

# Status and prospects of the development of Chinese SMEs

## I. The character of small and medium-sized enterprises in china

Due to China's specific national conditions, the development of SMEs are different from the developed countries, it formed the following characteristics:

### 1、Quantity, widely distributed, involving a wide range of industries

SMEs are an important part of the modern national economy and have a wide range of social and economic infrastructure. Therefore, whether in developed or developing countries, the number of SMEs occupies absolute advantage. As of the first half of 2013, China has implemented 14 million SMEs, accounting for more than 95% of the national total companies.

### 2、Corporate life is short; Rapid replacement of old and new ones

SMEs have narrow channels to finance, leading to lack of funds for SMEs, and lack of developing momentum; with small scale, low product quality and technological content, SMEs have less competitive and small market influence; Due to the weak ability to collect and analysis market information, SMEs are unable to promptly determine the economic climate changes, changes in the financial environment and industrial situations, having a weak anti-risk ability. So their life cycle is relatively short, every

year a large number of SMEs close down, while there are a large number of them are created, the new and old companies update quickly.

### 3、 Concentrated in labor-intensive industries, small scale, poor technical equipment

In the background of a large population, economic backwardness, poor technical equipment, the developed Chinese SMEs are concentrated mainly in labor-intensive industries, and some low-tech traditional industries. The majority of SMEs use traditional technology into agriculture, animal husbandry, fisheries and other traditional industries, so the output scale of China's SMEs are relatively small, launching low-tech products.

### 4、 Corporate ownership and management degree of unity; Owners and operators combined

Under highly uniform conditions of the ownership and operations, the business goals and objectives are highly consistent with the owner, which makes SMEs dynamic and flexible; while simple internal organization structure, management personification, not too many layers of management, the power of management centralized in the hands of one owner. Distance between managers and general practitioners are short, and many have a certain relationship, such as blood, kinship, geographical, etc. So the process of organizing, coordinating, directing, monitoring are quicker.

### 5、 Lack of talent, the spirit of teamwork is not strong

The staff of SMEs flow fast, SMEs lacks qualified personnel. Due to the limitations of their own size and strength of enterprises, SMEs are often difficult to attract top talent to join; it is difficult to pay the high salaries of senior personnel required. For the talent which companies already have, the SME is often difficult to stabilize fully utilized because the boss, management, corporate culture and welfare issues. Since SMEs lack stability and excellent team, its survival and development often encounter great difficulties.

## **II. The status and role of SMEs in China**

The effect of SMEs in modern society is wide-ranged and deepen; its influence on the development of the national economy is also profound and long-lasting, especially the development of township enterprises and private technology enterprises are particularly fast, and has become a new highlight in the development of national economic. In particular, the important role of SMEs mainly in the following areas:

### **1、 SMEs are an important cornerstone of social stability**

Firstly, SMEs are an important channel for providing job vacancies. In China, the survival and development of SMEs mainly in labor-intensive industries, the labor accommodated and the marginal labor for each unit of investment are significantly higher than that of large enterprises, in most areas the difference are about more than doubled. Currently, employment in SMEs account for about 80% of the national employment. And there are

more than 85% job vacancies offered from SMEs. Secondly, SMEs have become an important part of our national economy. The majority of SMEs create 60% of the country's GDP, tax revenue accounted for 50% and exports accounted for 68 percent, providing more than 75% of urban jobs, providing about 80% of its source of revenue for local governments at all levels. SMEs promote economic development and narrow the gap between urban and rural areas, increasing job opportunities, not only arrange a large number of urban laid-off workers, but also absorb a large number of rural surplus labor, having solved the problem of the transfer of rural surplus labor force and employment effectively, and ease the contradiction between labor supply and demand, thus ensuring the stability and economic development of society.

## 2、 SMEs are important innovation strength

In the increasingly fierce market competition, the advantage of the survival and development of SMEs lies in its enormous potential for innovation. Especially in recent years, SMEs has been increasingly becoming a major force in institutional innovation and technological innovation area. In the aspect of institutional innovation, SMEs has created a stock cooperative system in China; It is neither different from the joint-stock company nor the partnership, so it's a new system which small and medium enterprises created that are suitable for SMEs, which most small and medium enterprises has used and showing better economic and

social benefits. SMEs are easy to build modeled organizational structures, this structure emphasis flexible and adapt ability, which is conducive to technological inventions and achievements conversion; China's SMEs have become the force of technological innovation. In the aspect of Innovation of technology, 70% of our patents, more than 82% of new product development is done by the SMEs. SMEs play a more and more important role in China's economic development, playing an increasingly important role in the promotion of technological innovation and accelerating the process of marketization.

