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The Research on Financing Problems of PRC's SMEs

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Abstract

With the rapid development of economy, middle and small-sized enterprises are playing a more and more important role in market economic and become an important part of national economy in our country which is also an active strength in the market. However, the manage environment of middle and small-sized enterprises is not very favorable, specially the problem of financing. The problem of fund shortage is becoming the most serious problem which restricts the development or even threats the survival of middle and small-sized enterprises.

This essay is going to analysis the finance theory according to different sizes of business, the financing channels and the present situation of our country small and medium-sized enterprises. It will also start from three aspects which are the policy environment, social and bank and the weakness of middle and small-sized enterprises themselves. In order to find the reason for financing difficulties, it will study the finical system, the credit guarantee system, the information symmetry and the cost of financing, etc. The aim of this essay is to put forward some improvement measures and countermeasures according to the reasons discussed above. Nowadays, our country is in the high-speed economic development stage, if we can not find a better way to deal with small and medium-sized enterprise financing problems, there will have severe negative impact on the economy development in our country. So research on the problems of small and medium-sized enterprise financing difficulties and finding the solution has practical significance.

Key words: Medium-sized and small enterprises; Financing; Bank; Self-construction

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CONCLUSION

It is known to all that the SMEs are playing a significant role in economic development of China. As the saying goes, one can't make bricks without straw, the old saying vividly reflects the important status of funds during the development of SMEs. However, the small scale, less profitable units, the ability to resist risk difference makes SMEs in financing debt exist greater risk, Moral risk caused by information asymmetry brings certain difficulties to the financing of SMEs to a certain extent. Therefore solving the SMEs' financing is very important for the healthy development of the present stage of our country economy, so the research on the financing problem of SMEs has a very important practical significance.

1. SMES AND ENTERPRISE FINANCING

1.1 The Definition of SMEs

SMEs mean the companies those who do not have large paid-up capital and also do not hire lots of employees. The United States issued "small enterprises" in regulation: "all owned and operated independently, enterprises are not dominant in an industry that belongs to small businesses." Details are shown as Table 1.

PRC's national bureau of statistics, ministry of industry and information technology, the national development and reform commission and the ministry of finance jointly issued SMEs type standard notice on June 18, 2011.The notice has been clear that SMEs are divided into three types——medium, small and micro, according to specific standard enterprise employees, operation income, total assets etc, combining with the characteristics of industry to identify. Details are shown as Table 2.

Table 1
Small and Medium-sized Enterprise Standard from Small Business Administration in US

Company type	The biggest sales revenue or Number of employees	Company type	The biggest sales revenue or Number of employees
Manufacturing industry	500 person	Wholesale trade	$5 million
Retailing and service industries	50 person $1 million	Construction industry	$5 million
Advertising agencies	$3.5 million	Insurance Agents and Brokers	$3.5 million
Mining of copper Meat processing	500 person	Professional agent and furniture store	$3.5 million
Canned food factory	1000 person	Mobile home sellers	$6.5 million
General contractors	$17 million	Radio and television repair shop	$3.5 million
Hardware wholesaler	100 person	Radio station	$3.5 million

Table 2
Latest Chinese Small and Medium-sized Enterprise Standard

Industry	Types	Unit	SMEs standard
Manufacture	Number of employees		20-300
	Business income	Ten thousand yuan	300-2000
Construction industry	Business income	Ten thousand yuan	300-6000
	Total Assets	Ten thousand yuan	300-5000
Wholesale business	Number of employees		5 - 20
	Business income	Ten thousand yuan	1000-5000
Retail industry	Number of employees		10-50
	Business income	Ten thousand yuan	100-500
Transport industry	Number of employees		20-300
	Business income	Ten thousand yuan	200-3000
Post industry	Number of employees		20-300
	Business income	Ten thousand yuan	100-2000
Lodging and Catering services	Number of employees		10-100
	Business income	Ten thousand yuan	100-2000
Agriculture forestry, animal husbandry and fishery	Business income	Ten thousand yuan	50-500
Warehousing	Number of employees		20-100
	Business income	Ten thousand yuan	100-1000
Real estate development industry	Total Assets	Billion yuan	0.2-0.5
	Business income	Billion yuan	0.01-0.1
Information transmission industry	Number of employees		10-100
	Business income	Billion yuan	0.01-0.1
Software and information technology services	Number of employees		10-100
	Business income	Billion yuan	50-1000
Leasing and Business Service	Number of employees		10-100
	Business income	Billion yuan	0.01-0.8
Property management	Number of employees		100-300
	Business income	Ten thousand yuan	500-1000
Other	Number of employees		10-100

