ENGINEERING A VENTURE CAPITAL MARKET: LESSONS FROM CHINA

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This article analyzes Professor Ronald Gilson's theory of "simultaneity" in engineering a venture capital market in the context of China. Based on both quantitative and qualitative data collected by the author, this article analyzes how China has created the fastest developing and the largest engineered venture capital market in the world within three decades. It concludes that the rise of venture capital in China is attributable to (1) increasing capital supply through various governmental programs, easing regulatory barriers towards institutional and foreign investors, providing tax incentives, and improving the exit environment; (2) enhancing the availability of financial intermediaries by introducing the limited partnership that creates an efficient relationship between venture capitalists and investors; and (3) encouraging entrepreneurship by improving the regulatory environment for small businesses. Through these measures, China has facilitated the simultaneous availability of capital with the appetite for high-risk, long-term investments and the emergence of a class of entrepreneurs with the skills and incentives to put that capital to work. One key factor of the rapid development of the Chinese market has been its increased reliance on market forces in allocating capital. On the other hand, a residual degree of bureaucratic involvement in capital allocation prevents the Chinese regime from being fully efficient. China serves as an (imperfect) model for other governments in the world where unfettered market forces have not brought about successful venture capital markets.

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INTRODUCTION

Venture capital ("VC") is widely recognized as a powerful engine that can drive a nation's innovation, job creation, knowledge economy, and macroeconomic growth. [1] As such, governments from various jurisdictions around the world, including Germany,[2] Australia,[3] Japan,[4]

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[1] Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1068 (2003). On the importance of VC, *see generally* Marco Da Rin et al., *The Law and Finance of Venture Capital Financing in Europe: Findings from the RICAFE Research Project*, 7 EUR. BUS. ORG. L. REV. 525 (2006).

[2] *See* Gilson, *supra* note 1, at 1094-1096.

[3] *See* THE TREASURY AND THE DEPARTMENT OF INDUSTRY, INNOVATION, SCIENCE, RESEARCH AND TERTIARY EDUCATION OF AUSTRALIA, REVIEW OF VENTURE CAPITAL AND ENTREPRENEURIAL SKILLS (2012), *available at* http://bit.ly/2tlIz3c.

[4] *See* Zenichi Shishido, *Why Japanese Entrepreneurs Don't Give Up Control to Venture Capitalists* (Mar. 30, 2009) (unpublished manuscript), *available at* http://bit.ly/2w8JrdA.

Israel,[5] Chile,[6] Taiwan[7] and Singapore,[8] have all tried to promote the development of VC markets. Generally, government programs have not been especially successful.[9] However, China's efforts seem to have borne fruit. Over three decades, China has created the world's second largest VC market in terms of annual VC investment,[10] second only to the United States (U.S.). This article will explore the elements of China's experience in engineering a national VC market, as well as concerns about its continued growth of the market.

In a ground-breaking article, Professor Ronald Gilson explained that a VC market requires three key elements to thrive: (1) providers of capital with appetites for high-risk, high-return investments; (2) specialized financial intermediaries—VC firms—that properly incentivize all participants in the VC market; and (3) entrepreneurs.[11] This much is straightforward, but as he further explained, these three elements must emerge *simultaneously*. The simultaneous emergence of all three elements is difficult to envision with or without government involvement. For example, if there is no capital available in an economy for high-risk businesses, how will entrepreneurs emerge to form such businesses, and how will intermediaries emerge to identify the best of those entrepreneurs and channel investment funds to them? Gilson refers to this as the "simultaneity problem."[12] He attributes the success of the U.S. VC market in solving the simultaneity problem to private ordering,[13] explaining that the "U.S. VC market developed organically, largely without government assistance and certainly without government design."[14] Instead, it was the "idiosyncratic" history of the U.S. VC market that encouraged the simultaneous emergence of entrepreneurs, investors, and the right vehicles that served as the "nexus of a set of sophisticated contracts."[15]

This raises the question of whether it is possible for governments to successfully engineer VC markets. Most governments have tried to address the simultaneity problem by creating government programs to provide capital, encourage entrepreneurship, and attract knowledgeable

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[5] *See* Gilson, *supra* note 1, at 1097. *See also* JOSH LERNER, BOULEVARD OF BROKEN DREAMS: WHY PUBLIC EFFORTS TO BOOST ENTREPRENEURSHIP AND VENTURE CAPITAL HAVE FAILED—AND WHAT TO DO ABOUT IT 42 (2009).

[6] *See* Gilson, *supra* note 1, at 1098.

[7] Christopher Gulinello, *Engineering a Venture Capital Market and the Effects of Government Control on Private Ordering: Lessons from the Taiwan Experience*, 37 GEO. WASH. INT'L L. REV. 845 (2005).

[8] LERNER, *supra* note 5, at 42.

[9] Gilson, *supra* note 1, at 1070; LERNER, *supra* note 5, at 192.

[10] *See* ERNST & YOUNG, BACK TO REALITY: GLOBAL VENTURE CAPITAL TRENDS 2015 3, 10-12 (2016), *available at* https://go.ey.com/1QifExd [hereinafter BACK TO REALITY].

[11] Gilson, *supra* note 1, at 1076-78, 1093.

[12] *Id.* at 1093.

[13] *Id.* at 1069, 1093.

[14] *See id. at* 1070.

[15] *Id.* at 1069, 1093.

financial intermediaries. For the most part, however, these programs failed because they could not adequately respond to the problems inherent in VC financing: uncertainty, information asymmetry, and agency cost.[16]

China offers a fascinating case study of how a VC market can be engineered: its VC market is one of the fastest developing and largest engineered markets in the world.[17] Before 1985, VC did not exist in China.[18] But after three decades of development, China now receives the second largest annual VC investment in the world.[19] In 2016, 636 new VC funds were set up in China, collectively raising more than USD 50 billion of fresh capital for investment. This represented a 79.46% increase over the previous year.[20] Additionally, there were 3,683 VC investment deals closed in 2016, an increase of 6.91% from 2015, and of 91.2% from 2014.[21] Total VC investment in China was USD 48.9 billion, surpassing VC investment in the entirety of Europe combined.[22] Also, of the top five VC deals worldwide in 2015, three were made in China.[23] While the United States dominated global VC activity by deal quantity and value in 2015 with 3916 investment deals (in total valued at USD 72.3 billion), two out of three top deals were China-based.[24] VC exits were also impressive, with the amount raised from exits via IPO and M&A reaching USD 8.2 billion and USD 11.5 billion respectively, in 2015.[25] For context, VC exits via IPO and M&A in the United States raised USD 6 billion and USD 54 billion respectively in the same period.[26] As of the end of 2014, VC investments contributed directly and indirectly to 9.3% of China's GDP.[27] These figures underline the

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16 *Id.* at 1070.

17 Anette Jönsson, *Venture Capital Continues to Flow into Chinese Startups*, WALL ST. J. (Apr. 28, 2015), http://www.wsj.com/articles/venture-capital-continues-to-flow-into-chinese-startups-1430244889. *Venture Capital Soars and Investor Expectations Follow*, NIKKEI ASIAN REV. (Feb. 18, 2016), http://asia.nikkei.com/Politics-Economy/Economy/Venture-capital-soars-and-investor-expectations-follow; Lucinda Shen, *China is the Biggest Venture Capital Firm in the World*, FORTUNE (Mar. 9, 2016), http://for.tn/2tZyM0S.

18 *See* text accompanying note 59, *infra*.

19 *See* BACK TO REALITY, *supra* note 10, at 3, 10-12.

20 Qingke Yanjiu Zhongxin (清科研究中心) [Zero2IPO Research Center], Qingke Yanjiu Niandu JuZhi (清科研究年度巨制) [*Zero2IPO's Yearly Mangum Opus*], Touzijie (投资界) [PEDAILY] (Jan. 21, 2017), http://bit.ly/2sZtjFD.

21 *See* Zero2IPO Research Center, *Venture Capital Annual Report 2014*, ZERO2IPO PUBLISHER (2015), http://research.pedaily.cn/report/free/1301.shtml.

22 *See* BACK TO REALITY, *supra* note 10, at 3, 10-12.

23 *Id.* at 10.

24 *Id.* at 3.

25 *Id.* at 10.

26 *Id.* at 6.

27 Niu Fulian (牛福莲) & Wang Jingjing (王晶晶), Jujiao Xin Changtai Xia Fengxian Touzi Gaige Yu Chuangxin (Xia) (聚焦新常态下风险投资改革与创新(下)) [*Focusing on the Reform and Innovation of Venture Capital under the New Normal (Part II)*], Zhongguo Jingji Shibao (中国经济时报) [CHINA ECONOMIC TIMES] (Jul 10, 2015), http://bit.ly/2ujIISe.

significance of the Chinese VC market and its influence on China's economy.

The growth of the VC market in China over the past decade is without precedent. In the U.K., VC investments peaked in 2007 and have remained relatively stagnant,[28] totaling USD 4.8 billion in 2015 (0.168% of U.K.'s 2015 GDP).[29] The value of VC investments in Germany and France amounted to USD 2.9 billion (0.086% of GDP) and USD 1.9 billion (0.078% of GDP) respectively in 2015.[30] In stark contrast, China's VC market has maintained rapid growth since 2002, with fund raising, investments, and exits reaching a record high in 2015 (0.450% of GDP).[31]

In contrast to the U.S., China's VC market did not emerge as a result of market forces alone, but was instead consciously and strategically designed by the state from the outset. Specifically, governmental policies and actions facilitated the development of the VC market in order to encourage innovation and technological development, and to stimulate structural reforms of the economy. China's fascinating experience challenges the orthodox view that top-down governmental efforts to promote VC are unlikely to be successful. Moreover, despite doubt as to the effectiveness of private ordering in China[32] due to its weak investor protection[33] and lack of judicial independence,[34] China has succeeded in building a VC market. The pivotal question is: how did China manage to create the second largest VC market in the world despite its immature legal infrastructure?

Based on quantitative and qualitative data,[35] this article analyzes

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[28] *Annual Value of Venture Capital Investments on the UK Market from 2007 to 2015*, STATISTA, http://bit.ly/2s3499m (last visited May 24, 2017).

[29] BACK TO REALITY, *supra* note 10, at 3, 10-12.

[30] *Id.* at 9.

[31] Zero2IPO Research Center, *supra* note 20.

[32] *See generally* Jiangyu Wang, *China: Legal Reform in an Emerging Socialist Market Economy*, *in* LAW AND LEGAL INSTITUTIONS OF ASIA: TRADITIONS, ADAPTATIONS AND INNOVATIONS (E. Ann Black & Gary F. Bell eds. 2011); Donald Clarke, Peter Murrell, & Susan Whiting, *The Role of Law in China's Economic Development*, *in* CHINA'S GREAT ECONOMIC TRANSFORMATION (Loren Brandt & Thomas G. Rawski eds. 2008).

[33] *See generally* Nicholas C. Howson & Vikramaditya S. Khanna, *The Development of Modern Corporate Governance in China and India*, *in* CHINA, INDIA AND THE INTERNATIONAL ECONOMIC ORDER (Muthucumarasawamy Sornarajah & Jiangyu Wang eds., 2010) (on investor protection).

[34] *See generally* Chapter 4 of JIANFU CHEN, LEGAL INSTITUTIONS IN CHINESE LAW: CONTEXT AND TRANSFORMATION 147-70 (2008).

[35] The empirical study consists of: (I) a study on a sample of fifty VC agreements. These agreements are obtained from leading law firms and VC firms, i.e. Banyan Capital, Jubilee Capital, Shenzhen Cedar Capital, Shiyue Hualong Capital, Songhe Yuanwang Capital, Chengwei Capital, Island Peak Innovation, King & Wood Mallesons (Beijing, Shanghai and Shenzhen offices), Fangda Law Firm (Beijing and Shanghai offices), Zhong Lun Law Firm (Beijing and Shenzhen offices), Global Law Firm (Beijing office), Jincheng Tongda & Neal Law Firm (Beijing office), Chongqing Zhonghao Law Firm, Yuan Tai Law Offices, Deheng Law Firm (Shenzhen office), and Shenzhen Huashang Law Firm; (II) interviews with sixty venture capitalists, legal counsels, representatives of institutional

how China has addressed the simultaneity problem. The Chinese government has helped solve the problem by laying down the necessary legal and institutional infrastructure for a VC market, including: (1) providing public capital through various government programs and increasing private capital by easing regulatory barriers towards institutional investors, providing tax incentives, and improving the exit environment; (2) enhancing the availability of financial intermediaries and fund raising by introducing the limited partnership, a new and popular business vehicle that creates an efficient relationship between venture capitalists and investors; and (3) encouraging entrepreneurship by revising the country's corporate and securities laws and streamlining the process of establishing businesses and doing business.

The Chinese government's role in allocating capital, however, is not without flaws. The VC market's rapid growth stemmed largely from the fact that the central government has laid down the institutional and legislative infrastructure to increase the role of market forces in the capital allocation process. But there are institutional obstacles, including the flawed cadre appointment system and flawed incentives for government officials, that prevent local governments from achieving the delicate balance of allowing local government funding to operate based on market forces while concurrently pursuing the governments' policy goals.

The lesson to be learned from the Chinese experience is that the optimal role of a government in engineering a VC market should be to provide the necessary enablers, while playing only a limited role in the capital allocation process by simply providing seed funding and leaving specific capital allocation decisions such as selection of portfolio companies and designing investment strategies to private VC firms with the right incentives. This is a lesson that could be valuable to other countries, such as Japan[36] and Germany,[37] that have attempted to promote the development of a VC market without significant success, and to other countries that are attempting to promote the formation and growth of a VC sector.

The remaining parts of this article are structured as follows. Part I examines the Chinese experience of engineering a VC market. Part II identifies the institutional impediments in China and suggests room for future reforms. Part III critically discusses the lessons learned from

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investors and entrepreneurs. The interviewees come from the six cities that are the major places of VC in China, namely Beijing, Shanghai, Tianjin, Shenzhen, Chongqing, and Guangzhou; (III) a study of official data published by the leading service providers, i.e. the annual reports published by the Zero2IPO Research Center, the *China Venture Capital Yearbook* published by China Venture Capital Research Institution, and the annual reports published by the VentureChina.cn.

[36] *See* Shishido, *supra* note 4.

[37] *See* Ronald J. Gilson & Bernard S. Black, *Does Venture Capital Require an Active Stock Market?*, J. APPLIED CORP. FIN. 36, 36-48 (1999).

China for other jurisdictions. A brief conclusion follows.

I. TACKLING THE SIMULTANEITY PROBLEM IN CHINA

A. *The Difficulty Overseas*

The key challenge for governments seeking to engineer a VC market is ensuring the simultaneous availability of three factors—a challenge that Gilson termed the "simultaneity problem." The first factor is investment capital. Venture capitalists provide a special type of capital for early-stage, high-growth, high-risk, often high-technology firms that need equity capital to finance product development or growth.[38] Because of venture capitalists' appetite for high-risk, high-return investments, and because of their managerial skills and industrial connections, venture capital plays an important role in commercializing cutting-edge science and innovation.[39]

The second factor is the availability of specialized financial intermediaries that serve as the "nexus of a set of sophisticated contracts" and that implement an effective incentive structure in a VC cycle.[40] There are two main contracts that place financial intermediaries between sources of capital and innovative businesses. The first contract arises at the fund-raising stage between the investor and the VC fund, which is typically organized in the U.S. as a limited partnership. This contract alleviates the agency costs between the investor and fund manager and incentivizes the latter through mechanisms such as a fixed term, mandatory distributions, and structuring of the fund manager's compensation.[41] The second contract arises between the VC fund and the portfolio company. This contract addresses the uncertainty, information asymmetry and agency costs between the VC fund and entrepreneurs and incentivizes both participants through mechanisms such as staged financing, allocation of control to the fund, structuring of the entrepreneur's compensation and incentivizing exit. [42] The interaction, or "braiding," of the two contracts enhances the efficiency of each in terms of incentivizing exit and constraining opportunistic behavior by the VC fund against entrepreneurs.[43]

The last essential factor for creating a national VC market is the availability of entrepreneurs. Gilson assumes that the supply of entrepreneurs is the "sole function" of the availability of capital and

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[38] *Id.* at 36.

[39] Gilson, *supra* note 1, at 1068. *See also*, LERNER, *supra* note 5, at 181-182 (emphasizing the importance of a large domestic market with investors willing to take risks with younger firms in the development of a VC market).

[40] Gilson, *supra* note 1, at 1069, 1093.

[41] *Id.* at 1087-90.

[42] *Id.* at 1078-87.

[43] *Id.* at 1091-92.

specialized financial intermediaries. In his view, by providing *funding* through the right contractual *vehicle*, government can encourage a supply of *entrepreneurs*.[44]

International experience reveals that resolving the simultaneity problem is not an easy task. Over recent years, many governments have sought to engineer a VC market but have encountered difficulties to varying extents.

In Germany, funding remains the major issue for start-ups, and governmental efforts at resolving the issue have not been sufficient.[45] Germany's Deutsche Wagnisfinanzierungsgesellschaft ("WFG")[46] proved a failure due to the interference by the government: capital allocation was determined by WFG's board committee, which was largely comprised of bureaucrats.[47] It also failed to incentivize venture capitalists to choose portfolio companies because the government provided a guarantee and insured up to 75% of WFG's losses and because profits were limited by the entrepreneur's call option.[48] Further, WFG personnel were not incentivized to provide technological or management assistance to portfolio companies because of the restriction of profits placed on WFG.[49]

The Indian government has faced challenges in ensuring the availability of capital and specialized financial intermediaries. Although VC fund regulations were enacted in India to encourage the funding of early-stage companies, this goal has been compromised because VC funds have primarily been used as a vehicle to invest in more mature companies, rather than start-ups.[50] Further, VC funds in India are typically organized as trusts because the limited partnership vehicle is not available.[51] Participants in the Indian VC market are thus unable to

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[44] *Id.* at 1102-03.

[45] MARTIN SELTER & THOMAS PRUEVER, LIQUIDITY MEETS PERSPECTIVE: VENTURE CAPITAL AND START-UPS IN GERMANY 36 (VC TRENDS INITIATIVE BY EY 2015) https://go.ey.com/2tljvd8. *See also* Gilson, *supra* note 1, at 1094-1097. As of 2013, the average VC investment in Germany stands at merely €780,000, compared to €6m in America. *See A Slow Climb*, The Economist (Oct. 15, 2013), http://econ.st/1sYYdea.

[46] Deutsche Wagnisfinanzierungsgesellschaft "translates roughly to 'German Venture Financing Fund." *Gilson*, supra note 1, at 1094 n.66 (citing Ralf Becker & Thomas Hellmann, *The Genesis of Venture Capital: Lessons from the German Experience, in* VENTURE CAPITAL, ENTREPRENEURSHIP, AND PUBLIC POLICY 33 (Vesa Kanniainen & Christian Keuschnigg eds., 2005)).

[47] See *id.* at 1094-97.

[48] *Id.*

[49] *Id. See also* Ralf Becker & Thomas Hellmann, *The Genesis of Venture Capital: Lessons from the German Experience, in* VENTURE CAPITAL, ENTREPRENEURSHIP, AND PUBLIC POLICY 33 (Vesa Kanniainen & Christian Keuschnigg eds., 2005).

[50] Akil Hirani, *India, in* GLOBAL VENTURE CAPITAL TRANSACTIONS: A PRACTICAL APPROACH 229 (Beat Brechubul & Robert J. Wooder eds., 2004).

[51] Abhinav Surana & Apurva Kanvinde, *Private Equity in India: Market and Regulatory Review*, WESTLAW UNITED KINGDOM, http://tmsnrt.rs/2tlKuoT (last updated Nov. 1, 2016).

take advantage of the efficient contracting structure for specialized financial intermediaries prevalent in the U.S.

While the government of Singapore has enhanced the availability of funding for start-ups through various programs and introduced the limited partnership to provide a new business vehicle for venture capitalists and investors, concerns have been raised about the government's significant role in the capital allocation process.[52] The imposition of various eligibility requirements on the entrepreneurs, types of portfolio companies, and industries may dampen incentives for participants in the VC market.[53] There is also a "lack of a large base of entrepreneurs" due to the perceived high opportunity costs of becoming an entrepreneur in Singapore.[54]

Nevertheless, some government programs, such as the Israeli Yozma Program and the Chilean Corporation for the Incentive of Production ("CORFU") Program, have achieved a certain degree of success.[55] These successes highlight the shortcomings of other countries and are consistent with the success of the Chinese government's efforts. For example, the Israeli Yozma program did not make investment decisions and provided no guarantee against loss.[56] These investments were made by highly incentivized private fund managers who bore the investment's risk and possessed the control rights to directly monitor the portfolio companies.[57]

VC has had a much shorter history in China than in the U.S.[58] The concept of VC was first officially introduced in China in 1985 in the central government's *Decision to Reform the Science and Technology System*.[59] The industry only began to emerge in the same year when the first VC firm, the China New Technology Venture Capital Company (*zhongguo xinjishu chuangye touzi gongsi*) was set up as a government-initiated project.[60] Prior to that, and before the launch of the open-door

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[52] Newley Purnell, *Singapore Aims to Become Southeast Asia's Silicon Valley*, WALL ST. J. (Feb. 26, 2014), http://on.wsj.com/1IcA35S.

