

Study on the Optimization of the Capital Structure of Small and Medium-Sized Enterprises

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Abstract: The capital structure of an enterprise can be divided into debt capital and equity capital. Capital structure management is an important part of enterprise management, it has an indispensable influence on enterprise value. However, many small and medium-sized enterprises lack management experience or are influenced by the external situation, resulting in a series of problems such as difficult financing and borrowing, unreasonable capital structure and so on. These problems can be solved by using a series of methods including supporting the development of financial lending platform, establishing funds for small and medium-sized enterprises and helping enterprises improve their diathesis, etc.

1. Introduction

No matter in the mature or immature capital market countries, small and medium-sized enterprises are an important part of a country, which is a wide range of social and economic basis and has a lot of advantages. With the economic development of country and the implementation of a series of encouragement policies, the small and medium-sized enterprises of our country have sprung up and become a powerful force in the economic and social development of our country. At present, there are more than 40 million small and medium-sized enterprises in country, accounting for 99% of the total number of enterprises in our country, which is 60% of GDPs in our country in recent years. Thus, it can be seen that the development of small and medium-sized enterprises is related to promoting employment, social stability and the economic development.

2. An overview of the capital structure of small and medium sized enterprises

The capital structure of an enterprise can be divided into debt capital and equity capital. The capital structure of the enterprise has a very important influence on its financing behavior and enterprise value. Investors and enterprises themselves can estimate the debt paying ability and financing ability of the enterprise and even the profitability in the future through this important index. Therefore, the scientific management of this index is of great importance to the enterprise. The function of scientific and reasonable capital structure are to optimize and balance the risk, cost and value created by the company, to maximize the shareholders' equity, and to maximize the value of the enterprise. However, the unreasonable capital structure has obviously become the main One of the main difficulties of small and medium-sized enterprise in the development of the industry. Therefore, it is very important to find the appropriate capital structure management method.

3. Factors influencing the capital structure of small and medium-sized enterprises

In recent years, with the development of our country and the support of policy, the small and medium-sized enterprises of our country have grown rapidly, which has increased a lot of strength

for the economic development. Although these enterprises are developing rapidly, they also have many problems brought about by the rapid development. Many small and medium-sized enterprises have not taken reasonable measures to face a series of difficulties brought about by the development of enterprises. Therefore, the bankrupt number of small and medium-sized enterprises in our country has also been increasing in recent years. One of the most important factors leading to the attainability of enterprises is their most easily overlooking capital structure management. This is mainly related to the scale of the development of the enterprise, the form of organization, and the risk preference of the operator. First of all, we can explore the internal impact of capital structure of small and medium-sized enterprises.

3.1 Internal factors affecting the capital structure of small and medium-sized enterprises (SMEs)

3.1.1 Enterprise size

Firstly, enterprise size is one of the factors. Many investors and institutional investors often judge whether or not they should invest and how much they invest based on the size of the firm. Because of the asymmetric information between small and medium-sized enterprises and banks or investment institutions, unlike listed companies which have to disclose accounting statements. Therefore, banks or investment institutions can not understand the reliable accounting information of SMEs, resulting in SMEs' external financing cost is much higher than large enterprises [2]. On the contrary, large enterprises have a great advantage in financing, they are almost in an active position, banks or investment institutions are even lower interest rates to allow big companies to use their money. At the same time, SMEs will find that market short-term loan costs are relatively low, which makes startups or SMEs prefer to short-term financing. For example, small and medium-sized enterprises rely too much on short-term loans will find it difficult to repay their loans in a short period of time if they are suddenly unable to turn over short-term funds, and even risk their bankruptcy. Due to the lack of professional personnel of capital structure management to carry out good planning of the structure of the company, during the long-term development enterprises have hidden dangers

3.1.2 Manager's risk preference

Manager's risk preference is also one of the internal factors of enterprise capital structure. Because in most small and medium-sized enterprises, the managers are often shareholders, they have great rights in the company, so the risk preference of these managers represents the risk preference of the company. For example, some managers do not want outside investors to join the company, they want to hold firm control and ownership of the company. Therefore, in most cases, these small and medium-sized shareholders, often both are as capital owners and operators. Because they rarely hear different voices in the team, they inevitably make biased decisions, which also lets the company miss a lot of rapid development opportunity. At the same time, some external factors, such as whether the financial institutions support, the national macroeconomic policies and the development of the economy, the development of the market have a great impact on the capital structure of enterprises.

