China’s Corporate Social Credit System: How businesses can prepare

China developed the Corporate Social Credit System (CSCS) to ensure corporate compliance and improve behaviour of companies doing business in China. It is part of the People’s Republic of China’s plan to build a single, standardized reputation system for local and foreign firms alike.

The system touches on virtually all aspects of a company’s business operations in China. It assesses the performance and demeanor of companies, by analyzing topic-specific ratings (e.g. tax, customs and environmental protection) and compliance records (e.g. on anti-monopoly cases, data transfers, pricing and licenses). The automated system collects data, processes and rates it against the defined requirements. Based on their rating, Chinese authorities will reward businesses with “good” and sanction those with “bad” behaviour.

China has already introduced the system. It is expected to be fully implemented by the end of 2020.

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How the CSCS could affect businesses

Every company should expect the CSCS to track all of their activities and operations in China. Businesses will face intensified scrutiny of their day-to-day operations once China fully implements the system.

Penalties for low social credit scores

Businesses will receive low corporate social credit scores if they have unsatisfactory corporate compliance to Chinese rules. As a consequence, China could declare offending companies to have “bad behaviour”.
This could result in sanctions, which depending on the rating, could include:

- penalty fees
- higher inspection rates
- targeted audits
- restricted issuance of government approvals
- exclusion from preferential policies
- restrictions from public procurement
- public blaming and shaming
- being blacklisted in extreme cases

Rewards for compliance

Companies will receive a high corporate social credit score if they are assessed to be adequately complying with Chinese rules.
Compliance, or “Good behaviour” could result in:

- lower tax rates

- good credit conditions
- facilitated market access and more public procurement opportunities
- simpler passage through Chinese customs

Challenges of compliance

Complying with the system's regulatory requirements **will be challenging** for companies. This is mainly due to the strictness, comprehensiveness, intricacy and crosscutting interdependence of the ratings. The self-enforcing nature of the CSCS will also create **strategic challenges**. For example, the system makes firms accountable to the behaviour of business partners along the supply chain. This will expose them to risk of non-compliance due to actions of third parties. This might be challenging for SMEs that lack a robust corporate compliance infrastructure.

In theory, the CSCS treats every legal entity in China the same. While the absence of human involvement reduces leeway for subjectivity, it could still be used in a discriminatory fashion. On the one hand, the same rating system applies to all companies. However, the divergences between local and global standards may make it harder for foreign firms to meet Chinese standards. This could prove to be especially true for firms that are new to the Chinese market.

How to prepare

While the system is already largely operational, it is not too late for companies to prepare. To be ready for the full implementation of the CSCS, businesses operating or wanting to operate in China should prepare thoroughly to manage related risks.

Companies should:

- understand what the system requires from them
- assess where they stand with respect to requirements
- identify gaps
- implement internal adjustments

Businesses should also communicate openly with both central and local authorities. Raise questions and problems on the overall system with Chinese government authorities. Discuss compliance requirements specific to Chinese regions with relevant local authorities.

Businesses should have on-the-ground **compliance experts** in the regions of China in which they are operating. This allows the company to remain informed of and abide by the local compliance requirements in real time. Compliance experts could also leverage their pre-existing relationships to assist companies to develop a two-way information flow with the central government and local authorities.

Get help from the Trade Commissioner Service

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- Doing business in China
- Canadian small and medium enterprise gateway to China
- Contact the Canadian Trade Commissioner Service in China

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