[53] *See id. See also* interview with Mr. K, company founder of a Singaporean start-up, in Singapore (Sept. 9, 2016).

[54] Winston T.H. Koh & Poh Kam Wong, *The Venture Capital Industry in Singapore: A Comparative Study with Taiwan and Israel on the Government's Role* 25 (National University of Singapore Entrepreneurship Centre Working Papers, Paper No. WP2005-09, 2005), http://bit.ly/2tqafVF.

[55] *See* Gilson, *supra* note 1, at 1097-99.

[56] *Id.* at 1097.

[57] *Id.*

[58] *See* LERNER, *supra* note 5, at 8. The United States has over 70 years of experience in VC.

[59] Zhonggong Zhongyang Guanyu Kexue Jishu Tizhi Gaige de Jueding (中共中央关于科学技术体制改革的决定) [*The Decision to Reform the Science and Technology Systems*], Renmin Ribao (人民日报) [People's Daily] (Mar. 13, 1985), http://bit.ly/2snLfJC.

[60] *See* Zhu Shaoping & Ge Yi (朱少平 & 葛毅), Zhonghua Renmin Gonghe Guo Hehuo Qiye Fa de Xiuding: Lifa Jincheng Ziliao Huibian (《中华人民共和国合伙企业法》的修订:立法进程资料汇编) [COLLECTION OF MATERIALS RELATING TO THE AMENDMENT OF THE

policy and economic reform (*gaige kaifang*) in 1978, there were no private enterprises, let alone start-ups or VC. The Chinese VC market developed slowly and was dominated by state-owned VC firms and VC funds in the 1980s and 1990s due to the lack of a developed stock market and unfamiliarity with the new concept,[61] as well as the limited choices of business vehicles available at that time.[62] The market began to develop rapidly only after 1998 when Cheng Siwei, then vice chairman of the National People's Congress Standing Committee, presented a groundbreaking "No.1 Proposal" urging the development of a VC market.[63] After the proposal, a series of policies and laws were promulgated, including the Strategy of Invigorating China through Science and Education (*kejiao xingguo*) and the Law on Promoting the Transformation of Scientific and Technological Achievements.[64]

As discussed below, the Chinese government has helped to tackle the simultaneity problem effectively within three decades.[65]

B. *Capital*

1. The Need for Venture Capital in China

Today, there is a strong demand for high-risk, high return VC in China, with the increased number of small businesses and the improved innovation and IT infrastructure. In the first nine months of 2015, over 3 million small businesses were registered, accounting for 96.62% of the total number of new registered businesses.[66] In Beijing's Zhongguancun district, the so-called "Chinese Silicon Valley," an average of 7 new companies were registered every minute from March 2014 to May 2015.[67] Beijing has become Asia's largest hub for entrepreneurship.[68]

PARTNERSHIP ENTERPRISE LAW] 4 (2004). *See also* Lu Haitian et al., *Venture Capital and the Law in China*, 37 HONG KONG L.J. 229 (2007).

[61] *See* Lin Lin, *Venture Capital Exits and the Structure of Stock Markets: Lessons from China*, 12 Asian J. Comparative L. 1, 7 (2017).

[62] Limited Partnership was not available under Chinese law in this period.

[63] Cheng Siwei (成思危), Zhongguo Fengxian Touzi de Lishi yu Xianzhuang (中国风险投资的历史与现状) [*The History and Status Quo of China's Venture Capital*], in Cheng Siwei Lun Fengxian Touzi (成思危论风险投资) [CHENG SIWEI ON VENTURE CAPITAL] (2008).

[64] *See* Appendix 2, *infra*.

[65] *See* Part I.B.E, *infra*.

[66] Press Release, Zhonghua Renmin Gongheguo Guojia Gongshang Xingzheng Guanli Zongju(中华人民共和国国家工商行政管理总局) [State Administration for Industry and Commerce], Gongshang Zongju: Quanguo Xin Dengji Qiye Baochi Gaowei Zengjiang (工商总局：全国新登记企业保持高位增长) [State Administration for Industry and Commerce: Country-Wide, Newly-Registered Businesses Maintain High Levels of Growth], (Oct. 15, 2015), http://bit.ly/2snfq3H.

[67] Zhang Lulu, *China's Startup Boom: 7 New Firms Every Minute*, CHINA.ORG.CN (Jun 9, 2015), http://on.china.cn/1B2Rt59.

[68] Zheng Lipeng (郑利鹏), Na Shenme Zhengjiu Ni: Zai Tanlan Zhong bei Wanhuai de Zhongchou Nazhi Zhu (拿什么拯救你：在贪婪中被玩坏的众筹那只猪) [*How to Rescue ECF?*

However, the growth of start-ups and small and medium size firms ("SME") has long been constrained by a substantial capital gap in China as China's stock markets are unable to serve as viable financing channels for SMEs. Apart from dealing with the prohibitively high costs and long waiting times (caused by the current approval system) involved in an IPO, start-ups and SMEs, by virtue of their youth or size, also face difficulties meeting the stringent listing requirements set by the two Main Boards.[69]

Moreover, unlike state-owned enterprises ("SOEs",) that are able to receive low-interest loans from state-owned banks (in part due to administrative influence), private companies face enormous difficulties in securing bank loans.[70] Statistics show that among 56 million micro and small enterprises in China's industrial and commercial areas, only 11.9% are able to obtain loans from banks.[71] Further, these micro and small enterprises receive less than 25% of the loans extended by state-owned commercial banks.[72] Such problems with securing debt financing are exacerbated for start-ups, which typically have insufficient collateral to offer as security.[73] This inadvertently contributed to a high demand for VC as an important means of start-up financing.

In addition, China's Gross Domestic Product ("GDP") growth rate fell from 10.4% in 2010 to 6.918% in 2015,[74] with traditional economic sectors such as manufacturing and real estate showing signs of weakening.[75] Also, with a population of 1.3 billion and a labor force of 900 million, China faces strong pressure to address an increasingly significant unemployment issue.[76] It is thus imperative for the government to foster the development of high-technology industries and a knowledge-based economy to enhance competitiveness and promote

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The Industry Spoilted by Greed], Pintu Shangye Pinglun (品途商业评论) [PINTU360.COM] (Feb. 1, 2016), http://bit.ly/2si4NUu.

[69] Lin, *supra* note 61, at 18-19.

[70] *See* Lan Yuping (蓝裕平), Fengxian Touzi ke Youxiao Jiejue Zhongxiao Qiye Rongzi Nan (风险投资可有效解决中小企业融资难) [*Venture Capital can Effectively Solve the Problem of Capital Financing of Small and Medium Enterprises*], Guoji Rongzi (国际融资) [INTERNATIONAL FINANCING] (Sep. 8, 2010), http://bit.ly/2x2QstS.

[71] Jiedai Bao Qiye Ban Heng Kong Chu Shi, Zhong Xiao Wei Qiye Rongzinan Youwang Chedi Pojie (借贷宝企业版横空出世 中小微企业融资难有望彻底破解) [*With The Launch of Jiedaibao, SMEs' Financial Gaps May be Solved*], Meiri Toutiao (每日头条) [KKNEWS.CC] (Mar. 1, 2016), http://bit.ly/2v55Yoa.

[72] *Id.*

[73] Lin Lin, *Managing the Risks of Equity Crowdfunding: Lessons from China*, 2 J. CORP. LEGAL STUD. 327, 329 (2017).

[74] *GDP Growth (Annual %)*, WORLD BANK, http://bit.ly/2tpOaGw (last visited May 24, 2017).

[75] Mark Magnier, *As Growth Slows, China Highlights Transition from Manufacturing to Service*, WALL ST. J. (Jan 19, 2016), http://on.wsj.com/1KpyCk5.

[76] Press Release, Guowuyuan (国务院) [State Council], Guowuyuan Guanyu Dali Tuijin Dazhong Chuangye Wanzhong Chuangxin Ruoga Zhengce Cuoshi de Yijian (国务院关于大力推进大众创业万众创新若干政策措施的意见) [Views of the State Council on Policy Measures Relating to Mass Entrepreneurship] (June 16, 2015), http://bit.ly/2t1Q9Oh.

sustainable growth. Developing a national VC market is therefore high on the agenda of the Chinese government.

2. Increasing Capital Supply via Government Guidance Funds

Funds for VC investment can be divided into two types depending on their source: government funding[77] and private funding. Government funding has been recognized as one of the most important sources of funding for fueling entrepreneurship across countries, after bank credit.[78] Many countries have issued various government programs to support entrepreneurial businesses, typically through setting up government-sponsored funds to make investments in start-ups. Recent examples include New Zealand's Venture Investment Fund ("NZVIF")[79] and Singapore's Early Stage Venture Fund ("ESVF") program.[80]

In China, VC funding has been provided to tech start-ups through government-sponsored programs, particularly through Government Guidance Funds ("GGF") (*zhengfu yindao jijin*), which are designed to increase the supply of VC to early-stage enterprises and implement national industrial policy by directing capital into government encouraged innovative industries.[81]

The size of the government program is important to VC financing. A public program that is too small would hardly have any impact on a large and diverse economy, while a program that is too large might crowd out private funding and obstruct market forces in the allocation of start-up financing.[82] Also, small firms typically face great difficulties in raising capital, due to information asymmetry between entrepreneurs and investors.[83] Government funds are advantageous as they have an "add-on effect" in raising capital: with proper structuring, investors are willing to invest in such funds once government investors have taken the lead.[84]

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77 In this article, government funding typically refers to the capital provided by central and local governments.

78 *See The EY G20 Entrepreneurship Barometer 2013*, ERNST & YOUNG (2013), https://go.ey.com/2uqMw7b. *See also* ERNST & YOUNG, ADAPTING AND EVOLVING: GLOBAL VENTURE CAPITAL INSIGHTS AND TRENDS 2014 (2014), at 14, *available at* https://go.ey.com/1gw404b [hereinafter ERNST & YOUNG – TRENDS 2014].

79 For a detailed analysis of the program, see JOSH LERNER ET AL., A STUDY OF NEW ZEALAND VENTURE CAPITAL AND PRIVATE EQUITY MARKET AND IMPLICATIONS FOR PUBLIC POLICY (LECG 2005), *available at* http://bit.ly/2ujnHqt.

80 Terence Lee, *Singapore Government to Pump $48 Million into Six Venture Capital Funds*, TECHINASIA (Apr. 22, 2014), http://bit.ly/2ujlpGU.

81 *See* Guanyu Changye Touzi Yindao Jijin Guifan Shelin Yu Yunzuo de Zhidao YiJian (关于创业投资引导基金规范设立与运作的指导意见) [Opinion on Venture Capital Fund Specifications and Operational Guidance] (promulgated by the St. Admin. for Industry and Commerce, Oct. 18, 2008), http://bit.ly/2s3806c.

82 LERNER, *supra* note 5, at 117-19.

83 *Id.* at 69.

84 *Id.* at 70.

As shown in Figure 1 and Table 1, the size of the Chinese GGF program arguably used to be too small—only 2% of the total investable amount was contributed by GGFs. This problem was more pronounced in rural areas, where GGFs were so lacking in size that they could not play effective roles in guiding capital flow to start-ups.[85]

To resolve this problem, there has been a new wave of GGFs established at both the central and local levels since 2015. As can be seen from Figure 1, in 2015 alone, 297 GGFs were established with a combined investment amount of RMB 1.5 trillion, which was 5.24 times the amount raised in 2014.[86] As of the end of 2015, there were 780 GGFs in China, managing RMB 2183.447 billion (USD 319.7 billion).[87]

Significantly, at the central government level, a RMB 40 billion (USD 6.5 billion) State Venture Capital Investment Guidance Fund ("SVCIGF") *(guojia xinxingchanye chuangyetouzi yindao jijin)* was set up in 2016 to support start-ups in emerging industries and foster innovation.[88] A National SME Development Fund *(guojia zhongxiao qiye fazhan jijin)* with 60 billion RMB was also set up in the same year to promote the development of SMEs.[89] These two national funds, together with a number of local GGFs, are likely to leverage government funding to attract private investors to participate in the funds.[90]

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[85] Qingke Yanjiu Zhongxin (清科研究中心) [Zero2IPO Research Center], Qingke Paiming: 2016 Zhengfu Yindao Jijin Paiming Qidong Zaiji, Jiemi Wanyi Guimo Yindao Jijin Shichang Geju (清科排名：2016 政府引导基金排名启动在即，解密万亿规模引导基金市场格局) [*Zero2IPO Ranking: 2016 Government Guided Fund Ranking About to Launch, Decipher The Market Structure of Thousand-billion Level Guided Fund*], Touzijie (投资界) [PEDAILY] (Jan. 28, 2015), http://bit.ly/2siKMNF. *See also* Guojia Xinxing Chanye Chuangye Touzi Yindao Jijin Jiang Zhengshi Touru Yunzuo (国家新兴产业创业投资引导基金将正式投入运作) [*SVCIGF Will Be Operating Soon*], Fujian Ribao (福建日报) [FUJIAN DAILY], Aug. 26, 2016 at 7, *available at* http://bit.ly/2s2Z6Wu.

[86] Zerp2IPO Research Center, *supra* note 85.

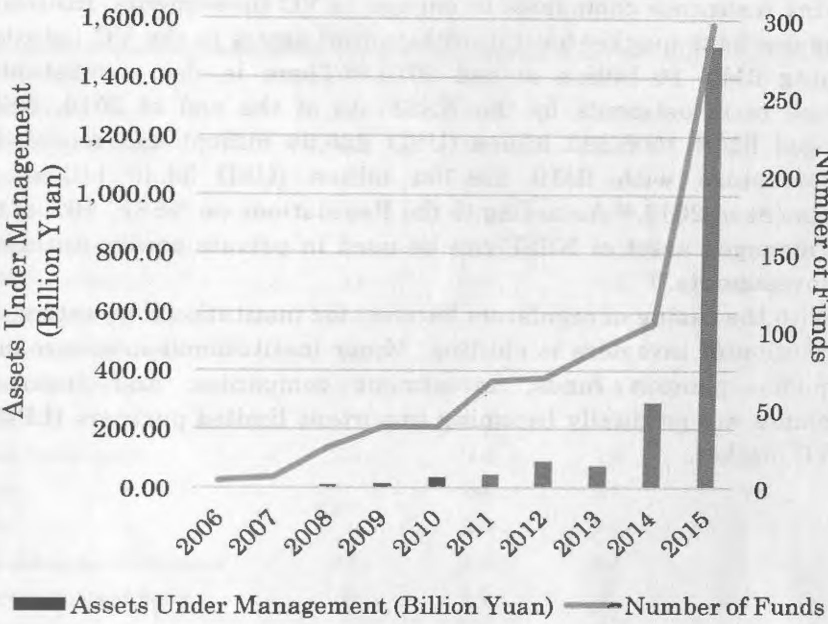
[87] *Id.*

[88] *Id.*

[89] Guojia Zhongxiao Qiye Fazhan Jijin Shouzhi Shiti Jijin Guimo Da 60 Yiyuan (国家中小企业发展基金首支实体基金规模达 60 亿元) [*First National SME Development Fund Reaching 6 Billion in Fund Size*], Zhongguo Xinwen Wang (中国新闻网) [CHINA NEWS.COM] (Aug. 29, 2016), http://bit.ly/2s38cSY.

[90] *See* Zero2IPO Research Center, *supra* note 85.

FIGURE 1: GOVERNMENT GUIDANCE FUNDS IN CHINA (2006-2015)[91]



3. Increasing Capital Supply from Institutional Investors

Institutional investors such as commercial banks, insurance companies, trust companies, and pension funds have long been prohibited from making equity investments due to policy constraints under previous regulations.[92] This has contributed to a predominance of wealthy individuals and families in the VC market, as highlighted in Table 2.

Recognizing the importance of institutional investors as a source of investable capital in long-term and high-risk investments, and in light of recent success stories in Israel and Singapore, which have had attracted global investors to their VC industries,[93] China's regulators have made efforts to promote VC investment from qualified institutional investors and foreign investors.

Regulators – notably including the China Securities Regulatory Commission ("CSRC"), China Insurance Regulatory Commission ("CIRC"), and China Banking Regulatory Commission ("CBRC") – have since 2008 begun to remove restrictions preventing the National Social

[91] Zero2IPO Research Center, *supra* note 81.
[92] *See* Appendix 2, *infra*.
[93] LERNER, *supra* note 5, at 101.

Security Fund ("NSSF"), insurance companies, commercial banks, investment funds, and trust companies from making equity investments.[94] For example, after the CIRC issued a set of guidelines allowing insurance companies to engage in VC investments, insurance companies have quickly built up substantial assets in the VC industry, reaching RMB 10 billion at end 2014.[95] There is also a substantial increase in investments by the NSSF. As of the end of 2015, NSSF managed RMB 1508.592 billion (USD 226.94 billion) and recorded a 15.14% return with RMB 228.704 billion (USD 34.40 billion) on investment in 2015.[96] According to the Regulations on NSSF, 10% of the total managed asset of NSSF can be used in private equity (including VC) investments.[97]

With the easing of regulatory barriers for institutional investors, the distribution of investors is shifting. Major institutional investors such as public pension funds, investment companies, and insurance companies are gradually becoming important limited partners (LPs) in the VC market.

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[94] Since 2008, the NSSF has been permitted to make equity investments in certain funds. Since 2010, insurance companies were allowed to make equity investments. Since 2014, insurance companies were permitted to make investments in VC funds. *See* Appendix 2, *infra*.

[95] Gui Jieying (桂洁英) 2015 Yi Jidu Huoyue LP Zengzhi, 14, 337 Jia, Xianzi, Yindao Jijin Qianzai Guimo Pangda (2015一季度活跃LP增至14, 337家，险资、引导基金潜在规模庞大) [*For the First Quarter of 2015, Active LPs have Increased to 14,337; Insurance Companies and Government Guidance Funds are Potentially the Largest Investors*], Touzijie (投资界) [PEDAILY] (Apr. 28, 2015), http://bit.ly/2tZcvA0.

[96] Baidu Baijia GPLP (百度百家 GPLP), Shebao Jijin: Jiemi Touziquan Da BOSS Xuanxiu PE de Biaozhun (社保基金：揭秘投资圈大BOSS选秀PE的标准) [*Social Security Fund: Revealing the Big Boss' Standards of Drafting PE*], Touzijie (投资界) [PEDAILY] (May 9, 2016), http://pe.pedaily.cn/201605/20160509396982.shtml.

[97] Quanguo Shehui Baozhang Jijin Tiaoli (全国社会保障基金条例) [Regulations of National Social Security Fund], (promulgated by the State Council, Mar. 26, 2016, effective Apr. 1, 2016), http://bit.ly/2s377ur.

TABLE 1: PERCENTAGE OF CAPITAL RAISED BY LPS IN CHINA'S VENTURE CAPITAL AND PRIVATE EQUITY MARKET (BY INVESTABLE AMOUNT) (2011-2015)

	2011(%)[98]	**2012(%)[99]**	**2013(%)[100]**	**2014(%)[101]**	**2015(%)[102]**
Listed companies	28.7	26.3	26.3	25.0	24.5
Public pension funds	20.4	20.7	20.3	19.2	17.8
Sovereign wealth funds	19.0	19.1	18.7	17.5	16.0
Enterprises[103]	3.5	3.4	3.6	4.5	4.5
Fund of funds	5.9	6.4	6.3	6.1	5.6
Investment companies	2.8	4.0	4.1	4.5	4.7
VC PE institutions	3.7	3.2	3.3	3.8	3.8
Enterprise annuity fund	4.3	4.1	4.0	3.7	3.4
Governmental agencies	0.4	0.9	1.0	3.4	5.9
Wealthy families and individuals	0.7	1.1	1.3	1.5	1.6
Private family funds	1.4	1.4	1.3	1.2	1.1
Trusts	3.8[104]	0.2	0.3	0.4	0.5
Banks		3.0	2.9	2.8	4.0
Asset management companies	1.7	2.3	2.3	2.3	2.4
Government-guided funds	1.8	2.1	2.1	2.0	2.0
Endowment funds	—	0.1	0.1	0.1	0.1
Insurance institutions	1.1	1.0	1.1	1.1	1.1
University endowment funds	0.8	0.7	0.7	0.7	0.6
Others	—	0.2	0.2	0.2	0.3
Total	100.0	100.0	100.0	100.0	100.0

[98] 2011 Nian Zhongguo Simu Guquan Touzi Shichang LP Niandu Yanjiu Baogao Jianban (2011年中国私募股权投资市场LP年度研究报告简版) [*Summary of Private Equity Market LP Yearly Research Report 2011*], Touzijie (投资界) [PEDAILY], http://bit.ly/2uCGxtV.

