^{st}\) May 2015, viewed 18\(^{th}\) May 2018 [http://www.gov.cn/zhengce/content/2015-05/01/content_9688.htm](http://www.gov.cn/zhengce/content/2015-05/01/content_9688.htm)

\(^{35}\) Ibid.


3.3.2 Innovation and entrepreneurship

Innovation and entrepreneurship rank highly on the strategic agenda of most countries today. China is not only no exception to this trend, but it is taking the lead along with countries like the US.

**China as a global innovation powerhouse**

In the past few years, China has risen to the top of globally recognised rankings such as the Bloomberg Innovation Index or the World Intellectual Property’s Global Innovation Index (GII). According to the latest GII, China is currently 17th among 126 countries in terms of total innovation score – the highest score received by any country not in the high-income category. Since in 2016 China entered the top 25, it has consistently moved upward and is now 1st or 2nd in the world in terms of research and development (R&D) expenditure, number of researchers, patents and publications.

Looking at the start-up environment in China, Start-up Genome’s Global Startup Ecosystem Rankings 2019 puts Beijing and Shanghai in the top 10 Global Startup Ecosystems, and Shenzhen as part of the contenders to the top 30. According to the report, Beijing is one of the top five startup ecosystems in the world and it has two out of the three most valued unicorns globally. Meanwhile, Shanghai enjoys a high number of angel investors and a considerable amount of R&D funding.

Finally, British consulting firm Preqin’s latest research shows that in 2018 venture investments reached $105 billion, second only to the United States. Estimates for numbers of unicorns (venture-backed private companies valued at more than $1 billion) in China in 2018 range from 86 to 165 and 186 depending on the source.

China’s push towards improving its innovation capabilities goes as far in time as the early 2000s, and subsequent strategies and policies such as the 13FYP, CM2025 or *A New Generation of Artificial Intelligence Development Plan* have continued this trend, with the added goal of bolstering indigenous innovation. In terms of specifically SME-geared policies, the *Guiding Opinions on Further Promoting the Informatisation of Small and Medium Enterprises* also plays an important role in encouraging the technological upgrading of SMEs, especially through measures such as encouraging large Information Technology (IT) companies to open up their resources for SMEs; supporting the use of IT for R&D purposes; and promoting the integration of IT technologies with traditional

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40 Data from CB Insights, TechCrunch Unicorn Leaderboard (as of June 2019) and Hurun Greater China Unicorn Index 2018.
41 *Global Startup Ecosystem Rankings 2019*, Startup Genome, 9th May 2019, viewed 20th June 2019 [https://startupgenome.com/reports](https://startupgenome.com/reports)
manufacturing methods.\textsuperscript{43}

Also looking at SME-specific policies, the revised SME Promotion Law supports this push for innovation through a series of provisions, some of which include establishing preferential tax policies for enterprises and investors in the area of technological innovation; encouraging SMEs to develop new technologies with independent IP; and fostering cooperation between SMEs, universities and R&D centres.

On entrepreneurship, one of the ways through which the revised SME Promotion Law encourages the creation of businesses is reducing the administrative and financial burden (see the provisions indicated in sections 2.1.2. and 2.2.). Further measures include putting idle facilities to use for entrepreneurs as low-cost offices or implementing tax and fee reductions for college graduates and unemployed or disabled workers setting up micro and small enterprises. Aside from the VAT rate adjustments announced earlier in the year, further measures to promote entrepreneurship and innovation through tax reductions were announced by the State Council on 25\textsuperscript{th} of April 2018. Following the guidelines by the Central Economic Work Conference and the Government Work Report, the State Council introduced seven tax measures for micro and small enterprises that are estimated to lower the overall tax burden of these companies by CNY 60 billion.\textsuperscript{44}

