

## Research on SME Financing and Its Development

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**Abstract:** The coexistence of SME financing difficulties and private lending difficulties is a unique phenomenon in the field of investment and financing in China. Based on the perspective of institutional arrangements, this paper uses logical analysis to analyze the root causes of this double dilemma. The research results show that financial repression is the direct cause of the dual dilemma of China's SMEs financing and private lending, and the existing economic system with public ownership as the main body has many defects in its institutional origin. To fundamentally solve the double dilemma, it is necessary to start from the aspects of changing ideology, reforming public-owned enterprises, and reforming the political system.

### 1. Introduction

Since the reform and opening up, China's SMEs have experienced rapid development, playing an increasingly important role in prospering the economy, increasing employment, promoting innovation, and maintaining stability. At present, there are more than 10 million small and medium enterprises (SMEs) registered in the industrial and commercial sector in China, accounting for 99.3% of the total number of enterprises in China, creating 80% of jobs for the urban labor force. Statistics show that the total production value of China's SMEs accounts for 60% of the country's total output value. Imports and exports account for 70% of the country's total import and export volume, and the total amount of taxes paid on the country accounts for more than 50% of the country's total tax revenue. At the same time, SMEs have the advantages of rapid response and flexible mechanisms, and they are playing an increasingly prominent role in technological advancement and innovation. Since the reform and opening up, about 65% of patents were invented by SMEs, more than 75% of technological innovations were completed by SMEs, and more than 80% of new products were developed by SMEs. In addition, SMEs have a flexible management system, a wide range of business operations, and rich business projects. They have the characteristics of low investment, quick results, and strong adaptability. When the economic cycle fluctuates, they can take advantage of "turning small boats and turning around better" and make timely changes. Quickly adapt to changes in economic structure and market demand.

### 2. Many Difficulties in the Operation of SMEs in China

Information asymmetry is the root cause of the financing problems of small and medium-sized enterprises, and the uncertainty of business prospects is an important reason for the financing difficulties of SMEs. Many small and medium-sized enterprises are in a competitive industry, have low market entry thresholds, are not technically monopolized, have poor anti-risk capabilities, and are most vulnerable to the impact and impact of economic cycle fluctuations, leading to unstable business operations. These factors have increased the Concerned, and unwilling to lend to SMEs. Under the current economic and financial situation at home and abroad, some small and medium-sized enterprises in our country have experienced difficulties in their operations, and they have been concentrated and prominent in some regions. (1) Rapidly rising prices of production factors in recent years, especially since 2007, the purchase price index of raw materials, fuels, and power has risen all the way, although the ex-factory price index of industrial products and the retail price index of goods have also risen, but have fallen below the former. The rise in the prices of energy and raw materials has caused great difficulties for the SMEs operating downstream of the

industrial chain. The increase in labor wages has increased the operational difficulties of labor-intensive enterprises. The promulgation and implementation of the new "Labor Contract Law" in 2008 has better protected the legitimate rights and interests of workers but also increased the operating costs of labor-intensive enterprises. Some studies have estimated that the implementation of the new "Labor Contract Law" will increase the cost of labor by 30% to 40%. In addition, with the improvement of social living standards and rising prices, the requirements for workers to raise wages have become more and more urgent and have been highlighted in the improvement of labor wage standards. (2) The international financial crisis has brought a lot of difficulties to the development of export-oriented SMEs affected by the international financial crisis. The lack of external demand has led to fewer international orders for SMEs, especially export-oriented SMEs, lower product prices, increased inventories, and capital turnover. Difficulties, and even funding problems. (III) Changes in RMB appreciation and export tax rebate policies have reduced the profit margins of labor-intensive, low-value-added, SMEs without market pricing power. With the continuous improvement of China's overall national strength, the RMB will inevitably enter an appreciation channel. The appreciation of the renminbi led to a significant decline in the profitability of small and medium-sized enterprises that competed on the international market by relying on low prices, and some companies were even eliminated. In 2007, China extensively adjusted the tax rebate policy for export products, eliminated 553 export tax rebates for products with high energy consumption, high pollution, and resources, and reduced the export tax rebate rate for 2,268 products that are likely to cause trade friction. If the value-added products of the enterprises involved are low and the industrial transformation is slow, it will lead to a decline in profit margins and even closure. According to some surveys, among the companies that accounted for more than 50% of the sales in the international market, "exchange rate appreciation and export tax rebate rate reduction" ranked first and second in the major difficulties facing the company. (4) Enforcement of environmental protection policies has increased the operating costs of small and medium-sized enterprises. Through strengthening environmental governance and safe production, the government has internalized the production and operating costs that enterprises should have undertaken but did not assume, and restored the true costs of production and operation of enterprises. This will inevitably result in Squeezing its high cost of deformity at low cost.

