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The Research of External Financing Options of Small and Medium-Sized Enterprises in China

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Abstract

Since the reform and opening up, small and medium-sized enterprises (SMEs) in China developed rapidly, which have become an important part of China's economic and social development. However, the financing difficulties of SMEs have become increasingly prominent during recent years, and it hinders the healthy development of SMEs in China. This paper analyzes the current financing situation of SMEs in China, and conducts a deeply comparative analysis for several common external financing means of SMEs. In addition, this article provides some suggestions about how to solve financing difficulties if SMEs in China.

Key words: Small and medium-sized enterprises (SMEs); External financing means; Options

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INTRODUCTION

Small and medium-sized enterprises (SMEs) are economic units with smaller personnel scales, asset scales and operation scales, compared with large enterprises. The standard definition is different in different countries all over the world.

Small and medium-sized enterprise as an important part of the national economy, which plays an important role in a market economy plays a very important role. According to statistics, at present, there are more than eight million SMEs in China, and the proportions of small and medium-sized industrial enterprises in the national industrial output value and profits and taxes are about 60% and 40%. Additionally, SMEs provide 75% of urban employment opportunities in China. Especially since the 1990s, the 75% of China's industrial output value added is created by SMEs, which has become an important level in China's economy. Many familiar large enterprises (such as Microsoft Corporation, McDonald's company, etc.) grow up with SMEs; And SMEs have flexible mechanisms which are helpful for them to adjust business strategy flexibly according to market supply and demand. SMEs could lead technological innovation and management innovation in the industry field to some extent, and it becomes the driving force of the development of market economy.

1. THE CURRENT FINANCING SITUATION OF SMALL AND MEDIUM-SIZED ENTERPRISES IN CHINA

Corporate finance is mainly based on two channels: internal financing and external financing. Since most SMEs are in the seed stage and growth stage in the corporation life cycle, they can gain relatively small scale of capital through the original capital investment and their own accumulation, which is named "internal financing". Therefore, SMEs have greater dependence on external financing. External financing contains direct financing and indirect financing. Direct financing mainly refers to the financing way without financial institutions as the intermediate, which is the monetary capital transfer based on direct communication between sponsor units and financing units. Indirect financing refers to that if some people have temporarily idle monetary capital, they can provide the money to financial intermediaries by

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deposit money or buying securities which are issued by banks, trust institutions, insurance company, etc. and then financial institutions provide the capital to enterprises who are lack of capital by loaning, discounting or buying securities, so that financing process can be realized.

1.1 Analysis of Internal Financing Situation of Small and Medium-Sized Enterprises in China

Small and medium-sized enterprises in China usually start by personal family accumulation and zero debt because of restrictions from both inside and outside factors. Operating funds are usually raised from relatives, friends and enterprise surplus. In developed countries, self-raised funds are still the preferred financing way of enterprises. For example, during recent 20 years, self-raised funds account for more than 65% capital source of SMEs in US because of its management advantage (ownership concentration). SMEs in Japan only used 30% internal funds in 2000; however, this capital proportion quickly rose to 70% in 2006. This phenomenon that SMEs highly rely on self-raised funds is quite similar with SMEs in China, but the driving force of this phenomenon is different. In developed countries, external financing is active behavior, but SMEs in China are hard to raise money from external channel due to various reasons, they have to use internal financing. In short, SMEs are in possession of the high proportion of self-raised funds, and external financing source is limited. Therefore, for the development of SMEs, we must firstly solve the difficult problem of external financing.

1.2 Analysis of Indirect Financing Situation of Small and Medium-Sized Enterprises in China

Indirect financing, as a form of external financing, is mainly manifested in commercial bank loans to SMEs. Due to the limit of operation scale and the imperfection of China's capital market, according to "China private economic development report" statistics, commercial bank loans take up about 98.7% of total capital source of SMEs. Even so, loans to SMEs accounted for the proportion of the total entire banking loans is still not high. According to the National Bureau of Statistics' data in 2010, it is clear that in 2010, financial institutions in China issued short-term loan totally 14.6611 trillion yuan in 2009, but township enterprises and individual enterprises, which accounts for most of SMEs , only get loans of 902.9 billion Yuan and 17,117 billion, respectively. It only takes up 6.2% and 4.9% of the total short-term loan. From this point of view, the indirect financing of SMEs in China takes few proportions of the total loans of financial institutions.

