
CHAMBERS GLOBAL PRACTICE GUIDES

Venture Capital 2025

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**China: Law and Practice
& Trends and Developments**
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CHINA

Law and Practice

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Zhong Lun Law Firm was established in 1993, and is a pioneering partnership law firm in China. Through decades of strategic growth and unwavering commitment to excellence, the firm has emerged as a pre-eminent full-service law firm. With nearly 400 equity partners and a robust team of over 2,200 professionals, Zhong Lun represents the pinnacle of legal expertise and institutional capability. As one of the first Chinese law firms to specialise in private equity, Zhong Lun has developed unparalleled insights and deep-rooted expertise in this complex do-

main. Its practice comprehensively addresses the entire life cycle of private fund operations. By combining meticulous legal acumen with strategic foresight, the firm has consistently positioned itself as a leading legal service provider in China's dynamic private equity landscape. Its sustained excellence has been internationally recognised, with Chambers Global repeatedly ranking Zhong Lun in Band 1 for Private Equity – a testament to the firm's exceptional performance and industry leadership.

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Catherine Chen serves as an equity partner and leads Zhong Lun's Private Equity and Asset Management practices. In her pivotal role, she strategically guides the firm's private equity

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1. Trends

1.1 VC Market

TJ Bio's Strategic Restructuring and USD70 Million Series C1 Equity Financing

On 7 February 2024, I-Mab (NASDAQ: IMAB) announced a strategic transformation to become a US-based biotechnology company through a complex divestment of its Chinese operations. The company executed definitive agreements with TJ Biopharma (Hangzhou) Co, Ltd ("*TJ Bio*"), an unconsolidated affiliate, and a consortium of China-based investors.

Key transaction details included the following:

- total equity investment – USD70 million in TJ Bio;
- asset transfer – 100% of I-Mab Biopharma Co, Ltd ("*I-Mab Shanghai*")
- consideration – up to USD80 million (renminbi equivalent); and
- additional component – extinguishment of approximately USD183 million in existing repurchase obligations.

The transaction represented one of the most sophisticated and intricate deals in the 2024

Chinese biotech sector. Its complexity was marked by multiple challenging legal dimensions, including:

- negotiations with state-owned new investors;
- comprehensive asset spin-off strategy;
- delicate management of existing investors' redemption rights; and
- intricate cross-border corporate restructuring.

The strategic move underscores I-Mab's deliberate repositioning in the global biotechnology landscape, demonstrating advanced corporate strategic planning and complex legal manoeuvring.

Curon's USD1.3 Billion Asset Sale to Merck

Curon Biopharmaceutical, incubated in 2017 by three major financial investors (6D, Boyu and Temasek) with a total USD150 million investment, recently completed a significant asset sale to Merck valued at USD1.3 billion (including a USD700 million upfront payment). The transaction centered on CN201, a promising B-cell depletion therapy asset developed during their seven-year investment period.

Despite strong backing from these prestigious investors, Curon faced challenges in raising Series B funding in the difficult biotech market. Rather than pursuing traditional exit routes such as initial public offering (IPO), the investors strategically pivoted towards an asset sale approach. This culminated in the successful Merck transaction, which represented an optimal exit opportunity for the financial investors.

The Merck deal not only validated the value of CN201 but also demonstrated how patient capital and strategic flexibility in exit planning can create significant returns in biotech investments. This transaction stands out as a prime example of successful value creation in the biotech sector, where development timelines often extend beyond typical venture capital horizons.

1.2 Key Trends

Market Dynamics and Contraction

2022–2023 slowdown: comprehensive market recalibration

The post-COVID-19 pandemic economic landscape witnessed a fundamental restructuring, characterised by extensive market adjustments and intensified regulatory oversight across sectors. As global economic uncertainties prevailed, investor confidence wavered, leading to a marked decline in both transaction volumes and investment values across primary market segments.

Sectoral impact was particularly evident in the technology sphere, where deal momentum decreased substantially, while the consumer goods sector experienced similar investment contractions. This broader market correction manifested in diminished year-on-year performance metrics, both in terms of transaction frequency and total invested capital, as investors adopted more rigorous risk assessment frame-

works and demonstrated heightened caution in their investment approaches.

2024 continuing trends: persistent market challenges

The investment environment remained constrained, with transaction volumes continuing to show restraint amidst increasingly robust compliance frameworks that moderated capital flows.

Escalating geopolitical tensions significantly impacted cross-border investment activities, contributing to a sharp decline in foreign investment participation. This period also witnessed enhanced government oversight of domestic investment strategies, fundamentally altering established market dynamics.

Redemption Rights in Chinese Private Equity/Venture Capital (PE/VC) Transactions: a Deep Dive

Prevalence and structural uniqueness

The Chinese PE/VC landscape exhibits distinctive characteristics in its approach to redemption rights, with over 90% of transactions incorporating these provisions. Notably, approximately two thirds of these arrangements extend to include joint and personal founder liability, functioning essentially as “*put option*” a framework that fundamentally diverges from traditional investment protection mechanisms observed in US or EU markets.

The structural architecture of these rights places significant responsibility on founders, who bear personal liability for investment repayment. Redemption triggers are typically anchored to specific performance metrics, including failure to achieve IPO objectives, missed valuation targets, or shortfalls in predetermined financial benchmarks.

Founder vulnerability: systemic risks

The implications of these structures manifest in profound legal and financial consequences, with over 90% of redemption right cases encompassing both corporate and individual founder liability. The potential ramifications extend beyond mere financial penalties, to include:

- comprehensive asset seizures;
- nationwide travel restrictions;
- inclusion in national credit blacklists; and
- effective prohibition from future entrepreneurial pursuits.

This vulnerability is further amplified by China's unique legal framework, characterised by the absence of personal bankruptcy laws and debt discharge mechanisms, resulting in perpetual personal liability for investment shortfalls.

Supreme Court judge interpretation: redemption right exercise parameters, December 2025

The judicial framework has established clear parameters for redemption right exercise, implementing a mandatory six-month window for activation and providing explicit timeframes for triggering repurchase obligations. This interpretation, although “unofficial”, classifies redemption rights as a hybrid construct, combining “*formation right*” during the initial six-month trigger period with “*claim right*” subject to a subsequent three-year statute of limitations. While maintaining contractual flexibility for parties to negotiate specific timeframes, courts retain authority to invalidate excessively prolonged terms, emphasising the need for explicit and unambiguous contractual language.

This interpretation has sparked considerable debate. Supporters maintain that it helps stabilise the company by eliminating uncertainty

through “*use it or lose it*” approach to repurchase rights. However, critics argue that this interpretation may backfire, as investors – fearing the loss of their protective rights – might hastily exercise their repurchase options, ultimately compromising the company's operational health.

Market and strategic implications

The evolving landscape has prompted sophisticated adaptation strategies among both investors and founders. Contractual frameworks now demand explicit redemption timeline specifications, detailed trigger date definitions, comprehensive procedural documentation and precise notification protocols. Investors have responded with enhanced due diligence processes, accelerated exit strategy development and more robust litigation preparedness measures.

Broader economic and innovation ecosystem impact

The market is experiencing structural transformation as funding models increasingly mirror debt financing structures, potentially suppressing entrepreneurial risk-taking and elevating barriers to entry for innovative start-ups. Government policy signals suggest potential “*tolerance policies*” and ongoing regulatory recalibration, reflecting efforts to balance investor protection with innovation support.

Concluding perspective

The redemption rights framework in China's PE/VC ecosystem represents a sophisticated risk management mechanism that reflects the market's unique developmental trajectory. This system demands unprecedented contractual precision, strategic agility and comprehensive risk assessment capabilities, while highlighting the intricate balance between investor protection and entrepreneurial freedom.

The future trajectory of China's investment ecosystem will largely depend on successfully navigating the delicate equilibrium between safeguarding investor interests and fostering a vibrant, innovative entrepreneurial landscape. This balance becomes increasingly critical as the market continues to evolve and mature within its distinctive regulatory and cultural context.

1.3 Key Industries

Technology and Telecommunications (TMT)

The TMT sector has demonstrated remarkable resilience and strategic significance, particularly in semiconductors, AI and fintech, where investment activity exhibited substantial momentum. This growth trajectory was carefully modulated by regulatory oversight that struck a balance between fostering technological innovation and implementing robust data security protocols, most notably through China's Data Security Law.

The investment landscape evolved to incorporate enhanced due diligence mechanisms and comprehensive cybersecurity evaluations, reflecting the sector's increasing sophistication and regulatory compliance requirements. Strategic technological domains garnered particular attention, underscoring the sector's pivotal role in national development priorities and global competitiveness initiatives.

Life Sciences and Biotech: Declined Pathway

The life sciences and biotech sector has undergone a significant recalibration, departing markedly from previous optimistic market projections. This downturn emerges from an intricate interplay of factors, including persistent macroeconomic headwinds, increasingly complex regulatory frameworks, escalating geopolitical tensions and inherent structural market constraints.