[99] 2012 Nian Zhongguo Simu Guquan Touzi Shichang LP Niandu Yanjiu Baogao Jianban (2012年中国私募股权投资市场LP年度研究报告简版) [*Summary of Private Equity Market LP Yearly Research Report 2012*], Touzijie (投资界) [PEDAILY], http://bit.ly/2sZlejV.

[100] 2013 Nian Zhongguo Simu Guquan Touzi Shichang LP Niandu Yanjiu Baogao Jianban (2013年中国私募股权投资市场LP年度研究报告简版) [*Summary of Private Equity Market LP Yearly Research Report 2013*], Touzijie (投资界) [PEDAILY], http://bit.ly/2sShJ3Q.

[101] 2014 Nian Zhongguo Simu Guquan Touzi Shichang LP Niandu Yanjiu Baogao Jianban (2014年中国私募股权投资市场LP年度研究报告简版) [*Summary of Private Equity Market LP Yearly Research Report 2014*], Touzijie (投资界) [PEDAILY], http://bit.ly/2sZwGfH.

[102] Qingke Nianbao: Simutong Shoulu LP Zengzhi 15,849 Jia, Zhengfu Yindao Jijin, Shangshi Gongsi, Xianzi Cheng 2015 Zui Ri Jigou LP (清科年报：私募通收录 LP 增至15,849家，政府引导基金、上市公司、险资成 2015 最热机构 LP)[*Year 2015: Qingke Annual Report: PE LPs increase to 15,849, Government Guidance Funds, Listed Companies, Insurance Institutions are the most popular institutional LPs*], Touzijie (投资界) [PEDAILY] (Feb. 01, 2016), http://bit.ly/2tBwQf9.

[103] Enterprises excludes listed companies.

[104] In 2011, Trusts and Banks were counted together. *Summary of Private Equity Investment Market LP Yearly Research Report 2011*, *supra* note 98.

TABLE 2: PERCENTAGE OF TYPES OF LIMITED PARTNERS IN CHINA'S VENTURE CAPITAL AND PRIVATE EQUITY MARKET (BY NUMBER) (2011-2015)

	2011(%)[105]	2012(%)[106]	2013(%)[107]	2014(%)[108]	2015(%)[109]
Wealthy families and individuals	46.1	50.2	50.8	54.4	53.0
Enterprises[110]	19.5	17.2	16.6	14.9	14.6
VC/PE institutions	7.0	6.3	6.3	6.2	6.2
Investment companies	4.7	5.9	6.1	8.5	9.4
Government-guided funds	3.7	2.8	2.7	2.0	2.1
Listed companies	3.0	4.3	4.2	3.9	4.7
Asset management companies	3.1	2.3	2.1	1.7	1.7
Governmental agencies	3.0	3.2	3.9	3.1	3.0
Trusts	3.6[111]	0.6	0.7	0.5	0.5
Banks		1.3	1.1	0.8	0.7
Public pension funds	1.9	1.3	1.1	0.8	0.7
Fund of funds	1.8	1.5	1.5	1.3	1.5
University endowment funds	1.0	0.5	0.4	0.3	0.3
Insurance institutions	0.6	0.6	0.6	0.4	0.4
Private family funds	0.5	0.3	0.3	0.2	0.2
Sovereign wealth funds	0.4	0.3	0.3	0.2	0.1
Enterprise annuity fund	0.1	0.1	0.1	0.1	0.1
Endowment funds	--	0.3	0.3	0.2	0.2
Others	--	1.0	1.0	0.9	0.8
Total	100.0	100.0	100.0	100.0	100.0

[105] *Summary of Private Equity Investment Market LP Yearly Research Report 2011*, *supra* note 98.

[106] *Summary of Private Equity Investment Market LP Yearly Research Report 2012*, *supra* note 99.

[107] *Summary of Private Equity Investment Market LP Yearly Research Report 2013*, *supra* note 100.

[108] *Summary of Private Equity Investment Market LP Yearly Research Report 2014*, *supra* note 101.

[109] *Year 2015: Qingke Annual Report: PE LPs increase to 15,849, Government Guidance Funds, Listed Companies, Insurance Institutions are the most popular institutional LPs*, *supra* note 102.

[110] Enterprises exclude listed companies.

[111] In 2011, Trusts and Banks were counted together. *Summary of Private Equity Investment Market LP Yearly Research Report 2011*, *supra* note 98.

TABLE 3: PERCENTAGE OF CAPITAL RAISED IN THE U.S. VENTURE CAPITAL MARKET[112] (BY AMOUNT)

U.S.	2014(%)	2015(%)
Wealthy investors and family offices	8	10
Corporations	5	1
Public pension funds	32	31
Corporate pension funds	6	10
Union pension funds	1	2
Insurance companies	6	10
Endowments	5	7
Sovereign wealth funds	12	6
Funds of funds	6	3
Discretionary advisers	1	2
GP contributions	1	2
Bank/financial services	9	2
Others	8	15
Total	100	101 (due to rounding)

4. Increasing Capital Supply from Foreign Investors

Since 1995, China has promulgated regulations aimed at promoting the establishment of foreign funds. For example, the *Administrative Measures on Foreign-Established Industry Investment Funds* allows Chinese firms to raise funding overseas together with foreign firms,[113] and the *Regulations on the Administration of Foreign Invested Venture Capital Enterprises* allowed foreigners intending to invest in the Chinese market to do so by setting up a Foreign Invested Venture Capital Enterprise ("FIVCIE").[114]

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[112] LAURA KREUTZER, PENSIONS ARE STILL LP TOP DOGS, BUT WEALTHY INVESTORS GAIN GROUND 18 (2015), http://bit.ly/2vcOHtl.

[113] Sheli Jingwai Zhongguo Chanye Touzi Jijin Guanli Banfa (设立境外中国产业投资基金管理办法) [Procedures for the Management of China's Industrial Investment Funds Abroad] (promulgated by the People's Bank of China, Sept. 6, 1995, effective Sept. 6. 1995) http://bit.ly/2u4009D. This regulation has since repealed. Feizhi de Guizhang he Guifanxing Wenjian (废止的规章和规范性文件) [Repealed Regulations and Standards] (promulgated by the People's Bank of China, Jan. 5, 2007, effective Jan. 5, 2007), art. 36, http://bit.ly/2u3tBA9.

[114] Waishang Touzi Chuangye Touzi Qiye Guanli Guiding (外商投资创业投资企业管理规定) [Provisions Concerning the Administration of Foreign-funded Venture Investment Enterprises] (promulgated by the Ministry of Foreign Trade and Economic Cooperation, the Ministry of Science & Technology, the State Administration for Industry and Commerce, the State Administration of Taxation and the State Administration of Foreign

Since 2011, Shanghai, Beijing, Tianjin, Chongqing, and Shenzhen have promulgated regional Qualified Foreign Limited Partner ("QFLP") programs to attract foreign qualified institutional investors to make equity investments in their regions.[115] Under the QFLP, foreign-invested funds and fund management companies are permitted to convert their foreign currency capital into RMB in order to invest into RMB funds.[116] In 2012, the Renminbi Qualified Foreign Limited Partner ("RQFLP") program was launched by Shanghai to broaden the scope of foreign investors eligible to make VC investments.[117] Under RQFLP, qualified foreign fund managers are permitted to raise offshore RMB from offshore investors to invest in RMB funds set up in Shanghai.[118]

5. Tax Incentives

A favorable tax environment is an important factor in increasing the supply of private capital in a VC market.[119] Many local Chinese governments have implemented preferential tax policies for VC firms that serve as general partners (GPs), and for their investors who serve as the limited partners (LPs) in VC funds (see Table 4).[120]

Today, individuals and families form the majority of LPs (by number) in the market. As of 2015, 53% of LPs in China are wealthy individuals and families,[121] 14.6% are private enterprises, and 9.4% are investment companies.[122] As of 2014, China had the largest population of high-net-worth individuals in Asia (890,000), holding a combined wealth of USD 4.5 trillion, a 19.3% increase from the previous year.[123] Further, the majority of leading VC firms are also both private and foreign.[124] There is also a growing number of VC funds set up by non-

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Exchange, Jan. 30, 2003, effective Mar. 1, 2003, revised Oct. 28, 2015), art. 2, http://bit.ly/2tlDhVP.

[115] Ming Wang et al, CHINA'S FINANCIAL MARKETS: ISSUES AND OPPORTUNITIES 128 (2014).

[116] Sheppard Mullin Richter & Hampton LLP, *Renminbi Qualified Foreign Limited Partner: An Incremental Step Toward RMB Internationalization in the Private Equity Industry*, LEXOLOGY (MAY 20, 2013), http://bit.ly/2t23BBN.

[117] Mayer Brown LLP, *Shanghai Launches New RQFLP Programme*, LEXOLOGY (JAN. 14, 2013), http://bit.ly/2s2PZEX.

[118] *Id.*

[119] John Armour & Douglas Cumming, *The Legislative Road to Silicon Valley*, 58 OXFORD ECON. PAPERS 598, 603-13, 617-26 (2006).

[120] Gui Jieying, *Cancellation of PE Tax Incentives Causes a Stir amid the Trend of Market Innovation and Mass Entrepreneurship*, PEDAILY.CN (Apr. 10, 2015), http://bit.ly/2tlZ6Eb.

[121] The number of wealthy individual and families is big while the fund size they raise is small (1.6% in year 2015). *See* Table 2, *supra*.

[122] *See* Table 2, *supra*.

[123] *Annual World Wealth Report*, CAPGEMINI & RBC WEALTH MANAGEMENT (2015), http://bit.ly/2tqfwwa (last visited May 24, 2017).

[124] *See The Top 50 VC Firms of the Year 2015* (ranked by Zero2ipo), PEDAILY.CN (Dec. 4, 2015), http://bit.ly/2snlpW0.

state owned companies,[125] including Chinese internet giants Tencent and Alibaba.[126] Interviewees have stated that these tax incentives have greatly increased their interests in making VC investments.[127]

TABLE 4: TAX RULES FOR PRIVATE EQUITY/VC FUNDS AT SELECTED LOCATIONS IN CHINA[128]

Region	**Tax Regulations**[129]
Beijing	GPs and LPs pay individual income tax at a rate of 20%.[130]
Tianjin	Individual GPs and LPs pay individual income tax at a rate of 20%. Within the Tianjin Economic-Technological Development Area, individual partners receive 100% subsidies for tax on income beyond the 20% individual income tax of individual partners.[131]
Shanghai	Individual GPs pay individual income tax at a rate of 35% for income above RMB 50,000; LPs pay individual income tax at a rate of 20% for equity investment income.[132]
Chongqing	Individual GPs pay individual income tax at progressive tax rates ranging from 5-35%; LPs pay individual income tax at a rate of 20%. Pursuant to China's Western Development program, funds organized as companies are subject to corporate income tax at a rate of 15%.[133]
Shenzhen	Individual GPs pay individual income tax at a progressive tax rate ranging from 5-35%; LPs pay individual income tax at a rate of 20%.[134]

6. Improving Exit Environment

The establishment of the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE) in 1990 offered new exit channels for

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[125] *See* ERNST & YOUNG – 2014 - TRENDS, *supra* note 78, at 20.

[126] Tencent and Alibaba are two top Chinese e-commerce companies.

[127] Interview with Mr. Tian (anonymity requested), Partner, Songhe Yuanwang Capital, in Singapore (Dec. 30, 2016).

[128] Gui, *supra* note 120.

[129] The private equity funds in this table also include VC funds.

[130] Liu Tianyong (刘天永), Simu Guquan Jijin Caiyong Shenme Zuzhi Xingshi Zui Jie Shui? (私募股权基金采用什么组织形式最节税?) [*What is the most tax-efficient structure for Private Equity Funds?*], Zhongguo Kuaji Shiye (中国会计视野) [CHINA ACCOUNTING VISION] (Oct. 18, 2016), http://bit.ly/2sni4Gx.

[131] *Id.*

[132] *Id.*

[133] Chen Zhonghua & Chai Nan (程中华 & 柴楠), Simu Guquan Touzi Jijin Shuishou Zhengce Daibipin (私募股权投资基金税收政策大比拼) [*Comparison of Tax Policies for Private Equity Funds*], Xinlang Caijing (新浪财经) [SINA FINANCE] (May 23, 2017), http://bit.ly/2sS9tiq.

[134] Liu, *supra* note 130.

VC investments. Before that, VC-backed firms were unable to exit via IPOs. In 2016, 148 VC and private equity backed companies were listed on China's stock markets via IPO.[135] In October 2009, the exit environment was further improved by the launch of a new NASDAQ-like secondary board ChiNext.[136] ChiNext provides more relaxed listing requirements as compared to the two main boards, i.e. the SSE and SZSE.[137] The launch of ChiNext has indeed facilitated VC-backed exits. In the five-year span after ChiNext's launch, 519 exits were made via ChiNext, with a market return of RMB 743.4 billion.[138] As of October 23, 2014, 519 companies that were backed by VC or private equity were listed on ChiNext.[139]

In 2013, the nation-wide expansion of the National Equities Exchange and Quotation ("NEEQ") system (also known as the "New Third Board") also provided an important exit vehicle for VC-backed firms.[140] Unlike the Main Boards and ChiNext, all of which employ the merits-based approval system for IPOs, the NEEQ uses the filing system, under which board listings are not subject to CSRC approvals.[141] Such a filing system involves largely reduced listing costs for the applicants.[142] Moreover, the relatively low listing requirements and shorter listing timelines have greatly expedited financing for SMEs and start-ups, especially for the companies that were unable to meet the listing standards of the Main Boards or ChiNext.[143] In the year 2016 alone, 1230 VC-backed companies were quoted on the NEEQ, accounting for 61.5% of the total exits in 2016.[144]

C. *Investment Vehicle*

In order to create the right incentives for investment in attractive technologies and businesses, a business vehicle that appropriately allocates legal rights and obligations must be available. The limited partnership has been the predominant vehicle for collecting investment funds in the U.S. since the 1970s.[145] The limited partnership, managed by a venture capital firm, collects and holds funds for future investment

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[135] Zero2IPO Research Center, *supra* note 20.

[136] *ChiNext, China's Nasdaq*, PEOPLE'S DAILY, http://bit.ly/2tlIMnm.

[137] Lin, *supra* note 61, at 17.

[138] *Id.*

[139] *See* Zuo Yonggang (左永刚), Chuangyeban Wunian VC/PE Cheng Zuida Yingjia (创业板五年 VC/PE 成最大赢家) [*Five Years of GEB: VC/PE is the Biggest Winner*], Zhengquan Ribao (证券日报) [SECURITIES DAILY] (Oct. 23, 2014), http://bit.ly/2tZmtBz.

[140] Lin, *supra* note 61, at 24.

[141] *Id.*

[142] *Id.*

[143] *Id.*

[144] Zero2IPO Research Center, *supra* note 20. For further information on the correlation between the stock market and the VC market in China, see Lin, *supra* note 61, at 17.

[145] *See* LERNER, *supra* note 5, at 10.

and the shares of start-ups in which it has invested. In recent years, a number of jurisdictions, including Singapore,[146] New Zealand,[147] Taiwan,[148] Japan,[149] and Switzerland,[150] have introduced the limited partnership into their business menus to attract more equity investment in their regions. Other jurisdictions that already have the limited partnership vehicle, such as the United Kingdom[151] and Australia,[152] have also recently amended their limited partnership regimes in order to encourage the growth of VC investment.

The central concept characterizing the limited partnership is that there are two types of partners. LPs who make capital contributions to the firm enjoy a limited liability shield and have no right to participate in its management, whereas GPs have the right to manage the firm and bear unlimited liability for the debts and obligation of the firm.[153] The combination of limited liability and general liability, and the prohibition of LPs to take part in the management of the firm, is particularly attractive to investors who want to delegate management of their funds to professional venture capitalists.[154] The limited partnership is governed by a partnership agreement that offers flexibility for the partners to customize terms to align the interests of the investors and the venture capitalists.[155]

Further, as compared to companies, limited partnerships enjoy a greater degree of confidentiality over their financial information—an attractive feature for investors who do not wish to disclose their

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146 Singapore Limited Partnerships Act 2008 (Cap. 163B). The act came into operation on May 4, 2009. *Id.*

147 Limited Partnerships Act 2008 (N.Z.). The act came into force on May 2, 2008. *Id.* at s. 2.

148 Taiwan's Limited Partnership Law was passed on June 24, 2015. Youxian Hehuo Fa (有限合夥法) [Limited Partnership Law] (Taiwan).

149 Tōshi jigyō yūgen sekinin kumiai keiyaku ni kansuru hōritsu [Limited Partnership Act for Investment], Law No. 90 of 1998 (Japan).

150 A special form of limited partnership, designed for collective investments in alternative investment area, was introduced into Swiss law in 2007. *See* Hannes Glaus, *New Partnership*, INT'L. FIN. L. REV., June 2007, at 54, 54.

151 The British Government announced in 2006 that it would reform the Limited Partnership Act 1907 to clarify and modernize the law relating to limited partnerships. Certain changes based on these recommendations were brought forward in a Legislative Reform Order (LRO) in June 2009.

152 In 2007, a Tax Laws Amendment (2007 Measures No. 2) Bill was introduced to Australia in order to relax the eligibility requirements for foreign residents investing in VC LPs and Australian VC funds. *See* Press Release, Minister for Revenue and the Assistant Treasurer, Government to Make Further Improvements to the Tax System (Mar. 29, 2007) *available at* http://bit.ly/2t23o1q.

153 *See, e.g.*, DEL. CODE ANN. tit. 6, § 17-101 et seq. (West 2010); Singapore Limited Partnerships Act 2008 (Cap. 163B), s 6; Limited Partnerships Act 2008, ss 25-31 (N.Z.).

154 It must be noted that when the GP is organized as a corporation, the issue of unlimited liability has effectively been sidestepped.

155 Joseph McCahery & Erik Vermeulen, *Limited Partnership Reform in the United Kingdom: A Competitive, Venture Capital Oriented Business Form*, 5 EUR. BUS. ORG. L. REV. 61, 72 (2004).

investment.[156] Limited partnerships also generally enjoy considerably lower formality costs as compared to corporations,[157] as well as pass-through tax treatment.[158]

1. Adoption of the Limited Partnership and Its Popularity

Recognizing the importance of limited partnerships to venture capital, the Chinese legislature has also introduced this new business vehicle in China[159] under the revised Partnership Enterprise Law ("PEL").[160] The adoption of the limited partnership was part of the government's strategy to develop scientific innovation as articulated in its 11th Five-Year Plan (2006-2010),[161] which identified the promotion of VC investment as a critical element for achieving "independent innovation" and sustainable economic progress.[162]

Shortly after the enactment of the revised PEL, the first Chinese limited partnership was set up on June 27, 2007.[163] Today, the limited partnership has become the most popular business vehicle among newly raised VC funds in China.[164]

Consistent with the benefits of limited partnerships elsewhere in the world, the Chinese limited partnership regime also have two types of partners: GPs, who are jointly and severally liable for the debts and liabilities of the firm, and LPs, who are only liable to the extent of their capital contributions.[165] LPs are not permitted to "carry out partnership affairs", while GPs have the right to conduct the day-to-day management of the firm.[166] The PEL also provides a "safe-harbor" list of

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156 UK LAW COMMISSION & SCOTTISH LAW COMMISSION, LIMITED PARTNERSHIPS ACT 1907: A JOINT CONSULTATION PAPER 3 (CONSULTATION PAPER NO. 161; DISCUSSION PAPER NO. 118, 2001), *available at* http://bit.ly/2s2NGlz.

157 *Features of a Limited Liability Partnership,* ACCOUNTING AND CORPORATE REGULATORY AUTHORITY, http://bit.ly/2uujfFA.