In addition, it is more difficult for SMEs to in the line with the credit conditions of commercial bank, so commercial banks often refused to loan to SMEs for their imperfect and infeasible financial system and the lack of real estate mortgage assets. Many commercial banks inflict strict conditions in all aspects to SMEs who apply for loans (such as loan return rates, debt ratio, nature of the industry, the average daily deposits, the shareholder structure and mortgage), which to shut out many SMEs. High-class SMEs, with salable products, high benefit and high credit quality, more and more become the object for financial institutions to strive for. All financial institutions have increased line of credit of high-class SMEs line, and improved financial services to the high quality SMEs. However, some SMEs with the development potential and bad current situation are often neglected due to the lack of recognition ability of banks. As for the SMEs with poor efficiency, most of them cannot identify good projects and products; even if they are applying for bank loans, they would also be rejected by banks because they do not meet the loan conditions and cannot obtain bank loans. According to statistics, the rejection rate of loan application for China's SMEs is much larger than that for large enterprises. So SMEs in China are in a serious disadvantage position in obtaining bank loans.

1.3 Analysis of Direct Financing Situation of Small and Medium-Sized Enterprises in China

Direct financing channels for SMEs are bond financing, equity financing, asset securitization and venture capital. At present, the conditions of debt and equity financing of SMEs in China are high, so it is difficult for SMEs to enter. Although the SME financing plate is launched in the Shenzhen Stock Exchange on 27th May, 2004, it can only solve the financing problem of the very few high-tech SMEs, and the effect is not optimistic. The issuance of corporate bonds is under strict government control, and its scale is based on the annual operational aspect of national macroeconomic, and which are assigned to various localities and departments. These factors made it is difficult for SMEs to raise funds through the capital market.

2. EXTERNAL FINANCING PATTEM COMPARISON OF SMALL AND MEDIUM-SIZED ENTERPRISES IN CHINA

2.1 Guarantee Loans Financing

Guarantee loans financing is to set up a special loan guarantee agencies to give guarantees to SMEs when they apply for loans to banks, which not only can reduce banks' credit risk, but also can enable SMEs to obtain the necessary funds. Guarantee agencies are generally non-profit organization, and it implements the membership management. When member companies loan to bank, they could be secured by the security agencies, which is a viable means for SMEs to obtain bank loans. According to the statistics of 12th guarantee agencies for SMEs joint

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conference, by the end of 2010, the number of credit guarantee institutions for SMEs in China has been reached 4817, and the registered capital is 391.5 billion Yuan, the average capital per unit is 81.27 million Yuan. In 2010, newly increased amount guaranteed is 979.4 billion Yuan, with the year-on-year growth 35.35%. The newly increased guarantee business is 220,000.

2.2 Finance Lease

Finance lease means that the company who needs equipment proposes financing application to leasing company, and then the leasing company purchases equipment from supplier and rents out to businesses to use, and the lessee to pay the rents on schedule, which achieves from "financing items" to "circulate necessary funds". Finance lease mainly has the following four forms: firstly, direct lease, which means that the lessor to the lessee's request to purchase equipment and leased to lessee to use directly; secondly, leveraged lease, it refers to that the lessor raised the equivalent of 20% to 40% of the rental equipment price funding, and the remaining 60% to 80% of the capital equipment will be purchased by the loans from banks or other financial institutions, because the lessor takes it as collateral; thirdly, transfer lease, it indicates that the lessor rents equipment from other leasing companies based on the needs of lessee, and then sub-leased to the lessee to use; fourthly, sale-back-lease, which implies companies will sale their own equipment to the lessor, and then rent back to use by themselves. Finance lease, with the characteristics of long financing maturity, unchanging ownership of the leased asset and stability good of lease contract, which does not take up bank line of credit, so entrepreneurs can use equipment after pay the first rent instead of using long-term capital investment. So that funds can be transferred to the most urgently needed place, which could reduce the capital turnover pressure caused by equipment remodeling, and to avoid paying large amounts of cash and increasing costs due to price fluctuations and inflation. Finance lease is an effective way to solve the problems of SME financing, which could help companies achieve the return of funds and capital appreciation.

2.3 Growth Enterprise Market Listing and Financing

Growth Enterprise Market (GEM) is a security exchange market outside the main board, which is specially designed for SMEs and emerging companies to provide financing channels and growing space to them, and it is an important part of the multi-level capital market. China's GEM was established in 2009 to provide more convenient financing channels for SMEs. The biggest feature of GEM is low entry threshold, and there are 368 companies listed on GEM at present, which opens up new financing channels for SMEs with potential; at the same time, GEM presents more strict information disclosure requirements to listed companies to promote them to improve their corporate governance structure and standardize their operations. GEM puts forward higher requirements to sustainable profitability of SMEs, and the data shows that only in 2011, 22 companies failed to pass muster of IPO by GEM, and 8% of which are caused by sustained profitability problems.