This sectoral contraction signals a critical juncture requiring fundamental restructuring and strategic realignment, as stakeholders navigate an increasingly challenging operational environment. The deviation from anticipated growth trajectories necessitates a comprehensive reassessment of investment strategies and operational frameworks within this vital sector.

2. Venture Capital Funds

2.1 Fund Structure

Venture Capital Fund Structures in China: a Comprehensive Analysis

Legal framework and organisational structure

The limited partnership enterprise (LPE) dominates China's venture capital landscape, featuring a dual-tier management structure. General partners (GPs) serve as strategic architects, bringing expertise from elite consulting firms and entrepreneurial backgrounds, while bearing unlimited personal liability. Limited partners (LPs), comprising institutional investors, state-owned funds and international pension funds, provide capital while maintaining limited liability protection.

Alternative frameworks include AMAC-regulated private equity funds offering standardised compliance mechanisms, and contractual investment structures allowing greater operational flexibility. These frameworks reflect China's evolving financial governance landscape.

Governance and decision-making mechanisms

Investment governance centres on GPs as strategic operators, supported by Investment Committees comprising seasoned professionals and industry experts. This structure ensures multi-layered investment scrutiny and comprehensive

risk assessment. LPs maintain strategic oversight through carefully negotiated veto rights on fundamental fund matters, including strategy shifts and GP replacement considerations.

Corporate documentation framework

The governance architecture rests on four key documents:

- the Limited Partnership Agreement (LPA), serving as the constitutional document;
- Subscription Agreements governing capital commitments;
- Private Placement Memorandums (PPMs), detailing investment thesis and risk frameworks; and
- Side Letters, enabling bespoke arrangements with sophisticated investors.

Ecosystem participants and market context

The ecosystem comprises GPs from elite professional backgrounds, diverse LP constituencies, and custodian banks providing critical infrastructure. Recent trends indicate increasing regulatory sophistication, enhanced transparency requirements and growing institutional participation, reflecting China's integration with global financial standards.

This sophisticated venture capital framework balances operational flexibility with strategic governance, establishing a robust foundation for China's evolving investment landscape.

2.2 Fund Economics

Primary Economic Participation Mechanisms

Management fee structure

Fund operations are sustained through a standard 2% annual management fee, calculated on committed capital during the investment period and deployed capital during the harvest phase. This structure ensures operational sustainabil-

ity while providing base compensation for Fund Principals and covering essential management costs.

Carried interest framework

The carried interest mechanism allocates 20% of fund profits to Fund Principals, subject to an 8% hurdle rate. This performance-based compensation activates only after LPs recover their initial investment, creating a strong alignment of interests between fund managers and investors.

Market standard terms

Investor protection mechanisms include an 8% preferred return requirement and comprehensive claw-back provisions, enabling recovery of excess carried interest distributions. The governance framework implements high water mark principles to prevent carried interest on unrealised gains, while requiring significant personal capital commitment (1%–5%) from the management team.

This economic structure creates a balanced ecosystem that aligns manager incentives with investor interests while maintaining robust protective mechanisms for all stakeholders.

2.3 Fund Regulation

Regulatory Framework for Chinese Venture Capital

Securities investment fund law

The foundational regulatory framework establishes comprehensive guidelines for fund establishment, operations and investor protection. This legislation defines permissible investment strategies, risk management protocols and fundamental legal infrastructure, ensuring systematic oversight of investment activities.

AMAC regulations

The Asset Management Association of China (AMAC) mandates compulsory registration and compliance for all venture capital funds. Requirements encompass detailed information submission, ongoing reporting obligations and periodic regulatory reviews. This framework standardises industry practices while implementing robust monitoring mechanisms for investor protection.

Foreign exchange regulations

The State Administration of Foreign Exchange (SAFE) oversees a specialised framework for funds involving foreign LPs or cross-border investments. The system manages capital contribution restrictions, investment return repatriation and currency conversion protocols, reflecting China's balanced approach to international capital flows while maintaining careful economic oversight.

2.4 Particularities

Evolving Fund Structures in Chinese Venture Capital

Government-backed venture capital funds

Government guidance funds (GGFs) serve as strategic drivers of national innovation, focusing on critical sectors such as semiconductors, AI and clean energy. These funds align with national initiatives such as Made in China 2025 and the Dual Circulation Strategy, significantly influencing private venture capital investment patterns.

Impact funds and ESG integration

The market shows increasing adoption of ESG principles and impact investing, particularly in green technology, healthcare innovation and educational technology. Government support through financial subsidies and regulatory incentives reinforces this trend, emphasising renewable energy and sustainable innovation.

Funds-of-funds (FoFs) and continuation funds

FoFs, predominantly backed by government guidance funds, provide strategic diversification across multiple venture capital investments. Continuation funds offer innovative life cycle management solutions, extending investment horizons and maximizing portfolio returns. This structure supports a growing secondary market for venture capital fund interests.

Foreign participation and extended holding periods

International engagement operates within a controlled framework through Qualified Foreign Limited Partnership (QFLP) programmes. The ecosystem addresses extended holding periods through innovative approaches, including extended fund durations (12–15 years) and strategic co-investment structures.

3. Investments in Venture Capital Portfolio Companies

3.1 Due Diligence

Corporate Structure and Ownership

Due diligence begins with thorough shareholder verification, examining registered and beneficial ownership structures, undisclosed equity agreements and preference rights. Corporate governance review encompasses incorporation documents, subsidiary structures and governance mechanisms.

Regulatory and Permits

The process validates business licences, sector-specific compliance and alignment with foreign investment regulations.

Contractual Framework

Critical contract analysis covers material agreements, employment arrangements and financial

commitments, including detailed examination of security interests and governmental registrations.

Intellectual Property

Intellectual property (IP) verification focuses on ownership confirmation, registration status and licensing agreements, while implementing comprehensive risk mitigation strategies.

Dispute Management

Litigation assessment examines pending disputes, historical proceedings and compliance with judicial decisions.

ESG and Local Context Considerations

Environmental compliance, labour practices and governance mechanisms undergo systematic evaluation. The process incorporates unique Chinese market characteristics, including guanxi networks and dynamic regulatory environments, while maintaining rigorous verification standards.

3.2 Process

Investment Round Timeline and Collaboration Framework

Due diligence timeline structure

Early-stage venture capital rounds typically conclude within two to four weeks, reflecting simpler corporate structures and streamlined diligence requirements. Late-stage private equity rounds extend to four to six weeks, accommodating more complex corporate arrangements and comprehensive stakeholder considerations.

Collaborative legal framework

Investors generally engage shared counsel for comprehensive due diligence, with costs typically reimbursed by the company. This collective approach enhances efficiency while reducing redundant investigations. Each investor may retain separate counsel for term negotiations,

enabling protection of specific interests within the collaborative framework.

Stakeholder dynamics

The process balances existing investor insights with new investor perspectives, creating a dynamic ecosystem that preserves historical context while incorporating fresh strategic input. This structure maintains efficient collective progress while protecting every single investor's interests throughout the financing round.

This balanced approach optimises the investment process through structured collaboration while preserving individual stakeholder protections.

3.3 Investment Structure

Preferred Equity Structures in Chinese Venture Capital

Contractual framework

Given the absence of formal “*preferred share*” classification under PRC law, investors utilise contractually engineered equity interests to establish preferential rights. This innovative approach mirrors common law preferred share characteristics while accommodating Chinese regulatory requirements.

Key preferential rights

These include:

- dividend preference;
- liquidation preference;
- redemption rights;
- anti-dilution adjustments;
- pre-emptive rights;
- right of first refusal (ROFR);
- co-sale rights;
- drag-along rights; and
- protective provisions (veto rights).

Implementation strategy

The structure balances robust investor protection with operational flexibility, tailoring rights to specific investment stages and company trajectories. This framework demonstrates the sophisticated legal engineering prevalent in Chinese venture capital, effectively bridging regulatory constraints through contractual innovation.

This approach creates a comprehensive preferred equity framework that maintains investor protection while adhering to Chinese legal requirements.

3.4 Documentation

Core Document Framework

This framework encompasses the following.

- Equity/share subscription/purchase agreement:
 - (a) investment terms and equity allocation;
 - (b) closing conditions;
 - (c) comprehensive representations and warranties; and
 - (d) indemnification provisions.
- Shareholders' agreement:
 - (a) inter-shareholder relationship governance;
 - (b) investor rights and protections;
 - (c) exit mechanisms and transfer restrictions; and
 - (d) corporate governance framework.
- Articles of association:
 - (a) fundamental corporate governance structure;
 - (b) internal operational rules; and
 - (c) a legally registered constitutional document.

Template Ecosystem

Unlike the standardised NVCA framework, Chinese venture capital relies on proprietary law firm

templates. While maintaining consistent structural approaches across funds, these templates allow significant customisation for specific transactions. The ecosystem facilitates template sharing and adaptation while reflecting evolving market practices.

Documentation Strategy

Law firms maintain comprehensive template libraries serving as negotiation starting points. This approach enables sophisticated investment structures while preserving flexibility for unique circumstances, creating a balanced framework that supports efficient deal execution while accommodating transaction-specific requirements.

