

A Comparative Analysis of Financing Channels for Small and Medium-sized Enterprises (SMEs)

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Abstract. Small and medium-sized enterprises (SMEs), as an essential component of the Chinese economy, represent 99% of total enterprises, contributing 60% of China's GDP, 50% of tax revenue, and 80% of urban employment. However, SMEs often face difficulties in obtaining affordable financing, with capital shortage being their most significant challenge. This study aims to compare different financing channels for SMEs to optimize financing decisions, reduce financing risks, enhance financing capabilities, promote the development of financing markets, and improve competitiveness. This research is of vital importance for the sustainable development of SMEs and economic growth. This paper will analyze and compare the advantages and disadvantages of financing channels, focusing on bank loans and trust loans, and present an overview of the overall financing scale and channels in the pre-pandemic era. Despite economic uncertainties, Chinese SMEs have demonstrated resilience and adaptability. They are actively seeking new market opportunities, optimizing financing strategies, reducing operating costs, and responding proactively to government policies. These efforts are expected to help them navigate through economic challenges and achieve sustainable development.

Keywords: Small and Medium-sized Enterprises (SMEs); financing channels; private sector.

1. Introduction

In today's highly competitive business environment, small and medium-sized enterprises (SMEs) play an indispensable role in economic growth and innovation but face significant challenges. Against the backdrop of China's economic transformation, issues such as difficulty in obtaining financing and high financing costs have become more prominent [1]. These enterprises not only provide a substantial number of job opportunities but also drive the development of new products and services, injecting vitality into the economic system [2]. However, due to the decline in credit, SMEs face substantial difficulties in obtaining loans and financing, despite repeated attention and no concrete solutions [3]. Zhang, the chief expert of the China Service Trade Association, stated that SMEs globally account for over 90% of all enterprises, 70% of the total employed population, 50% of GDP, demonstrating the robust vitality of SMEs, which are a significant force driving economic growth and social development in China and worldwide. However, these enterprises have been severely affected by the scarcity of resources, labor, market opportunities, and technological support during the three-year pandemic and other global crises. A significant amount of funds circulates among state-owned enterprises, government departments, and the financial system, with reports indicating the successful achievement of monetary policy targets [4].

By the end of 2020, the broad money supply (M2) increased by 10.1% year-on-year, and the scale of social financing stock increased by 13.3% year-on-year. The overall financing cost for enterprises has significantly decreased, with the weighted average interest rate for corporate loans in December 2020 at 4.61%, a 0.51 percentage point decrease compared to the previous year, setting a new record low. The credit structure continues to improve, with the balance of inclusive small and micro loans and medium and long-term loans for manufacturing increasing by 30.3% and 35.2%, respectively, by the end of 2020. The renminbi exchange rate has become more flexible, maintaining basic stability at a reasonable equilibrium level based on market supply and demand. China is currently undergoing a crucial period of economic transformation and structural adjustment [5]. Finding solutions to the issue of SME financing difficulties is essential. At the governmental level, China should learn from

the successful experiences of developed countries and improve and implement measures to support SME financing, creating a credit guarantee system suitable for SMEs.

This study will delve into the analysis of these financing channels [6], including traditional financing and non-traditional financing such as bank loans and trust loans. Subsequently, this paper will comprehensively compare these channels and, through case studies and data analysis, provide practical recommendations to assist SMEs in making more informed financing choices. By conducting an in-depth study of SME financing channels, this paper aims to provide critical insights into financing decisions for business owners, investors, and policymakers, promoting sustainable economic development and innovation.

2. Analysis of Financing Channels

Bank loans, among traditional financing channels, offer significant advantages for SME financing [7]. These advantages include a stable and reliable source of funding, low-cost financing, availability of long-term financing, a variety of loan types, establishment of credit records, professional advice and support, legal compliance, and widespread accessibility. These factors make bank loans the preferred method to meet short-term and long-term financing needs for businesses.

Common disadvantages include strict approval processes, long approval times, and collateral requirements [8]. Banks often require collateral or assets, which may not be feasible or convenient for some businesses. Credit risk is also a concern, as failure to repay on time may result in credit risks, including late fees and credit rating downgrades. In summary, bank loans remain a significant financing channel for SMEs, especially suitable for stable businesses and long-term financing projects. However, SMEs need to carefully weigh the pros and cons of bank loans, considering their specific needs, credit status, and availability, to determine whether to choose bank loans as a financing option or explore other financing channels.

Trust loans, as a financing method, offer several attractive advantages [9]. Firstly, they provide diversified sources of financing, reducing reliance on a single financing institution and lowering financing risks. Secondly, trust loans typically come with flexible financing conditions that can be customized to meet specific business needs, including financing amounts and repayment arrangements. Thirdly, they often have lower financing costs compared to some traditional financing methods, reducing the overall cost of financing for businesses. Additionally, trust loans are suitable for various types of projects and industries without the need for traditional physical collateral, providing more financing options. Lastly, trust companies can often provide professional asset management and supervision, aiding in effective project oversight and risk management. These advantages make trust loans an attractive choice for many businesses seeking financing.