The constant improvement of stock market provides a large number of capitals for SMEs, and this market developed rapidly during recent years. Compared with the bank financing channels, stock market could provide adequate financial support for every listed company, but the stock market benefits from its narrow channels and the shell resources are extremely tense, which makes it difficult to become the main financing channel of the SMEs.

2.4 Private Equity Financing

Private equity financing is that non-listed companies directed to introduce equity investor with strategic value by closed channels. It considers the future exit mechanism to sell the shares and gain benefits during the transaction implementation process by way of listing, merger and acquisition, management buy-back. Private equity investors are generally less involved in day-to-day operations of enterprises, but they strictly control the future development direction of the company; compared with bank loans, private equity financing has the lower restriction on enterprises' qualifications, which is more suitable for SMEs.

Different from bank loans, private equity financing would increase owners' equity rather than increasing their debt, so private equity financing will strengthen the balance sheet of companies to enhance the ability to resist risks. Private equity financing usually does not require companies to pay for dividends, which does not bring pressure on company's cash flow. For the enterprises who introduce private equity companies, it not only has the long duration and obtains a relatively stable source of funding, but also brings management skill, advanced technology, market shares and relevant experience into the enterprise. Partners of the private equity funds usually are experienced entrepreneurs and investment professionals, and they become one of the owners of company by the private equity investment, so they have consistent interests with the existing business owners. Private Equity Funds would try their best to help businesses grow, for example, entering into new markets, finding the proper supplier and providing professional management consulting, etc.

According to the data released by Qingke Research Center in 2011, there are 82 private equity investment funds which could invest in mainland China finishing raising with the amount of $27.621 billion only in the year 2010; the number of total investment cases is 363, and the total trade volume is $10.381 billion. Visibly, private equity financing, as a new capital force, is becoming one of the channels of mainstream financing.

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2.5 Venture Capital Investment

Venture capital investment is that the venture investors conduct risk capital investment in the initial period of enterprise development, and then wait until the company developed relatively mature to change form of the invested capital from stock equity into funds through the market exit mechanism, so that venture investors could recoup the capital outlay and gain high risk return. Risk investment period is generally 3 to 5 years, and the investment style is equity investment, with the purpose of realizing capital return during the process of property flows, which means investors try to make enterprises bigger by investing and providing value-added services and then exiting through the IPO.

The venture capital investment in China started in the 1980s, and China's venture capital industry has been greatly developed in the tide of market economy. For the investment fields, the venture capital investment in China are almost in Internet companies in the 1990s, such as Sina, Sohu, Alibaba and other Internet companies. However, different from previous investment concentrating to the Internet industry, the newly risk investments are keen on traditional items, and education training, the restaurant chain, clean technologies and auto after-market become popular investment spot. Once traditional industries form a chain brand, it is easy to form an overall effect, and restaurant chains and hotel chains industry have broad prospects in China's market, with good growth and stable return, which must be the favor of venture investor. From the current point of view, some characteristics of China's venture capital industry are particularly noteworthy. For example: for the risk investment subject, the capital sources of venture investment in China are mainly from financial allocation, so this mode suppresses private investment, which is not conducive to the capital growth of amount and scale; for laws and regulations and supporting measures, although Chinese government provides some tax benefits to the high-tech venture capital companies, the relevant laws for venture capital industry have not been introduced yet, and there are no relevant supporting policies and regulations for the market access, tax incentives, and financing management.

According to the data of Investment Analysis and Forecast Report of China venture capital industry from 2012 to 2016, it is clear that there are a high record of 220 Chinese enterprises with the venture capital or private equity investment background conducting initial public offering (IPO) in global capital markets in 2010, and 50% of which are investments for SMEs. According to the characteristics of SMEs, venture capital investments are generally distributed to the seed stage, starting period and expansion stage of enterprises. The rapid development of the venture capital investment provides opportunities to SMEs to gain equity financing, especially for small companies, which could effectively improve SME capital institutions and provide more value-added services.

2.6 Mortgage Financing

Mortgage refers to a kind of activity that hockers take their movable property, property rights or real estate as pawn to pawnshop, and then get money after paying for certain percentage of costs, and pay interests and principal within agreed period to redeem hock items. Mortgage financing is a fast and convenient way of financing for SMEs to satisfy their short term capital demand. SMEs financing's characteristics of small credit selling, short loan circle, high loan frequency and urgent loan needs are coincide with the pawnshop's features of small amount, short-term, safety and convenience, so there is a natural blood relations as financial partners between SMEs and pawnshop.

