Research on governmental capital optimization and SME development

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Abstract Small and medium size enterprises (SMEs) are playing a significant and irreplaceable role in the economic development, and a key focus involved in developing process of SME is the financing issues. There have been a variety of researches and studies regarding SME financing which mainly emphasize on financial system and insurance. The paper begins with the discussion and analysis of SMEs development from governmental capital operation perspective, and then presents methodological proposals on creating favorable developing environment and strengthening financing capability of SMEs by means of effectively and efficiently operation of governmental capital.

Key words governmental capital, merchant bank, enterprise financing, loan lending

1. Preface

Undoubtedly, SMEs (Small and medium size enterprises) are indispensably part of economic development anytime in any country. The SMEs of China shaped up on such special background as follows: 1) beginning with a original stage where SMEs had been ignored and neglected during planned economy period; 2) during the early period of reform and opening to the outside world, SMEs earned their survivals mostly relying on import; 3) after the establishment of socialistic market economy, the production factors resources of SMEs changed, along with more depending on domestic market demand, and till then, the financing issues were gradually popping out. Despite of the evidently important roles acted by SMEs such as employment problem resolving, enterprising spirit stimulating and technologic innovation, etc, there are more than enough obstacles standing in the way of SMEs relate to financing issues, unfairness of market and self-developing power, to name only a few. In that spirit all circles of the society have done volume theoretic and practical study regarding enterprise financing, relative governmental laws and regulations, sanity of financial system and enhancing self strength of enterprise and so on. Although foreign researchers already have provided some good solutions, they are not easy to be adopted and implemented in practical applications or even incompatible due to the their unique characteristics of SMEs in China. Based on the context and hypothesis that government possesses operational capital, the paper puts forward a brand new analysis framework for the development of SMEs.

2. Literature Review

2.1 The basic theory of SMEs financing

2.1.1 The financial system

As far as the rural financial system concerned, WANG Shuang-zheng (2005) [1] points out issues which are brought drawbacks to rural financing, listed as the absence of diverse rivalryship and effective competing schema, serious outpour of rural capital, irregular and protection-deficient rural financing operation, unsound macroscopically control system and poor information delivery. Grounding on aspects which refer to rural financing issues of constructing the competitive financial order, establishing authentically cooperative finance and informal finance, LIU Hui-sui (2005) [2] presents the method to build rural financial system. Based on the existing rural financial system’s inability in supporting the “country, agriculture and peasantry” as the financial service provider, ZHANG Qing-liang (2005) [3] indicated that the new type of rural financial form should mainly make up of civilian capital (I.E. rural private finance).

When it comes to the policy financial system, BAI Qin-xian and XUE Yue-hua (2001) [4] described government financial supporting as the main capital resource of SMEs policy banks which were based
on tiny profit, in the southeast of China the government should provide credit guarantee to aid SMEs acquiring financial loans. The research bureau of People’s Bank of China also recommended building a SMEs-oriented policy bank from top to bottom as shown in its “China SMEs financial system investigation reports”[7].

From relationship perspective between organizational structure of Banks and SMEs, LIN Yi-fu, ZHANG Qi and LIU Ming-xing (2004)[5] brought forward that the characteristics and changes of the finance development and bank structure submit to those of factor endowment configuration and the whole industry, which meant that the financial development level went up accordingly to the advance of economy and knock down the centralization degree of bank as the developing level rising.

Small banks have fewer departments and administrative levels and a relatively dispersive credit decision right, while the big banks usually possess of multilayer management levels, and the decision right is comparatively centralized. Based on the comparison of these two kinds of banks, WU Jie (2006)[6] indicated that the loan lending for SMEs were mostly depending on flexible soft information, thus small banks were suitable for SMEs relationship lending, some branches of state-owned commercial banks were supposed to selectively provide relationship lending by decentralization and flat/compressed reform, and authorize more power to bank clerks who engaged in SMEs relationship lending. The investigation conducted by research bureau of People’s Bank of China (2005)[7] on 1105 SMEs of five representative regions and six cities of east, central and west China 2003 also showed that granting client managers with relevant decision right and adopting customer manager system including motivation and constraint mechanism might carry significant and innovative implication in improving SME financing.