Trust loans, as a financing method, come with several advantages but are also accompanied by some disadvantages. These include higher interest rates and management fees, inapplicability to all businesses and projects, stricter risk management requirements, varying legal and regulatory environments, project supervision requirements, inadequacy for meeting large-scale financing needs, and market risks. When considering trust loans as a financing option, companies should carefully weigh these disadvantages and collaborate closely with trust companies to ensure they obtain the financing solution that best suits their needs [10].

3. Comparison of Traditional and Emerging Financing Channels

The key comparison points are listed as follows:

Flexibility: Emerging financing channels are typically more flexible, catering to different types of businesses and financing needs. Traditional financing is often more standardized.

Risk: Emerging financing channels may come with higher risks, especially for startups, but they also offer the potential for higher returns.

Speed: Emerging financing channels are generally faster, with quicker approval and financing processes, suitable for urgent financing needs.

Cost: Traditional financing usually offers lower interest rates, while emerging financing may have higher costs, especially for high-risk projects.

Ownership and Control: Traditional financing typically does not involve the transfer of company equity, whereas emerging financing channels may involve the transfer of company equity, affecting control. When choosing a financing method, companies need to balance their specific needs, risk tolerance, and availability. Sometimes, a combination of traditional and emerging financing channels may be considered to achieve the optimal financing structure.

4. Factors Influencing SMEs' Choice of Financing Channels

In 2018, China's financing entered a low point due to various reasons. Firstly, the Chinese government continued to implement a financial deleveraging policy, leading banks to exercise cautious scrutiny over credit activities, thereby restricting financing channels, especially in shadow banking and illegal fundraising. Secondly, the escalating trade tensions between China and the United States created uncertainty, reducing the demand for financing for some enterprises. Thirdly, China's economic growth slowed down, particularly in the latter half of the year, resulting in reduced financing needs for certain companies. Additionally, factors such as tightened regulations, capital market volatility, and increased credit risks also influenced the overall activity in the financing market (seen from Fig. 1 and Fig. 2)

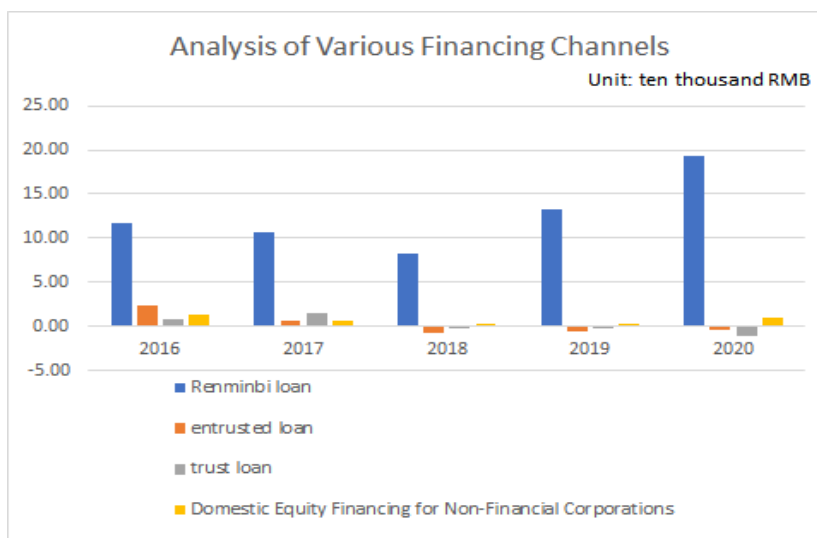


Fig. 1 Analysis of various financing channels.

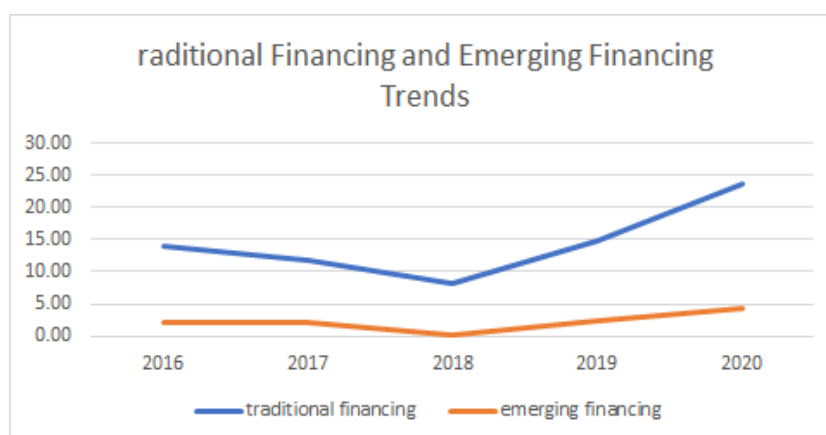


Fig. 2 Analysis of rational financing and emerging financing.