3.5 Investor Safeguards

Liquidation Preference Structure

Seniority frameworks establish hierarchical distribution rights based on investment stage and valuation. Recent market trends show increasing adoption of “double dipping” mechanisms, allowing investors to both recover initial investment with interest and participate in remaining distributions ratably, enhancing downside protection and upside gains.

Anti-Dilution and Pre-Emptive Rights

Anti-dilution protection primarily utilises the Weighted Average Method, adjusting investor ownership based on subsequent financing amounts and pricing. Pre-emptive rights, standard in Chinese venture capital, enable existing investors to maintain proportional ownership through priority participation in new share issuances.

Redemption Framework

Redemption rights provide strategic exit options through:

- defined activation timeframes;
- predetermined redemption pricing;
- performance-linked triggers; and
- structured payment mechanisms.

Market Dynamics

The ecosystem demonstrates increasing sophistication in investor protections, particularly in downside scenario provisions. This evolution reflects adaptive responses to changing market conditions and investment risk profiles, creating a more robust protection framework for investors.

3.6 Corporate Governance

As passive shareholders, financial investors commonly rely on pro investor governance mechanisms in venture investments.

Governance Influence Strategies

These include shareholder/board level protective provisions, as follows.

- Critical corporate matters:
 - (a) liquidation or dissolution;
 - (b) a change-of-control deal;
 - (c) IPO;
 - (d) related party transactions;
 - (e) disposal of major assets;
 - (f) significant corporate restructuring; and
 - (g) board composition.
- Financial matters:
 - (a) budget approvals;
 - (b) capital expenditure thresholds;
 - (c) debt incurrence; and
 - (d) annual financial plans.
- Strategic decisions:
 - (a) material business strategy changes;
 - (b) mergers and acquisitions;
 - (c) entry into new business lines; and
 - (d) significant contractual commitments.

Governance Characteristics

These include a primarily passive investment approach focused on downside protection, indirect management influence, and being structured to prevent value-destructive decisions.

Mechanism of Influence

Contractually defined governance rights are carefully negotiated in shareholders' agreements, and are balanced to protect investor interests while maintaining management flexibility.

3.7 Contractual Protection

Representations, Warranties and Indemnification

The representations and warranties framework encompasses the following.

- Corporate fundamentals:
 - (a) legal establishment and existence;
 - (b) corporate authorisation validity;
 - (c) accurate capitalisation structure; and
 - (d) incorporation compliance.
- Operational assurances:
 - (a) financial statement accuracy;
 - (b) asset ownership verification;
 - (c) IP rights confirmation; and
 - (d) material contract validation.
- Compliance certifications:
 - (a) regulatory adherence;
 - (b) employment law compliance;
 - (c) ESG standard conformity; and
 - (d) data protection protocols.

Covenant Structure

This encompasses the following.

- Operational commitments:
 - (a) ongoing regulatory compliance;
 - (b) business continuity maintenance; and
 - (c) asset preservation requirements.

- Restrictive provisions:
 - (a) non-compete obligations;
 - (b) confidentiality requirements; and
 - (c) corporate change limitations.

Indemnification Framework

This encompasses the following.

- Compensation scope:
 - (a) direct financial losses;
 - (b) equity value diminution; and
 - (c) transaction-related costs.
- Liability distribution:
 - (a) company – primary indemnification responsibility; and
 - (b) founders – joint liability with cap on their share' fair market value/markable value, unless the liability is due to fraud, wilful misconduct or gross negligence, where it is unlimited liability.

This framework establishes comprehensive protection mechanisms while maintaining practical enforceability within the Chinese legal context.

4. Government Inducements

4.1 Subsidy Programmes

Government Guidance Funds in Chinese Growth Investment

Strategic framework

Government guidance funds represent China's innovative approach to catalysing strategic investment, combining State direction with market dynamics. These funds strategically mobilise private capital into priority sectors while providing crucial risk mitigation mechanisms, effectively accelerating innovation and supporting economic transformation.

Priority investment sectors

The funds target five key strategic domains that align with China's long-term development goals:

- advanced manufacturing – focusing on smart manufacturing, robotics and Industry 4.0 initiatives;
- clean energy and sustainability – supporting renewable energy, energy storage and green technology;
- digital economy and AI – advancing cloud computing, big data analytics and AI applications;
- semiconductor technologies – developing domestic chip design, manufacturing and related equipment; and
- biotechnology and healthcare – investing in pharmaceutical research, medical devices and healthcare innovation.

Operational structure

The funds operate through a sophisticated investment approach that balances government oversight with market efficiency. This structure employs a private sector co-investment model, typically taking minority equity positions to maintain market dynamics while sharing investment risks. The focus on early-stage funding helps bridge critical financing gaps in emerging sectors.

Investment architecture

The operational framework is built on:

- multi-tiered investment vehicles that accommodate various risk profiles and investment horizons;
- professional management teams with both public and private sector expertise;
- market-driven methodology ensuring commercial viability; and

- flexible deployment criteria adapting to sector-specific needs.

4.2 Tax Treatment

Corporate Income Tax Structure

China's corporate tax framework balances standardised taxation with strategic incentives, creating a dynamic environment that supports innovation while maintaining fiscal stability. The system combines broad-based taxation with targeted benefits for strategic sectors and emerging companies.

Standard Tax Regime

The foundation of China's corporate taxation rests on a universal 25% Corporate Income Tax (CIT) rate, providing a consistent baseline across industries. This standard framework ensures regulatory clarity and establishes a level playing field for all business entities, while serving as the foundation for more specialised provisions.

Innovation Enterprise Benefits

To accelerate technological advancement and economic transformation, qualified innovation-driven enterprises enjoy significant tax advantages:

- preferential 15% CIT rate – available to companies meeting specific innovation criteria;
- priority sector focus – technology and AI development, biotechnology research and applications, green energy solutions and advanced manufacturing initiatives; and
- start-up support – special exemptions for early-stage companies, reducing initial tax burden during critical growth phases.

Investment Vehicle Taxation

The tax treatment of investment vehicles, particularly venture capital funds, aligns with international best practices while incorporating

Chinese characteristics. The framework emphasises:

- limited partnership structures with tax pass-through benefits;
- direct taxation at the investor level rather than fund level;
- mechanisms to prevent double taxation across investment chains; and
- harmonisation with global investment standards to facilitate cross-border capital flows.

Geographic Tax Incentives

China leverages location-based tax policies to drive regional development and specialised industry clusters.

Strategic zones

Different specialised zones offer distinct advantages:

- special economic zones – comprehensive tax benefits supporting international trade;
- high-tech parks – focused incentives for technology development; and
- free trade zones – enhanced tax provisions for cross-border transactions.

Regional benefits package

Location-specific incentives include:

- reduced tax rates for qualified operations;
- strategic tax exemptions for priority industries; and
- investment subsidies promoting regional development goals.

4.3 Government Endorsement

China's Equity Financing Ecosystem: Market Evolution Framework

Stock market reform structure

China's equity market transformation represents a strategic shift towards greater market efficiency and accessibility, fundamentally reshaping the country's capital raising landscape.

Registration-based IPO system

The transition from an approval-based to a registration-based IPO system marks a significant evolution in China's capital markets. This modernised approach features:

- streamlined listing processes, reducing timelines to six months;
- market-driven valuation mechanisms, replacing administrative pricing;
- enhanced transparency requirements aligned with international standards; and
- progressive implementation across STAR Market and ChiNext Board.

Multi-tier market architecture

The ecosystem operates through strategically differentiated boards, each serving distinct company profiles.

- Main board – home to established corporations with proven track records.
- SME board – catering to growing mid-sized enterprises with stable operations.
- ChiNext – platform for high-growth innovative companies.
- STAR Market – specialised venue for cutting-edge technology firms, focusing on:
 - (a) semiconductor development and production;
 - (b) advanced manufacturing technologies; and

- (c) AI applications and biotechnology innovations.

International Integration Framework

Cross-border trading mechanisms

China has established robust international market connections through the following.

- Stock Connect programmes:
 - (a) Shanghai-Hong Kong connection facilitating northbound/southbound trading;
 - (b) Shenzhen-Hong Kong link expanding access to tech-focused enterprises; and
 - (c) Bond Connect initiatives broadening fixed-income market access.
- QFII/RQFII reforms:
 - (a) elimination of investment quotas;
 - (b) simplified application procedures; and
 - (c) improved market accessibility for global investors.

Global Listing Framework

Companies can optimise their capital-raising through multiple venues:

- Hong Kong – preferred regional hub offering regulatory familiarity and international exposure;
- NASDAQ – access to deep technology-focused investor base and global visibility; and
- alternative platforms – additional options through London and Singapore exchanges.

Global listing strategies prioritise high-growth sectors:

- technology and AI development;
- biotechnology innovation;
- advanced manufacturing capabilities; and
- digital economy initiatives.

5. Employment Incentives

5.1 General

Comprehensive Retention Framework

Chinese venture investments employ a sophisticated combination of legal obligations and incentive structures to ensure long-term commitment from founders and key employees, creating a balanced approach between enforcement and motivation.