2.1.2 Financial regulations
In anticipation to constructing regular policy system for SMEs, Research bureau of People’s Bank of China not only strived to build multi-layer SME-supporting policy and law system, bank financing system, capital market and professional investment companies for SME, but also put forward capital supply for assurance organization and multi-layer risk compensation mechanism[7]. Through the setup of credit and trust system, the central banks were aiming at enhancing macroscopically control, innovating motivation and constraint mechanism to establish complete set of measures to facilitate the development of SMEs.

2.1.3 The agency service
After the game analysis on the role of non-financial intermediaries during SMEs financing, XU Xu-song, XU Qin, LU Jun (2005)[8] found that the service intermediaries those who shared a favorable and long-term cooperative relationship with lenders could possibly raise the odds of successful financing for SMEs.

2.1.4 Game analysis on bank-enterprise credit
Under the dissymmetry of information, international SMEs financing theory mainly covers: credit quotas, financing cycle, relationship lending, and empirical studies. When facing the circumstances of excess requirement and dissymmetry of information, the commercial banks usually adopt the option of credit quotas and partly satisfy the lending demand in order to avoid adverse selection and moral risk, instead of the alternative to add funding furnish by raising interest rate.

The scrutiny into financing arrangements during the different phases of enterprises’ life cycle, and the bank-enterprise relationship indicate that the bank only pay attention to those SMEs which have a good credit record and reached a certain level of development and profit margin. Thus it’s very important for SMEs to maintain solid tie with bank which can be a long run to go, SMEs may start with the mortgage loans with a higher than markere’s interest rate, then gradually gain the trust from bank by opening up the enterprise operation and credit during the cooperation, after the test of time the banks are eventually willing to provide more lending with lower interest rate.

2.2 The development of SMEs
The spot checked on private SMEs of Guangdong province conducted by the development research project team which was join-handed by Statistics Bureau of Guangdong, Guangdong Bureau of SME and School of Business Administration in South China University of Technology on private economic growth SME of Guangdong, showed that there existed many drawbacks regarding SME itself, including
the strategic thinking, the appointment of top management, financial management, innovation and investment ability. Issues also lay on the side of government, such as the deficiency of relative regulations and SME financing mechanisms, the reform to fair market and work efficiency. So one of the most vital prerequisite for SMEs advancement was the joint effort and mutual improvement of enterprises and government. “《The development and forecast of SME in China》 ”yearly compiled by National Development and Reform Commission and SMEs research center of Chinese Academy of Social Sciences relates to all aspects of SMEs development, yet was mostly cover the financing issues.

3. Issues concerning governmental capital operation during the development of SMEs

《Capital》 defines “capital” as “the value which bring surplus value” which has three hierarchies: 1) being represented by value configuration; 2) bearing potential gain; 3) acting as a factor of production. The discussions on capital generally focus on enterprises, while the emphasis is on fund side when governmental capital concerned. There are a wide range of operative recourses at the government’s dispose which consist the legislation power of policy and regulation, controlling right on financial income, and the operation and supervision power over state-owned assets, etc. The financial income can not only be managed as a factor of production just as the way of enterprise application and bring future value, but also generate indirect value. For example, the success of government risk investment can be followed with aboard of civilian venture capital. From the standpoint of our country, the various operation modes of governmental capital exert an outstanding influence on microcosmic economic activities of SMEs. As shown in “The development research on private economic growth SMEs of Guangdong”, the SMEs anticipant services from government including market exploration and entrance assistance, financing assurance aids, technologic support, information consulting, and educational training [9] . Relating the advancement of SMEs, the governmental capital operation involves the following issues:

1) the government excessively use administrative power to intervene lending activities of merchant banks especially state-owned commercial bank. In response to the “《SME Promotion Law》” released by central government, People's Bank of China issues “Guideline on further improvement of SMEs financial service”, the relative merchant banks follow the footsteps of PBC: “Bank of China instructions for SMEs loan lending” by Bank of China, “Agriculture Bank of China administrative rules for SMEs credit management(draft note)” by Agriculture Bank of China, “Compendium of SMEs financial business development” by Pudong Development Bank. However these struggles and action can not completely fulfill SMEs’ thirst for capital. From the corresponding regulations issued by each bank according to the central policy, we can tell that many banks only pay a little bit more attention but actually don’t lower their doorsill for SME funding assistance due to the high moral risk of SMEs. For the sake of risk reduction, bank consistently sticks to the rigorous selection rules.

