

# Improvement of Equity Capital and Debt Capital Structure of Smes

Shuyu Peng

Oxbridge College, Kunming University of Science and Technology, Kunming, China

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**Abstract:** More than 90% of the total number of SMEs in China have been playing an important role, no matter in which type of country. To some extent, the debt paying and financing ability of SMEs will be restricted by whether the capital structure is reasonable or not. Further capital structure also has the ability to determine the future profitability of enterprises, which is one of the fundamental signs of judging the financial situation of enterprises. With the continuous development of market economy in China, the unreasonable capital structure of SMEs restricts the long-term development of enterprises. Many operators ignore the embodiment of capital composition, capital cost and financing efficiency in different industries, only considering the liquidity. It will inevitably bring constraints to the development of enterprises. This paper puts forward the existing problems in the capital structure of SMEs in our country at present, analyzes the reasons and gives the solution, hoping to help the SMEs to optimize the capital structure and provide methodology for creating greater owner equity value.

## 1. Introduction

### 1.1 Lack of Target Capital Structure and Insufficient Research on Enterprise Capital Structure

Most managers believe that it is difficult to find a perfect capital structure in practice because of the many factors that restrict the capital structure and the degree of uncertainty that each element contains. However, it is possible to find rational capital structure through comprehensive evaluation of various influencing factors, so that the capital structure reached in the financing process and the target capital structure can be integrated organically. Most managers don't set a standard by summarizing industry characteristics, business type, financial situation, asset characteristics, product cycle, tax policy and shareholders, managers' preferences, etc. The capital structure is established by general way.

Managers are sometimes only willing to look at the size of development, pursue high profits, ignore their own cause of high debt, and make the enterprise's existing assets can not be fully operated. In the lack of awareness of capital structure and the establishment of an enterprise evaluation system based on scientific indicators such as capital cost ratio, operating leverage, asset-liability ratio, liquidity ratio and current ratio, it will be difficult to control debt risk.

### 1.2 The Efficiency of Enterprise Investment is Limited and the Modern Enterprise System is Not Perfect

The establishment of modern enterprise system is the core idea of improving capital structure. At present, the main problem is that the investment benefit is not good, the enterprise does not fully follow the track of market and capital operation, and the lack of rational analysis and scientific argumentation in the early stage of the investment project, the effect of investment return is not highlighted, so the investment benefit is limited. Secondly, whether the establishment or development of enterprises or even expand the scale, that need a continuous supply of blood support, and the quality of hematopoietic function, directly restrict every step of the enterprise forward, this hematopoietic function is the framework of financing structure. The information of SMEs under the imperfect modern enterprise system is not transparent, so that banks have to take a stronger audit process, this process makes SMEs in urgent need of blood transfusion has difficulty to maintain.

### **1.3 Insufficient Total Equity and Liability Funds**

At present, SMEs have small scale, small profitability, single profit source, slow capital accumulation and insufficient total capital. Enterprises need a large amount of capital investment in the process of production and operation. The lack of total capital directly affects the development and expansion of enterprises, but also makes enterprises in the face of market changes can not be flexibly adjusted, the situation will seriously lead to the bankruptcy of enterprises. The lack of capital also hinders the enterprises in the process of loan financing and affects the normal production and operation of the enterprises. SMEs equity capital gap is also large, enterprises own capital and equity capital is insufficient, which is mainly due to enterprises insufficient accumulation of capital and external equity financing in the process of development.

### **1.4 Structural Imbalance between Equity Capital and Debt Capital**

China's SMEs through the equity method financing proportion is low, and some other developed countries are quite different. From the perspective of debt financing, bank loans and commercial credit are the main debt channels. The proportion of enterprises financing through issuing bonds is relatively small. In the bank loan channel, through the fixed assets loan proportion is less and less, pursues the higher liquidity.

## **2. Analysis of Unreasonable Elements of Capital Structure**

In recent years, the SMEs, which belong to the complex economic structure, have developed rapidly and gradually become an important part of our economy. But compared with other large enterprises, has been behind all sides of the large enterprises. So there are still many obstacles to optimizing the capital structure.

### **2.1 Insufficient Retention in Small Business Profit Distribution**

China's SMEs lack of long-term management ideas, internal profit distribution in the retention of insufficient. Most enterprises lack the concept of accumulation through their own, mostly adopt the policy of more dividends, but rarely from the perspective of the growth to consider. They rarely use their own funds to make up for the lack of capital, resulting in capital accumulation is stretched. Inadequate capital will affect the state of business, but more serious will cause enterprises to move forward hardly, financing constraints.

### **2.2 The Financing Risk of Smes is High and the Mortgage Goods Are Seriously Insufficient**

SMEs provide relatively single products or services. They hold relatively small scale and insufficient funds left behind. As a result, the ability to combat risk is weak. In the first quarter of this year under the impact of the virus, SMEs in tolerance to risk showed a low degree of antagonism. At the same time, the lack of scientific and effective management methods makes the information quality not high, and increases the information asymmetry. Second, its collateral is also relatively small, especially some technology-based enterprises, which has no machinery and equipment. Mainly software, innovative ideas is its main asset, which is another challenge to financing. At present, most enterprises have a strong sense of risk caution, barely willing to guarantee. In addition, the loan risk has increased as some of the assets that SMEs can use for mortgage have been used for mortgage and the asset-liability ratio is high.