158 UK LAW COMMISSION & SCOTTISH LAW COMMISSION, *supra* note 156, para. 1.5-1.6.

159 Yan Yixun (严义埙), Hehuo Qiye Fa Xiuding de Liyou (合伙企业法修订的理由) [*Reasons of Revising the Partnership Enterprise Law*], Zhongguo Renda Wang (中国人大网) [NPC.GOV.CN] (May 8, 2006), http://bit.ly/2t1Sglp.

160 Hehuo Qiye Fa (合伙企业法) [Partnership Enterprise Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) [hereinafter Partnership Enterprise Law], http://bit.ly/2siBv8s.

161 *See* Guomin Jingji he Shehui Fazhan Di Shiyi Ge Wunian Guihua Gangyao (国民经济和社会发展第十一个五年规划纲要) [Outline for tbe Eleventh Five-year Plan for the National Economic and Social Development] (promulgated by the Standing Comm. Na'l People's Cong., Mar. 14, 2006), http://bit.ly/2sno8P6.

162 *See* Yan, *supra* note 159.

163 Li Jingying (李静颖), Wenzhou Shoujia PE Banlu Zheyi Donghai Chuangtou Zhuanru Huanya Chuangtou (温州首家 PE 半路折翼东海创投转入环亚创投) [*The First Venture Capital Limited Partnership in Wenzhou Donghai Venture Capital is Now a Subsidiary of Huanya Chuangtou*], Diyi Caijing Ribao (第一财经日报) [FIRST SECURITIES DAILY] (May 8, 2008), http://bit.ly/2tlNAsy.

164 *See* Table 5, *infra.*

165 Partnership Enterprise Law, *supra* note 126, at art. 2.

166 *See id.*, arts. 2, 67, and 68.

the activities in which LPs may engage without being viewed as "carrying out the partnership affairs," in order to assist LPs in demarcating the legitimate scope of their participation in the firm's activities.[167]

In addition, the Chinese limited partnership provides an efficient contract between the GP and the LPs.[168] First, in contrast to England[169] and Singapore[170] which adopt the aggregate approach towards limited partnership and do not consider the limited partnership as a separate legal entity, the Chinese regime does possess entity features and does have certain attributes which are consistent with separate legal personality, such as the right to hold assets,[171] to sue, and be sued.[172] Furthermore, the limited partnership is not dissolved upon the dissociation of partners,[173] and a creditor's recourse against the GP is postponed until he has exhausted his remedies against partnership assets.[174] The entity approach adopted by the Chinese law helps to facilitate the continuity of the limited partnership. Second, apart from allowing limited partnerships to enjoy pass-through tax treatment at the entity level in China, there are also a number of preferential tax policies for LPs and GPs in VC funds provided by the local governments.[175]

Prior to the introduction of limited partnership, the major business forms for domestic venture capitalists to raise funds were the Limited Liability Company ("LLC"), the Joint Stock Company ("JSC"), the general partnership, and trust. These types of entities had disadvantages that discouraged investment. LLCs and JSCs faced double tax treatment, substantial formation costs and substantial financial disclosure requirements,[176] while general partnerships gave rise to unlimited liability for all partners and a similarly harsh tax

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167 *See id.*, arts. 68.

168 *See generally* ZHU & GE *supra* note 60.

169 Martin Palmer, *UK: English Limited Partnership Registration*, MONDAQ.COM (May 11, 2016), http://bit.ly/2t2aVPv.

170 ACCOUNTING AND CORPORATE REGULATORY AUTHORITY, *supra* note 157.

171 Partnership Enterprise Law, *supra* note 126, at arts. 20, 21, 22.

172 *See* Minshi Susong Fa (民事诉讼法) [Civil Procedure Law] (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug 31, 2012, effective Jan. 1, 2013), art. 49, WESTLAW CHINA, *available at* http://bit.ly/2tlSqGV.

173 Partnership Enterprise Law, *supra* 126, at art. 48.

174 *Id.* at art. 38.

175 *See* Table 4, *infra*.

176 Before the revision of the PRC Company Law 2005, it was not easy to incorporate a company in China as the minimum capital required for the Limited Liability Company and the Joint Stock Company was RMB 30,000 and RMB 5 million respectively. *See* Jichun Shi, How Chinese Enterprises to Live to Freedom and Competition: Further Integration of the Corporate Law and Competition Law of China with Global Standards 13-14 (NYU Global Fellows Program, Oct. 25, 2006), http://bit.ly/2tZlXn4. For tax issues, see NANCY MARSH ET AL, PARTNERSHIPS IN CHINA: THE NEW FRONTIER, par. 5.1 (2008), http://bit.ly/2tlF78Q.

burden.[177] As for the trust-type fund,[178] although it also enjoys pass-through tax treatment,[179] due to the complex structure, insufficient protection to investors,[180] as well as the lack of registration regime,[181] it has not been a popular business form for fund raising in China.[182]

TABLE 5: PROPORTION OF DIFFERENT TYPES OF BUSINESS FORMS USED FOR NEWLY RAISED VC FUNDS (2008-2013)[183]

	Limited Partnership	**Company**	**Trust**	**Others**	**Total**
2013	68.96%	24.14%	0.00%	6.90%	100%
2012	57.50%	35.00%	5.00%	2.50%	100%
2011	69.64%	28.57%	0.00%	1.79%	100%
2010	46.56%	45.80%	1.53%	6.11%	100%
2009	25.20%	67.48%	3.25%	4.07%	100%
2008	51.19%	39.29%	4.76%	4.76%	100%

177 MARSH, supra note 176. Before 2000, the PRC partnership enterprise was subject to taxation both at the enterprise level and upon distribution. Since 2000, the partnership enterprise has become tax transparent.

178 The trust-type fund emerged in China in 2008. It is regulated by Xintuo Gongsi Siren Guquan Touzi Xintuo Yewu Caozuo Zhiyin (信托公司私人股权投资信托业务操作指引) [Operational Guidelines for Private Equity Investment Business Trust Companies] (promulgated by the China Banking Reg. Comm., June 25, 2008, effective, June 25, 2008), http://bit.ly/2tXNF68.

179 Deloitte, *New Belgium-China Income Tax Treaty Applicable as of 1 January 2014*, 2 (Jan. 27, 2014), http://bit.ly/1iQU98h.

180 For example, in contrast with GPs, trustee companies do not bear unlimited liability. Such companies only bear unlimited liability in specific situations, such as illegal activities or breach of the trust agreement, while bearing no liability for any failures under ordinary operating situations. As such, the accountability of the trustee company towards the fund is limited. See Jianbo Lou, An Overview of PRC Trust Law and Trust Business, 6-7 (unpublished manuscript), http://bit.ly/2tmcyrX.

181 As the trust regime lacks a compulsory public registry, the identity of the beneficiaries cannot be determined, and this becomes an obstacle when the portfolio company of the trust-type VC fund wants to conduct an IPO in China. CSRC requires pre-listed companies to retire any shares held by trustee companies. *See* Zhongguo Xintuo Yexiehui (中国信托业协会) [China Trust Industry Association], Hangye Fazhan Baogao Zhi Chanpin Pian: Siren Guquan Touzi Xintuo (行业发展报告之产品篇：私人股权投资信托) [*Industry Development Report on Products: Private Equity Investment Trust*], Xinlang Caijing (新浪财经) [SINA FINANCE] (NOV. 10, 2016), http://bit.ly/2tvgk2z.

182 *See* Table 5, *infra*.

183 *See* CHINA CONSTRUCTION PRESS, CHINA VENTURE CAPITAL ANNUAL REPORTS 2008-2013 (on file with author). The sample size for the years 2008 to 2013 is 84, 123, 131, 112, 40 and 29 respectively.

2. Introduction of Foreign-Invested Limited Partnership

To allow foreign investors to use the limited partnership in raising funds, the State Council issued a new measure to allow foreign venture capitalists and investors to set up a foreign invested limited partnership (FILP).[184] It offers a new business vehicle for foreigners to raise VC funds in China.

Prior to this, one of the popular business vehicles used by foreigners to raise funds was the FIVCIE.[185] As stated above, the FIVCIE was an important legal innovation in its time, but it had flaws. Compared to the FIVCIE,[186] the FILP is subject to fewer procedural requirements in its establishment and operation. For example, unlike the FIVCIE which requires the fund's manager to satisfy certain capital and experience requirements,[187] there is no such requirement under the FILP. Further, unlike the FIVCIE regime which requires the fund manager to contribute at least 1% of the total capital,[188] the fund's manager under the FILP is not required to make a minimum contribution and is allowed to contribute in the form of services.[189] Also, FILPs can be registered and may reduce their capital without obtaining governmental approval.[190] They are not required to make up for accumulated losses or to allocate part of their profits to a reserve fund.[191] They enjoy flexibility in the structuring of profit distributions without reference to capital contribution.[192] In the FILP, the Chinese partners may be designated as LPs, while foreign investors may serve as GPs, giving them greater control over the fund.[193]

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[184] Waiguo Qiye Huozhe Geren zai Zhongguo Jingnei Sheli Hehuo Qiye Guanli Banfa (外国企业或者个人在中国境内设立合伙企业管理办法) [Administrative Measures on the Establishment of Partnership Enterprises by Foreign Enterprises or Individuals] (promulgated by. St. Council, Nov. 25, 2009, effective Mar. 1, 2010), http://bit.ly/2tlSxC9.

[185] Waishang Touzi Chuangye Touzi Qiye Guanli Guiding (外商投资创业投资企业管理规定) [Provisions Concerning the Administration of Foreign-Funded Venture Investment Enterprises] (promulgated by the Ministry of Foreign Trade and Economic Cooperation, the Ministry of Science & Technology, the State Administration for Industry and Commerce, the State Administration of Taxation, and the State Administration of Foreign Exchange, Jan. 30, 2003, effective Mar. 1, 2003), *available at* http://bit.ly/2s2FXDT.

[186] *See* text accompanying note 113, *supra*.

[187] Provisions Concerning the Administration of Foreign-Funded Venture Investment Enterprises, *supra* note 176, art. 7(2) (providing that the mandatory investor (i.e. the fund manager) must have managed assets to the value of at least USD 100m in the most recent 3 years before the application).

[188] *Id.*, art. 7(6).

[189] Baker & McKenzie, *China Issues Foreign-invested Partnership Rules* 1 (Dec. 2009), http://bit.ly/2sSfKux.

[190] Samuel H. Shaddox, *China's Foreign Invested Partnership Enterprise Law: The Lifeless or Sleeping Dragon?* 22 PACIFIC RIM L. & POL. J. 469, 473-474 (2013). *See also* Appendix 2, *infra*.

[191] *Shaddox, supra* note 182, at 471-74.

[192] *Id.*

[193] *Id.*

D. Entrepreneurs

The last essential factor for creating a VC market is the availability of entrepreneurs. This presents a "chicken and egg" challenge. Without entrepreneurs there will be no capital to fund them, and without capital to fund them, there will be no entrepreneurs—even if individuals with the requisite qualities are available.

1. Policies and Tax Reliefs to Strengthen Entrepreneurship

First, as indicated in Appendix 2, since 1978, a large number of substantive laws and policies were promulgated to serve the mission of the "Four Modernizations" Policy and the "Strategy of Invigorating China through Science and Education" (*ke jiao xing guo*). Since May 2013, the central government has issued at least 22 documents, including two fundamental opinions issued by the State Council to embark on the *Mass Entrepreneurship and Innovation* reform.[194] This was followed by several specific measures that aimed to improve institutional mechanisms to facilitate entrepreneurship and innovation, for instance, by deepening business system reforms, strengthening intellectual property protection and establishing a mechanism for the training and hiring of talented professionals.[195]

These policies resulted in the emergence of young entrepreneurs in China's VC market.[196] It is reported that 2.3% of the university graduates of 2013 have chosen to start businesses.[197] There are also an increasing number of overseas returnees (*haigui*)[198] who have started businesses with their technological knowhow and overseas resources. As of 2014, the number of overseas returnees stood at 1.8 million, accounting for 51.4% of total overseas graduates.[199] In an interview conducted with 913 overseas returnees, 78.4% of whom had returned after 2010,[200] more than half indicated that their decisions to return to China was largely based on the attractive entrepreneurial environment,[201] reflecting the positive effect of government policies in

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194 Views of the State Council on Policy Measures relating to Mass Entrepreneurship, *supra* note 76.

195 *Id.*

196 *See, e.g., id.*

197 Chen Zhengfei (陈正飞), 90hou "Chuangke" Jueqi: Tiansheng de Chuangyejia (90后"创客"崛起：天生的创业家) [*Post-90s Entrepreneurs: Genius Entrepreneurs*], Juece Wang (决策网) [JUECE.NET.CN] (May 4, 2015), http://bit.ly/2snteef.

198 Haigui (海归) is a Chinese language slang term for Chinese people who have returned to mainland China after having studied abroad for several years.

199 Quanqiuhua Zhiku (全球化智库) [CENTER FOR CHINA & GLOBALIZATION], Zhongguo Haigui Jiuye Chuangye Diaocha Baogao 2015 (2015 中国海归就业创业调查报告) [2015 CHINA OVERSEAS RETURNEES ENTREPRENEURSHIP REPORT] (2015), *available at* http://bit.ly/2uW8egn. The number of overseas returnees in 2014 was 3.2% more than the number in 2013, and almost 10% more than that in 2012.

200 *Id.*

201 *Id.*

encouraging entrepreneurship.

Second, various forms of tax relief have been provided to national scientific parks and incubators to encourage innovation.[202] For example, qualified incubators are exempted from paying real estate taxes and taxes on using urban land.[203] They are also exempted from business taxes for income received from renting work sites, housing, and incubation services provided to incubated companies.[204] Such developments have caused a nationwide surge in the number of incubators, from 534 in 2005 to 896 in 2010, and then to 1500 in 2015.[205] As of March 2015, there were more than 1,600 incubators supporting more than 80,000 start-ups.[206] In 2015, China saw 1,102,000 invention patent applications, which was 18.7% more than the previous year, with 359,000 being authorized.[207]

2. Entrepreneur-Friendly Company Law Reforms

Various company law reforms to promote entrepreneurship have been recently carried out in a number of jurisdictions, including several EU states,[208] Taiwan,[209] and Singapore.[210] These reforms typically focus

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[202] The 2006 *Outline of the National Program for Long- and Medium-Term Scientific and Technological Development* mentioned that "qualified science and tech incubators and National University Science Parks will be exempt from corporate tax, income tax, property tax, and urban land use tax for a specified period of time".

[203] Under the Notice on Issues concerning the Taxation Policy of the National University Science Park 2007, "real estate and land may be used by qualifying incubators for their own purposes or be offered to incubated companies for free or for a rent. Such real estate and land shall be exempted from real estate taxes and land use taxes." Guanyu Guojia Daxue Kejiyuan youguan Shuishou Zhengce Wenti de Tongzhi (关于国家大学科技园有关税收政策问题的通知) [Notice on Issues concerning the Taxation Policy of the National University Science Park] (issued by the Minstry of Finance & State Administration of Taxation, Aug. 20, 2007), http://bit.ly/2tpOl4N.

[204] In 2013, the Ministry of Finance and the State Administration of Taxation extended the abovementioned policy to 31 December 2015. *See* Press Release, State Administration of Taxation of The People's Republic of China, MOF, SAT Issue Circulars on Preferential Tax Policies for Incubators and University Science Parks 2014, (Jan. 15, 2013), http://bit.ly/2snnP7d.

[205] Wan Ge (万格), Touzhong Guandian: Guonei Fuhuaqi Fazhan Shitou Xunmeng, Zijin Yali cheng Zhuyao Pingjing (投中观点：国内孵化器发展势头迅猛 资金压力成主要瓶颈)[*China Venture Viewpoint: domestic incubators are developing rapidly, and pressure to raise capital is becoming the major bottleneck*], 投中网 [CHINAVENTURE.CN] (Jan. 27, 2014), http://bit.ly/2tm7YcW.

[206] *See* Keji Buzhang Wan Gang Da Jizhe Wen (科技部长万钢答记者问) *Science and Technology Minister Wan Gang Answers Reporters' Questions,* 中国网 [CHINA.ORG.CN] (May 30, 2015), http://bit.ly/2snoYvm.

[207] Press Release, State Intellectual Property Office of the PRC, China Received over 1 Million Invention Patent Applications in 2015 (Jan. 20, 2016), http://bit.ly/2fJpqUc.

[208] Mette Neville & Karsten Engsig Sorensen, *Promoting Entrepreneurship - The New Company Law Agenda*, 15 EUR. BUS. ORG. L. REV. 545 (2014).

[209] In 2015, Taiwan introduced a new corporate form, the Closely-Held Company Limited by Shares, to provide flexibility for fund-raising for start-ups. *See* Joseph P.Y. Tseng & Jacqueline Fu, *Amendment to Taiwan's Company Act Establishes 'Closely-Held*

on updating existing corporate forms, introducing new types of private companies, reducing capital requirements and procedures for setting up companies, as well as providing more flexibility in share transfer and corporate governance. While some may argue that company law reforms alone do not strengthen enterprises and entrepreneurship, empirical studies have found that fine-tuning regulations for companies can have a positive effect on entrepreneurship,[211] in particular reducing the minimum capital requirement.[212]

The LLC is a prominent business form for portfolio companies (i.e. start-up firms) in the Chinese VC market. In recent years, important amendments have been made to the PRC Company Law to modernize the corporate regime, to reduce the costs in setting up a business, and to facilitate the development of VC.

First, one of the most significant company law reforms was the abolition of certain registered capital requirements for domestic and foreign companies in 2013.[213] Prior to this revision, LLCs were required to have a minimum registered capital of at least RMB 30,000 (USD 4,800).[214] Also, domestic and foreign investors were required to contribute the first installment of registered capital within 90 days from the date of incorporation, and the remainder within two years. The amendment removes this statutory threshold. Since March 1, 2014, investors have been free to decide the amount of registered capital in their companies. Companies are no longer required to appoint an accounting firm to verify mandatory capital contributions and register the paid-in capital amount with the company registration agency.

Second, the newly introduced "three-in-one" business registration reform is another noteworthy improvement in the ease of starting business in China. Starting from October 1, 2015, there is no need for different government agencies to issue business certificates separately for enterprises applying for registration. Unified registration procedures, numbering, and coding rules have been put into practice nationwide.[215]

Third, an additional important reform is the launch of a new annual

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Company Limited by Shares' to Provide Flexibility on Fund-Raising for Startups, K&L GATES (Jul 27, 2015), http://bit.ly/2ujnAv2.

[210] *See* Lin Lin & Michael Ewing-Chow, *The Doing Business Indicators in Minority Investor Protection: The Case of Singapore*, 1 SING. J. LEGAL STUD. 46 (2016).

[211] *See* Neville & Sorensen, *supra* note 208, at 584 ("there is little doubt that legislation on companies can contribute to promoting entrepreneurship.").

[212] *Id.*

[213] On December 28, 2013, the Standing Committee of the National People's Congress passed certain amendments to the PRC Company Law of 2006, effective as of March 1, 2014. *See* Gongsi Fa (公司法) [Company Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 28, 2005, effective Mar. 1, 2006, last revised Dec. 28, 2014), http://bit.ly/2tZcpby.

[214] *Id.*, art. 26.

[215] Press Release, State Administration of Taxation of The People's Republic of China, *supra* note 204.

reporting system in 2014.[216] Under the new system, companies are no longer required to submit annual reports. Instead, the regulator will conduct random reviews of the contents of a company's public reports.

These initiatives have greatly reduced the cost and procedures involved in setting up and doing business. China's ranking on the World Bank's Ease of Doing Business Index has also gradually increased from No. 99 in 2013 to No. 78 in 2017.[217]

In 2016, 16,513,000 new businesses were registered in China, a 11.6% rise from the same period the previous year.[218] This increasing number of registered businesses could be attributed, to a certain extent, to fundamental changes in the domestic business regulatory environment.

E. The Venture Capital Response to Governmental Actions

As discussed in this part, the Chinese government at both the central and local levels has helped to tackle the simultaneity problem by establishing legislative and institutional infrastructure conducive to VC development.[219] A significant amount of legislation has been promulgated to facilitate the different stages of the VC cycle, including fundraising, investment, and exit. Specifically, and with reference to the hierarchy of laws, there have been: (1) national laws[220] ranging from the Company Law to the Partnership Enterprise Law;[221] (2) administrative regulations[222] ranging from the Interim Measures for Administration of Start-up Investment Enterprises[223] to the newly promulgated Interim Measures for Supervision and Administration of Private Investment Funds;[224] and (3) various local regulations governing issues such as

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216 On February 14, 2014, the SAIC published the *Notice on Ceasing the Annual Inspection of Enterprises*. Gongshang Zongju: Qiye Nianjian 3 Yue 1 Ri Qi Quxiao (工商总局：企业年检 3 月 1 日起取消) [*Notice on Ceasing the Annual Inspection of Enterprises*], Remin Ribao (人民日报) [PEOPLE'S DAILY] (Feb. 20, 2014), http://bit.ly/2siPSt7.

