

## SME Financing of the Post-crisis Era in China Based on Blue Ocean Strategy

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**Abstract:** This paper deeply analyzed the financing characteristics of small and medium-sized enterprises (SMEs) in China and the new challenges they faced. Based on “Blue Ocean Strategy”, some countermeasures were put forward to improve the financing capability of SMEs in China. In this way, the cooperation among the government, financial institutions, and SMEs can be promoted. Meanwhile, the problem of the financing difficulty in SMEs can be solved to facilitate them to develop healthily and sustainably.

**Keywords:** Post-crisis era, SME (small and medium-sized enterprise), Financing, Blue Ocean Strategy

### 1 Introduction

Recently, small and medium-sized enterprises (SMEs) in China have developed rapidly. However, compared with large enterprises, SMEs show obvious competitive weakness of the business operation and the financing difficulty is still an important factor restricting their development. Especially in the post-crisis era, the financing cost of SMEs increases sharply, which prevents them from sustainable development and growth. Hence, the traditional thinking mode should be broken and “Blue Ocean Strategy” should be encouraged to help SMEs to break their development bottleneck. “Blue Ocean Strategy” comes from the book *Blue Ocean Strategy* written by two professors of W. Chan Kim and Renee Mauborgne in 2005. Under the framework of “Blue Ocean Strategy”, enterprises need to create in the practice through the value innovation. That is, they are expected to widen the current market boundary and expand the requirement space to seek more broad new market. By doing in this way, not by conducting “Red Sea” competition with opponents, they can keep the enterprise profit increasing.

### 2 The Financing Characteristics of SMEs in China in the Post-crisis Era

The number of SMEs accounts for over 99% in the total enterprises in China and SMEs contribute more than 50% to the tax revenue. Meanwhile, their contribution rate to GDP (Gross Domestic Product) is over 60%. Besides, they provide 82% of the new product development and 80% of the urban posts<sup>1</sup>. SMEs contribute more to the sustained and stable growth of the national economy. But at the same time, their financing difficulty also becomes increasingly notable as follows:

(1) Compared with large and medium enterprises, small and micro businesses (simply called as SMB in the rest sections) show high loan financing demand. In 2011, the loan balance of SMB was 10800 billion yuan with the year-on-year growth of 25.8%. The growth speed was higher than that of the large enterprise loan 14.2% and that of the medium enterprise loan 12.5%<sup>2</sup>. In 2012, the loan balance of SMB was 11580 billion yuan with the year-on-year growth of 16.6%. The growth speed was higher than that of the large enterprise loan 8% and that of the medium enterprise loan 1% in the same term<sup>3</sup>.

(2) SMEs show the single financing channel. Their main capital source is the internal financing, including the following ways: their own capital, capital from relatives and friends, and the profit retention etc. The main external financing channel is financing institutions like banks etc. That is, they

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<sup>1</sup> The chairman Lai Xiaomin in China Huarong Asset Management Co., LTD.: Suggestions for solving the financing difficulty of SMEs.

<sup>2</sup> People's Bank of China (PBOC): The statistical report of the loan orientation to financial institutions in 2011.

<sup>3</sup> People's Bank of China (PBOC): The statistical report of the loan orientation to financial institutions in 2012.

lack the financing methods such as the stock right and the bond.

(3) Financing problems SMEs face are diverse in different regions. Besides the economic level in each region, this is also related with the formulation and the implementation of relevant policies in each region.

### **3 New Challenges**

#### **3.1 The financing crisis caused by the nonstandard private lending**

As a financing means with simple operation and abundant resources, private lending plays an important role in relieving the current situation of inadequate bank credit funds. In the post-crisis era, SMEs show insufficient capital, but the financing cost and the threshold of financing institutions like banks and so on increase gradually. As a result, to maintain the business, SMEs have to conduct the financing of private lending from small and medium-sized lending companies. But the loan pressure of high interest rate usually becomes the root cause of SME entrepreneurs' "escape" without paying off debts. So, the nonstandard private lending market is prone to cause the crisis of SME capital chain break and the financing risk increases thereby.

