

Empirical research on the SMEs' credit-guarantee in China*

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Abstract: After the authors' thorough study of the experiments of other countries and regions, it is posed that credit-guarantee is the key for solving the problem of the difficulties of SMEs' financing. Based on two surveys and interviews with 57 SMEs and some commercial banks' staff, this study on the practice and implement action of SMEs' credit-guarantee revealed some problems existing in the practical process. A series of policy suggestions are given for improving the SMEs' credit-guarantee in China.

Key words: SMEs, Credit-guarantee, Reform of financing system

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INTRODUCTION

The proportion of loans to SMEs (Small and Medium-sized Enterprises) in China is only 8% of the total banking loans. This does not accord with the reality that SMEs account for 99% of the total number of China's registered enterprises, contribute to 1/3 of the GDP, 2/3 of the industrial increment value, to 38% of export, and provide 75% of employment positions (Guo, 2000). In reality, the SMEs' operating style (without credit rating, mortgage and guarantee) usually makes banks very cautious of their loan applications. The difficulty of financing from banks has become a main constraint in the development of SMEs in China (Zheng, 1999).

Based on April-June 2000 investigations of SMEs and November-December 2000 investigations of credit management divisions of commercial banks, this study focused on exploring practices, problems and solutions to SMEs' credit guarantee in China. Some 57 SMEs (21 located in Hangzhou, 15 located in Shenzhen, 8 located in Ningbo, 2 located in Shaoxing, 1 located in Yuhang, 9 located in Cixi, and 1 located in Zhuhai) responded to our Questionnaire 1 containing 23 questions.

Managers of commercial banks in Hangzhou City and Ningbo City answered Questionnaire 2 containing 15 questions. This survey involved 12 credit management divisions of these banks (5 in Industrial and Commercial Bank of China, 1 in China Construction Bank, 2 in China Bank, 2 in Agricultural Bank of China and 2 in Pudong Development Bank Co., Ltd).

CREDIT-GUARANTTEE: A WORLDWIDE SOLUTION TO SMES' FINANCING DIFFICULTY

The SMEs' difficulty in financing exists not only in China but is also worldwide. Most western countries have found solutions to this problem. For instance, in the U.S., 37% of the SMEs can get loans from banks, with loans to SMEs by commercial banks being 20.3% of their total value of loans in 1996 (Dong, 1999). In Taiwan Province, loans from commercial banks is the main source of SMEs' financing. Among the 9 methods of financing used by SMEs, long-term loan is the fourth and short-term loan is the first (Lin et al., 2000).

What is the key to resolving the difficulty

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of SMEs' financing and why are western commercial banks willing to extend loans to SMEs? What is the main reason Chinese banks hesitate to, and very seldom, if ever, extend loans to SMEs? The answer is that these countries' commercial banks have all established a perfect SMEs' credit guarantee system which is still absent in China. Table 1

shows that 83.33% of commercial banks in China require credit-guarantee when SMEs apply for loans; and that 66.67% of SMEs could not find appropriate credit-guarantor. This finding explains the difficulty of SMEs in getting financing from commercial banks in China.

Table 1 Difficulties of SMEs' credit-guarantee

Questions	Choices	Number of responses	% of total
(1) Is it prerequisite for SMEs to provide credit-guarantee when they apply for loans?	(a) Yes	10	83.33
	(b) No	2	16.67
(2) Can SMEs find appropriate credit-guarantor when they apply for loans?	(a) Yes	15	26.32
	(b) No	38	66.67
	(c) Not always	4	7.01

Source: Survey data, Questionnaire 1 and Questionnaire 2.

Note: Question (1) was answered by commercial banks; Question (2) by SMEs.