From the European perspective, according to the \textit{BCS 2019}, 62 per cent of respondents reported their Chinese counterparts as being equally or more innovative than European firms. More interestingly, far from perceiving this as a threat, the vast majority (81 per cent) of European businesses actually saw opportunity in domestic Chinese innovation, likely because they expect to benefit from both better suppliers and stronger competition, which can spur them on to deliver higher quality goods and services at the best possible prices.\textsuperscript{45} Another aspect of this is the potential of benefiting from the Chinese innovation environment as a foreign start-up founder. Although EU SME Centre research on this area is still at the initial stage, European founders interviewed reported having generally benefitted from the considerable support network in innovation hubs in spite of the challenges associated with founding a company as a foreign national in China. A common denominator in the founders interviewed so far is the general lack of reliance on national innovation funding mechanisms (in spite of their abundance both at the national and local levels) when it comes to the development of their companies. This may be due to lack of knowledge on these opportunities (an issue that platforms like the EU-funded China Innovation Funding are currently trying to address),\textsuperscript{46} although issues like unreliability in terms of quick access to the funds – key to SMEs and start-ups – and accessibility of these funding programs to foreign businesses also remain possibilities to be further analysed.

\textsuperscript{43} \textit{Guiding Opinion on Further Promoting the Informatisation of Small and Medium Enterprises}, MIIT, January 2017, viewed 18\textsuperscript{th} April 2018, \url{http://www.miit.gov.cn/n1146295/n1652858/n1652930/n3757016/c5475728/content.html}

\textsuperscript{44} \textit{‘Double Innovation’: Micro and Small Enterprises Welcome another CNY 60 Billion Tax Reduction ‘Red Packet’}, State Council, 4\textsuperscript{th} May 2018, viewed 25\textsuperscript{th} June 2019, \url{http://www.gov.cn/guowuyuan/2018-05/04/content_5287879.htm}


\textsuperscript{46} China Innovation Funding homepage, 2018, viewed 5\textsuperscript{th} July 2019, \url{http://chinainnovationfunding.eu/}
The EU and China are already cooperating on SMEs and innovation through platforms like the SME Policy Dialogue and the Innovation Cooperation Dialogue. As SMEs are drivers of innovation, further exploring synergies between the two cooperation mechanisms could go a long way towards creating value for both European and Chinese small businesses and start-ups.

3.3.3 International development

Since its inception, China’s ‘Going Global’ policy and its derived measures have mainly supported the internationalisation of domestic SOEs. However, in the past years a number of regulations have also pushed for the international development of Chinese SMEs. Articles 41 and 42 of the SME Promotion Law support the development of SMEs in foreign markets through measures such as facilitating the use of foreign exchange, easing personnel entry and exit procedures for SMEs going abroad, and encouraging national policy-based financial institutions to develop their import-export credit business.

Aside from the SME Promotion Law, one of the most important recent policies providing the basis for SME international development is the Five-Year Action Plan for Promoting the International Development of SMEs (2016-2020).47 The Notice of the Two Departments on Carrying out the Special Action for Supporting the Participation of SMEs in the Belt and Road Initiative further develops relevant measures for SME participation along the BRI. These include – among others – the creation of a “Belt and Road Initiative SME Cooperation Platform”,49 the promotion of two-way investment through the creation of a cooperative zone for SMEs in China and partner countries, and the development of special trainings to help SMEs improve their management capabilities.

Looking at European business interest in the BRI, the BCS 2019 shows that although European businesses do see opportunities along the BRI, 88 per cent report being unable to participate in the initiative due to challenges like lack of suitable projects and insufficient information, among others.50 Although the EU SME Centre is aware of a few success cases of SMEs participating in BRI projects, SMEs are also affected by these and other challenges such as insufficient access to project funding or lack of potential business partners. There are also certain concerns held by the international community regarding the access opportunities for foreign companies in BRI projects vis-à-vis Chinese companies that should be addressed in order to strengthen international cooperation for the project.51

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48 *Notice of the Two Departments on Carrying out the Special Action for Supporting the Participation of SMEs in the Belt and Road Initiative*, Ministry of Industry and Information Technology and China Council for the Promotion of International Trade, 27th July 2017, viewed 18th May 2018, [http://www.miit.gov.cn/n1146295/n1652858/n1652930/n3757016/c5755651/content.html](http://www.miit.gov.cn/n1146295/n1652858/n1652930/n3757016/c5755651/content.html)