1.2 The Enterprise Financing

1.2.1 The Relative Concepts of Enterprise Financing

Enterprise financing refers to the enterprises as the main body in financing activities, effectively raise money through certain financing channels for basic daily activities, according to the requirement of their own. Financing is the first task of enterprise financial management. Whether in the early stage of a new company setting up or in the developing and expanding period of a company, financing problem runs through all the stages. Financing means collect fund directly or indirectly according to the supply and demand in the capital market. Generally, financing refers to a kind of economic behavior that funds flow in the capital market to alleviate the financial stress. It's an interactive process, including input and output of funds. When a certain amount of capital is injected into the corporation, the management will make full use of it. That process make a perfect circle in capital flowing.

Normally, enterprise financing can be divided into two common ways: endogenous financing and external financing according to the source of funds. Especially, exogenous financing can be divided into direct financing and indirect financing. Details are shown as Figure 1.

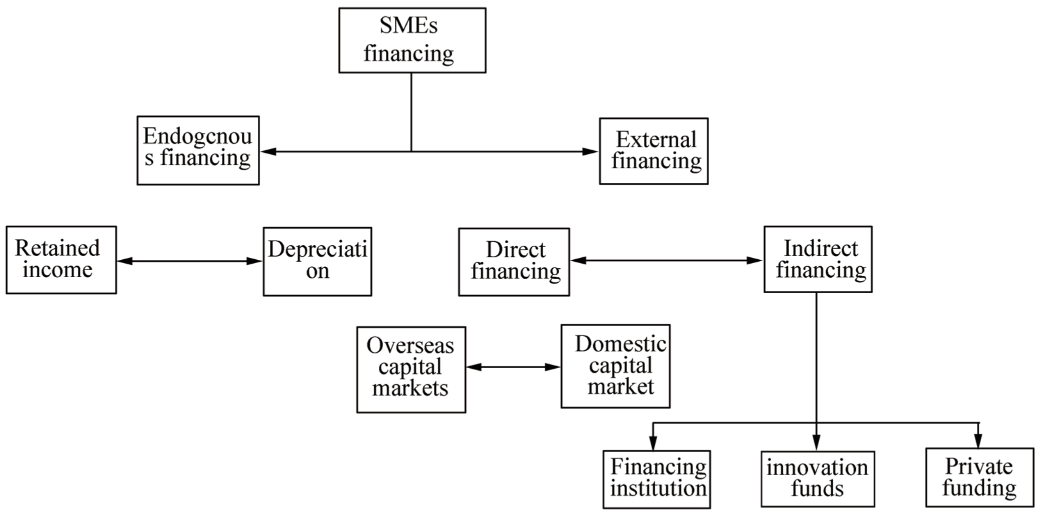

Figure1
SMEs Financing System

1.2.2 Related Theories of Enterprise Financing

(1) MM theory. In 1958, Modigliai and Miller put forward in the famous "MM theory" in their classical paper "the cost of capital, corporate finance and investment theory" (Shi, 2001)：Assuming that there is a complete capital market that does not need to pay corporate income tax, the management risks of the enterprise in the market are all the same, only with the difference of capital structure. There aren't inevitable relations between the enterprise's capital structure and enterprise's market value.