Credit-guarantee refers to an agreement between the creditor who is usually a bank and/or financial institution and a legally registered special agency. If the guaranteed SME will not or cannot repay the loan extended to it, the guarantor agency will repay it. The practices of western countries have fully demonstrated the importance of the credit-guarantee in the SMEs' financing process. Today more than 20 countries and administrative areas have established the SMEs' credit-guarantee system successfully. Italy is called "the nation of SMEs"; with its financing guarantee mainly accomplished through its credit-guarantee funds and its cooperation guarantee system. Since 1980 24% of the small handicraft businesses and 28% of the small industrial businesses have become its members. For instance, the 23 cooperation guarantee groups in the Yimmlia area in 1996 had about 65000 members and the total value of guaranteed credit reached 0.26 billion US dollars (Tang, 1999). In Canada the main body of the SMEs' credit-guarantee is the policy credit-guarantee system. Until March 1999, the total value of SME guaranteed credit was 8 billion Canadian dollars, which included the 29 100 loans (valued at 2 billion Canadian dollars) in 1997 and 1998 (Di, 1999).

EXPLORATORY PRACTICE OF SMES' CREDIT-GUARANTEE IN CHINA: A BRIEF REVIEW

The practice model and organizing form

The current experimental model of broadly speaking SMEs' credit-guarantee in China can be summarized as one body with two wings. The body is the SMEs' credit-guarantee consisting of city credit-guarantee, provincial re-guarantee and national re-guarantee, and the two wings are commercial guarantee and cooperation guarantee (Chen, 2000). According to our investigation in Zhejiang Province, the organizing forms of SMEs' credit-guarantee can be classified into three categories. The first form adopts completely marketing operation and is usually in corporation form controlled by director boards and CEO. The Economic Credit-guarantee Co., Ltd at Jinhua, Shaoxing and Dinghai of Zhejiang Province are examples. The second is non-profit organization form such as the SMEs' Credit-guarantee Centers at Jiangshan and Jiaying of Zhejiang Province. The third is a medium service organization form such as the SMEs' Credit Promotion Committee at Yinxian of Zhejiang Province (Fig. 1).

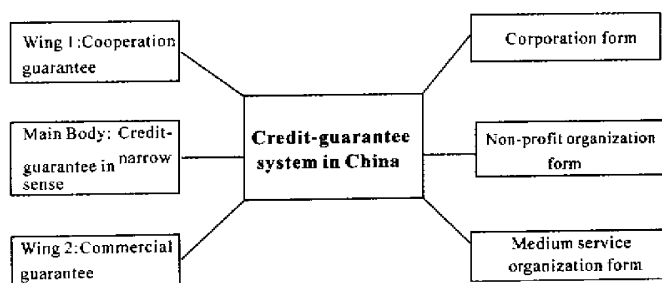


Fig. 1 The practice model and organizing form of SMEs' credit-guarantee in China

The development and effect of SMEs' credit-guarantee in China

The SMEs' credit-guarantee activities started in China in 1992 with the experimental emergence of businesses cooperation guarantee foundations in Chongqing and Shanghai. Since the announcing of «Guidelines for establishing experimental units of SMEs' credit-guarantee system» on June 14, 1999, the SMEs' credit-guarantee activities have stepped into a new stage and the experimental activities have spread rapidly throughout China. Twenty-eight provinces and autonomous regions have set up SMEs' credit-guarantee experimental units by late October, 1999. The guaranteed funds have reached to about 4.5 billion RMB according to preliminary statistics (Chen, 2000).

Generally speaking, the development and financing situation of SMEs have been improved in some degree since the developing of SMEs' credit-guarantee experiments. For instance, in Zhenjiang of Jiangsu Province the effects of SMEs' credit-guarantee system experiment became obvious after one year's operation. Guarantee funds amounting to 18 millions RMB have been collected and by April 2000, 39.1 million RMB guarantee had been provided for 33 SMEs (Ma, 2000).

THE MAIN PROBLEMS WITHIN SMES' CREDIT-GUARANTEE IN CHINA

The perceptual bias to the nature and significance of credit-guarantee in China

Although much experience had been

gained, there still exist some perceptual biases about the nature and significance of SMEs' credit-guarantee in China. It must be clarified that in China the SMEs' credit-guarantee system is the main component of the SMEs serving system in China; and will help to promote the SMEs' understanding of the credit concept and also promote the construction of China's credit system. The short-term aim of establishing the SMEs' credit-guarantee system is to solve the problem of SMEs' difficulty in getting bank loans, and the long-term aim is to implement the SMEs functions of providing increasing employment, increasing government revenue. Only through the overall recognition and understanding of the nature and significance of the SMEs' credit-guarantee can a perfect SMEs' credit-guarantee system be established practically.