217 *Doing Business Reports on China*, WORLD BANK GROUP, http://bit.ly/1fY9Qsj (last visited Aug. 21, 2017).

218 Press Release, Gongshang Zongju Xiang Meiti Jieshao 2016 Nian Quanguo Shichang Zhuti Fazhan Deng Xiangguan Qingkuang (工商总局向媒体介绍2016年全国市场主体发展等相关情况) [The State Administration for Industry and Commerce Introduced the Development of National Market Entities in 2016] (Jan. 20, 2017), http://bit.ly/2tlJqAS.

219 *See* Appendix 1 and Appendix 2, *infra*.

220 National laws are promulgated by the National People's Congress and its Standing Committee.

221 Zhengquan Touzi Jijin Fa (证券投资基金法) [Securities Investment Fund Law] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 28, 2003, revised Dec. 28, 2012, effective June 1, 2013), *available at* http://bit.ly/2si7HZu.

222 Administrative regulations are promulgated by the State Council and the ministries under the State Council.

223 Chuangye Touzi Qiye Guanli Zhanxing Banfa (创业投资企业管理暂行办法) [Interim Measures for Administration of Start-up Investment Enterprises] (promulgated by the St. Dev. & Reform Comm'n, et al., Nov. 15, 2005, effective Mar. 1, 2006), http://bit.ly/2tZcQ5G.

224 *See* Guojia Fazhan Gaigewei Bangongting Guanyu Jinyibu Guifan Shidian Diqu Guquan Touzi Qiye Fazhan he Beian Guanli Gongzuo de Tongzhi (国家发展改革委办公厅关于进一步规范试点地区股权投资企业发展和备案管理工作的通知) [Notice of the General Office

establishment of funds and tax.

In particular, the legislation and policies described above have contributed to the effective engineering of China's VC framework: (1) providing public funding through GGFs and increasing private funding by easing regulatory barriers towards institutional investors and foreign investors; (2) enhancing the availability of financial intermediaries through introducing a new and popular business vehicle – the limited partnership – for VC fundraising; and (3) facilitating the establishment and operation of entrepreneurial firms through supportive industrial policies, tax relief, and revisions to the corporate legal regime.

As Figure 2 and Figure 3 demonstrate, from 2002 to 2015, China's VC market experienced steady growth in the total amount of funds raised. Figure 2 provides a timeline for the development of the market and illustrates how the development of the VC market is largely influenced by regulatory policies and laws. For example, although the number and volume of funds raised dipped in 2009 due to the global financial crisis, both the number of newly established venture funds and the amounts raised increased two-fold in 2011. As explained above, this VC boom can be attributed to the launch of the new NASDAQ-like secondary board ChiNext, new measures allowing more institutional investors and foreign investors to make equity investments,[225] and the substantial increase in investments by the NSSF (of more than RMB 6 billion). Also, although the suspension of the IPO process by CSRC from November 2012 to January 2014 negatively affected fundraising in both 2012 and 2013, the 2013 nationwide expansion of the NEEQ system, which offered a new exit channel for VC-backed companies, was followed by a sharp increase in new VC commitments.[226]

Further, with regard to investor composition, although the Chinese market was dominated by state-owned VC firms and funds in the 1980s and 1990s, it has since seen a rapid emergence of private firms and funds. Today the majority of leading VC firms in China are both private and foreign.[227] Private funding primarily from listed companies and

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of the National Development and Reform Commission on Further Regulating the Development and Filing Management of Equity Investment Enterprises in Pilot Areas] (effective Jan. 31, 2011), http://bit.ly/2v0lGiX; Guojia Fazhan Gaigewei Bangongting Guanyu Cujin Guquan Touzi Qiye Guifan Fazhan de Tongzhi (国家发展改革委办公厅关于促进股权投资企业规范发展的通知) [Notice on Promoting Regulation and Development of Equity Investment Enterprises] (Nov. 23, 2011), http://bit.ly/2tlVzq7; Simu Touzi Jijin Guanliren Dengji he Jijin Beian Banfa (shixing) (私募投资基金管理人登记和基金备案办法(试行)) [Measures on the Registration of Private Investment Fund Managers and Filing of Private Investment Funds (for Trial Implementation)] (promulgated by the Asset Management Association of China, Jan 17, 2014, effective Feb. 7, 2014), http://bit.ly/2sSvTQL.

225 *See* Appendix 2, *infra*.

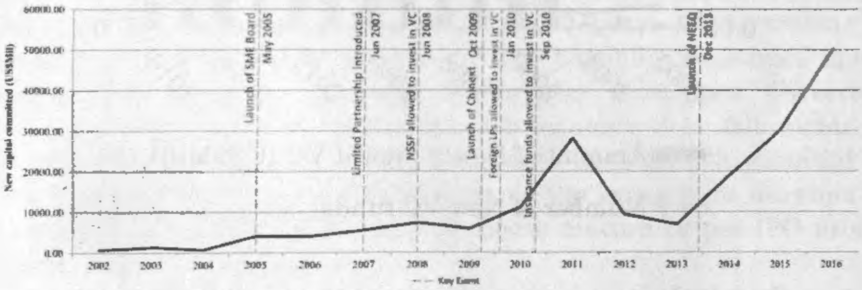
226 Lin, *supra* note 61, at 16-17, 24-26.

227 *See* Qingke-2015 Zhongguo Guquan Touzi Niandu VC Jigou Pingxuan Paiming (清科-2015 中国股权投资年度 VC 机构评选排名) [*Zero2IPO-China Top 50 Venture Capital*

investment companies has become a major source capital to the VC market in China.[228] Although their average investment is smaller, private individual and families form the majority of investors.[229]

Finally, with supportive policies and an improving regulatory environment, China's entrepreneurial culture is also evolving. A new generation of entrepreneurs – the "post-90s" generation of entrepreneurs – has emerged.[230] Unlike their parents, these second-generation entrepreneurs are more inclined to pursue their dreams by setting up their own businesses.[231] Having received good educations and having grown up in the age of the Internet and the rise of China, they tend to be less afraid of failure. They are also able to adapt quickly to changes in the business environment.[232]

FIGURE 2: NEW VENTURE CAPITAL COMMITMENTS AND MAJOR LEGISLATIVE AND POLICY CHANGES (2002-2016)[233]



Institutions in 2015], Touzijie (投资界) [PEDAILY] (Dec 4, 2015, 7:02 PM), http://bit.ly/2snlpW0.

[228] *See* Table 1, *supra*.

[229] *See* Table 1, *supra* (noting that government guidance funds only account for 2% of all investors on average).

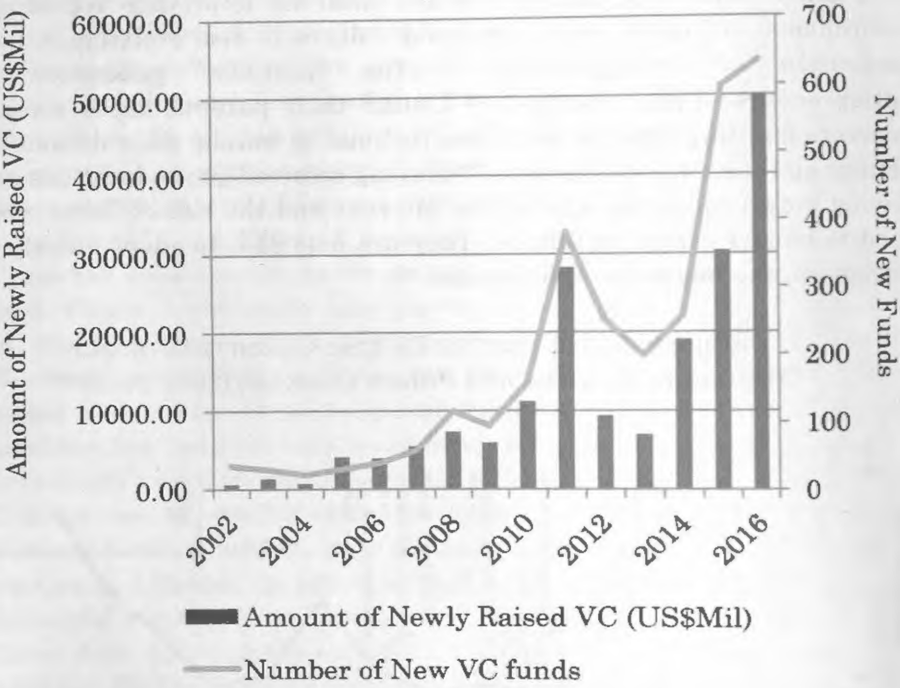
[230] Interview with Ms. S, Vice President, Banyan Capital, in Beijing, China (Oct. 2015). Interview with Mr. Zhu, partner, Island Peak Innovation, in Singapore (Dec. 16, 2016)

[231] *Id.*

[232] *Id.*

[233] This graph is drawn from the contents of Appendix 2, *infra*.

FIGURE 3: NEW VENTURE CAPITAL COMMITMENTS AGAINST NEW VENTURE CAPITAL FUNDS 2002-2016 (USD MILLION)[234]



II. ROOM FOR IMPROVEMENT AND SUGGESTIONS

Although China has solved the simultaneity problem with a certain degree of success, institutional impediments may nonetheless prevent the Chinese VC industry from realizing its full potential. This part discusses how the Chinese government can improve on what it has done to facilitate even greater growth of VC.

A. *Problems with Public Funding*

GGFs have not been unproblematic despite positive progress and swift development. There are GGFs at both the central and local levels. National GGFs are set up by the central government, while local GGFs are set up by local governments at different levels (i.e. province, city, and county). As of December 2015, 417 GGFs were city-level GGFs, and they managed an investment amount of RMB 824.3 billion, while there

[234] This graph is based on data from *Summary of Private Equity Investment Market LP Yearly Research Report 2012*, supra note 99 (2002-2012) and *Year 2015: Qingke Annual Report: PE LPs increase to 15,849, Government Guidance Funds, Listed Companies, Insurance Institutions are the most popular institutional LPs*, *supra* note 102 (2005-2016).

were only 9 national-level GGFs, managing RMB 274.85 billion.[235] While most of these GGFs were recently established and it is still too early to test their roles in the VC market empirically, there are several flaws in the structure of the local GGFs and the rules by which they operate.

First, local government intervention is prevalent within local GGFs. Local governments often mandate the sectors, companies, or locations to be funded.[236] In particular, it is common for a local government to require a VC firm to inject GGF funding in certain companies within the region.[237] This could lead to conflicts between the GGF and the VC firm, resulting in disincentives to the latter in finding promising projects and causing it to be less willing to receive funding from GGFs in future projects.

There are also problematic local regulations that unduly restrict the duration of investments and size of the portfolio companies. For example, Jiangsu province specifies that the maximum duration of the GGF investment is five years,[238] which is inconsistent with the international practice of between 7 to 10 years.[239] Restricting the duration of investments and size of the portfolio companies ignores market force in the selection of portfolio companies. Investment managers may have to choose those companies that fall within the restricted categories but not the companies with growth potential and are in need of venture capital. Shortening the investment duration will encourage investment managers to choose mature or pre-IPO projects instead of early-stage start-ups.

Second, the selection of managers in some local GGFs is flawed. For instance, the manager of the Shanghai Angel Investment Guidance Fund (AIGF) is not selected from the private sector, but is statutorily

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[235] Zero2IPO Research Center, *supra* note 85.

[236] For example, Article 6(5) of the Implementation Rules for Shanghai Angel Investments Guidance Fund states that the investor is to invest mainly in companies within Shanghai. Shanghaishi Tianshi Tozi Yindao Jijjn Guanli Shishi Xize (上海市天使投资引导基金管理实施细则), [Implementation Rules of the Shanghai Angel Investment Guidance Fund] (promulgated by the Shanghai Municipal Development and Reform Commission, Dec. 16, 2014, effective Dec. 16, 2014), art. 6(5) HUKEHE [2014] No. 49 http://bit.ly/2t1V5CN.

[237] Article 8 of the Implementation Rules of the Shanghai Angel Investment Guidance Fund, *supra* note 236, states that investments by the Shanghai Angel Investments Guidance Fund into each portfolio company shall be between RMB 5 million – 30 million RMB and that this amount shall not exceed 50% of the total subscribed capital of the portfolio company.

[238] Article 41 of the Measures of the Jiangsu Emerging Industry Venture Capital Investment Guidance Fund states that the duration of investments made by the Jiangsu Emerging Industry Venture Capital Investment Guidance Fund shall not exceed 5 years unless approval is sought from the fund's management committee. Jiangsusheng Xinxing Chanye Chuangye Touzi Yindao Jijin Guanli Banfa (江苏省新兴产业创业投资引导基金管理办法) [Measures of the Jiangsu Emerging Industry Venture Capital Investment Guidance Fund] (promulgated May 20, 2013, effective May 20, 2013), http://bit.ly/2tZzn2D.

[239] LERNER, *supra* note 5.

appointed. The manager currently appointed is a subsidiary[240] of another government-backed fund, the Shanghai Technology Entrepreneurship Foundation for Graduates ("EFG"),[241] that "shall exercise the rights as the investors of the Shanghai AIGF."[242] Two questions naturally follow: First, how would EFG "exercise the rights as an investor" and operate the fund effectively since it does not hold any equity interests in the fund? Second, how would the EFG monitor the fund effectively when the fund is being operated by its subsidiary? Also, unlike the ordinary VC limited partnership model where a professional VC firm serves as the GP and is subject to various legal and contractual constraints (e.g. unlimited liability for the debts of the fund, fiduciary duties, and the LPs' derivative action mechanism), there is no effective mechanism to constrain the behavior of the Shanghai AIGF's statutorily mandated fund manager.

Moreover, under the Shanghai AIGF Measures,[243] a steering committee comprising the deputy mayor of Shanghai and other government bureaucrats is in charge of the policy-making and supervision of the fund.[244] The lack of open selection mechanism for local cadres in charge of the GGFs may lead to problems including bureaucratic red-tape and a lack of expertise and professionalism within the GGFs.

Further, the Shanghai AIGF Measures mandate the establishment of a separate investment committee comprised of external experts and government representatives to review and vote for investment proposals.[245] These officials may intervene directly in the decision-making process of the fund, thus causing internal conflicts. Also, while the GP of a limited-partnership type VC fund in the United States and the United Kingdom is constrained by fiduciary duties and potential

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[240] Shanghai Venture Capital Jieli Technology Financing Group *(shanghai chuangye jieli keji jinrong jituan).*

[241] This Foundation was established by the Shanghai government as a not-for-profit organization in 2006.

[242] Implementation Rules of the Shanghai Angel Investment Guidance Fund, *supra* note 236, at art. 3.

[243] Article 3 states that the steering committee is the highest management institution for the Shanghai AIGF and is responsible for the policymaking and supervision of the fund. *Id.* Public information reveals that the steering committee is led by the deputy mayor of the Shanghai and includes bureaucrats from 12 departments of the Shanghai government. *See* Liang Jialin (梁嘉琳), Xunzhao "Xiao Ali" Shanghai Chengli Guonei Shouge Zhengfu Tianshi Yindao Jijin (寻找"小阿里" 上海成立国内首个政府天使引导基金) [*Looking for "small Ali" Shanghai set up the First Domestic Government Angel Guide Fund*], Jingji Guancha Bao (经济观察网) [ECONOMIC OBSERVER] (Dec 24, 2014), http://bit.ly/2siFqlz.

[244] Liang, *supra* note 243.

[245] Article 12 of the Implementation Rules of the Shanghai Angel Investment Guidance Fund, *supra* note 236, states that the fund must set up an independent investment review committee to review investment proposals. The committee will comprise experts and representatives from relevant government agencies. *Id.*

personal liability,[246] officials in this committee are not penalized for decisions made by the committee. Consequently, ensuring that these officials do not misuse resources of the fund to obtain personal benefits remains a difficult task.

Third, local governments or GGFs often guarantee investment losses suffered by VC firms, resulting in flawed incentives for the VC firm and the entrepreneurs. Examples include the GGFs of Beijing,[247] Jiangsu,[248] Guangzhou,[249] and Shanghai.[250] For example, the Shanghai government guarantees and compensates VC firms for up to 60% of their actual losses caused by investments in scientific and technological enterprises at the seed stage or up to 30% at the start-up stage,[251] as well as RMB 3 million of their actual losses for each investment project and RMB 6 million for annual investments by each investment firm.[252]

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246 Kenneth Jacobson, *Fiduciary Duty Considerations in Choosing between Limited Partnerships and Limited Liability Companies*, 36 Real Prop. Prob. Trust J. 1, 6 (2001); Larry E Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 Suffolk U. L. Rev. 927, 939 (2004).

247 Special subsidies exist for VC investments in Zhongguancun, an area in Beijing with a high concentration of technology firms. Zhongguancun Guojia Zizhu Chuangxin Shifanqu Youxiu Rencai Zhichi Zijin Guanli Banfa (中关村国家自主创新示范区优秀人才支持资金管理办法) [Measures on the Zhongguancun Talent Attraction Investment Fund], ZHONGKEYUAN FA [2013] No. 40 (promulgated by the Zhongguancun Science and Technology Park Management Committee, Nov. 18, 2013, effective Nov. 18, 2013), http://bit.ly/2s3k4Ek.

248 The Measures on the Jiangsu Emerging Industrial Venture Capital Investments Guidance Fund, Jiangsu Development and Reform Commission states that angel investment firms would be compensated for up to 50% of the losses they incur from investments into seed or early-stage technology-based enterprisea, provided that these losses were incurred within three years from the time the relevant investments were made, up to a limit of RMB 3 million. Jiangsusheng Xinxing Chanye Chuangye Touzi Yindao Jijin Guanli Banfa (江苏省新兴产业创业投资引导基金管理办法) [Measures on the Jiangsu Emerging Industrial Venture Capital Investments Guidance Fund] (promulgated by the Jiangsu Development and Reform Commission, May 20, 2013, effective May 20, 2013), http://bit.ly/2tZzn2D.

249 The Trial Measures for the Technology Enterprises Incubator Venture Capital and Credit Risk Compensation Fund of Guangdong Province states that VC firms will be compensated for up to 50% of the losses they incur from investments made into early-stage enterprises in the Guangdong Province Technology Enterprises Incubator, up to a limit of RMB 2 million. Guangdongsheng Kexue Jishu Ting Guangdongsheng Caizheng Ting Guanyu Keji Qiye Fuhuaqi Chuangye Touzi ji Xindai Fengxian Buchang Zijin Shixing Xize (广东省科学技术厅广东省财政厅关于科技企业孵化器创业投资及信贷风险补偿资金试行细则) [Trial Measures for the Technology Enterprises Incubator Venture Capital and Credit Risk Compensation Fund of Guangdong Province] (jointly promulgated by the Guangdong Provincial Office of Science and Technology and the Guangdong Provincial Department of Finance, Feb. 15, 2015, effective Apr. 1, 2015), http://bit.ly/2sSymL1.

250 Shanghaishi Tianshi Touzi Fengxian Buchang Guanli Zhaxing Banfa (上海市天使投资风险补偿管理暂行办法) [Shanghai Angel Investment Risk Compensation Interim Measures], (promulgated by Shanghai Sci. & Tech. Comm., Shanghai Fin. Bureau, and Shanghai Dev. & Reform Comm'n, Dec. 29, 2015, effective Feb. 1, 2016), http://bit.ly/2ujSS5k.

251 *Id.*, art. 9.

252 *Id.*, art. 10.

Such VC firms are less incentivized to perform effectively and work in the best interests of the funds. Guarantee schemes that are funded by taxpayers' money also may create public grievances towards the GGFs, as the very nature of VC investments is high-risk. Guarantee schemes are also problematic because they are usually implemented by officials who may not possess sufficient expertise in calculating the losses suffered and who may prefer to compensate VC firms that are government-backed. For example, the Shanghai AIGF Measures state that a steering group comprising government officials is responsible for the implementation of the compensation scheme.[253] Statistics show that many of the VC firms that received compensation for their investment losses were indeed government-backed firms.[254]

Fourth, GGFs often negotiate for smaller compensation packages for GGF-backed VC firms than for private VC firms, resulting in worse incentives for GPs of GGF-backed VC firms. Typically, the most popular distribution of the GP's compensation is the so-called "2/20 Rule."[255] The GP receives an annual management fee for its services comprising 2 to 2.5% of the committed capital, and a carried interest of 20 to 25% of the profits realized by the fund.[256] This is, however, not always the case in China. Local governments are often overly protective of the taxpayers' money while negotiating profit allocation, resulting in the VC firm being paid less than a 20% carried interest,[257] or in the GGFs being given priority in the distribution of profits over the VC firm.[258] Meanwhile, there is a lack of clear and detailed rules on the evaluation of the fund and the appraisal system of the GP in some local GGFs.[259]

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[253] *Id.*, art. 11.