(2) Balance theory. In the mid-1970s, Myers, Bradley, Frank, and Goyal pointed out the theory of static balance and dynamic balance theory by a lot of research. Simply, the value of the enterprise will not increase as creditor's rights financing unlimitedly (Chai, 2011). Because the risks and expenses the enterprises taking are rising as the proportion of debt financing of enterprises rising ceaselessly. The risk of bankruptcy will continue to increase, as well. The income from bonds will be lower than expected. In the meanwhile, the cost of debt issuance and the difficulty of release will increase, so that it will lead to a drop in the length of the value. So the best capital structure in enterprises should take a balance between debt and cost.

(3) Agency cost theory. Jensen and Mecking, the founder of Agency cost theory, think there are serious enterprise interest disputes in the process of development, which mainly reflect in the disputes between the agent and the principal. For the detailed points are the interest disputes between the owner and the management and the interest disputes between the owner and the creditor. The interest disputes cause the equity agency costs and debt agency costs.

(4) Financing order. Mayers thinks when comprehensively considering transaction cost of various financing methods, ordering in accordance with the cost, corporations always prefer to giving priority to financing transaction with lower cost in 1984. Enterprise usually takes advantage of endogenous financing with the profit achieved by depreciation and expenses saved. The benefit is very obvious. This kind of financing method has no transaction cost. However, it may lead to bad consequences, such as the leak of significant information. That is actually not confidential. More seriously, it runs risks in the ownership of the enterprise. Thus, when

deciding which financing method to adopt the corporation should take a deep consideration in the balance of the benefits that will achieve between ownership and profits.

2. PRC'S SMES PRESENT SITUATION

2.1 The Source of PRC's SMEs

PRC's SMEs as a kind of specific financing group have the following characteristics:

2.1.1 Initially Rely on Internal Finance

With the deepening of the reform and opening up in the 1970 s, more and more SMEs begin to set up. The development history of SMEs in our country is really short so that the enterprises are lack of reliable credit records and are not always faithfulness and accuracy of financial statements. SMEs credit guarantee ability is not good enough, so that it has some difficulty to get the trust of the external investors, banks and other financial institutions. So the owners of SMEs can only rely on endogenous financing including their own capital and profits, and sometimes exogenous financing including funding from a small number of friends and relatives, also from some angel investors, investment and very few other informal channels.

2.1.2 Support from the State Financial Capital

In 2009, the central government provided 9.6 billion yuan for the development of SMEs in our country, and invested 20 billion yuan for SMEs technical renovation and allocated 3 billion yuan funds to SMEs for the improvement of the science and technology of SMEs.

With the further development of market economy in our country, the state financial support proportion in the enterprise gradually reduce in its own funds, but the national finance funds for SMEs is still presenting one of the most important aspects in SMEs financing channels.

(1) Bank financing. For most enterprises, bank financing is one of the most wide and basic source of funds, especially for SMEs. Without the funds from the banks, they may go into liquidation and fall through. It's one of the most vital methods in SMEs Financing.

(2) Non-bank financial institutions financing. Enterprises borrow money to sustain and accelerate the development of current position through the non-bank financial institutions such as the trust and investment companies, securities companies, insurance companies, leasing companies. Even though the loan from these financial institutions is smaller than that from the bank, delightedly the use of the capital is more flexible. In this case, non-bank financial institutions financing from these financial institutions has been well received by many SMEs.

(3) Free funds from residents. With the development of economy, residents have some idea about financial knowledge, coupled with rising inflation in China in recent years. In the other side, the bank deposit rate decreasing constantly, more and more residents prefer to purchase enterprise bonds instead of depositing the money in the bank.

2.2 Chinese SMEs Financing Present Situation Analysis

Main problems discovered in PRC's SMEs financing at present are as follows. The first is that the financing channels are too narrow, including narrow direct financing channel and less indirect financing credit support. The second is that financing cost is too high.

2.2.1 The Financing Channels Are Too Narrow

Because of historical reasons, the threshold of China listed companies is relatively high. And Government supervision of listed companies is very strict. Adding to incomplete venture capital system, it is difficult for SMEs to raise funds through capital market publicly. According to the statistics announced by People's Bank of China in August 2003, 98.7 percent of PRC's SMEs financing source is from bank loans. Direct financing to SMEs accounted for only 1.3 percent of corporate finance. Since China venture capital system is not perfect, but also lack of a more complete legal regulations and support policies, which makes it difficult to get financial support for SMEs through equity financing, results in the majority of SMEs in face of a shortage of liquidity and large-scale investment projects when the first thought to receive financial support through bank loans. But many restrictive conditions for bank loans make companies cannot obtain financing support timely and fully. Monetary tightening in recent years makes SME financing even worse.