#### **3.2 The asset crisis caused by SME credit risk**

SMEs in China are small in scale and short in survival time. Besides, the corresponding financial management system is poor and the daily operation management is largely influenced by the external environment. All the factors increase the possibility of the credit risk to some degree, which leads to the asset risk of SMEs. For example, in 2011, a SME entrepreneur in Wenzhou "escaped" because of the capital chain crisis of the private lending. After this incident, many indexes of financial data declined in Wenzhou. Among the indexes, the non-performing loan ratio (NPLR) of financial institutions was 0.55% with the link relative growth of 0.18%. This was the first growth in the recent 10 years<sup>4</sup>. In July, 2012, NPLR of financial institutions in Wenzhou rose to 2.85%. In terms of enterprises, the non-performing loan was mainly concentrated in small enterprises and medium enterprises, with the non-performing loan balance reaching to 6.668 billion yuan and 7.939 billion yuan respectively. The non-performing loan balance of SMEs accounted for 81.62% of the total non-performing loan balance, in which NPLR of small enterprises was 76.99%<sup>5</sup>.

#### **3.3 The sharp increase of the SME financing cost**

In the post-crisis era, China mainly implements prudent monetary policies and the credit scale is restrained. Thus, the cost and threshold of the loan financing are much higher for enterprises. Compared with large enterprises with large-scale loan and stable profit, SMEs present weak loan bargaining right due to lack of mortgaged goods, poor anti-risk capability, and unstable profitability etc. The financing cost reduction effect caused by Central Bank's interest cut in 2012 was mostly to the advantages of large enterprises. At present, the borrowing cost is among 5%-10% for 59.4% of SMEs and for over 40% of SMEs, the cost even exceeds 10%<sup>6</sup>. Therefore, in 2013, the financing of SMEs is still full of challenges.

### **4 Blue Ocean Strategy: the Important Strategic Choice of the SME Financing in China in the Post-crisis Era**

#### **4.1 Improving the cooperative mechanism among enterprises**

SMEs should improve the cooperative awareness. They are expected to make full use of relevant

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<sup>4</sup> China Securities Journal: The non-performing loan of Wenzhou Bank.

<sup>5</sup> Daily Business: The non-performing loan of financial institutions in Wenzhou.

<sup>6</sup> Boao Asia BBS annual meeting in 2013: "The financing development report of small and micro businesses: current status of China and Asian practice".

resources according to their own regions and industrial characteristics to establish the effective organization pattern. Then, they can combine with each other positively to form the SME combo. Besides, they also need to pay more attention to the coordination relationship with large enterprises. In this way, they can form the operation management mode of the enterprise group and improve their own financing capacity to obtain more financing opportunities. For example, Weihai City Commercial Bank in Shangdong province and Weihai SME bureau developed the strategic cooperation project “Blue Ocean Plan” in 2012. By creating new financial service modes, the financing difficulty of SMEs is further relieved. So far, Weihai City Commercial Bank has issued two-period collective trust loan for 9 SMEs, reaching up to 0.13 billion in total<sup>7</sup>.

#### **4.2 Innovative financing modes**

By forming innovative financing modes, SMEs can explore and establish the long-term mechanism of financial services adapting to the SMEs’ economic restructuring and the development mode transformation. Thereby, higher SME financing demand can be satisfied. Firstly, SMEs should form innovative SME financing guarantee modes based on the integration of multi-aspect superior resources. Establishing the multi-layered guarantee system is an important means for satisfying SME financing demand. According to the statistics of China Banking Regulatory Commission (CBRC), by the end of 2012, corporate body number of the financing guarantee industry had reached to 8590 in total nationwide, with the year-on-year growth of 2.2%. The year-end guarantee balance approached to 2170.4 billion yuan in total, with the growth of 16.4% compared with the balance in the beginning of that year. Besides, the balance of the SME financing guaranteed loan was 1144.5 billion yuan, with the year-on-year growth of 15.3%. This favors the development of SMEs greatly. Secondly, SMEs should establish the integrated platform of financing services. The financing supermarkets are gathered together, such as banks, trusts, insurance, bonding companies, financial lease, small loan companies etc. Thus, the service platform for bank-enterprise interaction, online service, and financing consultation is established between SMEs and financial institutions.