The indifferent attitude of banks to SMEs' credit-guarantee

In our survey we found that the commercial banks' attitude towards SMEs' financing were "indifferent". Only 1 among 12 credit management divisions established a specific department dealing with SMEs' financing although People's Bank of China in 1998 required that all branches of commercial banks must establish a specific division dealing with SMEs' financing. One third of divisions considered that SMEs' financing was insignificant and 91.68% of the divisions cooperated infrequently with SMEs in the aspect of their financing (Table 2).

It was obvious that the commercial banks did not participate actively in the credit guarantee system; they were just bystanders.

Table 2 Banks' attitude towards SMEs' financing

Questions	Choices	Number of responses	% of total
(1) Did the bank establish a specific division dealing with SMEs' financing?	(a) Yes	1	8.33
	(b) No	11	91.67
(2) Did the bank attach importance to the SMEs' financing?	(a) Very important	1	8.33
	(b) Hard to say	7	58.33
	(c) Not important	4	33.33
(3) Did the bank cooperated with SMEs in the aspect of their financing?	(a) Often	1	8.33
	(b) A little	6	50.00
	(c) Scarcely	5	41.68

Source: Survey data, Questionnaire 2.

Table 1 and Table 2 show that 88.3% of banks require credit guarantee when SMEs apply for bank loans and only 8.33% of banks cooperated with SMEs often, 91.67% of banks had little cooperation with SMEs. In the interviews with 8 managers of credit management divisions of those banks, we got the impression that the banks did not really care whether the SMEs can find suitable credit guarantee or not, let alone do some guarantee innovation and actively provide services for SMEs.

On the other hand, some new types of banks pay much attention to SMEs' credit-guarantee. For instance, the Hangzhou branch of Guangdong Developing Bank participated actively in SMEs' credit-guarantee since it noticed the reality that the SMEs account for 99.8% of the total number of businesses in Zhejiang; and that SMEs contribute to 81.4% of the gross industrial value of Zhejiang Province. Since 2000, this bank has provided a variety of innovative credit-guarantees to SMEs and has already extended 3.105 billion RMB loans to 1435 SMEs, which amount comprised 45% of its total loans (Xu et al., 2000).

The problem of regulation of the operation of guarantee funds

In the interview, 7 managers comprising 58.33% of the total number interviewed thought that the operation of SMEs' credit-guarantee funds was not quite up to standard and expressed their doubts about the effec-

tiveness of credit guarantee. While on the other hand the SMEs feel that the procedures of applying for credit guarantee are too complicated and the fees charged are also too high. Many SMEs complain they had to pay membership dues when they join the credit-guarantee foundation; and that they had to pay guarantee fees again in addition to the interests paying to banks when they try to get a bank loan, so they would rather come to the bank directly. It is obvious that some negative aspects of credit guarantee have influenced the behavior of SMEs toward, and adversely affect, the credit guarantee system and credit market. This is not compatible to the original intention of establishing SMEs' credit-guarantee funds.

The problem of funds raising

About 50% of the SMEs' credit-guarantee funds in China come from different levels of local government (Ma, 2000). According to the current government budget of China it is not realistic to put a lot of money in establishing SMEs' credit-guarantee. This is probably the main reason inactivity of many credit-guarantee agencies after their establishment. Thus, it is particularly important to raise funds in various ways in order to maintain the operation of the credit guarantee foundation. In addition to government investment, other sources of guarantee funds should include land or asset allocation, money raised from the society, membership dues, etc.

SUGGESTED MEASURES TO PERFECT SMEs' CREDIT-GUARANTEE SYSTEM IN CHINA

Establish affinity with SMEs

Our investigation found that SMEs had some defaults preventing them from getting

loans demanded from banks smoothly. Table 3 showed clearly that the poor management, difficulty to find guarantor, and low lever of credit were the most three important factors influencing SMEs' financing from banks. Consequently, either credit guarantee organizations or commercial banks should establish affinity and enhance cooperation with SMEs on their own initiative.