[254] *Id.*, art. 8 (specifing that applicants for compensation shall make a filing with the relevant registrar in charge of VC investments). Statistics show that out of more than 110 VC firms which had made filings for compensation as of January 2016, most were state-owned VC firms. *See* Fengxian Touzi Shibai, Pingshenme Zhengfu Lai Tieqian (风险投资失败，凭什么政府来贴钱) [*Why Should the Government Be Subsidizing Venture Capital Investment Failures*], Jinri Huati (今日话题) [IN TOUCH TODAY] (Jan. 27, 2016), http://bit.ly/2tq6PC8.

[255] Under this rule, the venture capitalists are entitled to a flat 2% of total asset value as a management fee and an additional 20% of any profits earned as carried interest. *See* PAUL GOMPERS & JOSH LERNERK, THE VENTURE CAPITAL CYCLE 91-126 (2nd ed., 2004).

[256] Kate Litvak, *Venture Capital Partnership Agreements: Understanding Compensation Arrangements*, 76 U. CHI. L. REV. 161 (2009).

[257] Zero2IPO, *supra* note 85.

[258] Qidi Zhengfu Yindao Jijin: Sida Wenti Lanlu VS Sida Qushi "Guanfeng" (起底政府引导基金：四大问题拦路 VS 四大趋势"观风") [*Uncover Government Guide Fund: Four Problems VS Four Trends*], Touzijie (投资界) [PEDAILY] (May 12, 2016), http://bit.ly/2tqdk89.

[259] Article 23 of the Implementation Rules for Shanghai Angel Investments Guidance Fund, *supra* note 236, states generally that the steering committee and its office are responsible for the supervision and evaluation of government guidance funds, but provides no specific evaluation criteria. Article 30 of the Interim Measures of the Government Investment Fund simply specifies that the GGF should set up an evaluation system for the fund, but provides no detailed rules on how the assessment should be made. *See* Zhengfu Touzi Jijin Zanxing Guanli Banfa (政府投资基金暂行管理办法) [Interim Measures

Lastly and most importantly, there are two institutional obstacles that prevent local governments from allowing local GGFs to operate based on market forces. The first is the flawed cadre appointment system in China. Since the early years of the Chinese Communist Party, China's cadres have always been appointed by higher-level supervisors.[260] Also, under the cadre responsibility system (*gangwei zerenzhi*), appointed cadres are personally held responsible for achieving certain targets and policies laid down by higher-ups.[261] In the context of GGFs, these systems have led to the inevitable intervention of local governments in the selection of the portfolio companies. In order to make sure that public capital is properly used and that the officials in charge have some form of personal responsibility, municipal governments typically mandate the mayor of the city to be the chairman of the steering committee of the GGF.[262] The second institutional obstacle is the flawed incentive mechanisms of government officials. In China, GDP growth remains one of the key performance indicators of the municipal government.[263] This has encouraged many local GGFs to mandate that the fund invest only in certain industries and companies in their region that have already gained significant market success.[264]

Nevertheless, these problems have not prevented the growth of the VC market. The negative impact caused by the flawed structure of the local GGFs appears not to have been significant economically. The most likely reason may be that the size of GGF has been small: it accounts for only 2% of the total investment amount in the market.[265] The figure was much smaller before 2011[266] and is even smaller for local GGFs.[267] Another reason may be the fact that most of the local GGFs were established in 2015, so for now the negative impact caused by the guarantees and problematic compensation is still limited.

Moreover, cognizant of the problems within the local GGFs discussed above, the Chinese central government and many local governments have begun to move towards a *market-oriented approach*

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on Government Investment Funds], (promulgated by the Ministry of Finance), art. 30, CAIYU [2015] No. 210, http://bit.ly/2tm19J1.

[260] Hu Wei, G. Zhiyong Lan, & Liu Songbo, *Innovations in Cadres Selection and Promotion in China: The Case of Mudanjiang City*, 8 BUS. PUB. ADMIN. STUD. 48 (2014).

[261] Maria Edin, *Remaking the Communist Party-State: The Cadre Responsibility System at the Local Level in China*, 1 CHINA: INT. J. 1 (2003).

[262] *See* text accompanying note 243, *supra*. *See also* Implementation Rules of the Shanghai Angel Investments Guidance Fund, *supra* note 236.

[263] Telephone interview with Mr. W, Head of the General Office of Human Resource Department, Guangdong Branch of the Communist Party of China (Aug. 19, 2016); Telephone interview with Mr. Z, Deputy Head of Panyu District of Guangzhou City, Guangdong Province (Aug. 20, 2016).

[264] See text accompanying notes 237-238, *supra*; Implementation Rules of the Shanghai Angel Investments Guidance Fund, *supra* note 236.

[265] *See* Figure 1, *supra*.

[266] Zero2IPO Research Center, *supra* note 85.

[267] *See* Figure 1, *supra*.

in the provision of funding for VC.[268] This involves *attracting more private investors and reducing government intervention* in the operation of the GGFs.[269] Since 2015, government agencies including the National Development and Reform Commission (NDRC) and Ministry of Finance, as well as many local governments have issued measures to reduce government intervention in the fundraising and operation of local GGFs and mandate the market-oriented approach among GGFs.[270] For example, the Interim Measures of the Government Investment Fund 2015, which govern GGFs, specify that GGFs should operate based on market forces and the fund should be managed by professional GPs instead of the government.[271] The NDRC Interim Measures for Management of Government Funded Industrial Investment Fund 2016 also specified that the government investment funds shall operate based on market forces and the government who provides capital "shall not participate in the daily operation of the funds."[272] This would allow venture capitalists and entrepreneurs to work more effectively and achieve positive results in a venture capital cycle that is driven primarily by market forces.

Notably, the national-level SVCIGF is also a positive step forward on both points.[273] The SVCIGF comprises 40 billion RMB of capital funding, with 10-15 billion RMB coming from the government and the remaining 25-30 billion RMB from other investors such as private enterprises and institutional investors.[274] With a target of 40 billion RMB, together with a number of forthcoming local GGFs, the SVCIGF tackles the problem of the old GGFs being too small to make a difference in guiding capital flow to start-ups. Moreover, by allowing more than half the funding to originate from the private sector, government interference is mitigated, and the fund is likely to rely chiefly on the market for guidance. Fund managers can make more informed commercial decisions on capital allocation.[275] Furthermore, investment-wise, the SVCIGF will invite public tenders from professional fund managers and give priority for returns to private investors.[276]

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[268] *Id.*

[269] *See* Zero2IPO, *supra* note 85.

[270] *See* Appendex 2, *infra*.

[271] *See, e.g.*, Interim Measures on Government Investment Funds, *supra* note 259, art. 11.

[272] Zhengfu Chuzi Chanye Touzi Jijin Guanli Zanxing Banfa (政府出资产业投资基金管理暂行办法) [Interim Measures for Government Funded Industrial Investment Fund Management] (promulgated by the Nat'l Dev. and Reform Comm. Dec. 30, 2016, effective Apr. 1, 2017) art. 6., http://bit.ly/2tZxTVJ.

[273] See Diagram 1, *infra* (outlining the structure and capital flows of the SVCIGF).

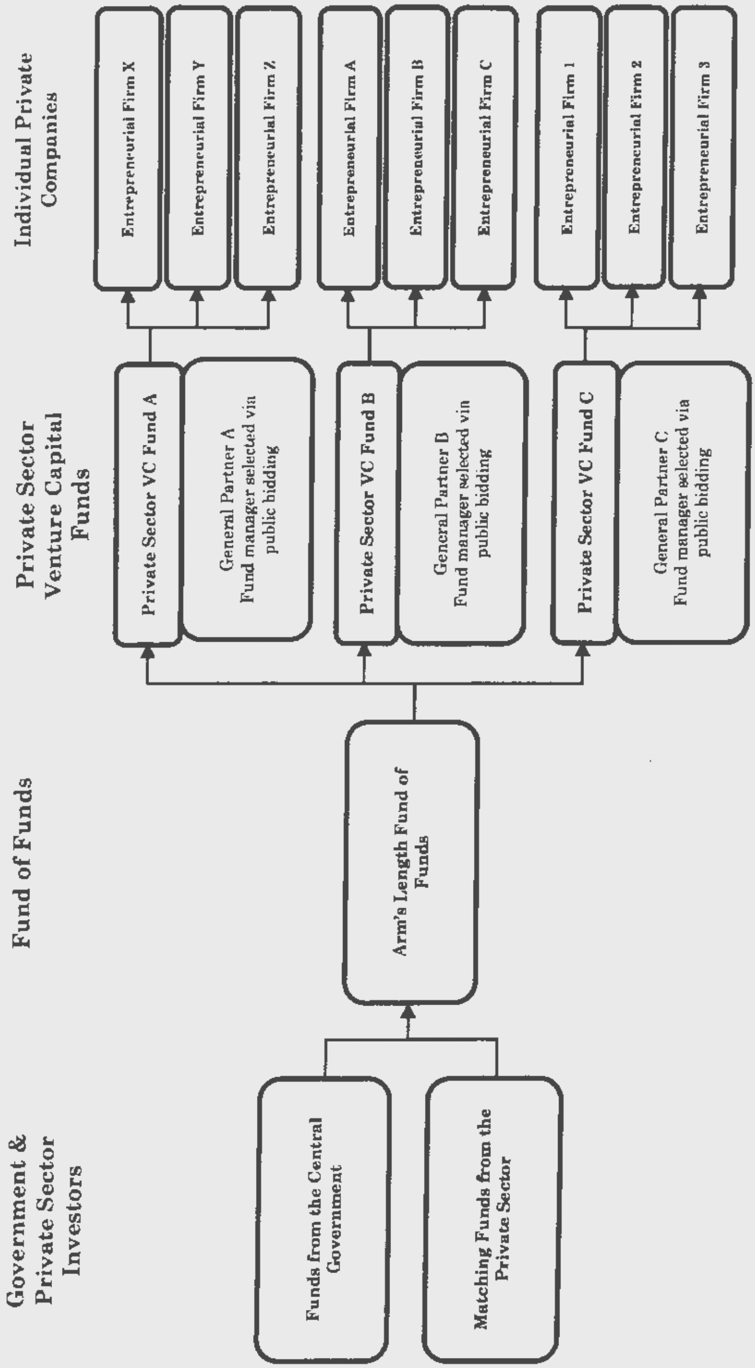
[274] 400 Yi Guojia Chuangtou Jijin Dingceng Fangan Sheji yi Jiben Wancheng (400亿国家创投基金顶层方案设计已基本完成) [*The Design of the 40 billion State Venture Capital Investment Fund is almost completed*], Xinlang Caijing (新浪财经) [SINA FINANCE] (Mar 30, 2015), http://bit.ly/2tqft3E.

[275] *Id.*

[276] *Id.*

Nevertheless, as the SVCIGF was just launched, it remains to be seen whether it will be implemented effectively according to the announced guidelines.

DIAGRAM 1: STATE VENTURE CAPITAL INVESTMENT GUIDANCE FUND (SVCIGF) 2015



In light of the public nature of the GGFs, the unique party-state system, and protectionism at the local level, I suggest the following ways to improve government participation in GGFs.

First, the government ceding control to market forces would mitigate operational inefficiencies arising from the incompetence and lack of professional experience on the part of government authorities.[277] Requiring matching funds from the private sector would help to reduce the dangers of uninformed decisions and political interference.[278] Local governments should avoid intervention in the selection of portfolio companies and fund managers. Funding should be provided to early-stage start-ups that are in high demand of capital, instead of later-stage, government-linked companies that allow for the creation of quick returns.

Second, the impact of government-sponsored funds "depends not only on the design of the program but also on the selection of the" managers.[279] Instead of appointing government-linked VC firms, governments should select experienced, professional, and independent VC firms to manage the funds.

Third, a well-designed appraisal and compensation system (such as the 2/20 rule[280]) should be established to provide incentives to the fund's manager. Also, more detailed rules should be provided on the evaluation, regular reporting, and auditing of the GGFs to fill the legislative gap in the existing regulations governing GGFs.[281]

Fourth, the structure of the GGFs should be simplified to reduce bureaucracy and transaction costs. A "fund of funds" (FOF) approach taken by the SVCIGF seems more desirable for GGFs.[282] Under this model, the consolidated fund will make investments in a number of other funds, and each of these funds will invest in a portfolio of companies. By doing so, the consolidated fund enjoys broader exposure to the industry and diversification of the risks associated with a single investment, in contrast to GGFs of old, in which a local fund is usually restricted to only one project.[283]

Fifth, under various local regulations, there are no detailed rules governing the stage wherein investments are made into portfolio companies.[284] Giving the funds disproportionate representation or even

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[277] *See* LERNER, *supra* note 5, at 128-133.

[278] *Id.*

[279] Douglas Cumming & Sofia Johan, *Pre-Seed Government Venture Capital Funds*, 7 J. INT'L ENTREPEURSHIP 26, 26-27 (2009).

[280] *See* the explanation in note 255, *supra*.

[281] *See, e.g.*, Implementation Rules of the Shanghai Angel Investment Guidance Fund], *supra* note 236; Measures on the Jiangsu Emerging Industrial Venture Capital Investments Guidance Fund, *supra* note 248. Various local regulations governing GGFs do not provide rules on these issues.

[282] *See* Diagram 1, *supra*.

[283] *See* Diagram 1, *supra*.

[284] *See* Diagram 1, *supra*.

control of the portfolio company's board of directors could help reduce agency costs at the financing stage.[285] I suggest that the GGF should appoint a representative to serve as a director on the board of the portfolio company to restrict the entrepreneur's discretion and behavior in using the GGF funding. The GGFs may also require veto rights in important matters or the power to replace the entrepreneur as the portfolio company's chief executive officer.

B. Problems with Investment Vehicle

Although there is little doubt that the adoption of the limited partnership in China has contributed to a more favorable environment for the VC industry and reduced transaction costs in the fundraising process, there are some special features that require further legislative attention.

First, unlike other jurisdictions such as US-Delaware,[286] the U.K.,[287] and Singapore,[288] which do not impose an upper limit on the number of partners in the limited partnership, the Chinese limited partnership has a requirement of at least two and a maximum of fifty partners.[289] The maximum number of partners may unduly constrain the size of the fund and is inconsistent with international practice. As such, I suggest that the restriction on the number of partners be removed.

Second, partners are allowed to transfer their partnership shares to outsiders (subject to various requirements) under the PEL.[290] An assignee of a GP will become a GP himself and be subject to rights and obligations in accordance with the amended agreement and the PEL.[291] This stands in stark contrast to the assignee's position under U.S. law, where a transfer in whole or in part of a partner's transferable interest in the partnership does not entitle the transferee to participate in the

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[285] Gilson, *supra* note 1, at 1082.

[286] DEL. CODE ANN. tit. 6, § 17-101(9) (West 2010) ("limited partnership" means "a partnership formed under the laws of the State of Delaware consisting of 2 or more persons and having 1 or more general partners and 1 or more limited partners"). *See also* GOVERNMENT OF SINGAPORE, STUDY TEAM ON LIMITED PARTNERSHIPS AND LIMITED LIABILITY PARTNERSHIPS, REPORT OF THE STUDY TEAM ON LIMITED PARTNERSHIPS, par. 8.4.1 (2007), *available at* http://bit.ly/2tlIs8o.

[287] Although the UK used to impose an upper limit on the number of partners, there is no longer such a limit for all types of partnerships since 2001. GOVERNMENT OF SINGAPORE, STUDY TEAM ON LIMITED PARTNERSHIPS AND LIMITED LIABILITY PARTNERSHIPS, *supra* note 241, at para. 8.4.1. Section 4(2) of Limited Partnerships Act 1907 now states "[a] limited partnership must consist of one or more persons called general partners, ..., and one or more persons to be called limited partners..." Limited Partnerships Act 1907, 7 Edw. 7 c 24, § 4(2) (Grt. Br.).

[288] s 3(2) of Limited Partnership Act (Chapter 163B) states that "A limited partnership must consist of (a) one or more of general partners; and (b) one or more of limited partners." Singapore Limited Partnerships Act 2008 (Cap. 163B) s 3(2).

[289] Partnership Enterprise Law, *supra* note 126, art. 61.

[290] *Id.* at arts. 22, 73.

[291] *Id.* at art. 24.

management of the partnership business.[292] Arguably, any change of the GP is likely to result in serious consequences for a fund, particularly with regard to the LPs' interests since they rely on the expertise of the GP when deciding to invest in the fund. Therefore, the PEL should not entitle the transferee, during the continuance of the partnership, to participate in the fund's management.

Third, unlike the Delaware code, the PEL does not provide any rules specifying how an existing company or partnership may convert into a limited partnership or *vice versa*.[293] There is a practical need for VC limited partnerships to be able to convert into companies, especially when the limited partnership-type funds would like to expand their business.[294] Currently, funds must deregister as limited partnerships and re-establish themselves as companies in order to convert to companies. Ideally, the Chinese legislature would provide a seamless process for the conversion of limited partnerships to companies.

Fourth, Delaware and the UPA do not require newly admitted partners, whether general or limited, to be personally liable for the prior obligations of the partnership.[295] Logically, the newly admitted partner ought not to bear any liability for the prior debts of the firm, since he was not a partner then and was not involved in any form of management of the firm. However, similar to a GP in a German limited partnership,[296] a GP in a Chinese limited partnership will assume joint liability with the existing partners for debts incurred by the firm before he joined the firm. Correspondingly, a new LP will bear liability to the extent of his capital contribution even if the partnership's debts were incurred before he joined the firm.[297] This restriction would reduce the attractiveness of the limited partnership to the venture capitalists and investors. I suggest that the PEL not require newly admitted GPs or LPs to be personally liable for the prior obligations of the partnership.

Lastly, another distinctive feature of the PEL is the requirement that limited partnerships be dissolved in the event that the limited partnership is left with only LPs.[298] The limited partnership should be

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[292] UNIF. PARTNERSHIP ACT §503 (Nat'l Conference of Comm'rs on Unif. State Laws 1997).

[293] *See* DEL. CODE ANN. tit. 6, §17-217 (West 2013).

[294] Yang Guang (阳光), Renminbi Jijin Bianlian: GP Gaobili Chuzi Ji Huigui Gongsizhi Cheng Qushi (人民币基金变脸 GP 高比例出资及回归公司制成趋势) [*RMB Funds Change Faces: Trends of Converting Back to Companies and Increasing Capital Contributions by GP*], Tou Zhong Wang (投中网) [CHINESE VENTURE] (Jun. 2, 2009), http://bit.ly/2sScNKr.

[295] *See* DEL. CODE ANN. tit. 6, § 15-306 (West 2011); UNIF. PARTNERSHIP ACT §306.

[296] The German Commercial Code §130 provides that a new partner is liable as the other partners for partnership obligations incurred before he joined. HANDELSGESETZBUCH [HGB] [COMMERCIAL CODE], § 130. The German Commercial Code also provides that a new limited partner shall be liable for partnership obligations incurred before he joined. *Id. at* § 173.

[297] Partnership Enterprise Law, *supra* note 126, at arts. 44, 77.

[298] *Id.* at art. 75.

converted into a general partnership if it is left with only GPs.[299] Equivalent provisions are not found in the PEL's German, French, and U.S. counterparts. A Chinese limited partnership with only LPs should be allowed to continue operating as a limited partnership over a grace period so as to explore possible options and attract incoming GPs. Also, as a typical VC fund usually lasts for ten years and makes long-term investments in a number of companies, forcing a limited partnership to be dissolved would create unnecessary costs and adversely affect the operation of the investee portfolio companies, which largely rely on the funding and management of the VC fund.