Contractual Commitment Mechanisms

Non-compete provisions

The cornerstone of contractual retention includes carefully structured non-compete clauses that extend across multiple timeframes:

- during the active employment period;
- throughout the equity ownership duration; and
- a two-year post-employment restriction period.

Full-time contribution requirements

Comprehensive engagement obligations are structured to ensure dedicated focus and optimal performance. Mandatory engagement elements include:

- exclusive dedication to the venture's operations;
- explicit prohibition of parallel entrepreneurial activities; and
- specific performance metrics and time commitment standards.

Documentation framework

These obligations are formally documented across multiple agreements:

- Shareholders' Agreement (SHA) – governing equity holder obligations;

- Share Purchase Agreement (SPA) – establishing investment terms; and
- employment contracts – detailing day-to-day responsibilities.

Breach consequences

The framework includes clear enforcement mechanisms for commitment violations:

- SPA-triggered indemnity obligations for covenant breaches; and
- SHA-mandated redemption rights for a material breach.

Additional Retention Strategies

Performance-linked compensation involves a comprehensive incentive structure that complements legal obligations through various mechanisms, as follows.

- Equity-based incentives:
 - (a) traditional stock option programmes with vesting schedules;
 - (b) restricted share units (RSUs) aligned with performance metrics;
 - (c) phantom equity arrangements for flexible value sharing; and
 - (d) long-term bonus structures tied to company milestones.
- Strategic implementation – the compensation framework is designed to:
 - (a) align individual interests with company success;
 - (b) create meaningful long-term value potential;
 - (c) establish clear performance-reward relationships; and
 - (d) support retention through extended vesting periods.
- Integration and balance – this multifaceted approach creates a robust retention framework that:

- (a) combines protective legal measures with positive incentives;
- (b) balances immediate restrictions with long-term rewards;
- (c) provides clear consequences while offering growth opportunities; and
- (d) maintains flexibility while ensuring commitment.

5.2 Securities

Equity Retention and Incentive Mechanisms for Founders and Employees

Founder equity framework – restricted share mechanisms

Founder equity retention rests on a sophisticated vesting framework that balances long-term commitment with flexibility.

Vesting structure

- Time-based vesting:
 - (a) four-year vesting schedule with one-year cliff;
 - (b) monthly or quarterly vesting; and
 - (c) accelerated vesting provisions for qualifying events (M&A/IPO).

Repurchase rights

The company maintains strategic control through carefully structured repurchase provisions.

Trigger events

- voluntary departure; and
- termination scenarios (with/without cause).

Valuation framework

- Unvested shares: repurchase at original cost.
- Vested shares:
 - (a) at cost – voluntary departure or for-cause termination; and
 - (b) fair market value – termination without cause or “good reason”.

Employee equity participation

Employee participation is facilitated through a comprehensive stock option framework:

- implementation through an LP structure;
- employee access via LP interests; and
- five-year standard vesting timeline promoting long-term alignment.

The framework combines multiple vesting approaches:

- a time-based vesting schedule; and
- performance-based acceleration opportunities.

Integration and impact

This comprehensive framework represents a sophisticated approach to equity-based retention and motivation. It effectively balances:

- short-term performance incentives with long-term value creation;
- individual reward potential with company risk management; and
- standardised structures with situation-specific flexibility.

5.3 Taxation of Instruments

Employee Stock Option Plan (ESOP) Taxation Framework in China – LP ESOP Structure

Tax-efficient configuration

China’s ESOP framework utilises an LP structure that optimises tax efficiency through:

- transparent tax treatment enabling direct pass-through;
- elimination of entity-level double taxation;
- direct attribution of tax obligations to individual participants; and
- structure alignment with global taxation standards.

Individual income tax assessment

The primary taxable event occurs at option exercise, with careful consideration of the following.

Tax base calculation

- Determined by the differential between:
 - (a) current fair market value (FMV) of shares; and
 - (b) original option exercise price.

Progressive tax rate application

- Rates scale from 3% to 45% based on income levels.
- Comprehensive income consideration, including:
 - (a) regular employment income;
 - (b) option exercise benefits; and
 - (c) other taxable income sources.

Capital gains taxation

Partnership interest disposal – tax rate structure

- Standard capital gains rate – 20%.
- Alternative rate schedule – up to 35%:
 - (a) applied based on specific circumstances;
 - (b) consideration of holding periods; and
 - (c) assessment of disposal volume.

Geographic considerations

Tax obligations vary based on location-specific factors:

- municipal-level regulations;
- economic development zone benefits; and
- special economic region provisions.

Strategic tax planning

Effective ESOP implementation requires careful consideration of:

- optimal exercise timing;
- strategic disposal planning;
- geographic tax arbitrage opportunities; and
- available tax relief mechanisms.

Documentation requirements

Proper tax treatment depends on maintaining:

- detailed exercise records;
- FMV assessments;
- holding period documentation; and
- disposal transaction records.

Geographic benefits

Various locations offer distinct advantages:

- economic development zones providing preferential rates;
- special economic regions with tax incentives; and
- municipal-level tax benefits for qualifying transactions.

Timing strategies

Tax efficiency can be enhanced through:

- strategic exercise timing;
- planned disposal schedules;
- co-ordination with other income sources; and
- utilisation of tax assessment periods.

5.4 Implementation

ESOP and Equity Framework for Chinese Companies – Core Structure and Implementation

Equity pool configuration

A standard allocation range of 10%–20% of total equity applies:

- implemented through an LP structure with tax pass-through mechanisms;
- featuring flexible sizing based on company stage, industry characteristics and talent strategy requirements; and
- supported by systematic dilution management across funding rounds.

Stage-Specific Implementation

Early stage (Seed/Series A)

This involves an initial pool of 10%–15% of total equity with broader distribution patterns focused on early team building, featuring generous individual allocations to attract key talent, and supported by flexible grant structures that enable rapid team expansion and critical role fulfilment.

Growth stage (Series B/C)

This involves dynamic pool adjustments with refined allocation strategy, incorporating performance-linked grants and sophisticated vesting mechanisms, balanced with proportional dilution management and strategic pool replenishment to maintain incentive effectiveness.

Late stage (pre-IPO)

This involves conservative new allocations emphasising retention through sophisticated vesting mechanisms, minimal dilution impact, and performance-based equity distribution, focused on key talent retention and value preservation approaching liquidity events.

Retention and Protection Mechanisms

Vesting framework

This involves a comprehensive four to five-year vesting schedule with a one-year cliff period, featuring monthly or quarterly accrual post-cliff, strategic acceleration provisions for M&A and IPO scenarios, as well as performance-based vesting criteria linked to both company and individual achievements.

Protection features

These include robust company repurchase rights triggered by departure events, with differentiated valuation mechanisms for unvested shares (at cost) and vested shares (based on departure circumstances), complemented by comprehensive non-compete provisions, full-time commitment requirements, and IP protection measures.

Taxation Structure

Exercise taxation

Tax base is calculated as FMV minus exercise price, subject to progressive rates from 3%–45%, incorporating strategic timing considerations for exercise and disposal, with geographic variations offering potential tax advantages based on local jurisdiction policies.

Capital gains treatment

A standard capital gains rate of 20% applies with an alternative rate of up to 35%, featuring regional variations based on economic zone benefits, municipal regulations and special region provisions, supported by systematic tax optimisation strategies and professional advisory guidance.

Strategic Implementation

Value optimisation

This involves industry-aligned allocation ranges with market-competitive individual grants, incorporating performance linkage mechanisms and regular value assessment, and supported by systematic review processes and adjustment capabilities to maintain competitive positioning.

Risk management

This involves comprehensive dilution control mechanisms integrated with clear documentation requirements, regular compliance monitoring and stakeholder protection measures, balanced with flexibility for market dynamics and company growth requirements.

Integration Framework

Corporate alignment

This involves strategic alignment between equity compensation and corporate objectives, supporting talent acquisition and retention, performance motivation and value creation, while enabling sustainable growth and stakeholder value enhancement.

Governance structure

This is a robust governance framework featuring regular review mechanisms, transparent communication protocols and professional advisory support, ensuring consistent compliance management and effective programme administration.

Implementation Considerations

Practical execution

A systematic implementation approach combines clear communication strategies, regular performance assessment, documented review processes and flexible adjustment mechanisms, supported by professional advisory services and stakeholder engagement.

Market context

The framework reflects the evolution of Chinese equity compensation practices, demonstrating a sophisticated approach to talent retention while balancing international standards with local market requirements, regulatory compliance and stakeholder interests.

6. Exits

6.1 Investor Exit Rights

Exit Strategies and Shareholder Rights Framework: Core Exit Mechanisms

Drag-along rights

A comprehensive majority investor mechanism enables forced sale participation across all shareholders, providing transaction completion assurance and control premium preservation, while eliminating minority blocking positions and establishing clean exit pathways for trade sales, liquidity events and strategic transactions.

Tag-along/co-sale rights

A robust investor protection framework ensures equitable exit opportunities through guaranteed participation in founder-initiated sales, maintaining transaction term parity and proportional participation, while preventing discriminatory conditions and mitigating valuation disparities across shareholder classes.