2.2.2 The Financing Cost Is Too High

The cost of corporate financing includes financing cost and interest expense. Due to the characteristics of present PRC's SMEs information opacity, low mortgage prices, complex security procedures and high expenses, the SMEs cannot get the equal treatment as state-owned enterprises. Conversely the SMEs need to spend more than the state-owned enterprises on floating interests and guarantee fees. Adding to cumbersome procedures and high cost, all make many SMEs turn to private lending. With the national controls on bank lending increasingly stringent, private lending interest rates continue to rise, based on the principle of supply and demand. According to the data of Wenzhou statistical bureau in 2011, the ROI of local SMEs has fallen to 1% to 3% versus 8% to 10% a few years ago. However, the interest rate of private lending in Wenzhou in 2011 had risen to 72% to 96%. Some higher rate even reached 240%. More seriously, most businesses are unable to pay off the interest of loans.

3. THE REASONS FOR PRC'S SMES FINANCING DIFFICULTIES

3.1 External Factors

3.1.1 The Policy Environment and Social Reasons

(1) Imperfect laws, inadequate government support. A healthy legal environment plays an important role

in enterprise's survival and development. However, at present our country has not issued a comprehensive laws and regulations about SMEs financing. The regulation of "SMEs promotion law" is too general, lack of specificity and difficult in implementing. Government policy towards SMEs just floating on the surface, it hasn't done specific research on the reality of the situation of SMEs. Government should establish SME development institutions, which should set up detailed plans on how to develop, and how to solve the financing difficulties of SMEs through government support system.

While the central government will allocate funds to SMEs annually, but considering the pace of development of SMEs in these funds for SMEs is inadequate and unbalanced regional development, local financial subsidies cannot take into account all SMEs. Local fiscal subsidies given to the SMEs, basically only those with good prospects for development or having been valued by the local government can obtain special funds from the government.

(2) Imperfect credit guarantee system of SMEs. Guarantee companies provide third party guarantee for SMEs, and enable the enterprises to obtain appropriate funds from banks and other financial institutions. The third party guarantee financing provides lots of convenience for SMEs. At present the credit guarantee institutions in China appear two extremes: too commercial and lack of commercial affected by planned economy.

(3) Imperfect capital market and private capital development. From a long-term point of view, capital market is the main field of SMEs financing resource in the future. Equity financing and debt financing are two main kinds of capital market financing. According to relevant laws and regulations, total share capital of a listed company shall not be less than 3000 yuan. But majority of SMEs in our country cannot meet this requirement, and thus unable to obtain financing through the stock market. Fortunately, the private capital is not very strict for SMEs financing. The procedure is simple, convenient and efficient. But at present our country has not yet admitted the legal status of private lending. Private lending cannot survive as indirect financing way of enterprises. And in some parts, the interest rates of private lending are too high so that the companies cannot burden.

3.1.2 Resistance from Banks

(1) Different treatments for SMEs. Along with our country economic system in the process of the planned economy to market economy, the original ownership of inertial thinking hasn't caught up with the change of the economic system development which lead to bank have ownership "discrimination" when considering to lend loans to enterprises.

(2) The defect of the enterprise credit evaluation mechanism in bank. Banks usually take enterprise credit rating before providing loans to SMEs. At present many commercial banks in China have not set up special SMEs credit evaluation system.

(3) Information asymmetry between banks and SMEs. There are a lot of problems between SMEs financial system and governance structure. Operating conditions are not transparent. The integrity of the financial statements and believable degree are low. In addition SMEs are worried about providing too much information for outside investors that will affects the enterprise ownership. In order to avoid the risk of lending, Banks tend to spend extra cost of capital used in the survey of SMEs, audit and supervision which will add the burden of the banks.