### 3、 SMEs are an important lever balanced regional economic structure

In China, SMEs are often in rural and urban junction, it plays an important role as a link among joint, complementary and coordinated development of urban and rural economy, especially the proposed strategy that the development of small towns and rural areas as rural modernization. It is urgent to develop small and medium enterprises. In addition, the SMEs also play an important role in strategy of the China Western Development.

### 4、 SMEs are the plots for China's economic reforms

In the reforming of economic structure in market economy-oriented, the reforming of SMEs is significant. SMEs' reforming is not only to provide a reference for the reforming of state-owned enterprises, but also to cut the cost of reforming, such as to ensure a high

rate of economic growth and the reforming of state-owned enterprises to absorb personnel diverted down under the inefficient development circumstances about state-owned enterprises; SMEs reforming can play a role of "plots" and "pioneer", to try a variety of reforming in the first, and provide experience for more large-scale reforming. The enterprise reforming and institutional innovation, such as contracting, leasing, mergers, bankruptcies, etc., are generally tested in the SMEs trial at first and then gradually promote to large state-owned enterprises.

#### 5、 SMEs are a force to expand exports

SMEs' business patterns are flexible, the cost is low and the transformations are convenient, they can adapt to today's rapidly changing international market and are active promoters of international trade. Since China have accessed to WTO, it provides more opportunities and challenges for China's SMEs. Due to fierce competition in the domestic market, many of Chinese SMEs focus on the foreign market, with its unique product and price advantage, they gradually moving towards the international market, and have made a great contribution on activating China's economy, improving competitiveness of our products in the international market, and promoting economic international exchange of technology; now they has been an important force in China's foreign exports.

### **III. Challenges faced by SMEs**

## 1、 Financing problem faced by SMEs

SMEs' financial system are not perfect and their financial management are confusing, lacking of dedicated professional accountants, their financial transparency of the information provided by the finance department reports is low and there is a serious beautification report fraud, which are difficult for banks and other financial institutions to give them a fair and reasonable corporate credit rating, so it is difficult to decide whether the bank approved the loan business. Serious information asymmetry between SMEs and banks leads to the low financing efficiency.

The credit line of SMEs are generally not high, and they seldom have sense of credit, leading banks and other financial institutions invest are very cautious when investing for SMEs. Some SMEs evade the bank loans make the bank can't recover the loan through the application of restructuring, bankruptcy, converting, and cancellation of legal person and even fled to escape the bank debt, and then form the bad debts, resulting in bank losses.

Most SMEs employ extensive or family management business model, compared with the modern management mode, these management business models lack clear property rights system and result in low quality and efficiency of management, causing considerable losses to SMEs, while these management model have been unable to adapt to the development of modern market economy and have been eliminated by the times. As a

result of adopting the poor management of the business model, it will reduce the prospects estimation for business development of the banks and other financial institutions.

SME's loan lacks high-quality collateral and reliable guarantor. SMEs' fixed assets and total fixed assets are very small, and intangible assets are difficult to transfer into collateral assets, at the same time rapidly changing assets led to a lack of collateral. Its own credit rating is low and security agencies of the market are not perfect, so it is hard to find the guarantor. Because of no collateral and guarantors, the financing of SMEs entered the dead cycle.

Lacking of the supporting of complete laws and regulations for SMEs financing activities, the government did not develop a complete perfect laws to regulate and promote the progress of SMEs financing smoothly. Currently there are two problems: First, the legislation is not standardized. Our country lacks a legislation which has unified standard. Secondly, China's financial market system is not perfect, the bill market and the interest rate market are immature and imperfect, there is a serious interference phenomenon about market segmentation and industry intervention, financial markets are suffered too much interference, and there are too little financing channels for SMEs.

The development of China's capital market is late, the system is not perfect, and its depth and breadth is not enough. There are too many



companies which issue stocks and bonds on the capital markets for financing, but the scale of the current market cannot meet the financing requirements of SMEs, SMEs do not have the qualification and conditions to issue stocks and bonds; China's capital markets based on mainboard, but the threshold of mainboard market financing is too high, SMEs are rarely able to finance directly through the issuance of securities.