### **3. Internal and External factors that Restrict the Financing of SMEs**

Most SMEs are in a competitive industry, with low technical content, poor anti-risk capability, high business risk, short-term business operations (usually only 3-4 years), and high levels of downturn or potential for bankruptcy. According to a report released by the Ministry of Industry and Information Technology in December 2009, according to the score of 10 points, the average health index of Chinese SMEs is 6.57 points, which is in a sub-health state, and its internal management level is also in the middle and lower reaches. The ephemeral nature of the life cycle of SMEs and the uncertainty of their operations have, to some extent, curbed the willingness of financial institutions to lend.

The scale and credit level of SMEs are low and restrict their financing capabilities. In 2009, the People's Bank of China surveyed a number of small and medium-sized enterprises in a concentrated area, indicating that over 50% of SME financial management systems were not sound, and over 60% of SMEs had credit ratings below 3B or 3B, which severely weakened their financing capabilities.

The lack of assets available for collateral security results in high financing costs. Due to banks' preference for SMEs' fixed assets, they are generally reluctant to accept SMEs' liquid assets. In SMEs' asset structure, the proportion of fixed assets is small, especially high-tech enterprises, and intangible assets account for a relatively high proportion. There is no real property that can be used as collateral, and it is difficult to meet the requirements for lending by financial institutions. Even if financial institutions agree to lend, in order to cover high risks, the interest rate of lending is also much higher than that of large corporate loans.

In addition, since the period for most guaranteed loans is within half a year and not more than

one year, credit guarantee agencies basically only guarantee short-term liquidity rather than long-term loans such as equipment investment, which increases the difficulty of financing for SMEs. The complicated guarantee procedures and high guarantee fees increase the financing cost of the company and affect the financing efficiency.

#### **4. Realistic Choices for Solving SME Financing**

The first is to enhance the overall strength of SMEs. Only by improving the comprehensive strength and business quality of small and medium-sized enterprises can their credit status be improved, and financing problems can be fundamentally solved. Therefore, SME managers should conscientiously learn financing knowledge, master certain financing methods and strategies, and conduct scientific operations. Accelerate product innovation and technological innovation and improve business management. The second is to standardize the financial accounting system. Small and medium-sized enterprises should establish a sound corporate financial system, internal control system and supervision mechanism, regulate the operation of enterprises through institutional construction, eliminate the occurrence of fake reports, fake contracts, and ensure the integrity, accuracy, and authenticity of financial information. Further improve the information disclosure awareness and information transparency of business managers, and pay attention to establishing long-term cooperative relationships with banks, and reduce the cost of information integration and supervision in the process of bank credit. The third is to focus on building an image of corporate honesty and trustworthiness. In order to enhance the overall competitiveness of SMEs and establish a good reputation in their own markets, SMEs should provide credit banks with complete and accurate financial information on a regular basis, and fully protect the bank's claims in the course of business operations, and eliminate bank debt and misappropriation of loans. In case of untrustworthy behavior, it is necessary to "have borrowed money" to effectively improve its credit rating and establish a good image of honesty and trustworthiness.