3.2 Internal Factor

At present our country still has much sufficient funds in the financial markets. But SMEs still have financing difficulties. The main reason of the conflict is credit crisis. Banks and other financial institutions don't prefer to lend to SMEs. The reasons for SMEs are shown as below:

First of all, SMEs in China are widespread in the labor-intensive industry. They are usually lack of own brand characteristics, depending on oversea brands.

Secondly, due to the sizes of SMEs being generally small, many owners of enterprises manage and run the enterprise directly. Banks and other financial institutions are not willing to lend money to SMEs because their financial system is not perfect, and their information transparency is poor, adding to unclear property rights and imperfect corporate governance structure problems.

Thirdly, from the perspective of financial institutions, how much money the owners put into the company takes on an anti-risk ability of the enterprises. SMEs in our country can hardly get mortgage loans from bank because of old production equipment, lack of fixed assets, etc.

4. THE WAY TO SOLVE THE PROBLEM OF PRC'S SMES FINANCING DIFFICULTIES

4.1 Improve the External Environment

4.1.1 Perfect the Relevant Laws and Regulations, More Substantive Polices to Take Care of SMEs

The relevant state departments should introduce some more detailed laws about the financing and the enterprise credit guarantee. At the same time, for SMEs financing from banks, private capital, the capital market, the relevant laws and regulations should also be introduced. Equal treatment of SMEs from national policies and regulations is very significant.

4.1.2 Set up Dedicated Services for SMEs

Our country should refer to the practice of foreign nations to set up specialized agencies for SMEs financing, management and supervision and so on. These institutions can specifically provide low-cost guarantee expenses or direct financing for SMEs.

4.1.3 Optimize the Capital Market, the Development of the Private Capital

Countries should take legislative in guiding non-governmental capital operation, to make the private capital healthy and orderly develop, At the same time, the nation and the market may help broaden the financing channels for SMEs.

4.1.4 Improve the Cooperation Between Banks and SMEs

First of all, banks should abandon the old idea so as to take equal treatment to large and medium-sized enterprises and gradually eliminate the ownership "discrimination". Secondly, at present, no matter large companies or medium-sized enterprises are all really in short of money. To the SMEs lack of money, banks should modify their operating strategy, and then design a set of credit evaluation for SMEs. And finally set up specifically service department to help SMEs financing step by step.

4.2 Perfect the Internal Factors

4.2.1 Facilitate the Transformation of Enterprises and Enhance Enterprise Core Competitiveness

Labor-intensive manufacturing plant locates in the bottom of "smile curve", which means they get a minimum of labor remuneration with the biggest workload. At present, the majority of our SMEs are engaged in processing service, their products lack of core competitiveness with low brand value. The development of enterprises is restricted by orders. If there is no work means there are no orders. Thus the factory will be closed. At this moment, conditional SMEs should decide the transition to transfer smile at both ends of the curve towards the development of enterprises by developing their own core technology and own brands.

4.2.2 Improve Their Financial System, Optimize the Management Structure of the Enterprises

Due to the financial chaos and opaque of the SMEs themselves, many banks and other financial institutions do not dare to lend funds to these businesses. Enterprises should establish modern enterprise financial system, and should improve the quality of their own, so as to provide open and transparent information to external users. In this case, we may solve financing problem due to the accuracy of financial reporting. In many cases, it is easy in setting and difficult in managing. Business owners may simply suitable for the creation, not suitable for business management, which reminds us to abandon the traditional family business governance and introduce a professional management team to take care of business. Such companies in this method can increase authenticity reliability of financial information so that the banks are willing to lend to businesses.

CONCLUSION

The speed of SMEs' development in China is more and more rapidly, the influence for China's economic and social aspects shouldn't be ignored. However, due to various defects existing in SMEs itself and the aspects of macro policy environment factors lead to the circumstances of the bankruptcy of the enterprise. Especially in recent years, the international economy brings more difficulties to the development of SMEs. The SMEs should be regarded as an essential part of market economy. Our country, society and financial institutions should guide SMEs towards healthy and correct path development which should be main engine of economic growth.

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