51 One of the main concerns of foreign companies relates to access to BRI projects and the fairness in the allocation procedures, especially in projects financed by Chinese banks. "Out of all the contractors participating
3.3.4 Competition and procurement

In order to increase SME participation in government procurement, the SME Law sets a series of supporting measures in Article 40. These include reserving more than 30 per cent of the total government procurement budget for SMEs (of which no less than 60 per cent would be saved for micro and small enterprises) and other mechanisms such as the formulation of purchase requirement standards, offering price reviews or preferential procurement.

Ensuring fair competition and a level-playing field also features prominently within the SME Promotion Law. In fact, the ‘three equalities’ principle is one of the underlying principles guiding the revision of the Law. Furthermore, Article 38 provides for the creation of a fair competition environment for SMEs, and in Article 39 cooperation between large and small enterprises is encouraged.

European institutions and organisations have long been sounding the alarm bells regarding the unequal access to procurement contracts in China that European companies experience. While in the Joint Declaration after the EU-China Summit the acceleration of the process of China’s accession to the World Trade Organisation Government Procurement Agreement is mentioned, the main pieces of legislation regulating public procurement in China reflect the government’s protectionism and push for indigenous innovation.

The clearest example of a discriminatory provision is Article 10 of the Government Procurement Law of the People’s Republic of China (2014 amendment), which stipulates that government procurement shall be based on the procurement of domestic goods, projects and services unless a) such goods, projects or services cannot be obtained within the territory of China or under reasonable commercial conditions; b) the procurement is made for use outside of China; c) it is otherwise provided in other laws or administrative regulations. Although isolated cases of European SMEs accessing government projects have been reported to the EU SME Centre, at the end of the day it is highly unlikely that European small businesses will be able to benefit from a market that even big multinationals have had considerable difficulties accessing.

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52 The ‘three equalities’ principle advocates for the provision of equal rights, opportunities and rules for various types of enterprises.


3.4 Intellectual Property

On 22nd January 2017, the MIIT and the State Intellectual Property Office (SIPO) published the Guiding Opinions on the Full Implementation of the Strategy for the Implementation of the Intellectual Property Strategy for SMEs. The Guiding Opinions sets forth the following seven key measures: implementing a patent navigation mechanism; establishing incentives to stimulate SME innovation; improving the efficiency and capability of SME IPR operations; strengthening the protection of IPR for SMEs; developing the IPR management capabilities of SMEs; deepening foreign exchanges and carrying out cross-border operations on SME IPR; and optimising the public service system on IPR for SMEs.

The SME Promotion Law also takes into consideration the importance of development, management and protection of IP for SMEs. As mentioned in section 2.1.1., IP now can potentially become a source of financing, since it can be used as movable property when requesting credits. In order to boost innovation, the development of technology and products with independent IP is encouraged. Finally, the State and the relevant departments at all levels are to provide IP-related services and guidance to SMEs.

Regarding enforcement of IP regulations, one of the more positive developments in recent years was the establishment of the Specialised IP Courts Pilot Project in Beijing, Shanghai and Guangzhou, and IP tribunals in various provinces in China. At the end of August 2017, the Supreme People’s Court (SPC) released a three-year report that assessed the value and contributions of the IP courts. The results were positive in terms of the volume and outcomes of cases accepted since 2014 (46,071). Furthermore, on 1st January 2019, an IP Tribunal at the appellate level was officially established by the SPC, which will centralise jurisdiction over appeals involving patent infringement/invalidation and other high-tech or antitrust IP disputes.

The establishment of internet courts in Hangzhou, Beijing and Guangzhou, which are able to process cases in connection to internet copyright ownership and infringement disputes, also has the potential to ease some of the IP-related dispute processes. In June 2018, the Hangzhou Internet Court accepted for the first time blockchain as a way of fixing copyright, and on 6th September 2018, the SPC confirmed that blockchain can be used—along with other means like electronic signatures—as a way of validating

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56 The IP court system was introduced in the second half of 2014 and has developed in terms of quality of judges and outreach capacity ever since with the establishment of courts in an increasing number of Chinese cities.