#### **4.3 Reducing the operating cost and the asset risk of SMEs**

In the post-crisis era, apart from the financing difficulty, the increasing operating cost also needs to be solved as soon as possible. Firstly, enterprises themselves should pay more attention to accumulation of their own capital and the implementation of the differentiated management mode based on the cost control in the daily operation. Moreover, they can also obtain more business opportunities by using the e-commerce platform of B2B. Secondly, government should formulate relevant fiscal and monetary policies comprehensively. The government needs to provide preferential tax policies for SMEs and allow them to have the access to “the flourish plan of SMEs” free of charge. Financing modes are required to be broadened and innovative modes should be formed. Through private capital from guarantee institutions etc., the collective bond-issuing scale of SMEs can be expanded. Furthermore, the approval process for enterprises to be listed should be simplified. Thus, the capital market can play its role such as IPO (Initial Public Offering) financing of SME board etc.

#### **4.4 Widening marketing ideas and improving competitiveness**

Development, maintenance, and improvement of SME market competitiveness can be reflected in marketing modes of enterprises to a large degree. Based on the implementation of “Blue Ocean Strategy”, enterprises’ basic aim is to realize the maximization of the whole values including society, clients, enterprises themselves. To achieve this aim, SMEs are expected to do the following. Firstly, under the premise of having a good knowledge of differentiated market demand, SMEs in China should create new marketing philosophy and widen marketing ideas. In the marketing practice, SMEs should do well in using the advanced marketing methods from other enterprises as the reference. Besides, they also

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<sup>7</sup> Weihai City Commercial Bank in Shangdong province, 2013.

need to make good use of convenient, fast, and low-cost marketing platforms involving a broad range, such as the internet etc.. Thus, they can form and carry out innovative marketing modes conforming to their own enterprise cultures and the personalized market demand positively and actively. Secondly, SMEs need to pay great attention to cultivating and recruiting knowledgeable, practical, and innovative marketing talents. In this way, the marketing ideas in enterprises can keep innovative all the time. Thereby, according to the differentiated market demand, SMEs can form innovative marketing modes to improve their competitiveness. Thirdly, SMEs are expected to carry out green marketing modes and bring the green culture into enterprises' marketing modes. That is, under the premise of realizing the social benefit, enterprises should improve their awareness to concern for consumers' physical and mental health. Meanwhile, in this way, the operating cost of enterprises is reduced or even enterprises' economic profit becomes higher.

#### **4.5 Emphasizing the development of the intrinsic value and the brand effect**

The market in the post-crisis era is complex and changeable, with much attention paid to the personalized demand. To survive and develop in the fierce market competition, SMEs need to break the traditional thinking set and timely obtain the information of the consumer demand, based on the adequate market research. Firstly, according to the differentiation of the consumer demand, SMEs should conduct the market segmentation. They make full use of their own unique advantages to satisfy the personalized demand of the particular market. Meanwhile, they can occupy some market shares in the local market and obtain good economic benefit. Thus, SMEs can maintain the sustainable and stable development. Secondly, the initiative of the product development and innovation needs to be improved to adapt to the diverse and personalized market demand. Under the framework of "value innovation" theory, SMEs are expected to emphasize the product innovation in many aspects such as "quality, function, services, and marketing" etc. Moreover, the development mode of the intrinsic value should be carried out from three aspects: market differentiation, product differentiation, and image differentiation. Thus, the brand effect is highlighted.

### **5 The Suggestions for the Implementation of SMEs' "Blue Ocean Strategy"**

#### **5.1 Establishment and improvement of relevant legal system of SME financing**

Establishing and perfecting the legal system of SME financing are the basis for solving the financing difficulty of SMEs in China. To safeguard the legitimate interests of SMEs, China should establish separate laws to help SMEs with their financing and development. In the SME Promotion Law enacted in 2002, many legal countermeasures were adopted to solve the problems such as SME financing difficulty etc. But there were no detailed laws and regulations corresponding to those legal countermeasures. As a result, it was difficult to put this law into effect. Government should formulate a series of specialized laws that require institutions such as banks, small loan companies, pawnshops and so on to provide the credit for SMEs. By establishing laws, the rights of institutions with credit behaviors are safeguarded. But the main content of the current Guarantee Law is the guarantee system of the real estate. Since there are few guarantees of the real estate for SMEs in China, this law is inconsistent with the actual situation of SMEs. Therefore, relevant legal system of the chattel mortgage guarantee is required to be perfected in Guarantee Law. Besides, the SME credit system platform should be established and perfected to effectively solve the problem that it is difficult for financial institutions like banks and so on to collect SME credit data. To some degree, this can improve SMEs' initiative to pay enough attention to formation and maintenance of their credit. Hence, it is necessary and urgent to enact some laws related to SME financing.