Compared with bank financing, mortgage financing has several major features: firstly, lenders fast, it means that the shortest time that company could money from pawnshop (specially for real estate hock) is 12 hours, however that for bank loans are at least more than ten days; secondly, the procedures of mortgage financing are simple and convenient as long as the pawn house has clear ownership and legitimate source; thirdly, mortgage financing has limited amount, from tens of thousands, hundreds of thousands to hundreds of thousands; fourthly, mortgage financing is generally for customers with short-term (1 to 3 months) financing needs, which is quite different from the bank loan financing mainly aimed at long-term customers (more than 1 year).

To the end of 2009, there are 3694 pawnshops in China with the 57.6 billion Yuan's Industry registered capital. Along with the national regulatory efforts to strengthen and the perfection of the credit system, pawn broking is poised to professional operation, and mortgage financing would also become a new convenient and flexible financing way to SMEs.

2.7 Intellectual Property Financing

In the era of knowledge economy, patent rights, proprietary technology, trademarks and other intangible assets as well as scientific research have increasingly become the investors' most important investees. So high-tech SMEs can take good advantage of this financial management development trend to give full play to their own advantages on intangible asset, and highlight the advantages of operation, technology and market in order to attract investors' investment or creditors' borrowing to solve financial problems.

Secured financing of intellectual property is a new way of financing. It is a way of direct financing that uses assets' future benefits as the capital resource and guarantee of debt service. This kind of financing could effectively solve the phenomenon of banks reluctance to lend which is caused by fewer tangible assets, high proportion of intangible assets and lack of mortgaged property of SMEs. It is not only able to provide good ideas for entrepreneurial

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companies to obtain funds, but also is a new business for banks to be carried out in the future. The high-tech SMEs who have the intellectual property rights can be submitted to the relevant competent departments to carry out the attempt of patents, proprietary technology, trademarks and other intangible assets as security for loans and other knowledge-based new business. Scientific and technological innovations can also be sold to those enterprises that need the technology. It gets development funds through asset replacement. But, in practical operation, the problem of intellectual property protection, financing evaluation and their guarantees determine need to be solved.

2.8 Angel Investment

Angel investment is a form of equity capital investment, which refers to that the wealthy individual investors invest to assist the original project or a small start-up company with specific technical or unique concept, and it is the one-time upfront investment. The financing characteristics of high-tech SMEs determine that the “angel investment” can become their important choice, and financing needs of high-tech SMEs in start-up period show the following obvious features: Firstly, capital demands have Strong Sustainability and high frequency. In the start-up period, high-tech SMEs need continuing invest for research and development activities, purchasing high technology equipment and timely updates technology in order to maintain the power and capacity of continuous innovation. Secondly, a single financing amount is relatively small. Despite the high-tech SMEs strongly demand the funds in the start-up period and need sustained financial support, but due to the smaller scale, single-financing amount is not too large. So tech SMEs requires a great deal of flexibility and risk capital investments, and angel investment could exactly meet their requirements.

Angel investments expand the financing channels of entrepreneurial businesses and provide an effective source of funds. Angel funds generally allow the enterprise which it invested a failure rate from 80% to 90%, and it could provide initial financial support to the technical achievements with development potential in which the traditional investment are lack of interest. Thus, angel investment provides a long-term source of funding to the entrepreneurial businesses based on its high-risk endurance and enthusiasm to high-tech start-ups enterprise. In addition, angel investors usually not only have large amount of capital, but also have a great deal of business and management experience, so many angel investors are successful entrepreneurs. Therefore, the angel investors not only invest their own funds into the enterprise, but pass their business management experiences which are accumulated over the years to entrepreneurs, sharing the existing sales channels with entrepreneurs and advising on the organizational structure and management style. Meanwhile, angel investors are looking for a reliable professional and technical personnel and management personnel to the entrepreneurs by their own network resources.

3. SUGGESTIONS TO SOLVE THE FINANCING DIFFICULTIES OF SMALL AND MEDIUM-SIZED ENTERPRISES IN CHINA

3.1 The Banks Should Timely Change the Marketing Strategy

In order to adapt to the needs of the market economic structure adjustment, banks should change the marketing strategy in a timely manner. Banks should actively and steadily expand SMEs credit business to organically combine supporting SMEs development and raising the loan benefit, and to make the SMEs as a new benefits growth point. Of course, the credit risk of SMEs is pretty high, so banks must stick to the precautionary principle in the operating process, and focus on the implementation of risk protection measures, such as taking a mortgage guarantee company, which could effectively control the risk of loans.