3.2 External factors affecting the capital structure of SMEs

3.2.1 National macroeconomic development

There is no doubt that, in our country, the national economic development situation is always the primary factor affecting the development of enterprises. During the boom period, the market demand is strong, the products of enterprises could be sold in time, and the risk of bad debts in accounts receivable was relatively small. People is optimistic about the prospects of most enterprises. Banks and investors will also be more emboldened to lend or invest. On the contrary, in the recession period, the supply exceeds the demand, the enterprise commodity unsalable is serious, the enterprise is more likely to encounter the bottleneck of capital financing. During this recession, the risk of small and medium-sized enterprises increased, and the bankruptcy of enterprises occurred from time to time. In order to avoid the risks, the banks are even more fear of the risks and more cautious to lend money, so investors do [3]. More absurdly, some banks, raise their lending standards at this critical time to avoid bad debts, there are even a variety of restrictive terms,

making SMEs loan financing more difficult.

3.2.2 Level of market development

In developed countries, capital markets are so mature that their small and medium-sized enterprises can raise enough capital at a lower cost of capital. But in developing countries, the capital market for this kind of enterprises is just beginning to start, most small and medium-sized enterprises can only through private loans to finance, which leads to a high ratio of assets and liabilities. Fortunately, the capital market in our country is developing more and more rapidly today, and many startups are able to obtain financing more easily. There are more and more new financing channels for enterprises, and the ratio of assets to liabilities will also improve. As a result, small and medium-sized enterprises rely too much on bank loans, the phenomenon of private lending has improved. Therefore, there are very big correlation between the capital structure of the enterprise and the domestic capital market.

4. Analysis on the present situation of the capital structure of small and medium- enterprises

4.1 Debt capital issues

Since the capital structure of enterprises is mainly composed of debt capital and equity capital, we can analyze the present situation of the capital structure of small and medium-sized enterprises from these two angles and the relationship between them. First of all, the problem of debt capital financing is bellowing, the asset-liability ratio of most small and medium-sized enterprises is very low. Because of their small scale or unreasonable capital structure, it is more difficult than large enterprises to obtain loans from commercial banks. Unlike large companies, they can get enough equity capital at lower capital costs. As a result, most of the financing channels for such enterprises tend to be directed towards private lending, with the preference being towards family and friends, internal financing, borrowing from friends, and even from the loan sharks[5].

As a result, this short-term lending model raises many problems. First of all, because of the small proportion of long-term borrowing, most of these funds are short-term loans, enterprises can not use long-term funds to remedy the gap of funds, they only rely on short-term liabilities to make up for the funding gap . But the risk of continuing short-term borrowing is very high. Once a loan is not available in time to fill the funding gap, there will be big liquidity problems, and even bankruptcy. Second, small and medium-sized enterprises are unable to getting enough funds from financial institutions and commercial banks only borrowing high-cost funds, which has a great impact on the operating profit and enterprise value.

4.2 Equity capital issues

As mentioned in the previous point, SMEs do not have a wide range of financing channels, and most of their capital comes from private borrowing or their own funding, lacking in diversity. In our country, nearly a majority of small and medium-sized enterprises are founded by one person, a few by several partners co-founded. Therefore, in the initial stage of establishment, the registered capital mainly comes from the individuals and their families, financing gived by others or investment institutions is very little. In the face of risk, these companies are not able to quickly replenish capital, thus greatly increasing the risk of bankruptcy.

4.3 The ratio of debt capital to equity capital issue

From the angle of enterprise capital structure, the financing way of enterprise is divided into debt capital and equity capital. After equity financing, the investor's investment principal and the accumulation of profits or losses in the operation will appear in the balance sheet, which reflects the operation of the enterprise. Debt financing means that the enterprise borrows funds from banks and other institutions. In all companies, equity financing and bond financing are reasonable proportions. For example, an unreasonable capital structure can be reflected in lacking equity capital. This will not only affect the normal operation of enterprises, but also lead to sudden death of enterprises. At the beginning of the establishment of many small and medium-sized enterprises, the start-up funds of the enterprises mainly come from the elders of the company. However, with the development of the company, the equity capital is becoming smaller, the debt capital is becoming larger and larger,

the ratio of assets and liabilities is gradually increasing. As a result the ratio of debt capital to equity capital is unreasonable, not only hindering the refinancing of enterprises but also buries a great hidden danger for the company's continuing operation.