Redemption rights

A structured investor exit guarantee system is activated by specific milestones or trigger events, including failed IPO attempts, missed strategic objectives or extended investment periods, and material breaches of representations or covenants, executed through company-funded redemption, founder-led share buybacks or predetermined valuation formulas.

Value Protection Structure

Liquidation preferences

A sophisticated priority distribution framework provides preferred shareholder protection through multiple structures (participating, non-participating, capped preferences), establishing clear hierarchical recovery mechanisms for investor capital protection and downside risk mitigation.

Transfer Restriction Mechanisms

Founder transfer constraints

Comprehensive restrictive transfer protocols require investor consent, strategic holding periods and structured approval processes, balanced with company growth requirements and market dynamics.

Right of first refusal

This involves a founders' share transfer process that incorporates investor right of first refusal (ROFR), mandatory offer notifications and opportunity matching for third-party terms, supported by structured transfer approval protocols and stakeholder protection measures.

Investor Transfer Guidelines

The nuanced transfer framework incorporates competitive restrictions, prohibited sales to pre-defined competitors and strategic market protection measures, while maintaining appropriate transaction flexibility.

Implementation Framework

Documentation requirements

The comprehensive legal framework incorporates detailed shareholders' agreement provisions, clear trigger event definitions, structured valuation methodologies and systematic process execution protocols, supported by professional advisory guidance.

Execution mechanisms

Standardised implementation procedures feature clear notification requirements, defined response timelines, transparent pricing mechanisms and established dispute resolution protocols, ensuring consistent and efficient execution.

Strategic Considerations

Value optimisation

This involves a systematic approach to transaction timing, valuation maximisation and stakeholder alignment, incorporating market condition assessments and strategic positioning to enhance exit outcomes.

Risk management

The comprehensive protection framework balances minority shareholder rights with majority control, ensuring fair treatment across shareholder classes while maintaining flexibility for market dynamics and growth requirements.

Practical Application

Exit preparation

The strategic preparation framework combines timing assessment, stakeholder communication, documentation readiness and process optimisation, supported by professional advisory services and systematic review procedures.

Transaction execution

A structured execution approach incorporates clear approval processes, transparent communication protocols and comprehensive compliance management, ensuring efficient and equitable transaction completion.

6.2 IPO Exits

Traditional Market Foundation

A-Share market position

The A-Share market stands as China's traditional cornerstone for corporate exits, offering domestic prestige combined with streamlined regulatory navigation. This primary route leverages established domestic investor relationships and regulatory familiarity, providing natural advantages in market understanding and compliance efficiency. Companies benefit from cultural alignment and simplified communication channels,

particularly valuable for enterprises with strong domestic market presence.

Regulatory environment

The China Securities Regulatory Commission's (CSRC) oversight has evolved into a sophisticated framework emphasising stringent listing requirements and enhanced financial scrutiny. Modern regulatory focus centres on financial transparency, corporate governance excellence and business model sustainability, while maintaining robust anti-speculation measures. This environment demands thorough operational history validation and precise financial performance documentation, creating a comprehensive but navigable regulatory landscape.

Market Dynamics

Contemporary challenges

Market conditions present complex challenges through macroeconomic uncertainties and sector-specific variations. The listing environment features extended review timelines and heightened rejection risks, requiring sophisticated preparation strategies. Companies must navigate valuation volatility while maintaining flexibility in market access timing and implementation approaches.

Strategic response

Successful navigation requires balanced preparation incorporating financial readiness, governance enhancement and stakeholder communication. Companies must maintain adaptable timelines while ensuring comprehensive documentation and professional advisory support, enabling responsive adjustment to market conditions while preserving strategic objectives.

International Listing Framework

Hong Kong Exchange (HKEX) pathway

HKEX offers a strategic hybrid platform combining international market access with regional proximity advantages. This route provides familiar regulatory frameworks aligned with international standards while maintaining strong mainland connections. Companies benefit from enhanced global visibility while leveraging existing cultural and operational synergies.

NASDAQ positioning

NASDAQ listings deliver advanced international market integration and sophisticated infrastructure access. This pathway particularly suits technology-driven enterprises seeking global ecosystem integration and institutional investor exposure. Companies gain access to deep liquidity pools and comprehensive research coverage while meeting elevated international standards.

Implementation Strategy

Location selection

Venue selection demands systematic evaluation of market depth, regulatory requirements and investor base characteristics. Analysis must balance quantitative metrics with qualitative factors including peer group alignment and index inclusion potential, while maintaining focus on long-term strategic objectives.

Preparation framework

Successful execution requires meticulous financial preparation, governance enhancement and compliance readiness. Companies must develop comprehensive stakeholder communication strategies while maintaining flexibility for evolving market conditions and regulatory requirements.

Risk Management

Regulatory navigation

Effective risk management combines multi-jurisdictional compliance expertise with systematic monitoring of market conditions. Companies must maintain robust contingency planning while ensuring responsive adaptation to regulatory developments and market sentiment changes.

Market timing

Strategic timing optimisation requires balanced consideration of market conditions, valuation environments and investor sentiment. Companies must maintain preparation readiness while preserving flexibility to capture optimal market windows.

Future Outlook

Market evolution

Capital markets continue advancing through regulatory modernisation and international integration enhancement. Evolution encompasses increasing sophistication in trading mechanisms and valuation methodologies while maintaining focus on market stability and investor protection.

Strategic adaptation

Forward-looking planning must incorporate emerging opportunities and regulatory changes while maintaining core strategic alignment. Companies must balance traditional market strengths with international opportunities while ensuring sustainable competitive positioning.

6.3 Pre-IPO Liquidity

Secondary Market Trading and Liquidity Mechanisms in the Chinese Venture Ecosystem

Market liquidity landscape and emerging secondary market dynamics

The Chinese venture ecosystem faces significant liquidity challenges stemming from tradi-

tional exit limitations, including extended IPO timelines, persistent regulatory uncertainties and prolonged investment holding periods. These challenges directly impact various stakeholders' needs, particularly in investor capital optimisation, employee equity monetisation and portfolio management flexibility. The evolving landscape necessitates innovative approaches to address these fundamental market constraints.

Structured liquidity mechanisms and secondary trading frameworks

To address market inefficiencies, emerging liquidity solutions have developed through structured approaches encompassing controlled secondary transactions, investor-to-investor transfers and company-facilitated trading platforms. These solutions are implemented through carefully regulated transfer mechanisms, transparent valuation processes and comprehensive compliance protocols, ensuring market integrity while facilitating necessary liquidity.

Regulatory and structural barriers in secondary market development

The development of robust secondary markets faces substantial impediments, including limited market infrastructure, strict transfer restrictions and complex compliance requirements. These challenges are compounded by valuation complexities, characterised by inconsistent pricing mechanisms, significant information asymmetry and limited market transparency, creating barriers to efficient secondary market operations.

Legal and governance framework

Successful secondary market operations require well-structured legal parameters, including comprehensive shareholders' agreements, clear transfer restriction provisions and detailed valuation methodologies. These are supported by robust governance mechanisms incorporating

board approval processes, right-of-first-refusal protocols and investor consent requirements, ensuring orderly market function while protecting stakeholder interests.

Future outlook

The Chinese venture ecosystem's secondary market is poised for continued evolution, with developments expected in trading mechanisms, more sophisticated liquidity solutions and increased regulatory clarity. These advancements will likely facilitate more efficient capital recycling and improved market functionality, benefiting all ecosystem participants.

7. Regulation

7.1 Securities Offerings

Regulatory Foundation

Legal ecosystem integration

The Chinese equity securities framework operates within an intricate regulatory ecosystem, integrating multiple legal domains including corporate law, securities regulations, foreign investment frameworks, employment legislation and tax compliance mechanisms. This multidimensional legal structure requires sophisticated navigation of intersecting regulatory requirements while maintaining operational efficiency and strategic flexibility in transaction execution.

Regulatory oversight structure

Primary regulatory oversight combines the coordinated efforts of key authorities including the CSRC, the Ministry of Commerce (MOFCOM), SAFE and the National Tax Administration. This integrated regulatory approach demands comprehensive cross-jurisdictional compliance while maintaining holistic regulatory perspective across all transaction dimensions.

Transaction Framework

Structural implementation

Transaction execution requires navigation of sophisticated compliance requirements through adaptable offering structures and flexible equity distribution mechanisms. This framework incorporates detailed documentation protocols while implementing tax efficiency strategies through optimised equity allocation and transfer pricing mechanisms, ensuring minimised tax burden within regulatory constraints.

Operational framework

Practical implementation encompasses systematic management of regulatory approval processes, including detailed documentation requirements and complex approval hierarchies. This operational structure requires proactive regulatory navigation supported by comprehensive due diligence and adaptive compliance strategies, ensuring sustainable transaction execution while maintaining regulatory alignment.