2) untapped issues during government financial expenditure. Repetitious subject selection may occur in soft science and philosophy and social science development fund, and irrational problems still exist in capital management of Department of Finance on account of insufficient understanding of practical situation.

3) over-decentralized governmental operation of SMEs development fund. Some special fund such as supporting central finance budget, mostly goes to facilitate specialized advancement of SME such as collaboration with big enterprises, technologic innovation, new product development and new technology promotion, Therefore, the decentralization of fund distributing can be triggered by relatively small total amount of yearly fund.

4) the establishment of relevant regulations and laws lagging behind the SMEs developing process, and lacking the compatibility as well. The release of “Property Rights Law”, “Guaranty Law” and “SMEs Promotion Law”during hard time of SMEs development, to a certain degree, have made contribution to the risk reduction of commercial banks, however, the influence on SMEs financing is insufficient: the “Guaranty Law” is mainly aimed at real estate property, and a confined range of personal property such as production equipment, intellectual property, note, debt securities and equity
which unfortunately are not possessed by SMEs in urgent funding need. To add it up, accounts receivable and inventory of SMEs don’t receive legally protections, so they are difficult to be part of the Guaranty.

4. Suggestions for effective operation of governmental capital in promoting SMEs development

1) Making good use of policy-based lending and accurately guide the developing way of SMEs. For instance, the “Property Rights Law” and “Guaranty Law” are supposed to represent and guarantee the power of bank over diversiform personal property of SME as loan provider. As the financing administrative department, PBC can release relative regulations according to the policies of central government. On the side of merchant banks, they should obtain a wider degree of flexibility so to change the dilemma between regulations and their practical performance.

2) The centralized and focus of governmental capital: In order to fundamentally bring more concern of merchant banks to the SME lending, the SMEs development fund should be carried out in focus and collective pattern of allocation. For example, according to national industry policy, regional progress circumstances and the scale of development fund, focus industry groups should be picked out and given special support. As far as the national and provincial funds concerned which cover all range of different kinds and levels, the rational action ought to, on the one hand, avoid repetition and similarity, and on the other hand provide centralized funding for the application researches based on specific requirement, thus make a combination of SMEs developing fund with other funds to shape a more powerful supporting system.

3) Lowering the doorsill of enroll capital and revenues claim: The governmental capital should stimulate the enthusiasm of the private investment, and the decrease of enroll capital and revenues claim may play a positive role in motivating private investors in growing number to establish investment company, explore and help small but promising high-tech enterprises. And then, the governmental capital can not only share and lessen commercial banks’ burden of SMEs lending, but also serve as the angel type of investment fund.

4) Reforming the Policy-based bank for SME based on the pattern of the top four asset management corporations (Cinda, Great Wall, Huarong and Orient): The policy banks are aiming at promoting development of SME according to the central government policy. Varying from the policy banks’ tiny profit, the civilian investment and joint-stock banks set target at maximizing enterprise benefit. However the exception makes its way: for instance the top four asset management corporations (Cinda, Great Wall, Huarong and Orient) draw back part of the debts after years of operation, and leave behind the debts which may not be obtained for good. The capital management corporations don’t lend loans, therefore chances are high that they may possibly end nowhere after the capital-withdrawal mission, the transformation to the form of SME policy bank may be an appropriate way out and keep their heads above water.

5. Conclusion

Referring to the analysis above, the government holds in its hand the controllable and operational capitals that maintain an important role during the development of small and medium size of enterprises. As far as domestic environment/situation of China concerned, it carries significant implication that the government has the consciousness of issues involved in capital operation and willingness to systemically and rationally use it.

References


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