SMEs themselves lack the ability to communicate with the capital markets. On the one hand, SMEs lack a thorough understanding of the capital market, they cannot choose the most effective way of financing to obtain financing from the capital markets, on the other hand due to various factors that small business owners are reluctant to reduce its control of the business, so that the access to capital market financing is not open.

In order to overcome the shortage of funds, SMEs should establish a modern enterprise system and standardize their management. SMEs must get rid of the consistent implementation of the "patriarchal" management mode, changing the operating mode. They must strengthen their financial management, and ask the funds to management, the information disclosure should be more transparent and openness.

SMEs should actively learn related financing knowledge and understand various financing channels, actively explore different financing methods to ease the financial pressure such as commodity finance, asset securitization, financing and leasing, making full use of existing capital

markets through capital operation, using mergers, alliances, buying shares, conversion and acquisition to promote cooperation between SMEs and competitive enterprises or large enterprises, to achieve all-win situation and to make up their own funds defects.

In order to get enough money solely rely on the limited access to loans from banks and other financial institutions is not enough, in order to obtain sufficient financial support, it is very necessary to develop diversified financing channels and tools. The methods that mortgage financing, lease financing, accounts receivable financing pledge, the selling of the accounts receivable, inventory financing pledge, intangible assets financing pledge and private financing can to some extent solve the shortage of funds.

In fact, since 2011, to solve the operating pressures problem faced by large, rising costs, financing difficulties and burdens emphasis of the SMEs, especially small and micro enterprises, the Chinese government issued a "the opinions to further support the healthy development of small and micro enterprises". All localities and departments executed earnestly, and achieved gratifying results. The first is the policy environment had a further promotion; the second is to further increase the intensity of fiscal support, the third is to ease the financing difficulties of making progressment, and at last structural adjustment and transformation upgrading has been improvement.

## 2、 the core staff losses problems of SMEs

According to statistical data analysis, the core staff of private SMEs account for about 20% -30% of employees, but the profits for enterprises creating accounted for 70% -80%. However, the core staff loss ratio is about nearly 70%, which has reached a very high level. Staff loss is very frequent, and most of them inflow into foreign talent or joint ventures. While China's labor is relatively abundant, but the issues are very prevalent which companies cannot hire available staff while the staff can't choose the long-term business. Under the conditions of market economy, highly competitive social environment will inevitably place the enterprises under the rule of survival of the fittest, every business will be faced with the birth, breeding, development, powerful, and the extinct of the development. However, the liquidity of the staff has also been a problem which enterprises must face with.

To solve the problem of loss of key employees, SMEs must do these:

— Change the model of management; establish a reasonable corporate governance structure

SMEs are generally invested by individuals or by family members jointly created. The enterprises often base on family members as the core and on the formation of blood relationship as a link, which is called "family" of management, this kind of management has a strong closed and exclusive characteristics. Instead of choosing the right employees, the

employment standards are in the pattern of cronyism, resulting in core staff feel unappreciated, not to be trusted or unfair treatment, and finally leading to a serious losses of key employees.

SMEs should change their arbitrary management and family management methods, in accordance with the general principles of organization structure design, building their own organizational structure, and establishing democratic and scientific decision-making mechanism. According to the requirements of modern enterprise system, achieving the separation of ownership and management, caring, respecting and trusting employees, giving a fair and equitable treatment of employees. Companies not only can attract the suitable people by doing these, but also can retain the company's core staff .o

— confirming the management thought, to establish a scientific management of human resources mechanism

In order to establish a correct concept of human resource management in the process of construction and development, companies must focus on the human factor and pay attention to the management of human resources. The management process of Human resources is made of eight steps, including: human resource planning, recruitment and dismissal, selection, inducted guidance, training, performance management, compensation and benefits, career development. Among them, the first three events can ensure that the companies identify and

hire capable employees; the followed two events make the skills and knowledge of employees are constantly updated; the last three activities can ensure that the companies are able to retain the core and outstanding staff who can maintain a talent of a high level of performance for a long time.

Establish and improve the training system, staff training is a long-term business investment in human resources; it is the most valuable investment and also the world's most expensive investment.

Establish fair employment mechanism, establishing and improving various rules and regulations in the company, and strive to create a fair competitive environment which gives talented people a chance to stand out.

Establish a set of incentive and restraint mechanisms for employees, it is very important to constraint behavior of the core employees, improve enterprise management, and ultimately maximized the interests of business operations.