The first is to establish the equity financing market for SMEs. The timely establishment of a second-tier market for equity financing by SMEs is an important approach and an important method for solving the financing difficulties of SMEs. Currently, we can refer to the requirements of the Hong Kong Growth Enterprise Market to set conditions for the listing of SMEs and encourage SMEs to participate in capital operations so that they can use the securities market to buy shells, backdoors, and reverse the backdoor listing. They can also use the stock market, equity (property) transactions. The market conducts mergers and acquisitions, asset restructurings, and uses foreign capital to restructure and transform through joint ventures, cooperation, and property transfer. At the same time, it is also possible to use intangible assets and virtual operations to carry out capital management, prompting small and medium-sized enterprises to expand rapidly, increase their strength, and solve important financing difficulties for SMEs. The second is to establish and improve the financial market system. Experience shows that a sound financial system can help increase the efficiency of fund allocation. Taking into account the fact that China's financing channels are single, it is necessary to establish multiple forms of financing channels to solve the problem of financing difficulties for SMEs. According to foreign experience, it is recommended to proceed from the following four aspects: First, encourage existing commercial banks to broaden the service sector, increase service awareness, and strengthen the support for SME credit; Second, we must actively create conditions to establish a policy for service for SMEs Financial institutions to provide financial support for SMEs; third is to encourage SMEs to establish cooperative and mutual-supporting financial organizations to solve the business development needs of funds; Fourth, to broaden the channels for direct financing of enterprises and encourage qualified quality SMEs are listed and financed, and gradually establish a mature system of counseling SMEs for listing and financing. Through the above measures, the formation of a unified financial market is promoted. The third is to establish small and medium-sized financial institutions as soon as possible The establishment of SME financial institutions is an important measure to solve the financing difficulties of SMEs, and the current conditions are relatively mature: First, existing commercial banks cannot meet the funding needs of a large number of SMEs; Second, there is a large amount of

private capital in China. There is a considerable portion of hot money circulating outside of legal capital, engaging in non-productive business activities such as usury, securities speculation, and real estate speculation. Third, in recent years there have been large-scale capital flight behaviors in China, which to a certain extent indicate the inefficiency of capital. The existence of the configuration. Fourth, China's underground economic activities are very active, and private lending is growing. Therefore, it should be legalized through the establishment of small and medium-sized financial institutions so as to play an active role in the financing of SMEs.

The fourth is to speed up the establishment of a credit evaluation system for SMEs. The social credit supervision system is not perfect. It is an important cause of information asymmetry between SMEs and financial institutions, SMEs arbitrarily defaulting on borrowing, and the owners of funds are afraid or unwilling to invest in SMEs. Therefore, the credit rating of SMEs should be taken into consideration. Establish an authoritative credit rating standard or credit evaluation system for different types of SMEs, and design different financial instruments according to different credit rating standards. At present, in some regions of China, there are established credit rating agencies for enterprises, but there are problems that the rating standards are not uniform and the authority is poor. At the same time, the dynamic supervision of small and medium-sized enterprises by corporate credit rating agencies is weak and they cannot report the credit rating of SMEs in a timely manner. It is recommended to set up a special credit supervision agency to track and supervise the credit status of SMEs and publish the credit rating of SMEs on a regular basis. This can achieve effective supervision of SME managers or enterprises, and enable investors to quickly and selectively to invest.

## **5. Conclusion**

In recent years, various departments of the country have issued various policies to support the development of SMEs, which have alleviated the financing difficulties of SMEs to some extent. However, the problem of “financing difficulties and expensive financing” still exists. This includes both the problems of the enterprises themselves and the reasons for the incomplete external financing environment. This paper deeply analyzes the deep-seated reasons that restrict the financing of SMEs from both the enterprise itself and the external environment. It also proposes policy recommendations to broaden financing channels and build a multi-tiered SME financing service system.

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