C. *Problems with Entrepreneurs*

Despite the effective policies and mechanisms put in place to promote the growth of entrepreneurs and entrepreneurial firms as discussed in the last part, more gaps in legislation must be filled to continue to address the issue of entrepreneurship in China, particularly in enhancing the protection of intellectual property rights. Interviewees stated that insufficient intellectual property protection has been a main concern for entrepreneurs and venture capitalists in China.[300]

Moreover, there is a lack of personal bankruptcy laws in China. In China, there are several sanctions for debtors that default on loans: (1) the debtor will be included in the *List of Dishonest Persons Subject to Enforcement* and will face a series of penalties; [301] (2) the debtor may be subject to expenditure limits [302] and restrictions on international travel;[303] (3) depending on the severity of the situation, courts may fine or impose custodial sentences on the debtor; [304] (4) if elements of criminal offences are met, the debtor may be prosecuted for his refusal

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[299] *Id.*

[300] Telephone interview with Mr. G, Partner, Chengwei Capital, Shanghai (Aug. 1, 2016).

[301] This is of particular relevance to a corporate debtor who may face more restrictions in its subsequent business operations. *See* Zuigao Renmin Fayuan Guanyu Gongbu Shixin Beizhixing Ren Mingdan de Ruogan Guiding (最高人民法院关于公布失信被执行人名单信息的若干规定) [Several Provisions of the Supreme People's Court on Announcement of the List of Dishonest Persons subject to Enforcement] (promulgated by the Supreme People's Court, Jul. 16, 2013), art. 1, http://bit.ly/2ujY2OD.

[302] Zuigao Renmin Fayuan Guanyu Xianzhi Beizhixing Ren Gao Xiaofei de Ruogan Guiding (最高人民法院关于限制被执行人高消费的若干规定) [Several Provisions of the Supreme People's Court on Restricting High Consumption of Judgment Debtors] (issued by Supreme People's Court, Jul. 01, 2010), art. 1, http://bit.ly/2tm8DeO.

[303] Guanyu Shiyong Zhonghua Renmin Gonghe Guo Minshi Susong Fa Zhixing Chengxu Ruogan Wenti de Jieshi (关于适用《中华人民共和国民事诉讼法》执行程序若干问题的解释) [Interpretation of the Supreme People's Court of Several Issues concerning the Enforcement Procedures in the Application of the Civil Procedure Law of the People's Republic of China], (Issued by Supreme People's Court, Nov. 03, 2008), art. 37, http://bit.ly/2snzKC3.

[304] Minshi Susong Fa (民事诉讼法) [Civil Procedure Law], (promulgated by the Nat'l People's Cong, Apr. 9, 1991, effective Apr. 9, 1991), art. 241, http://bit.ly/2tZfvfI.

to comply with payment judgments.[305] As noted by Armour and Cumming, a liberal personal bankruptcy regime has a positive impact on the success of a VC market.[306] Conversely, a stricter bankruptcy regime discourages potential entrepreneurs from taking risks and failed entrepreneurs from re-engaging in business.[307] Given the high-risk nature of VC, it is crucial to provide an appropriate exit mechanism for individuals who have failed in their entrepreneurial venture. Personal bankruptcy laws should allow them to start afresh, while at the same time ensuring that creditors can obtain a fair share of the bankrupt's assets.

Further, although there is an increasing number of second-generation entrepreneurs in China, these entrepreneurs are still relatively new and inexperienced in the VC market. The future challenge would likely be to attract skilled venture capitalists and experienced mentors who have the necessary start-up management expertise and the willingness to nurture young entrepreneurs. Indeed, observers have reflected that there is and will likely remain a gap between China and U.S. in terms of entrepreneurial culture.[308]

III. LESSONS LEARNED

Economic theory suggests two main rationales for public intervention to encourage entrepreneurship and favor start-ups.[309] The spillover hypothesis argues that public intervention should subsidize young, entrepreneurial firms that have to spend substantial research and development (R&D) expenditure but only receive limited private returns in the early stage of their life cycles.[310] In contrast, the market failure hypothesis explains that governments may rectify market

[305] Article 313 of China's Criminal Law states that "Whoever refuses to carry out a decision or order made by a people's court while he is able to carry it out is to be sentenced to not more than three years of fixed-term imprisonment, criminal detention, or be fined. If circumstances are particularly severe, he may be fined and sentenced to a fixed-term of imprisonment of more than three years and less than seven years." Zhongguo Renmin Gongheguo Xingfa (中华人民共和国刑法) [Criminal Law of the People's Republic of China], (promulgated by the Standing Comm. Nat'l People's Congress, July 1, 1979, last revised Aug. 29, 2015, effective Nov. 1, 2015), art. 313, http://bit.ly/2tZwb6Z.

[306] Armour & Cumming, *supra* note 119, 617-26, 628. *See also* John Armour, *Personal Insolvency Law and the Demand for Venture Capital*, 5 Eur. Bus. Org. L. Rev. 2004 87 (2004).

[307] Armour & Cumming, *supra* note 119, at 601-03.

[308] Zhongmei Liangguo Nianqingren Changye Huanjing Chayi Da (中美两国年轻人创业环境差异大) [*Large Disparity in Entrepreneurial Environments for Chinese and American Youngsters*] (Mar. 1, 2012), Xinlang Caijing (新浪财经) [SINA FINANCE], http://bit.ly/2tbPtWS.

[309] Marina di Giacomo, Public Support to Entrepreneurial Firms: An Assessment of the Role of Venture Capital in the European Experience, 8 J. Private Equity, no. 1, Winter 2004, at 22, 25.

[310] *Id.* (citing Zvi Griliches, *The Search for R&D Spillover*, 94 Scandinavian J. Econ. 29 (1992).

imperfections by fostering legal and fiscal environments that are conducive to private investors and entrepreneurs to operate (e.g. tax relief, bankruptcy process facilitating reorganization, a stock market that facilitates SME exits).[311]

As discussed in Part I, governments face difficulties in resolving the simultaneity problem in engineering a robust VC market. Several governments, such as those of Germany, India and Singapore, have attempted to tackle this problem but it has proven to be a difficult task. However, there is evidence to show that the three essential determinants have been gradually addressed by China. This part will discuss specifically the lessons that other countries could learn from China in tackling the simultaneity problem, as well as examine similar flaws present in the Chinese and other countries' models, which will require more attention in future legal and policy reforms.

A. *Capital*

1. Increased Domestic and Foreign Capital Supply

First, as to domestic private capital, China has gradually removed regulatory barriers to allow more institutional investors to invest in the VC market.[312] Arguably, this liberalization of the financial markets can be easily replicated by other countries.

Second, in terms of foreign capital, China has launched various programs for foreign investors to raise funds and make equity investments.[313] Other countries can learn from China's attempt to create a foreign investor friendly regulatory environment and engage in capital control liberalization. However, this may be subject to the specific political, economic and legal environments of a nation. For example, in Brazil, while FMIEEs (*Fundos Mutuos de Investimento em Empresas Emergentes*) are made available to serve as special investment vehicles for VC investments, the FMIEEs' unpopularity shows that the Brazilian government has yet to provide sufficient regulatory incentives that would encourage investors to take advantage of this structure.[314] Brazil also discourages foreign investment by imposing a financial transactions tax on foreign capital inflows[315]—a macroeconomic policy measure intended to prevent excessive inflation,

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[311] Josh Lerner, When Bureaucrats Meet Entrepreneurs: The Design of Effective Public Venture Capital Programmes, 112 ECON. J. F73 (2002).

[312] *See* Part I.B.3, *supra*.

[313] Part I.B.4, *infra*.

[314] Shannon Guy, *Private Equity in Brazil: Industry Overview and Regulatory Environment*, 2 MICH. BUS. & ENTREPRENEURIAL L. REV. 155, 173 (2013).

[315] On Brazil's taxing of financial transactions see Marcos Chamon & Marcio Garcias, *Capital Control in Brazil: Effective?* 6 (Paper presented at the 15th Jacques Polak Annual Research Conference of the International Monetary Fund, Nov. 13-14, 2014), http://bit.ly/2tmc7O4.

reduce risks of asset price bubbles, and curb strong exchange rate appreciation, which may hurt Brazil's export competitiveness.[316]

Third, with regard to public funding, China's establishment of various government programs[317] has substantially increased the supply of funding to the VC market. The reality is that countries have differing availability of public funds. Lackluster economic growth and fiscal profligacy in the boom years may cause a government to be burdened with dwindling public funds and face budgetary constraints. Germany's WFG program, for example, was only funded 50 million DM (approximately 81 million USD using 1990 rates).[318] Though the WFG program was conducted from 1976 to 1991[319] and inflation must be accounted for, its modest size provides less of an "add-on effect" in raising capital.

Public fund size, however, is not the only determining factor.[320] Many other factors affect the success and effectiveness of government programs, including the duration of the programs,[321] their flexibility,[322] the presence of incentives for a financial intermediary to monitor portfolio companies,[323] and the implementation process.[324] Notably, China's new SVCIGF program has taken a market-oriented approach, by allowing, *inter alia,* matching of more than half of the funding from the private sector, appointment of GPs via public bidding, and use of FOF structure to diversify investment risks. Regulations have also been issued to reduce government intervention in the capital allocation of government funds.[325]

Nevertheless, there are similar flaws found within China's local GGFs and other countries' public programs. For instance, like Germany's WFG, some of China's local GGFs guarantee investment losses suffered by VC firms, resulting in a lack of incentives for venture

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316 *Id.* at 2. Brazil's justification that strict capital control is necessary to maintain economic and financial stability, however, is not entirely sound. Its short crash and boom cycles, rapidly fluctuating currency, and high inflation are just symptoms of multiple political problems (such as corruption, paralysis of policymaking process, lack of implementation of structural economic reform) that it faces.

317 *See* Part I.B.2, *supra.*

318 Gilson, *supra* note 1, at 1095.

319 PAUL JOWETT & FRANCOISE JOWETT, PRIVATE EQUITY: THE GERMAN EXPERIENCE 15 (2011).

320 LERNER, *supra* note 5, at 117-23 (arguing that either too small or too large a government initiative can pose profound difficulties).

321 *Id.* at 112-16 (arguing that encouraging entrepreneurship requires a long-term commitment on the part of public officials).

322 *Id.* at 124-27 (suggesting that government officials must appreciate the need for the flexibility in VC investment and rely more on market forces in selecting portfolio companies).

323 *See* Gilson, *supra* note 1, at 1099-1100.

324 LERNER, *supra* note 5. The implementation process refers to whether the fund distribution is driven by market forces or whether there is an excessive amount of government interference.

325 *See* text accompanying notes 269-275, *supra.*

capitalists to monitor the portfolio companies. Further, there was government intervention in the selection of the portfolio companies in WFG and China's local GGFs due to the flawed incentive and appointment structure of GPs.[326]

Therefore, when emulating China's VC public funding system, other countries should take note to avoid the similar structural deficiencies present in some local GGFs and instead refer to the newly launched SVCIFG's market-oriented design. The government's role in the fund-raising process should be limited to being a LP who does not participate in the management of the fund. By doing so, the government leaves capital allocation decisions to market forces.

2. Tax Incentives

Multiple Chinese local governments have offered significant tax exemptions to both GPs and LPs in VC funds.[327] These tax exemptions increase investment profitability, thereby encouraging the supply of the VC to the industry. Various forms of tax relief are also provided to scientific parks and incubators to encourage innovation.

However, it could be difficult for certain states to follow China's example of greatly reducing tax rates. France, for instance, imposes a progressive income and capital gains tax rate up to 45%.[328] The high tax rates limit returns to a successful entrepreneurial venture and put a damper on VC activity. While individual investors may claim an exemption from income tax on investment income and capital gains derived through FCPI (*Fonds Communs de Placements dans l'Innovation*), in order to qualify for these tax exemptions, they must hold their shares for 5 years, immediately reinvest all fund distributions, and hold no more than 25% of the portfolio company's shares.[329] Such onerous exemption requirements reduce the effectiveness of the tax policy in encouraging VC investments.[330]

In contrast, Japanese tax law's hostility to the use of equity as an incentive means that additional cash-flow rights cannot be used by venture capitalists to encourage entrepreneurs to give up management

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[326] *See* text accompanying notes 239-271, *supra*.

[327] *See* Part I.B.5, *supra*.

[328] DELOITTE, FRANCE 2016 HIGHLIGHTS 22 (2016), *available at* http://bit.ly/2t2ggES.

[329] DECHERT LLP, PRIVATE EQUITY 2010 VOLUME 2: VENTURE CAPITAL: COUNTRY Q&A FRANCE 54 (2010), http://bit.ly/2s3s6x4.

[330] Ann Baker et al, *Venture Capital Investment in France: Market and Regulatory Overview*, WESTLAW UNITED KINDOM, http://tmsnrt.rs/2ttCjWJ.

control.[331] Japan's ambiguous and unfriendly tax rules thus present a real hindrance to the development of its VC industry.[332]

Ultimately, policymakers should strike a right balance when providing tax breaks. If a policymaker is of the view that the benefits of encouraging VC shall outweigh the potential loss in tax revenue, it may introduce a more favorable tax regime to boost the VC sector. However, excessive tax incentives would distort the efficacy of market forces in allocating capital and may allow poor performing VC firms to survive on tax incentives and government subsidies.

3. Active Stock Market

Through the launch of the national OTC market – NEEQ and the NASDAQ-like ChiNext Board with lowered listing requirements, China has greatly improved the IPO exit options for VC-backed firms.[333] Arguably, the establishment of SME-specific Board and the reduction of listing requirements can be copied by other stock market-centered countries to foster VC if those countries are willing to bear the high legislative costs. Moreover, the effectiveness of new stock exchanges is affected by the existing structure of the financial market. Given their longstanding and well-established bank-centered systems, countries like Japan and Germany[334] may face difficulties in attempting to develop into market-centered systems without far reaching reforms. Path dependency may present a thorny problem for institutional change.

B. Investment Vehicle

The Chinese limited partnership vehicle is made available for both domestic and foreign investors, and remarkably provides the twin benefits of separate legal personality and tax transparent treatment at the entity level.[335]

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[331] Shishido, *supra* note 4. Sweat equity may be challenged by the Japanese National Tax Agency as a gift and entrepreneurs will have to pay gift tax.

[332] Hajime Tanahashi et al, *Venture Capital Financing in Japan: A Combination of the Familiar and the Unique* IN PRIVATE EQUITY 2010 VOLUME 2: VENTURE CAPITAL 15, 15 (2010), http://bit.ly/2s36XmL.

[333] Lin, *supra* note 61, at 17.

[334] *See* Gilson & Black, *supra* note 37 (discussing the correlation between stock market and VC market in bank-centered systems). *See also* Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets*, 47 J. FIN. ECON. 243 (1998) (same).

[335] *See* Part I.C, *supra*. If a foreigner individual or enterprise establishes a limited partnership in China, it is subject to additional regulations including the Provisions on the Registration of Foreign-funded Partnership Enterprises and the Measures for the Formation of Partnership Enterprises inside China by Foreign Enterprises or Individuals. Waishang Touzi Hehuo Qiye Dengji Guanli Guiding (外商投资合伙企业登记管理规定) [Provisions on the Registration of Foreign-funded Partnership Enterprises], promulgated by State Administration for Industry and Commerce, Jan. 29, 2010, effective Mar. 1, 2010), http://bit.ly/2sdwb1N; Waiguo Qiye Huozhe Geren Zai Zhongguo Jinei Sheli Hefuo Qiye

In Taiwan, the recently introduced limited partnership is not seen as a viable investment vehicle for venture capitalists. The limited partnership is taxed the same way as a Taiwanese company and the lack of tax transparent treatment severely limits its functionality.[336] In the U.K. and Singapore, limited partnerships do not have separate legal personality as they are based on the common law aggregate approach on partnership. Singapore's drafter specifically highlighted the concern that overseas tax authorities may treat the Singapore limited partnership as an opaque entity for tax purposes if it has a separate legal personality. In turn, this would affect the adoption rate of the limited partnership in Singapore.[337] However, the tax transparency benefit arguably does not need to be inevitably intertwined with the absence of separate legal personality. The entity approach will ensure the continuity of partnerships by conferring perpetual succession and providing a more ideal business vehicle for investors.[338]

India, on the other hand, has no limited partnership and VC funds largely rely on the trust structure. Investors become trust beneficiaries and contractually retain the ability to exercise restricted passive control over the GP's investment decisions via the Contribution Agreement.[339] The trust offers organizational flexibility, limited liability for investors, and tax transparency.[340] However, notwithstanding the Indian trust's ability to reasonably govern the investment relations between the managers and investors, the trust's lack of separate legal personality remains a drawback.

Arguably, if the jurisdiction has preexisting business forms that are functionally similar to the limited partnership, there is then less pressing need to enact limited partnership legislation. Moreover, if governments wish to introduce the limited partnership, they must be willing to provide the vehicle with sufficient benefits and attributes to meet the business needs of potential users; failure to do so will result in waste of legislative resources.

Guanli Banfa (外国企业或者个人在中国境内设立合伙企业管理办法) [Measures for the Formation of Partnership Enterprises inside China by Foreign Enterprises or Individuals], (promulgated by the State Council, Aug. 19, 2009, effective Mar. 1, 2010), http://bit.ly/2ssOC77.

336 Cheryl H.L. Hsieh, *M&A Alert: Introduction of the Taiwan Limited Partnership Act*, K&L GATES (July 27, 2015), http://bit.ly/2sS8vDb.

337 Government of Singapore, Study Team on Limited Partnerships and Limited Liability Partnerships, *supra* note 286, at paras. 7.1.5–7.1.7.

338 The U.K. has considered changing the aggregate approach to the entity approach on partnerships. See law Commission & Scottish Law Commission, Partnership Law: Report on a Reference under Section 3(1)(e) of the Law Commissions Act 1965 (2003), http://bit.ly/2s34Yid.

339 *See* Purvi Kapadia & Poorvi Sanjanwala, *Venture Capital Investment in India: Market and Regulatory Overview*, THOMSEN REUTERS PRACTICAL LAW (2013), http://tmsnrt.rs/2whmOUm (last visited Aug. 19, 2017).

340 Nishith Desai Associates, *India, in* PRIVATE EQUITY 209, 210 (Charles Martin ed., 2010).

C. *Entrepreneurship*

To encourage entrepreneurship, China engaged in a series of entrepreneur-friendly company law reforms.[341] These reforms can be easily learned by other jurisdictions. Taiwan, for example, is also currently undergoing company law reform to streamline the business incorporation and operation process.[342]

China also provided numerous policy incentives and tax reliefs to improve innovation, legislative and institutional infrastructure for the VC industry.[343] The *continuous* nature of these policy incentives is key to the rapid development of the Chinese VC market.

The importance of continual government support may also be seen in Taiwan's example where investors in high-tech start-ups were historically granted a hefty income tax deduction. While this tax relief policy brought about substantial capital injection in the VC sector from 1995 to 2000, it was subsequently abolished in 2000.[344] The termination of policy incentives directly contributed to the Taiwanese VC industry's decline in recent years, proving that governmental promotion of entrepreneurship requires consistent and long-term effort.[345]

CONCLUSION

China, as an experimentalist in law and development, offers an important example of how a government can engineer a VC market. This article finds that the Chinese government has played an important role in helping the nation to establish the three key elements of a VC market, when one had not developed organically.

This article has shown the important role of the government in creating a VC market through law and policy. One characteristic of the Chinese VC market is that it is created and led by governments, both on central and local levels, through *continuous* law and policy reforms. Meanwhile, although China's market is established by governments, a key reason for its rise is the central government's efforts at adopting a more market-oriented approach towards capital allocation. This is reflected in three ways: First, the newly established SVCIGF and the new regulations governing the GGFs to reduce government intervention. Second, the changing role of the central government: from a direct

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[341] *See* Part I.D, *supra*.

[342] Tseng & Fu, *supra* note 209.

[343] *See* Appendix 2, *infra*.

[344] *See* Zhang Yuning (张育宁), Weishenme Zai Taiwan Chuangye Nabudao Chuangtou de Qian? Su Shizhong: Taiwan rang Zaoqi Touzizhe Dou Bian Bendan (为什么在台湾创业拿不到创投的钱？苏拾忠：台湾让早期投资者都变笨蛋) [*Why Taiwan Entrepreneurs Cannot Receive Venture Capital funding? Su Shizhong: Taiwan Made a Fool Out of Early-Stage Investors*], Keji Baoju (科技报桔) [TECHORANGE] (Apr. 15, 2013), http://bit.ly/2tlNqSl.

[345] *Id.*

financial intermediary that decides how exactly capital is to be allocated to a mere facilitator and provider of capital. Third, that private capital is becoming the major source of VC[346] with the eased regulatory regime, the more liberal regulatory framework governing the VC market, the predominance of the limited partnership, and the increased number of private VC firms, start-ups and entrepreneurs. By providing the legislative and institutional infrastructure for the VC market, the government can facilitate the increased role of market forces, especially in the area of capital allocation.