5. Ways to optimize the capital structure of small and medium sized-Enterprises

5.1 Focus on legitimate lending platforms on the market

In view of the debt problem of small and medium-sized enterprises, because of the credit or capital structure problems of SMEs themselves, it is difficult for SMEs to borrow urgently in state-owned commercial banks. However, there are some private financial companies that can effectively help small and medium-sized enterprises. For example, some car loan companies and mortgage companies with stable development, as long as the managers of small and medium-sized enterprises mortgage their fixed assets (corporate cars) in these mortgage company, they can borrow a sum of money to ease cash flow problems and prevent sudden death (bankruptcy) quickly. Although private financial companies have much higher interest rates on loans than commercial banks, because the loan is quicker they can solve the small and medium-sized enterprise's urgent need better. Of course, these lending platforms must be legal and compliant. Borrowing money from an informal lending platform will not only cause financial problems for companies but also lead to major cash flow problems.

5.2 Looking for angel financing

The angel investment is also a good way for the equity financing of enterprises, it mainly refers to those who have a certain net wealth to invest in the venture. This is a high risk and high return private investment. The investor and the enterprise just form a complementary relationship: the enterprise is in urgent need of financing and the “angel” who have a lot of idle money and would like to take high risks will invest in. The founders of small and medium-sized enterprises are often one or more closely related investors. When they are financing, they tend to pay their own money or borrow from their relatives and friends. But the business should not ignore the good opportunity for the “angel” to finance, which can inject a lot of energy into the development of a business without risking the company's asset-liability ratio. Also, angel investors are usually smart. Most angel investors do a lot of research on companies before they invest, not only just looking at the capital structure on their books but also can observing the development prospect and the working atmosphere of the enterprise through other channels. Therefore, the medium and small-sized enterprises that get angel financing are often the ones that angel investors are very optimistic about. Once the corporate self-image improved, there will be more investors to help the development of the company, so that the corporate capital debt situation further optimization.

5.3 Small and Medium-sized Enterprises should improve their own quality

In view of the unreasonable ratio of debt capital to equity capital, the capital market is not yet fully mature, small and medium-sized enterprises are difficult to raise enough capital because of their small scale and relative high risk. Therefore, to improve the ability of enterprises is one of the ways to solve the financing problem and also to further optimize the capital structure of enterprises. Small and medium-sized enterprises can optimize their capital structure through the following ways: first of all, we should improve the management system and understand which part of our capital structure is unreasonable. If the debt capital is high, try to raise money as much as possible. Investors or investment institutions with a desire to invest, increase equity capital to balance the capital structure of the enterprise. These enterprises need to improve their capital structure management ability. While expanding the external financing channels, they should also consider the true financing cost and the possibility of obtaining financing. Second, we pay attention to current affairs policy, many current affairs policies have a significant impact on enterprises. For example, the country's interest-rate adjustment policy is crucial for companies to borrow money, which would have cost \$25000 to borrow at \$1 million, while a 0.1 percent increase in interest rates would add \$1000 extra to their financial costs which is a huge expense for small and medium-sized enterprises that have just begun to grow. Of course, enterprises must change their own ideas. They

should be out of the current situation and have the perspective of long-term development of enterprises. We should not focus on short-term benefits because of their small size, without self-accumulation, not even basic corporate goodwill and credit. Therefore, the small and medium-sized enterprises should pay attention to improve the enterprise credit level, propagandizing their own image and enhancing investor's confidence.

6. Conclusion

The capital structure of small and medium-sized enterprises is restricted or influenced by internal reasons such as scale of enterprises, risk preference of managers and by external factors such as national economic situation, market development degree and so on. The most common performance is that companies expand their liabilities without paying attention to equity financing, thus causing hidden trouble to corporate liquidity. Therefore, it is necessary to improve the capital structure of our small and medium-sized enterprises. This paper holds that the optimization of the capital structure of small and medium-sized enterprises requires enterprises to enhance their financial management ability and their own credit and image to attract more investment from their own point of view. Second, the attention of enterprises to external financing channels is also very necessary, such as Angel financing, which has been very popular this year. Small and medium-sized enterprises can also borrow from legitimate and compliant financial lending platforms in the market. Especially in the case of shortage of enterprise capital chain, borrowing from financial companies is a good way to solve the urgent problem. The problem of capital structure is a complex problem considered from equity capital and debt capital. Small and medium-sized enterprises should achieve the optimization of capital structure according to different characteristics of their equity capital and debt capital.

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