Legal Architecture

Corporate governance framework

Governance structures incorporate detailed shareholders' agreement provisions covering comprehensive equity offering terms, transfer restriction protocols and rights definition. Articles of association provide foundational support through detailed equity issuance guidelines, governance structure specifications and robust investor protection mechanisms, ensuring comprehensive stakeholder protection.

Securities regulation compliance

Securities compliance demands comprehensive information transparency through detailed financial reporting and investor protection mechanisms. This framework requires systematic documentation processes, precise regulatory submissions and comprehensive compliance

verification, maintaining regulatory alignment while preserving transaction efficiency.

International Investment Integration

Cross-border transaction management

International investment frameworks require sophisticated navigation of foreign investment review processes, capital control regulations and cross-border transfer restrictions. This structure demands adaptive investment mechanisms and comprehensive regulatory navigation strategies, ensuring successful cross-border transaction execution while maintaining compliance integrity.

Future Development Trajectory

Evolution dynamics

Market evolution continues through increasing regulatory sophistication and enhanced compliance frameworks. This development encompasses more integrated regulatory approaches and continued market evolution, requiring adaptive strategic responses and sophisticated compliance mechanisms.

Strategic adaptation

Forward-looking planning must incorporate emerging regulatory trends and evolving market requirements while maintaining operational efficiency. This approach enables sustainable transaction execution through adaptive compliance strategies and sophisticated structural solutions.

7.2 Restrictions

Foreign Venture Capital Investment: Chinese Regulatory Framework

The Dynamic Investment Environment

The Chinese foreign investment landscape operates within an evolving regulatory ecosystem characterised by multidimensional restriction mechanisms encompassing FDI regulations, currency controls, sector-specific limitations

and national security considerations. This adaptive framework demonstrates continuous policy refinement reflecting geopolitical sensitivities and strategic economic alignment, requiring sophisticated navigation of dynamic regulatory requirements. The system maintains a systematic balance between investment attraction and market protection through comprehensive control mechanisms while enabling sustainable market development trajectories aligned with national strategic objectives.

Strategic Regulatory Architecture

The regulatory structure implements sophisticated oversight through integrated control mechanisms and strategic sector development initiatives. This comprehensive framework enables measured economic openness while preserving critical national interests through systematic monitoring and adaptive policy implementation. The architecture demonstrates increasing sophistication in balancing foreign participation with domestic market development, supported by enhanced compliance mechanisms and strategic sector alignment protocols.

Foreign Direct Investment Framework

Negative list mechanism

The negative list system provides comprehensive investment restriction frameworks through precise industry categorisation and dynamic restriction protocols. Annual regulatory updates ensure alignment with strategic economic objectives while maintaining systematic sector protection mechanisms. This structure enables clear operational guidance for foreign investors while preserving flexibility for policy adjustment and strategic sector development, supported by sophisticated compliance verification systems and detailed implementation protocols.

Industry classification framework

Prohibited sectors

Absolute restriction domains encompass strategically sensitive sectors including news media, publishing, cultural production and specific financial services. This framework maintains cultural integrity and information ecosystem control while preserving core national sovereignty interests through comprehensive restriction mechanisms. The system implements sophisticated monitoring protocols and systematic compliance verification while maintaining clear boundaries for foreign participation across restricted sectors.

Restricted industries

Controlled foreign participation frameworks govern strategic sectors including telecommunications, education and healthcare through sophisticated investment constraint mechanisms. These frameworks integrate detailed equity ownership caps, mandatory approval processes and comprehensive qualification requirements, while maintaining systematic oversight of foreign participation. The structure enables measured market access while preserving regulatory control through integrated monitoring systems and adaptive compliance requirements.

Encouraged sectors

Strategic investment promotion focuses on targeted sector development through sophisticated incentive mechanisms including tax optimisation strategies and streamlined approval processes. This framework provides preferential policy access and simplified regulatory navigation while maintaining alignment with national development objectives. The system implements comprehensive support mechanisms while ensuring appropriate oversight and compliance verification through integrated monitoring protocols.

Currency Control Architecture

SAFE regulatory framework

SAFE maintains comprehensive capital flow management through sophisticated cross-border transaction governance. This integrated system combines mandatory investment registration, detailed reporting protocols and systematic compliance verification, while enabling controlled capital movement. The framework implements comprehensive monitoring mechanisms while maintaining necessary flexibility for legitimate investment operations through sophisticated control protocols.

Capital movement mechanisms

The capital movement structure implements sophisticated regulatory controls through integrated approval processes and systematic compliance verification. This framework enables controlled capital flows while maintaining market stability through comprehensive monitoring systems and adaptive control mechanisms. The structure demonstrates increasing sophistication in balancing transaction efficiency with regulatory oversight, supported by enhanced verification protocols and strategic risk management systems.

Free Trade Zone Innovation

Strategic pilot programmes

Breakthrough regulatory approaches in pilot free trade zones demonstrate measured market opening through controlled foreign participation in strategic sectors. These programmes implement systematic innovation within controlled regulatory frameworks while maintaining comprehensive oversight mechanisms. The structure enables targeted experimentation with regulatory reforms while preserving strategic control through integrated monitoring systems and adaptive compliance requirements.

Innovation ecosystem development

Key pilot regions including Beijing, Shanghai, Guangdong and Hainan Free Trade Zones provide comprehensive innovation ecosystems through systematic policy experimentation and gradual regulatory liberalisation. These controlled innovation corridors enable measured testing of regulatory reforms while maintaining strategic oversight through sophisticated monitoring protocols and integrated compliance systems. The framework demonstrates increasing sophistication in balancing innovation promotion with regulatory control through enhanced verification mechanisms and strategic alignment protocols.

In a landmark policy shift for 2024, China significantly opened its gene therapy sector to foreign investment, marking a strategic departure from its traditionally prohibited stance. Through a carefully structured pilot programme in designated free trade zones, foreign enterprises can now invest in and develop technologies across key areas including human stem cell research, gene therapy, genetic diagnosis and cell therapy applications. This policy change not only demonstrates China's commitment to advancing its biotechnology sector but also creates unprecedented opportunities for international collaboration and knowledge transfer.

While maintaining necessary regulatory oversight and compliance requirements, this opening is expected to accelerate China's development in advanced medical treatments by attracting substantial foreign expertise and capital. The move reflects China's broader strategy of strengthening its position in the global biotechnology landscape while ensuring controlled and regulated market access for foreign participants in this sensitive healthcare sector.

Trends and Developments

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Zhong Lun Law Firm was established in 1993, and is a pioneering partnership law firm in China. Through decades of strategic growth and unwavering commitment to excellence, the firm has emerged as a pre-eminent full-service law firm. With nearly 400 equity partners and a robust team of over 2,200 professionals, Zhong Lun represents the pinnacle of legal expertise and institutional capability. As one of the first Chinese law firms to specialise in private equity, Zhong Lun has developed unparalleled insights and deep-rooted expertise in this complex do-

main. Its practice comprehensively addresses the entire life cycle of private fund operations. By combining meticulous legal acumen with strategic foresight, the firm has consistently positioned itself as a leading legal service provider in China's dynamic private equity landscape. Its sustained excellence has been internationally recognised, with Chambers Global repeatedly ranking Zhong Lun in Band 1 for Private Equity – a testament to the firm's exceptional performance and industry leadership.

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China's Private Equity Sector: Legal and Regulatory Perspective

China's private equity (PE) and venture capital (VC) landscape experienced substantial legal and regulatory transformation throughout 2024, influenced by economic restructuring initiatives, technological innovation, geopolitical tensions and an intensified focus on compliance frameworks and market stability. This analysis offers a comprehensive examination of pivotal trends and developments through a legal and regulatory lens in China's PE and VC sector.

Key Trends and Challenges

Overall decline in deal flow

The Chinese PE and VC markets have undergone significant recalibration over the preceding three-year period, characterised by a pronounced contraction in both transaction volume and deal valuation. Market intelligence spanning from 2022 through 2024 revealed several defining trends and contributory factors. The following analysis explores these developments.

2022–2023 slowdown

The post-COVID-19 pandemic economic realignment, in conjunction with enhanced regulatory oversight and global macroeconomic

volatility, precipitated a marked deceleration in transactional activity. The authors' analysis reveals a year-on-year contraction in both transaction frequency and aggregate value, with particular impact observed in previously high-performing sectors such as technology and consumer goods, which had historically served as primary growth catalysts.

2024 continuation

Current market indicators for 2024 demonstrated sustained investor circumspection, with transaction volumes remaining constrained. This persistent caution stems primarily from two key factors: increasingly stringent compliance frameworks (addressed comprehensively in subsequent sections) and ongoing geopolitical tensions that continue to impede cross-border capital mobility (examined in detail below).

Geopolitical challenges impacting Chinese PE and US investor reticence

Escalating geopolitical tensions and intensified regulatory examination, most notably through the Committee on Foreign Investment in the United States (CFIUS), have fundamentally altered cross-border investment paradigms, engendering pronounced reluctance among US

institutional investors regarding participation in Chinese PE vehicles. The following analysis delineates principal challenges and illustrative instances.