—fostering good corporate culture and enhancing the cohesion

Corporate culture is the common values and code of conduct formed in the process of laboring and communicating, it is the soul and spiritual support and has a strong cohesion effect. Therefore, it plays an important role in stabilizing the staffs. Good corporate culture can create a good mental environment for enterprises, improve ethical standards and

scientific and cultural quality of the staffs, forming cohesion in internal and improving the competitiveness of enterprises in external, shaping the indispensable spiritual bond and moral ties of enterprise development.

—— Increase the cost of job-hopping in core employees

Within the scope of the enterprise financial capability, SMEs should improve pay levels, and enhance the competitiveness of wages. Enterprise compensation management has the best incentive affection, it is the effective measures to attract and retain core employees, and achieve the sustainable development of enterprises.

#### **IV. Strengthen bilateral and multilateral international cooperation, and enhance the competitiveness of SMEs**

In order to explore the market actively, in addition to continuing to deepen bilateral and multilateral cooperation mechanisms, to promote small and medium enterprises pragmatic cooperation among China and Germany, Sweden and the APEC members, and to strengthen the SMEs' cooperation between China and India.

##### 1、 the rapid development of Sino-Indian trade

China and India Premier Li Keqiang and Singh realized exchange visits during 2013, reached a number of consensuses, decided to strengthen practical cooperation by implementing mutually beneficial policies and promoted economic and trade relations to a new level.

Trade in goods: According to Chinese customs statistics, from 2000-2012, Sino-Indian trade in goods with an average annual increase of 29.8%. Due to the impact of the economic downturn in Europe and America in the past two years, Sino-Indian's volume of trade reached \$66.47 billion in 2012, of which China exports \$ 47.67 billion, imports \$ 18.8 billion, decreased 10.1%, 5.7% and 19.6% compared to last year. From January to September in 2013, China and India's volume of trade is \$ 48.51 billion, decreased 4.5%, of which China exported 36.61 billion, increased 3.3%; imports \$ 11.9 billion, decreased 22.5%. India is China's 12th largest trading partner and seventh largest export market; China is India's second largest trading partner and the largest source of imports.

Services Trade: According to Chinese statistics, from 2008's 2.23 billion dollars to 2012's \$ 2.67 billion, India had \$ 710 million surplus. The main area of both services trade in the traditional areas of transport, tourism, transport services which accounted for 39.3% in India's services trading. According to WTO statistics, in 2012 the total import and export trade in services, India ranks seventh in the world, China ranked third place.

2、 India is one of China's important contracting market about overseas project

As of the end of September 2013, China had signed in India Habitat project contract amount \$ 62.08 billion, of which \$ 37.23 billion has been

finished. From 2006-2011, India ranked the first place in overseas project contracting market for six consecutive years. In 2012 it ranked the second place. The newly signed projects this year, mainly in the field of thermal power and communications.

### 3、 The bilateral direct investment with India is increasing

As of the end of September 2013, China's non-financial direct investment to India has a stock of \$ 880 million, the main investment areas including telecommunications, machinery manufacturing, metallurgy and manufacture of household appliances. China invested \$ 155 million in India from January 2013 to September 2013, which is an increase of 1.3 times on year-to year basis.

At the same time, India's cumulative direct investment projects in China reached 851; the actual amount of investment is \$509 million. From January to September in 2013, there are 51 new projects invested by India in China, the actual amount of investment is \$ 22 million, covering the area of investment banking, software, higher education, pharmaceutical, trading, steel, chemicals, clean energy and so on.

Sino-Indian trade and economic relations are developing rapidly. Of course, there are also some undesirable points. For example, India start to focus on trade deficit in goods trade in the past two years, China well understands the question and will take active measures to promote imports from India. We hope that both sides insist the positive and open



attitude in the broader field of goods, trade in services, investment, scientific and technological cooperation and tourism to find a balance, and gradually seek overall balanced and sustainable development of bilateral economic and trade relations. China also hopes that India continues to improve trade and investment environment, to solve the problem which it is difficult and slow for Chinese businessmen to handle a visa to go to India and the problem of discrimination against Chinese enterprises in foreign exchange management and infrastructure bidding. I believe that with the solution and the improvement of these problems will India and China achieve a higher level of economic and trade relations, the cooperation between small and medium enterprises will also create a new situation!