### **2.3 The Financial Management Mechanism and the Shareholder Structure is Not Perfect, the Credit Rating is Low**

Small and medium-sized enterprise governance question itself has many shortcomings, especially in the financial management aspect. The information transmission and the disclosure mechanism is poor. So that small and medium-sized credit evaluation is not good. SMEs face large competition, financial funds are relatively tight. Credit rating is an indispensable qualification of enterprises, which has become a major weapon to enhance their comprehensive strength. For SMEs credit rating identification, is the use of voluntary declaration method. In principle, as long as there

are more than three years of standardized operation, SMEs can participate in rating declaration.

SMEs with a credit rating of B or higher can obtain credit benefits from different banks, but most enterprises receive three B or less. Even satisfied-level companies actually get loans with a huge difference from their own imagination, resulting in the enterprise rating heat is not high.

## **2.4 Not Perfect in Reform of the Financial System**

Even though most of our SMEs have small scale, low tolerance risk, simple products or labor with low technology content, but SMEs occupied an important position in tax, GDP, patent innovation and employment contribution rate. However, this type of enterprise is facing a huge shortage of funds, in the closed business data, because of the broken capital chain of enterprises accounted for nearly 50%. In the macro environment of imperfect financial system reform, even the enterprises with better performance have the dilemma of limited financing channels. Specifically, first, state-owned commercial banks have inadequate services to SME; second, most SMEs do not have entry-level conditions for issuing corporate bonds, because the bond market of our country is basically not open to SMEs; third, after the introduction of the small and medium-sized enterprise plate that supplies the capital structure and capital operation path for SMEs, it does not mean that all enterprises can enter the second board market, and this financing channel has certain potential risks.

## **3. Channels for Improving Sme Capital Structure**

### **3.1 Improve the Credit Registration System and Creditor Protection System**

Credit guarantee means the guarantor and the bank and other creditors through a prior offer, and then in the form of a guarantee for the bank and other creditors to provide security. When the SMEs can not fulfill their contractual obligations, the responsibility is reimbursed by the guarantee institution, which to some extent reduces the risk degree of financial institutions to finance SMEs.

Credit guarantee can improve the credit level of SMEs, it can resolve and correct the information asymmetry between the two sides of some transactions, and alleviate the financing difficulties of SMEs; at the same time, it can spread the risk of banks and improve the effectiveness and security of loans. The most effective is that it exerts the economic leverage utility, guides the enterprise to maintain the credit record, promotes the establishment of the good credit system society.

### **3.2 Innovating Financial Products and Services and Establishing Good Banking-Enterprise Relations**

Platform integration can be used appropriately, for example, through intelligent push online credit services, actively expand the scope of online services. Recommending pure online and pure credit credit products to SMEs; opening up green channels to support registered financial institutions to apply online, simplify the approval process or pre-approval process. During the epidemic period, we can consider setting up a special module to set up a fast channel of demand feedback for financing services for SMEs, facilitate enterprises to quickly release financing needs, arrange special service teams to connect with enterprises, guide enterprises to complete online applications. Financial institutions. Using the credit big data to adjust the credit information model, to adjust the credit information service report for the industries affected by the epidemic situation, to make a special evaluation of the historical data of previous years and to form a credit report to support the relevant SMEs to obtain credit loans. Simplify the enterprise application process and increase the active recommendation service. Increasing credit evaluation, recommending enterprises with good credit and honest management to the financial institutions in which the platform is stationed, providing the financial institutions with the contact information and scoring situation of enterprises in time, and collecting the financing needs of enterprises in depth can help the financial institutions to understand the credit information of enterprises.

In the market economy, in order to realize the steady income of the bank at the same time, the bank and the enterprise establish a good and equal economic interest relationship, collect and summarize the preferential policies and supporting measures of the government departments and

financial institutions to the SMEs in an all-round way, and help the SMEs to understand the relevant policy information dynamically.

### **3.3 Improve the Governance Structure**

From the micro point of view, SMEs should improve their own governance structure, in order to live in a good market environment and financial system. Because the financing difficulty come from enterprise own governance structure unscientific, which causes the financial institution risks worry. Before improving the external environment, SMEs need to constantly improve their own financial management, governance level. Through the introduction of excellent compound and applied talents, the identification and accumulation of information of various macro and preferential policies, the construction and optimization of the system, the management and promotion of the turnover of assets use, the refinement and analysis of the market, so as to curb the risk of breaking the capital chain. The increase of debt repayment capacity to improve its financing difficulties.

To Strengthen the study of internal management and financial knowledge, improve their own management, financial management level, can fully integrate the existing financial instruments, obtain blood supply, and improve the turnover efficiency of funds. These are not only the need for bank loans, but also to ensure the long-term development of enterprises.

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