CFIUS scrutiny and regulatory hurdles

CFIUS has substantially expanded its supervisory purview over foreign capital deployments, with particular emphasis on transactions involving critical technologies, essential infrastructure and data-sensitive industrial sectors. CFIUS has articulated an evolving framework of national security considerations, necessitating more comprehensive and rigorous evaluations of transactions with nexus to nations designated as strategic competitors, most notably China. Illustrative examples include that:

- investments directed towards Chinese emerging technology enterprises are subject to elevated levels of regulatory examination regarding data security protocols and intellectual property protection mechanisms; and
- US institutional investors increasingly confront regulatory imperatives to divest holdings in Chinese ventures operating in strategically sensitive domains, including artificial intelligence systems, semiconductor development and manufacturing, and advanced biotechnology applications.

Structural decoupling of investment firms

In response to escalating CFIUS-associated regulatory contingencies, pre-eminent VC institutions have implemented comprehensive organisational restructuring of their China-focused operations:

- Sequoia Capital executed a strategic bifurcation of its Chinese investment platform, establishing the autonomous entity “Hongshan” in 2023, thereby creating distinct

operational and governance firewalls between its US and Chinese investment portfolios; and

- GGV Capital similarly effectuated a corporate separation, reconstituting its China-centric investment activities under the independently managed “Jiyuan Capital” entity, exemplifying a broader industry-wide strategic realignment in response to evolving geopolitical imperatives.

These strategic corporate recalibrations underscore sophisticated risk mitigation methodologies designed to insulate global investment operations from potential regulatory interventions, while preserving access to regional market opportunities through legally differentiated corporate structures.

Geopolitical tensions and national security considerations

The strategic competition between the United States and China transcends the jurisdictional parameters of CFIUS, encompassing a comprehensive matrix of regulatory mechanisms including stringent export control regimes (exemplified by semiconductor technology transfer prohibitions), targeted economic sanctions, and allegations pertaining to intellectual property misappropriation. This multifaceted regulatory landscape engenders heightened political risk assessment protocols among institutional investors, precipitating substantial capital reallocation away from industrial sectors perceived as entangled in bilateral strategic competition dynamics.

Impact on cross-border capital flows

This impact has been seen in the following ways:

- diminution of US-originated investment capital – Chinese emerging technology enterprises operating within strategically sensitive industrial sectors report statistically

significant reductions in VC deployments from US-domiciled investment vehicles, with institutional allocators increasingly redirecting capital towards alternative regional markets, predominantly South-East Asian jurisdictions and the Indian subcontinent; and

- extended regulatory review periodicity – CFI-US evaluation procedures have demonstrably extended transaction timelines, substantially elevating both direct transaction costs and introducing material levels of execution uncertainty into cross-border investment structures involving Chinese entities.

Regulatory ambiguity and compliance complexity

This includes the following.

- Interpretive uncertainty in CFIUS guidance – the Committee’s regulatory framework exhibits its substantive ambiguity regarding critical operational domains, particularly with respect to data governance protocols and cross-border information transfer mechanisms, thereby compelling emerging technology enterprises to implement excessively conservative compliance strategies that potentially constrain legitimate business activities.
- Conflicting data sovereignty regimes – adherence to China’s increasingly stringent data localisation mandates (codified within the comprehensive Cybersecurity Law, Personal Information Protection Law, and Data Security Law tripartite framework) creates fundamental compliance contradictions vis-à-vis US national security requirements. This regulatory incongruence introduces substantial operational complexities for multinational entities engaged in trans-Pacific commercial activities, necessitating sophisticated data architecture bifurcation and jurisdictionally segregated information management systems.

Summary: strategic implications for cross-border investment paradigms

The intricate interrelationship between heightened CFIUS enforcement protocols, escalating geopolitical strategic competition and accelerating institutional decoupling mechanisms have precipitated a fundamentally reconfigured operational landscape for trans-Pacific PE deployment. While pre-eminent investment institutions such as Sequoia Capital and GGV Capital have implemented sophisticated organisational bifurcation strategies to preserve market access, the pervasive regulatory indeterminacy and prioritisation of national security imperatives continue to function as material impediments to cross-border capital formation.

To maintain sustainable engagement in this complex jurisdictional environment, institutional investors must develop nuanced governance frameworks capable of simultaneously addressing dual regulatory pressures – implementing robust compliance architectures responsive to evolving US national security safeguards while concurrently navigating China’s increasingly assertive regulatory sovereignty regime.

Strategic reorientation towards lower-quantum, targeted transactions

Early-stage capital deployment recalibration

In response to heightened regulatory scrutiny and enhanced national security review thresholds applicable to later-stage, high-valuation transactions, institutional investors have strategically reallocated capital towards early-stage venture investments characterised by reduced regulatory complexity. Notwithstanding this tactical portfolio adjustment, the diminished transaction quantum associated with such investments has precipitated a statistically significant contraction in aggregate deployed capital across the investment landscape.

Limited partner investment selectivity enhancement

Institutional limited partners, encompassing insurance-based investment vehicles and sovereign-affiliated investment entities, have implemented increasingly stringent fund selection criteria, demonstrating marked preference for established investment managers with demonstrable performance metrics across multiple economic cycles. This capital concentration phenomenon has engendered material adverse consequences for emerging fund managers, contributing to a pronounced reduction in transaction volume and competitive dynamics within the investment ecosystem.

ESG integration and comprehensive risk governance

The progressive incorporation of robust ESG criteria into investment evaluation frameworks has substantively expanded due diligence protocols and extended pre-investment analytical timelines. This enhanced scrutiny has resulted in elongated transaction execution periods and a corresponding diminution in average transaction size, as investors increasingly prioritise compliance assurance and risk mitigation over expeditious capital deployment.

Renminbi-denominated investment vehicle expansion and operational complexities

Renminbi-denominated investment vehicles have consolidated their predominant market position within China's PE ecosystem, propelled by favourable regulatory frameworks and substantial domestic liquidity mobilisation. Nevertheless, significant structural challenges persist within this capital formation environment, such as the following.

Diversification of limited partner capital sources

While sovereign-affiliated institutional investors – including the National Council for Social Security Fund (NCSSF) and China Development Bank – maintain their foundational limited partner status, ultra-high net worth individuals and sophisticated family office structures have emerged as increasingly significant capital contributors. Concurrently, insurance-based investment entities have systematically expanded their alternative asset allocations, continuing to operate within the regulatory parameters established by the 2010 Provisional Regulations on Insurance Capital Utilisation, which authorise deployment of up to 5% of insurance capital reserves into PE instruments – a regulatory framework that continued to exert material influence on institutional capital allocation strategies throughout 2024.

Jurisdictional tax efficiency optimisation

Differentiated provincial taxation incentive regimes designed to attract PE capital formation have successfully induced foreign investment management entities into establishing onshore fund structures. However, the heterogeneous implementation of preferential tax treatment and refund mechanisms across administrative jurisdictions has generated substantial compliance complexity and regulatory arbitrage opportunities, necessitating sophisticated tax governance frameworks.

Compressed investment horizon considerations

The accelerated proliferation of renminbi-denominated investment vehicles has engendered legitimate concerns regarding potentially abbreviated investment evaluation cycles and compromised due diligence protocols. Industry thought leaders have articulated substantive reservations regarding the prioritisation of expeditious liquidity events over sustainable value creation, advocating for the implementation of

more rigorous investment evaluation methodologies and extended value creation timelines among fund management entities.

Regulatory compliance framework enhancement and risk governance protocols

2024 witnessed a fundamental recalibration towards anticipatory compliance architectures and sophisticated internal governance mechanisms.

AMAC registration protocol intensification

Alternative investment management entities encountered increasingly stringent registration requirements, encompassing comprehensive internal control system audits and submission of independent legal opinions attesting to regulatory compliance. This enhanced regulatory oversight necessitated substantial operational restructuring among market participants to satisfy escalating compliance thresholds.

Systemic risk identification and mitigation strategies

Regulatory authorities implemented targeted enforcement initiatives addressing non-compliant practices, including improper asset reclassification methodologies and securities trading violations predicated on material non-public information. These enforcement protocols increasingly leveraged advanced data analytics capabilities to monitor capital movement patterns with unprecedented granularity. In response, PE institutions have accelerated deployment of artificial intelligence-enhanced compliance monitoring systems to ensure adherence to evolving regulatory expectations.

Industry-specific investment dynamics and regulatory considerations

Certain economic sectors attracted disproportionate regulatory scrutiny and institutional capital allocation.

Technology and digital infrastructure ecosystem

Investment activity in semiconductor manufacturing capabilities, artificial intelligence applications, and financial technology platforms experienced substantial acceleration, with regulatory authorities simultaneously encouraging technological innovation while implementing more stringent data security regulatory frameworks (exemplified by China's Data Security Law). Transaction due diligence protocols expanded significantly to incorporate comprehensive cybersecurity vulnerability assessments and data governance evaluations.

Life sciences and biotechnology advancement

Streamlined regulatory approval pathways for pharmaceutical products and medical device certifications established the healthcare sector as a prioritised destination for PE capital deployment. This regulatory efficiency enhancement substantially improved investment return potential through accelerated commercialisation timelines.