The Chinese experience offers several lessons to other countries: First, governments can help solve the three-factor simultaneity problem—by providing public *funds* through the well-designed government programs; by introducing business-friendly legal *vehicles*; and by improving the regulatory environment for fund raising, investments, and exits, governments can encourage capital supply, boost *entrepreneur participation,* and attract knowledgeable financial intermediaries to the market. Second, governments can facilitate the creation of a market premised on market forces and private contracting by restricting its own participation to being a LP, and leaving capital allocation decisions to private-sector parties with right incentives.[347] Failure to do so would prevent the industry from attaining sustainable growth.

Nevertheless, there is substantial room for improvement in China. Various institutional impediments within each factor, as highlighted above, may prevent the industry from realizing its true potential. Moreover, in light of China's unique party-state system, conflicts between the central and local governments, the flawed cadre appointment system, and the flawed incentive mechanisms of government officials, it is difficult to ensure that local governments completely do not intervene in the capital allocation process. I suggest that the design of the government programs should be improved to keep such intervention to a minimum, while ensuring that the government's policy goals are still realized.

Additionally, the next big challenge for the government is to further develop a VC market based on private contracting. In this regard, one key task is to ensure the effective enforcement of the various contracts covering the entire VC cycle. As the effect of private ordering in China may not be known for years to come, considerable future research will be required before meaningful suggestions can be offered.

Lastly, the engineering of a venture capital market is highly specific to the context of each country. On top of capital, specialized financial intermediaries and entrepreneurs, an effective VC market also requires

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[346] *See* Table 1, *supra.*
[347] *See generally* Gilson, *supra* note 1.

a wide range of complex social, legal, and economic institutions[348]: robust stock markets,[349] sophisticated auditing and legal professions, strong investor protection,[350] effective judicial enforcement of contracts, liberal bankruptcy laws,[351] and an effective reputation market.

Further research must be done in these particular areas for there to be a comprehensive examination of how the relationship between the government and the free market should be balanced and how the effectiveness of contractual design can be maximized. Ultimately, it remains to be seen whether the Chinese VC market can replicate the success of the U.S. market in the long run.

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[348] Armour & Cumming, *supra* note 119.

[349] I address the correlation between the stock market and the venture capital market in Lin, *supra* note 61.

[350] Armour & Cumming, *supra* note 119 at 597. Armour and Cumming's empirical findings show that the "investor friendliness" of a country's legal and fiscal environment is a significant determinant of the supply of venture capital investment to entrepreneurial firms.

[351] *Id.* (arguing that a more liberal personal bankruptcy law stimulates demand for venture capital finance). However, as there is no personal bankruptcy law in China, this article will not address this issue in the context of China.

APPENDIXES

APPENDIX 1: LEGISLATIVE EFFORTS AT TACKLING THE SIMULTANEITY PROBLEM IN CHINA

	Legislative efforts	Existing & Potential Problems	Suggestions
Capital	Private capital: (1) Removed regulatory restrictions that prevented certain institutional investors from investing in VC funds, thus broadening the investor base; (2) Tax incentives to attract private capital in VC investments; (3) Foreign investors were progressively permitted to make equity investments through various special schemes; (4) Regulatory environment for exits was improved to attract venture capital investments. Public capital: (1) A large number of GGFs were set up to inject capital into the market, with the intention of attracting matching capital from the private sector; (2) The SVCIGF scheme supports a market-oriented approach to capital allocation.	Public capital: (1) Certain local governments' heavy intervention in the management of the fund and allocation of capital; (2) Governmental guarantees of investment losses; (3) Complicated internal structure of local GGFs.	Public capital: (1) Governmental guarantees of investment losses should be abolished; (2) Governmental intervention in the selection of portfolio companies and funds' managers should be restricted; (3) The structure of the local GGFs should be simplified to reduce bureaucracy; (4) A well-designed appraisal and compensation system should be established to provide right incentives; (5) Continuous education of government officials on the nature of the VC industry.

	Legislative efforts	Existing & Potential Problems	Suggestions
Specialized Financial intermediaries	(1) The limited partnership was introduced; (2) Various foreign investment vehicles were introduced to attract foreign capital.	(1) Regulatory problems concerning the limited partnership; (2) Private ordering problems for limited partnerships: LP activism and internal conflicts.	Addressing regulatory problems concerning the limited partnership vehicle such as by removing the maximum number of partners and providing more detailed statutory rules on partners' duties and LPs' derivative action.
Entrepreneurship	(1) The government has embarked on a policy of encouraging mass entrepreneurship and mass innovation through institutional measures; (2) The company law, tax law and securities law were revised to facilitate setting up and doing business: (3) A large number of substantive laws were promulgated or revised to improve IT infrastructure.	(1) Excessive tax preference treatment is given at the local level; (2) A lack of personal bankruptcy law and a lack of dual class structure: (3) A lack of dual-class stock structure under Chinese corporate law; (4) IP rights are insufficiently protected.	(1) Consider promulgating personal bankruptcy law to ensure that honest failed entrepreneurs are protected and given a fresh start; (2) Consider adopting the dual-class stock structure; (3) IP rights protection should be enhanced.

APPENDIX 2: LEGAL DEVELOPMENTS AND THE GOVERNMENT'S ROLE IN DEVELOPING THE VENTURE CAPITAL MARKET OF CHINA 1978-2016[352]

Dates	Law/Policy	Implications for VC Market
	CAPITAL	
Feb. 9, 2006	"Outline of the National Medium and Long-Term Science and Technology Development Plan" (2006-2020) published.[353]	Encouraged setting up guidance funds to support start-ups in the seed stage.
July 6, 2007	"Interim Measures for the Management of Venture Capital Guidance Funds which support Science and Technology-based Small and Medium Enterprises" published.[354]	Introduced institutional mechanisms to encourage innovation and support high-tech start-ups.
June 5, 2008	National Social Security Fund was allowed to make equity investments.[355]	Greatly increased the VC funding.
Oct. 18, 2008	"Guidance on the Establishment and Operation of the Venture Capital Guidance Funds" published.[356]	Provided clear guidance on the guidance funds.
Sept. 5, 2010	"Interim Measures for Equity Investment with Insurance Funds" issued.[357]	Insurance funds were allowed to invest in VC funds.

[352] This table seeks to highlight the most important legal developments in relation to the development of the VC market in China.

[353] Guojia Zhongchangqi Kexue he Jishu Fazhan Guiha Gangyao (2006 – 2020 Nian) (国家中长期科学和技术发展规划纲要 (2006-2020 年)) [National Medium and Long Term Development Plan for Science and Technology (2006 – 2020)] (promulgated by the Nat'l Assembly, Feb. 9, 2006, effective Feb. 9, 2006), http://bit.ly/2ssxTR2.

[354] Kejixing Zhongxiao Qiye Chuangye Touzi Yindao Jijin Guanli Zanxing Banfa (科技型中小企业创业投资引导基金管理暂行办法) [Interim Measures for Administration of Technological SME Venture Capital Guidance Funds] (jointly promulgated by Ministry of Finance of the PRC and Ministry of Science and Technology of the PRC, Jul. 6, 2007, effective Jul. 6, 2007, http://bit.ly/2tbMGwU.

[355] Wang Mengmeng (王萌萌), Jigou LP de PE Touzi Xianzhuang – Quanguo Shebao Jijin Baoxian Jijin (机构 LP 的 PE 投资现状—全国社保基金 保险基金) [*Current Investment Status of PE Institutional LPs – National Social Security Fund Insurance Funds*] (Aug. 8, 2014), Tou Zhong Wang (投中网) [CHINA VENTURE], http://bit.ly/2tBt9Jj.

[356] Guanyu Chuangye Touzi Yindao Jijin Guifan Sheli yu Yunzuo Zhidao Yijian (关于创业投资引导基金规范设立与运作指导意见) [Guiding Opinions on Establishment and Operation of Venture Capital Guidance Funds] (promulgated by State Council Office, Oct. 18, 2008, effective Oct. 18, 2008), http://bit.ly/2sxP7HS.

[357] Baoxian Zijin Touzi Guquan Zanxing Banfa (保险资金投资股权暂行办法) [Interim Measures for Insurance Funds Making Equity Investments] (promulgated by China

Dates	Law/Policy	Implications for VC Market
Jan. 24, 2011	Shanghai published the "Implementation Measures on the Pilot Program for Development of Foreign-invested Equity Investment Enterprises".[358]	Foreign-LPs are permitted to convert foreign currency capital into RMB to invest into RMB funds.
May 2011	First batch of Qualified Foreign Limited Partner (QFLP) funds set up under Chongqing QFLP Pilot Program.[359]	Encouraged foreign capital to make equity investments in Chongqing.
July 16, 2012	"Notice on Issues Relating to Equity and Real Estate Investments by Insurance Funds" issued.[360]	Expanded the scope of permissible equity investments by insurance funds.
Feb. 18, 2013	"Interim Provisions on the Management of Securities Investment Funds by Asset Management Institutions" issued.[361]	More institutional investors, such as social security funds, insurance funds, and fund companies were permitted to make equity investment.
Aug. 13, 2014	The State Council issued "Several Opinions of the State Council on Accelerating the Development of Modern Insurance Service Industry".[362]	Expanded the industries for insurance companies to make equity investments.

Insurance Regulatory Comm., Sep. 5, 2010, effective Sep. 5, 2010), http://bit.ly/2ssvWnK.

[358] Guanyu Benshi Kaizhan Waishang Touzi Guquan Touzi Qiye Shidian Gongzuo de Shishi Banfa (关于本市开展外商投资股权投资企业试点工作的实施办法) [Measures for Implementing the Municipal Pilot Project of Foreign Investment Equity Investment Enterprises] (jointly promulgated by Shanghai Financial Services Office, Shanghai Municipal Commission of Commerce and Shanghai Administration for Industry and Commerce, Dec. 24, 2010, effective Jan. 24, 2011), http://bit.ly/2tvOS4P.

[359] Liu Xue (刘雪), QFLP Zhengce Kuorong Hu Jing Jin Yu Sidi Shidian (QFLP 政策扩容 沪京津渝四地试点) [*QFLP Policy Expansion: Shanghai, Beijing, Tianjin, Chongqing being the Four Pilot Cities*] (Sep. 6, 2011), Xinhua 08 (新华 08) [XINHUA 08], http://bit.ly/2uakVod.

[360] Guanyu Baoxian Zijin Touzi Guquan he Budongchan Youguan Wenti de Tongzhi (关于保险资金投资股权和不动产有关问题的通知) [Notice on Insurance Funds Investing into Equity and Real Estate] (promulgated by China Insurance Regulatory Commission, Jul. 16, 2012, effective Jul. 16, 2012), http://bit.ly/2sycoJL.

[361] Zichan Guanli Jigou Kaizhan Gongmu Zhengquan Touzi Jijin Guanli Yewu Zanxing Guiding (资产管理机构开展公募证券投资基金管理业务暂行规定) [Interim Provisions on the Management of Public Securities Investment Funds by Asset Management Institutions] (promulgated by China Securities Regulatory Commission, Feb. 18, 2013, effective Jun. 1, 2013), http://bit.ly/2tc4fN1.

[362] Guowuyuan Guanyu Jiakuai Fazhan Xiandai Baoxian Fuwuye de Ruogan Yijian (国务院关于加快发展现代保险服务业的若干意见) [The State Council's Several Opinions on

Dates	Law/Policy	Implications for VC Market
Dec. 12, 2014	Notice of the China Insurance Regulatory Commission on Matters concerning the Investment of Insurance Funds in Venture Capital Funds[363]	Allowed insurance funds to invest into venture capital funds
Nov. 12, 2015	Ministry of Finance issued the Interim Measures for Government investment fund *(zhengfu touzi jijin zhanxing guanli banfa)*[364]	Regulated the government investment funds
Dec. 25, 2015	Ministry of Finance issued the Guiding Opinions of the Ministry of Finance on Injecting Fiscal Funds into Government Investment Funds to Support Industry Development *(guanyu caizheng zijin zhuzi zhengfu touzi jijin zhichi chanye fazhan de zhidao yijian)*[365]	Specified on how to use the fiscal fund in supporting industry developments
May. 11, 2016	CSRC issued a pilot scheme to grant ten banks access to VC investments following the removal of a legal bar on banks holding equity in non-financial companies they lend money to.[366]	Allowed banks to make VC investments.

Accelerating Development of the Modern Insurance Service Sector] (promulgated by State Council, Aug. 13, 2014), http://bit.ly/2uvMOXf.

363 Zhongguo Baojianhui Guanyu Baoxian Zijin Touzi Chuangye Touzi Jijin Youguan Shixiang de Tongzhi (中国保监会关于保险资金投资创业投资基金有关事项的通知) [Notice of the CIRC on the Relevant Matters Concerning Insurance Funds Investing into Venture Capital Funds] (promulgated by China Insurance Regulatory Comm., Dec. 12, 2014, effective Dec. 12, 2014), http://bit.ly/2tBNPRn.

364 Interim Measures on Government Investment Funds, *supra* note 259.

365 Caizhengbu Guanyu Caizheng Zijin Zhuzi Zhengfu Touzi Jijin Zhichi Chanye Fazhan de Zhidao Yijian (财政部关于财政资金注资政府投资基金支持产业发展的指导意见) [Ministry of Finance's Guidance Opinions on Financial Capital Injection into Government Investment Funds to Support Industry Development] (promulgated Dec. 25, 2015), http://bit.ly/2uvMNTo.

366 Zhu Xiaoshan (朱筱珊), 2016 Nian Chuangtou Hangye Shida Guanjianci (2016 年创投行业十大关键词) [*VC Industry's Top 10 Key Words for 2016*] (Dec. 30, 2016), Zhengquan Shibao Wang (证券时报网) [STCN.COM], http://bit.ly/2tvLfeZ.

Dates	Law/Policy	Implications for VC Market
Dec. 30, 2016	The National Development and Reform Commission issued Interim Measures for government funded industrial investment fund management *(zhengfu chuzi chanye touzi jijin zhanxing guanli banfa)*[367]	Regulated fund raising, registration, approval, investments, disclosure of information, evaluation and other issues relating to government funded industrial investment fund.
	FINANCIAL INTERMEDIARIES	
Oct. 31, 2002	"Provisions Concerning the Administration of Foreign-funded Venture Investment Enterprises" was passed.[368]	Regulated foreign invested enterprises.
Oct. 27, 2005	PRC Company Law was revised.[369]	Introduced the one-person company and streamline the process of setting up a company.
March 1, 2006	"Interim Measures for Administration of Start-up Investment Enterprises 2005" came into force.[370]	Regulated domestic VC enterprises and provided tax incentives to foreign invested VC enterprises.
Aug. 27, 2006	PRC Partnership Enterprise Law was passed.[371]	Introduced the limited partnership.
June 1, 2007	"Circular on Tax Policies Promoting Development of Venture Capital Enterprises" came into force.[372]	Provided tax incentives to VC Invested Enterprises.

[367] Interim Measures for Government Funded Industrial Investment Fund Management, *supra* note 272.

[368] Provisions Concerning the Administration of Foreign-funded Business-starting Investment Enterprises, *supra* note 114.

[369] Cao Kangtai (曹康泰), Guanyu "Zhonghua Renmin Gongheguo Gongsi Fa (Xiuding Cao'an) de Shuoming (关于《中华人民共和国公司法(修订草案)》的说明) [Explanation of Draft Revisions of the Company Law of the People's Republic of China], Address to the Nat'l People's Cong. (Feb. 25, 2005), http://bit.ly/2tuyEor.

[370] Interim Measures for Administration of Start-up Investment Enterprises, *supra* note 223.

[371] Partnership Enterprise Law, *supra* note 160.

[372] Guanyu Cujin Chuangye Touzi Qiye Fazhan Youguan Shuishou Zhengce de Tongzhi (关于促进创业投资企业发展有关税收政策的通知) [Notice on Relevant Tax Policies for Promoting Development of Venture Capital Industry], jointly issued by Ministry of Finance and State Administration of Taxation, Feb. 7, 2007, effective Jan. 1, 2006, http://bit.ly/2sdyAcK.

Dates	Law/Policy	Implications for VC Market
June 25, 2008	"Operational Guidelines for the Private Equity Investment Trust Business of Trust Companies 2008" came into force.[373]	Regulated trust-type funds.
Oct. 18, 2008	"Guiding Opinions on the Normalized Establishment and Operation of the Venture Capital Guiding Fund Made by the Departments Including the Development Reform Commission" was issued.[374]	Provided clearer guidance on the operation of the funds.
Nov. 25, 2009	Administrative Measures for the Establishment of Partnership Enterprises within China by Foreign Enterprises or Individuals was published.[375]	Provided a new foreign-invested vehicle for foreigners.
Dec. 28, 2013	Amendments to the PRC Company Law, effective on March 1 2014.[376]	Abolished tbe requirement of minimum registered capital.
Sept. 2015	China's business registration system reform on integrating "three certificates into one" with unified credit codes.[377]	Streamlining the registration process of starting a business.
	ENTREPRENEURSHIP	
Mar. 1986	Launch of National High Technology Research and Development Program of China (863 Program).[378]	Aimed to improve the country's innovation ability and development of cutting-edge technology.

[373] Operational Guidelines for Private Equity Investment Business Trust Companies, *supra* note 178.

[374] Opinion on Venture Capital Fund Specifications and Operational Guidance, *supra* note 81.

[375] Provisions on the Registration of Foreign-funded Partnership Enterprises, *supra* note 335.

[376] Gongsifa Xiugai Yian Huo Tongguo Zhuce Renjiaozhi Queli (公司法修改议案获通过注册认缴制确立) [*Company Law Amendment Bill has passed Registration System is confirmed*] (Dec. 29, 2013), Caixin (财新) [CAIXIN.COM], http://bit.ly/2twtxbi.

[377] Guowuyuan Bangongting Guanyu Jiakuai Tuijin "San Zheng He Yi" Dengji Zhidu Gaige de Yijian (国务院办公厅关于加快推进"三证合一"登记制度改革的意见) [Opinions of General Office of the State Council on Accelerating the Reform of the "Unification of Three Certificates" Registration System] (promulgated Jun. 29, 2015), http://bit.ly/2tyh5rt.

[378] Press Release, Keji Bu (科技部) [Ministry of Science and Technology], Guojia Gaojishu Yanjiu Fazhan Jihua (863 Jihua) Jiandu Weiyuanhui Chengli (国家高技术研究发展计划 (863 计划) 监督委员会成立) [Supervisory Committee Established for National High Technology Research and Development Program (863 Program)] (Aug. 30, 2002), http://bit.ly/2ty6DjC.

Dates	Law/Policy	Implications for VC Market
Aug. 1988	The Torch Plan was launched.[379]	A guiding plan for the development of high tech industries.
May 4. 1998	Project 985 was launched.[380]	Aimed to develop world-class universities.
Nov. 20. 2014	"Opinions of the State Council on Supporting the Sound Development of Micro and Small Enterprises" introduced.[381]	Introduced policy measures to support SMEs through financial support. tax incentives. etc.
Mar. 2. 2015	"Opinions of the State Council on the Expansion of the Space for Mass Entrepreneurship and the Promotion of Mass Entrepreneurship" issued.[382]	Promoted market-orientated mass innovation.

[379] Huoju Jihua Xiangmu (火炬计划项目) [*Torch Project*]. Kexue Jishubu Huoju Gaojishu Chanye Kaifa Zhongxin (科学技术部火炬高技术产业开发中心) [*Torch High Technology Industry Development Center, Ministry of Science & Technology*]. http://bit.ly/2tcQsGd.

[380] Press Release. Jiaoyu Bu (教育部) [Ministry of Education]. "985 Gongcheng" Jianjie ("985 工程"简介) [Introduction to "985 Project"]. http://bit.ly/2t3dUao.

[381] Guwuyuan Guanyu Fuchi Xiaoxing Weixing Qiye Jiankang Fazhan de Yijian (国务院关于扶持小型微型企业健康发展的意见) [Opinions of State Council on Supporting Healthy Development of Small and Micro-enterprises] (promulgated Nov. 20, 2014). http://bit.ly/2ubtr6u.

[382] Guowuyuan Bangongting Guanyu Fazhan Zhongchuang Kongjian Tuijin Dazhong Chuangxin Chuangye de Zhidao Yijian (国务院办公厅关于发展众创空间推进大众创新创业的指导意见) [Office of State Council's Guidance Opinions on the Development of Public Space to Promote Innovation and Entrepreneurship] (promulgated Mar. 11, 2015). http://bit.ly/2twDTZ1.