58 Hangzhou Court Uses Blockchain-Based Evidence For First Time, Yicai Global, 30th June 2018, viewed 2nd May 2019, [https://www.yicaiglobal.com/news/hangzhou-court-uses-blockchain-based-evidence-first-time](https://www.yicaiglobal.com/news/hangzhou-court-uses-blockchain-based-evidence-first-time). Hangzhou is famous for having one of the highest number of online writers in China; this is most likely the reason for the implementation of this procedure in that specific court.
In April 2019, the first blockchain-enabled notary opened in Beijing. These developments are especially significant for SMEs, as they can potentially reduce the costs associated with IP dispute processes.

In the past years, China’s push for innovation and entrepreneurship has generally led to a significant improvement in IPR enforcement, as perceived by European companies. However, key issues remain. According to the BCS 2019, progress in terms of European company ratings of IPR improvements had stalled, with positive ratings only increasing 1 per cent year-on-year. Even more concerning is the fact that 20 per cent of respondents reported having felt compelled to transfer technology in order to maintain market access, up from 10 per cent in 2017. Furthermore, out of those who had reported forced technology transfers, 63 per cent mentioned it had happened within the last two years, and a quarter said the transfer was currently taking place.

### 3.5 Protection of the rights of SMEs and supervision mechanisms

Chapter 8 of the SME Promotion Law addresses the protection of the rights of SMEs. Some of the measures include improving the feedback mechanisms for SMEs; ensuring government units, public institutions and large enterprises refrain from abusing the rights of SMEs through actions such as breaching their contract or defaulting on payments; ensuring local governments abide by relevant laws and do not force SMEs to participate in non-mandatory activities like trainings or appraisals; and standardising administrative fees and publishing a detailed catalogue to counter the charging of excessive fees.

With regards to the improvement of feedback mechanisms for SMEs, throughout the past year there have been positive developments such as the creation of a platform to provide feedback on tax and fee reduction measures for SMEs, or the platform where SMEs can report payment defaults from the government or SOEs. The development of these feedback mechanisms has in some cases uncovered serious cases of violation of the rights of SMEs – for instance regarding payment defaults, an issue that affects both Chinese and foreign SMEs and where, in spite of well-intentioned provisions in the SME Promotion Law and some success in its implementation, still lacks an effective enforcement system. The fact that instances of defaults can now be reported and made publicly known will hopefully help

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59 Understanding and Application of the Provisions of the Supreme People's Court on Several Issues Concerning the Trial of Cases in Internet Courts, ChinaCourt.org, 8th September, 2018, viewed 2nd July 2019, https://www.chinacourt.org/article/detail/2018/09/id/3489797.shtml


63 Platform for SMEs to report on default payments from Government Agencies and SOEs, MIIT, 3rd June 2019, viewed 5th June 2019 http://www.miit.gov.cn/n1146290/n1146402/n1146440/c6987274/content.html

64 According to the NPC report on the implementation of the SME Promotion Law, by the end of April 2019 a total of CNY 305.8 billion in arrears had been settled.

65 As of 2nd June 2019, the platform had registered 224,830 visitors, and the registered arrears amounted to CNY 3.74 million. The platform started operating on 10th April, 2019.
bring further focus to the issue and contribute to the development of policies and regulations geared towards addressing it.