Real estate and energy infrastructure development

Enhanced regulatory oversight regarding leveraged capital structures in the real estate and energy sectors materially contributed to diminished transaction activity. Development initiatives requiring substantial capital expenditure (including infrastructure projects and commercial real estate developments) encountered significant challenges in securing equity financing.

The Impact of the New Company Law

China's 2024 Company Law introduced substantial amendments that significantly impact PE and VC transactions in China. The following analysis outlines the key implications for industry practitioners.

Capital contribution system

Five-year mandatory capital payment

The new legislation mandates that all shareholders of limited liability companies (LLCs) fulfil their subscribed capital contributions within five years of incorporation, eliminating the previously unrestricted timeframe. This provision applies retroactively to existing companies, necessitating that PE/VC investors reassess their portfolio companies' capital structures and negotiate appropriate adjustments (such as capital reductions or accelerated payment schedules). Consequently, start-ups with inflated registered capital or extended payment terms may face considerable liquidity constraints, potentially affecting valuations and exit timelines.

Enhanced liability for defaulting shareholders

Shareholders who fail to meet their capital contribution obligations now face explicit liability for compensatory damages to the company. Founders and early-stage investors may bear joint and several liability for unpaid capital during the company formation phase.

Equity transfers and liability allocation

Stricter rules for defective equity transfers

The transfer of unpaid or underpaid equity interests now imposes supplementary liability on transferors if transferees subsequently default. While transferees bear primary responsibility for unpaid capital, transferors may incur liability if transferees fail to fulfil their obligations. Transfers of non-monetary assets with inflated valuations trigger joint liability for both transferors

and transferees, in the absence of a good faith defence by the transferee. Accordingly, PE/VC investors are advised to conduct thorough due diligence on historical capital contributions and to incorporate comprehensive indemnity provisions into transaction documentation.

Simplified transfer procedures

External equity transfers no longer require prior shareholder approval. Existing shareholders retain a 30-day right of first refusal (ROFR), but the procedural framework has been streamlined considerably.

Corporate governance and shareholder rights

Flexibility in governance structures

Companies may now adopt simplified governance models, including the elimination of supervisory boards in favour of audit committees. PE/VC investors should revise shareholder agreements to reflect this enhanced governance autonomy.

Enhanced minority protections

The legislation introduces new mechanisms enabling minority shareholders to challenge potentially abusive majority decisions, such as inequitable capital increases or dividend policies. PE/VC investors should leverage these provisions to safeguard their interests against founder dominance.

Procedural hurdles in redemption execution

Capital reduction requirements

For company-initiated redemptions, repurchases or buybacks of PE/VC investors' equity interests, mandatory capital reduction procedures now require unanimous shareholder approval, potentially complicating timely execution.

Creditor protections

Stringent creditor notification requirements during capital reduction processes may further delay repurchase transactions, creating potential conflicts with the statutory six-month completion deadline.

The 2024 Company Law represents a paradigm shift in China's corporate legal framework, emphasising enhanced creditor protection and increased shareholder accountability. For PE/VC investors, proactive adjustments to due diligence protocols, transaction terms and portfolio management strategies are essential to mitigate emerging risks and capitalise on new opportunities, particularly regarding class shares and streamlined exit mechanisms.

The Enforceability of Redemption Rights in China

Unlike in other jurisdictions, redemption rights in China's PE/VC investment transactions have emerged as a distinctive and contentious feature, reflecting the unique challenges and regulatory landscape of the domestic market. The following analysis examines their prevalence, implications and recent judicial developments.

Market characteristics and structural features

High prevalence and distinctive design

Approximately 90% of Chinese PE/VC transactions incorporate redemption rights, with a substantial proportion (up to two thirds) imposing joint and personal liability on founders through "put option" mechanisms. This contrasts markedly with US practice, where redemption rights primarily address liquidity concerns without imposing personal liability. Chinese redemption provisions typically require founders to personally repurchase investments with interest when companies fail to meet specified IPO or valua-

tion thresholds that trigger investors' enforcement rights.

Severe consequences for founders

The enforcement of redemption rights has precipitated a significant increase in litigation against founders, with over 90% of cases naming both the portfolio company and individual entrepreneurs as defendants. Many founders subsequently face asset preservation orders, travel restrictions and inclusion in China's national credit blacklist system, effectively precluding them from future entrepreneurial endeavours.

Market drivers and systemic pressures

IPO constraints and exit challenges

The periodic suspension of domestic IPO approvals and increasingly stringent regulatory scrutiny has left numerous start-ups without viable exit pathways, compelling investors to rely more heavily on contractual redemption mechanisms.

Capital reallocation and policy imperatives

With foreign investment declining substantially and increasing State influence over domestic fund allocation, PE/VC investors face mounting pressure to prioritise policy-aligned returns, often to the detriment of founders.

Legal framework deficiencies

The absence of comprehensive personal bankruptcy legislation in China exacerbates risks for founders, who cannot discharge investment-related liabilities through bankruptcy proceedings.

Recent judicial developments

In December 2025, a Justice of the Supreme People's Court articulated that redemption rights or put options in PE/VC agreements must be exercised within six months following the occur-

rence of triggering conditions (such as failure to achieve an IPO or specified financial targets). Where no specific timeframe is contractually defined, the “reasonable period” defaults to six months; exceeding this period results in the extinguishment of the right. This interpretation aligns with earlier judicial guidance, including the 2024 Supreme Court directive that emphasised stabilising commercial expectations and preventing indefinite liability for repurchase obligations.

Key aspects of the judicial interpretation

Bifurcated rights framework

Redemption rights are characterised as comprising both “formation right” and “claim right”. The six-month limitation governs the initial formation phase (to trigger the repurchase obligation), after which the standard three-year statute of limitations applies for enforcing payment obligations.

Contractual autonomy parameters

Parties retain the prerogative to negotiate alternative timeframes, but courts may invalidate excessively protracted terms (eg, exceeding three years) as “unreasonable” under contract law principles.

Implied waiver doctrine

Failure to exercise rights within the prescribed timeframe constitutes an implied waiver, precluding subsequent claims.

Impact on China’s PE/VC industry

Revised contractual practices

PE/VC firms must now explicitly define repurchase timelines in investment agreements to avoid defaulting to the six-month judicial standard. This necessitates precise specification of trigger dates (eg, post-IPO failure) and procedural requirements (eg, formal notification protocols). Ambiguous provisions (eg, references to

“reasonable period”) may engender disputes, as courts increasingly prioritise textual clarity over contextual interpretation.

Accelerated exit strategies

Investors face heightened pressure to act expeditiously upon the occurrence of triggering events, as procedural delays risk forfeiture of valuable redemption rights. This may incentivise more rapid negotiations or litigation initiation. Portfolio companies exhibiting suboptimal performance may experience accelerated exits through forced buybacks, potentially destabilising valuation metrics across market segments.

Litigation and enforcement complexities

Investors must meticulously document redemption demands (including timestamps and delivery confirmations) to avoid dismissal on procedural grounds. Judicial interpretation of the “reasonable period” standard may prove inconsistent in edge cases (eg, delayed discovery of triggering conditions), creating additional uncertainty.

This legal interpretation has ignited significant controversy within the investment community. Proponents argue that it enhances corporate stability by implementing a decisive “use it or lose it” framework for repurchase rights, effectively eliminating prolonged uncertainty that could hamper business operations. However, critics contend that this stringent interpretation could have unintended consequences: investors, faced with the prospect of losing their protective rights, might prematurely trigger their repurchase options out of an abundance of caution. Such defensive actions could precipitate a cascade of early redemptions, potentially undermining the company’s financial stability and operational viability. The tension between providing clear legal boundaries and maintaining flexible investor protections remains at the

heart of this ongoing debate. That said, these judicial pronouncements underscore the courts' commitment to balancing investor protection with commercial predictability, though their relatively rigid temporal limitations may strain PE/VC operational frameworks. Investment firms must adapt their practices expeditiously to preserve contractually negotiated rights.

Future prospects

While the Chinese government has indicated potential reforms, including “*tolerance policies*” for State-backed investors, the current investment environment remains challenging. The proliferation of redemption rights has effectively transformed PE/VC funding mechanisms to approximate debt financing structures, intensifying pressure on start-ups and potentially inhibiting innovation across the ecosystem.

In conclusion, redemption rights in Chinese PE/VC transactions reflect a complex interplay of liquidity protection mechanisms, regulatory imperatives and market uncertainty. However, their stringent enforcement has generated substantial risks for entrepreneurs and disrupted the equilibrium of the start-up ecosystem.

Conclusion

In 2024, China's PE sector navigated an increasingly complex landscape characterised by regulatory tightening, renminbi fund maturation, and cross-border innovation challenges. Legal practitioners assumed a pivotal role in interpreting evolving regulatory frameworks, structuring compliant transactions and implementing effective risk mitigation strategies. As the government continues to balance market vitality with systemic stability, the industry's capacity to adapt to nuanced regulatory developments will remain critical to sustaining growth and investment momentum.

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