Social Financing Scale Increment Statistics Table - Data sourced from the People's Bank of China, National Development and Reform Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission, China Central Depository & Clearing Co., Ltd., and the National Association of Financial Market Institutional Investors (NAFMII), among others.

Some of successful cases are given as follows:

Meituan Dianping: Meituan Dianping is a leading Chinese internet company, and its financing strategy includes initial public offerings (IPOs), venture capital, debt financing, and strategic collaborations. **Success Factors:** Meituan Dianping has employed various financing methods to support its expansion in multiple areas, including food delivery, hotel bookings, and tourism, making it a shining star in the Chinese internet industry.

Xiaomi Corporation: Xiaomi is a well-known Chinese smartphone and consumer electronics company, with a financing strategy encompassing IPOs, debt financing, and private equity financing. **Success Factors:** Xiaomi has raised funds through diverse financing methods, supporting its product development and global expansion, making it a significant player in the global smartphone market.

JD.com: JD.com is a Chinese e-commerce giant, with a financing strategy including IPOs, debt financing, equity financing, and strategic collaborations. **Success Factors:** JD.com has established a global e-commerce and logistics network through diverse financing strategies, becoming a significant player in both the Chinese and global markets.

These cases illustrate how some leading Chinese companies have successfully employed diversified financing strategies, including various types of financing methods, from IPOs to debt financing and strategic collaborations, to support their growth and expansion. These financing strategies provide different financing sources and options, helping them thrive in highly competitive markets.

5. Suggestions and Implications

According to the analysis, following suggestions are proposed. Firstly, businesses should clearly identify their funding requirements, understanding how much capital is needed and for what purposes, such as business expansion, equipment purchases, or new product development. Clear funding requirements help determine the most suitable financing method. Secondly, SMEs can adopt diversified financing strategies, including debt financing, equity financing, venture capital, and government assistance, among others. Diversified financing strategies reduce risks and provide multiple funding sources. Next, businesses should evaluate different financing channels, understanding the advantages and disadvantages of each, including costs, risks, availability, and financing conditions. This helps select the financing method that best meets the business's needs. Additionally, maintaining sound financial records and a good credit history is crucial for traditional financing. Businesses should ensure accurate and complete financial statements and maintain a positive credit history. Furthermore, creating a detailed business plan is a critical step. Businesses should articulate their development strategies, market opportunities, and competitive advantages clearly. A robust business plan can attract potential investors and lenders. Finally, choosing the right investors or lenders is crucial. Businesses should look for investors aligned with their values and goals, and carefully understand the financing terms and interest rates of different lenders. Through careful selection, SMEs can better meet their financing needs and achieve sustainable growth.

The limitations of the study are listed as follows:

Data Availability: The study may be limited by data availability, especially for private enterprises and emerging financing channels. Future research could explore ways to obtain more comprehensive data, possibly by establishing closer collaborations with financial institutions and businesses.

Time Constraints: Research may sometimes be constrained by time, preventing long-term tracking of the effects of financing channels. Future research could consider longer-term tracking and research designs to better understand the lasting effects of financing channels.

Industry Differences: SMEs in different industries may face distinct financing challenges and opportunities. The study may not have covered a wide sample of various industries. Future research could delve into financing differences among different industries.

Regional Differences: Financing environments vary significantly between regions and countries. The study may have focused on specific regions, which might not apply to SMEs in other areas. Future research could conduct cross-national comparisons to identify financing patterns in different regions.

For further studies, following concepts should be concerned:

Research on Emerging Financing Channels: Future research could delve deeper into emerging financing channels, such as blockchain financing and digital currency financing. These channels are continually evolving, and their impact on SMEs is not fully understood.

Risk Analysis: Future research could conduct more in-depth analyses of the risks and risk management strategies associated with different financing channels. This would help businesses better prepare for and plan their financing processes.

Policy Research: Government policies significantly impact the financing environment for SMEs. Future research could study how various government policies influence financing channel choices and provide policy recommendations.

Innovative Financing Tools: Future research could explore new financing tools and models to help SMEs secure funding better. This might include innovations in financial technology, smart contracts, and blockchain applications, among others.

6. Conclusion

To sum up, the researching financing channels for SMEs is an important field. As a matter of fact, future research can expand the understanding of this area by addressing limitations and exploring new directions. In this case, this will support SMEs in making financing decisions and promoting their development. Overall, these results offer a guideline for further exploration of financing channels for SMEs.

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