#### **5.2 Construction of the financial credit system for SMEs**

The financial credit system fitting for SMEs should be established under the policy guide of Central Bank and governments at all levels. The complementary action between commercial finance and the

policy-based finance is supposed to play its role to the full. Thereby, we can provide multi-angle and credit support for SMEs. Based on “Blue Ocean Strategy”, People’s Bank of China provides “window guidance” to promote the establishment of the differentiated financial credit system. Under the loan financing policy guide of the commercial finance, the financial credit system between State-owned Commercial Bank (SOCB) and SMEs is established. Innovative financial credit products are obtained timely to satisfy the actual financial demand of SME diversification. Besides, the differentiation in the management of SME credit policies should be reinforced between joint-stock commercial banks and regional financial institutions. In this way, the fights or vicious competition between joint-stock commercial banks and regional financial institutions can be avoided in the implementation of SME loan policies. By the end of 2012, there had been 939 new rural financial institutions nationwide, with the year-on-year growth of 19.47%. The loan balance was 234.7 billion yuan<sup>8</sup>, nearly a half of which was used to satisfied SME financing demand. Meanwhile, policy-based financial credit system needs to be established. Policy-based financial institutions serve as a carrier to conduct direct financing behaviors to SMEs, through the methods such as the construction of the guarantee system of SME policy-based finance etc. Besides, commercial financial institutions are guided and encouraged to support SMEs.

### **5.3 Improvement of the guarantee system for SME financing credit**

The establishment and perfection of the guarantee system of SME financing credit are required to be promoted. To achieve this goal, the credit of the business entity should be improved by reinforcing the business management. Apart from that, the differentiated credit guarantee system is also expected to be established and put into effect. China needs to construct the organization system framework of the guarantee system of SME financing credit step by step according to the plan. The policy guarantee is taken as the main part and the aim of helping SMEs with their development and growth is reflected in the daily operation management of guarantee institutions financed by the government. Meanwhile, mutual guarantee serves as the auxiliary part and on this basis, the initiative of the commercial guarantee is improved to play a positive role in the guarantee system. Thereby, the guarantee risk of SME financing credit can be reduced and relieved at different level.

### **5.4 Acceleration of the standardized process for private lending**

Since many occurrences of private lending disputes and debts-dodging incidences in Wenzhou, Inner Mongolia, Henan and so on in 2011, the government has paid much more attention to the standardization of the private lending. Under the policy guidelines of the central government and Central Bank, the standardization of private lending is accelerated. Each local government is encouraged and supported to enact a series of policy measures for the standardization of private lending. Under the framework of the unified supervision system, the regulation of private lending is reinforced at different level to standardize the development of private lending. Based on the private lending of SMEs, the capital of private lending is encouraged and supported to flow into industries. So, guarantee institutions of private lending and SME development fund are set up; besides, new financial organizations are also established to provide financial services for SMEs. By the end of March, 2013, there had been 6555 small loan companies nationwide and the loan balance had reached to 635.7 billion yuan, with yearly incremental loans of 43.4 billion yuan<sup>9</sup>. Hence, accelerating the standardized process of private lending like small loan companies and so on is an important strategic choice to relieve current SME financing plight.

## **6 Conclusion**

Based on the framework of “Blue Ocean Strategy” theory, the differentiated management mode for cost

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<sup>8</sup> China Association of Small and Medium Enterprises (CASME), 2013.

<sup>9</sup> People's Bank of China (PBOC), 2013.3.

control is implemented. Then, applying “value innovation” theory into the operating management of enterprises, and enhancing its internal management, accumulation and utilization of enterprises’ capital can be realized. Thus, enterprises can improve their internal financing capacity gradually. By implementing “Blue Ocean Strategy” of SME financing, the cooperation among the government, financial institutions, private lending companies, and SMEs can be promoted. With the combined forces, the situation of SME financing difficulty in China can be thereby changed.

**Brief Introduction to the Author:**

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