3.2 Speed up the Development of Regional Financing Guarantee Industry

Firstly, the policy financing guarantee institutions should fully play the leading and guidance role. Local governments should continue to strengthen the cooperation with the relevant national guarantee agencies to establish policy financing guarantee institutions to provide financing guarantee to SMEs in the service-oriented area. Secondly, the government should promote the development of commercial financing guarantee institutions. Private capital, foreign investment and other kinds of capital should be encouraged to actively participate in the local SMEs financing guarantee system. Thirdly, the linkage of the special funds of SMEs financing guarantee should be established. On the basis of the existing scale of special funds of the SMEs financing guarantee, set aside some funds in the budget each year which is to be used to enrich and expand the scale of the special funds for financing guarantees, and continue to intensify efforts to support various types of financing guarantee institutions.

3.3 Launch the “Credit Factory” Service Model

“Credit factory” service model mainly aims at the SMEs financing characteristics of “short term, frequency, rapid and emergency”, and its core strengths is innovation, which embodied in the following aspects: Firstly, it refers to the innovation of business processes. The approval process of SMEs credit is greatly shortened based on the intensification and simple process, and the approval cycle is shortened to five days from the past one or two months; Secondly, it means the innovation of operating mechanism, and banks should establish franchise organizations to arrange the special assistant-person to focus on services

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for SMEs; Thirdly, the innovation of credit policy, special customer evaluation standard and scope of access should be draft according to the characteristics of SMEs and industry; Fourthly, the innovative of products services, and provides personalized full-service programs based on small and medium-sized enterprises' different characteristics and needs to help SMEs continue growing. "Credit factory" should combine the trade and finance business of innovative company, which covers products such as loans, international and domestic settlement, to introduce various types financial services such as, the convenient deposit, flexible loan, quick settlement to fully meet the needs of SMEs; Fifthly, the innovation of management models, it requires a separate assessment and a separate credit scale for SMEs business, and implements incentive and restrictive mechanism which is different from other businesses; Sixthly, the innovation of service channels, fully play the multi-platform advantages of bank of China, such as, the commercial banks, investment banks and insurance business.

3.4 The New Financing Models for Small and Medium-Sized Enterprises

3.4.1 Cluster Financing

SMEs cluster is a more frequent phenomenon in recent years. SMEs clusters financing displayed a significant group effect. Cluster financing had overcome the weaknesses of lack of discourse power and bargaining position for individual company. It is forming a financing mechanism rooted in the cluster, the "cluster financing". Overall, SMEs clusters financing is a new type of financing system and operational mechanism of SMEs, which is based on SMEs clusters. Cluster financing mentioned here is not like other forms of SMEs financing which is a simple way of financing, but it is accompanied by a new form of organization. In this new cluster, management model is formulated by the collective financing needs and financing channels. In this new financing system, the traditional model that the separate SMEs negotiate with banking institutions has been broken by the new finance behavior. SMEs credit resources had been re-integrated by the model of co-financing organizations, which could improve the competitive advantages and scale advantages of enterprises' cost and financial capacity.

3.4.2 Electronic Commercial Draft

Electronic Commercial Draft has collected the functions of notes financing. With the help of ECDS on-line and the construction of electronic instruments trading platform, the relevant departments should actively promote the legislative department to solve the notes financing problems, and to build a more perfect laws and regulations to the financing paper market for effective monitoring. In October 2009, the People's Bank of China officially launched the ECDS-electronic commercial draft. The electronic commercial draft financing would solve the financing problems of SMEs from the following aspects: Firstly, note stock is increased effectively. Secondly, the transparency of information of unified bill market is increased. Thirdly, it should improve the basis of credit. Fourthly, reduce the risk of small and medium-sized financial institutions to carry out the bills business. Fifthly, improve the regulatory capacity of regulator. On the other hand, the policies are needed to introduce to expand the variety transactions of the bill market, which equals to the expansion the short-term financing channels of enterprises. At the same time, in order to improve the banking institutions initiative of issue and acceptance, the risks faced by the bank promissory notes should be minimized.

3.4.3 Supply Chain Financing

Supply chain financing transactions allow SMEs to use raw materials and goods that produced and sold for loans. Supply chain financing effectively activated the precipitation funds of the raw materials and inventory, which raises the turnover rate of funds, reduces the settlement risk, solves the financing problem of business scale management, and ultimately improve the efficiency of business operation. The supply chain financing is putting the core business credit into SMEs, which matches the risk level of the core enterprise, effectively reducing the small and medium enterprises - the borrower's mortgage-backed requirement. This financing model has solved the problem which SMEs are small scale and lack of mortgage-backed, well suited for small short-term liquidity financing.

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