The revised SME Promotion Law also provides for the establishment of regular inspections of SMEs, as well as for the evaluation of SME funds and the examination of infringements on SME rights. Furthermore, regular assessments on the developmental environment of SMEs are to be carried out by third parties at all levels.
4. Conclusion

One year into the entry into force of the SME Promotion Law, government investigations on its implementation show that results are starting to be felt. The geopolitical and economic situation at the global and domestic level has also undergone noticeable changes throughout the past year, and the need to counter risks created by issues like the US-China trade tensions or the economic slowdown has prompted the Chinese leadership to step up their efforts to improve the business environment, support the private sector and encourage foreign investment. This has been translated into moves such as the increasing allusions to the concept of ‘competitive neutrality’, the rolling out of multiple measures at the national and local levels to improve the business environment, the shortening of the Negative List in 2018 and 2019, and the passing of the Foreign Investment Law. As SMEs are likely to be among the first to experience the negative impacts of the aforementioned risks – and given their paramount importance when it comes to job creation and contribution to GDP – the Government at all levels has dedicated a considerable amount of focus to developing measures targeted specifically at SMEs.

According to the NPC enquiry on the implementation of the SME Promotion Law, it seems that there has been progress in most of the key areas of the SME Promotion Law, from access to financing to reduction of administrative and financial burden and protection of the rights of SMEs. However, leaders also acknowledge that there are lingering problems in all of these areas and that there is also significant room for improvement in terms of addressing them. Throughout the preparatory research period for this report and its drafting process, European SMEs have generally offered a similar assessment to the current state of play of the SME policy environment in China, in that – although they see improvements in certain areas – fundamental challenges remain when it comes to operating in China. The fact that, in spite of the considerable progress made, none of the Key Recommendations for the Inter-Chamber SME Working Group Position Paper has been eliminated in these past years clearly illustrates this point.

While the SME-related policy developments in the past years have for the most part been positive, the work of European institutions, business associations and European-funded projects such as the EU SME Centre and the IPR SME Helpdesk is still indispensable in order to continue giving voice to the European SMEs operating in China and ensuring a level-playing field vis-à-vis their Chinese counterparts.

66 Fair competition between SOEs and the private sector, in line with market principles.
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AI</td>
<td>Artificial Intelligence</td>
</tr>
<tr>
<td>AQSIQ</td>
<td>General Administration of Quality Supervision, Inspection and Quarantine</td>
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<tr>
<td>BCS</td>
<td>Business Confidence Survey</td>
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<tr>
<td>CBIRC</td>
<td>China Banking and Insurance Regulatory Commission</td>
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<tr>
<td>CCPIT</td>
<td>China Council for the Promotion of International Trade</td>
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<td>CM2025</td>
<td>China Manufacturing 2025</td>
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<tr>
<td>CNY</td>
<td>Chinese Yuan</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>EUR</td>
<td>Euro</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>IP</td>
<td>Intellectual Property</td>
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<td>IPR</td>
<td>Intellectual Property Rights</td>
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<tr>
<td>IT</td>
<td>Information Technology</td>
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<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
</tr>
<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
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<tr>
<td>NEEQ</td>
<td>National Equities Exchange and Quotations</td>
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<tr>
<td>NPC</td>
<td>National People's Congress</td>
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<tr>
<td>BRI</td>
<td>Belt and Road Initiative</td>
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<tr>
<td>PBOC</td>
<td>People’s Bank of China</td>
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<tr>
<td>PRC</td>
<td>People’s Republic of China</td>
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<tr>
<td>SAMR</td>
<td>State Administration for Market Regulation</td>
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<tr>
<td>SIPO</td>
<td>State Intellectual Property Office</td>
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<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
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<tr>
<td>SOE</td>
<td>State-owned enterprise</td>
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<tr>
<td>SPC</td>
<td>Supreme People’s Court</td>
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<tr>
<td>VAT</td>
<td>Value-added Tax</td>
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About the EU SME Centre
The EU SME Centre helps EU SMEs get ready for China by providing them with a range of information, advice, training and support services. To find out more, visit: www.eusmecentre.org.cn.

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Further reading…
The EU SME Centre has over 100 reports, guidelines and case studies in its Knowledge Centre, the following may be relevant to you:

- Individual Income Tax in China
- Tax Liability for Non-Resident Enterprises Engaging in Service Provision
- China Enterprise Income Tax
- Establishment and Operation of a Representative Office
- Establishment of a Foreign Invested Enterprise in China
- Repatriation and Reinvestment of the Assets of Foreign Invested Enterprise in China

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