Table 3 The SMEs' defaults influencing them financing from banks

	Defaults	Number of response	% of total
1	Poor management	36	63.2
2	Difficulty to find guarantor	33	57.9
3	Low lever of credit	31	54.4
4	Obsolete facilities	9	15.8
5	Poor product quality	7	12.3
6	Disharmonic social relations	7	12.3
7	Others	8	14.0

Source: Survey data, Questionnaire 1. Note: Some SMEs indicated more than one factors, therefore, the total number of responses exceed the number of SMEs in the sample (57).

Regulate the operation of guarantee funds to ensure long-term development

The management of SMEs' credit-guarantee funds should be strictly regulated during their experimental use or this will lead to strongly negative stakeholder responses. Every guarantee foundation must choose suitable banks as its cooperating partner and sign strict contracts with them concerning the responsibility taken, proportion of liability of each party, determination of credit rating, etc. Our survey revealed that there are many trade groups, member SMEs, social groups, financial institutions and investment companies who intend to provide money to participate in the activity of SMEs' credit-guarantee. These good intentions should be welcomed instead of discouraged. In the U. S., the credit guarantee funds were initially set up and funded by government while the government exited later as it is believed that the market can guide those activities functionally. Although it is necessary for the government to guide and promote the SMEs' credit-guarantee activities in China now, there are some specialists who pointed out that in the future the government should exit from the guarantee funds gradually (Dong, 1999).

Control risks and share responsibilities

The nature and current situation of SMEs determined that developing credit guarantee activities must involve risks. How to control risks and share responsibilities is the key to develop healthy credit guarantee activities. The pre-control of risks can be achieved through credit rating, project review and other measures. The real-time control of risks can be achieved through the daily operation of controlling repay-rate and compulsory re-guarantee according to the operating conditions of the funds. The afterwards control can be achieved through timely tracing. The sharing of responsibilities can be achieved through making clear the proportion of responsibility between guarantor and creditor, guarantor and re-guarantor, guarantor and SMEs.

Accelerate the reform on financial system

The banks are always in a dominant position in the relationship among banks, SMEs and guarantee agencies. No matter how urgently the SMEs require funds and how enthusiastic the credit guarantee agencies are, the operation of guarantee funds cannot prosper unless the banks show much interest in it.

Our surveys showed that state-owned banks still react indifferently to the SMEs' application for loans even though they had credit guarantee. In the interview we found that, in contrast, some new type banks such as Minsheng Banking Co., Merchant's Bank, Huaxia Bank and Guangdong Developing Bank Co. believe that the SMEs, especially private SMEs, have clearer property rights, more autonomy, better reputations and operate actively. These banks believe loans to these SMEs will involve only low risks if there exists a positive and functional credit guarantee system. So the state-owned banks should actually realize the position and functions of SMEs in national economy and realize the benefits of extending loans to SMEs and provide better financial services to them. China should accelerate reconstruction of commercial banks in cities and rural areas, and develop different types of commercial banks oriented to SMEs. Based on successful experiments of other countries China should also establish some SMEs policy banks when it is appropriate. Only when the financial institutions really realize the importance of extending loans to SMEs, can the SMEs' credit-guarantee system in China be developed into a new stage.

CONCLUSIONS

From the above analysis based on the survey data, it is reasonable that bank authorities think that extending loans to SMEs, compared with large-size businesses, involves some risk of default in general. We think that the credit-guarantee system is the key to solving the SMEs' financing difficulty. Although SMEs' credit-guarantee activities have been

explored widely in China and some models and organizing forms appeared, some problems in the SMEs' credit-guarantee system arose in several regions. In order to improve SMEs' credit-guarantee activities in China, some countermeasures such as constructing a suitable organization structure, regulating the operation of guarantee funds, controlling risks and sharing responsibilities, should be adopted. We maintained that whether a perfect SMEs' credit-guarantee system can be established, in some degree, depends on the reform of the financing system in China.

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