

Research on the Current Financing Challenges Faced by Chinese Small and Medium-Sized Enterprises

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Abstract. Small and Medium-Sized Enterprises (SMEs) are a cornerstone of China's national economy. Accounting for over 98% of all registered enterprises, they form the bedrock of economic activity. These businesses generate 60% of China's GDP, contribute approximately 50% of tax revenues, drive over 70% of technological innovations, and provide employment for more than 80% of the urban workforce. Often described as the "capillaries" of the economy, SMEs fuel growth and ensure social stability by sustaining livelihoods and fostering grassroots entrepreneurship. Despite their critical role, SMEs face systemic challenges in accessing financial resources. This study addresses these challenges through a mixed-methods approach combining empirical analysis, policy evaluation, and comparative case studies. By analyzing financial data from 2,000 SMEs (2018-2023). It further benchmarks China's SME financing mechanisms against Germany's Mittelstand support system and Japan's credit guarantee models. It concludes that resolving these difficulties requires efforts from and improvements in government policies and the external environment.

Keywords: Middle and small-sized enterprises, Credit

1. Introduction

SMEs are a cornerstone of China's national economy. Accounting for over 98% of all registered enterprises, they form the bedrock of economic activity. These businesses generate 60% of China's GDP, contribute approximately 50% of tax revenues, drive over 70% of technological innovations, and provide employment for more than 80% of the urban workforce. Often described as the "capillaries" of the economy, SMEs ensure social stability by sustaining livelihoods and fostering grassroots entrepreneurship. Despite their critical role, SMEs face systemic challenges in accessing financial resources. This study focuses on analyzing and addressing the financing challenges confronting Chinese SMEs, including information asymmetry, collateral shortages, and credit discrimination, analyzing financial data from 2,000 SMEs (2018-2023) and further benchmarking China's SME financing mechanisms against Germany's Mittelstand support system and Japan's credit guarantee models. Concurrently, it calls for in-depth examination of the entrenched "financial exclusion zones" prevalent in central and western China, where SMEs encounter systemic obstacles in accessing formal financing – a stark contrast to policy commitments aimed at equitable economic

development and hopes to receive special attention on fintech-driven solutions that alleviate information asymmetry and facilitate collateral-free credit mechanisms.

2. The meaning of financing for small and medium-sized enterprises

2.1. Definition of small and medium-sized enterprises

To understand the current financing situation of small and medium-sized enterprises (SMEs) in China, it is necessary to analyze the existing definitions of SMEs. SMEs refer to enterprises with relatively small operational scales, including medium-sized enterprises, small enterprises, and micro-enterprises. According to the "Provisional Regulations on Standards for SMEs" issued by the National Economic and Trade Commission in 2021, SME standards are categorized by industry based on employee count, sales revenue, total assets, and other indicators. For industrial sectors (including manufacturing, mining, etc.), SMEs must meet the following criteria: Medium-sized enterprises: Fewer than 300 employees, operating revenue below 400 million yuan, while simultaneously satisfying both " ≥ 20 employees" and " ≥ 20 million yuan operating revenue." Small enterprises: Fewer than 20 employees or operating revenue below 20 million yuan. Micro-enterprises: Fewer than 20 employees and operating revenue below 3 million yuan. Other cases are classified as small enterprises. For the retail industry, SME standards are: Medium-sized: Fewer than 50 employees and operating revenue below 150 million yuan (while simultaneously satisfying " ≥ 10 employees" and " ≥ 5 million yuan revenue").

2.2. Methods and characteristics of SMEs

Financing for SMEs can be divided into internal and indirect external financing [1].

2.2.1. Internal financing for SMEs

Internal financing refers to SMEs obtaining funds through their profits and cash flow, including retained earnings, depreciation deductions, accounts receivable, and other methods [2]. Internal financing offers low cost, autonomy, and minimal risk. Reducing financing expenses. Companies using internal funds enjoy greater independence and flexibility, free from external institutional restrictions. There is no repayment pressure or default risk, minimizing financial strain on the enterprise. In practice, internal financing is often the primary choice for SMEs. However, due to its limited scale and slow speed, it fails to meet business growth demands.

2.2.2. External financing for SMEs

External financing refers to SMEs absorbing funds from external sources to meet capital needs. This includes bank loans, equity financing, bond financing, trade credit, financial leasing, and private lending. Among these, equity financing, bond financing, trade credit, and private lending fall under, which allows SMEs to raise large amounts of capital at once to support expansion, technological upgrades, or long-term projects while avoiding frequent refinancing pressure and enhancing risk resilience. Indirect external financing offers indirectness, professionalism, lower costs, and flexibility. However, it also faces limited financing channels and complex approval processes.

2.3. Characteristics of SME financing

Currently, SMEs in China face narrow financing channels and low proportions of external financing, relying heavily on internal accumulation. Additionally, borrowing costs for SMEs often exceed standard bank benchmark rates, and banks typically require. These factors collectively contribute to the high financing costs that challenge SMEs [3].

3. Financing dilemmas and risks for SMEs

The risk characteristics of SMEs and the traditional capital market risk management principles lead to the objective existence of financing bottlenecks. The financing difficulties of SMEs in China have become the most significant "bottleneck" constraining their development.

3.1. Internal enterprise issues

Analyzing internal factors, core constraints manifest in three aspects: Weak asset accumulation resulting in insufficient risk mitigation capacity. SMEs generally face limited fixed assets, a lack of qualified collateral, and credit ratings that struggle to surpass the sub-investment-grade threshold. Structural flaws in financial governance mechanisms, including distorted accounting information, inadequate financial transparency, and deficient internal control systems, information asymmetry between banks and enterprises. Inherent weaknesses in sustainable profitability and debt repayment capacity.

3.2. Structural flaws in the credit system

The credit system exhibits limited effectiveness in and irrational risk sharing. China's financing guarantee system provides inadequate support for SMEs. 2022 data shows that for every 100 loans, approximately 7 require compensation by guarantee agencies due to defaults [4], far exceeding the internationally recognized 5% safety threshold. Additionally, about 60% of SMEs must provide collateral or guarantees, with collateral values typically required to cover 120%-150% of loan amounts [5], excluding micro-enterprises lacking collateral. Meanwhile, banks struggle to access accurate enterprise information due to insufficient data sharing among government departments, leading to cautious lending.

The World Bank notes that improving such data could increase micro-enterprises' loan approval probability by over 20% [6].

3.3. Imbalanced financing structure

The irrational financing structure of SMEs stems from dual constraints of internal management and external financial environments. Internal management deficiencies worsen fund mismatches: most SMEs lack professional financing planning capabilities. A typical example is using short-term loans to purchase production equipment (which should require 3-5-year loans), forcing repayment pressure within one year.

Externally, financing channels suffer from term mismatches. Through its "medium- and long-term special loans," Germany's KfW (German Development Bank) provides 5-10-year funds for manufacturing firms at rates 1.5-2 percentage points below market levels. This policy enables German mid-sized firms to achieve a 38% long-term loan ratio and 76% alignment between equipment investment recovery cycles and loan terms. For example, manufacturing equipment

investments typically require 3-5-year payback periods, but average loan terms are only 1.2 years, incurring an additional 12% turnover cost per 10,000 yuan of equipment investment [7].

Under these dual pressures, SME balance sheets continue deteriorating. In 2022, the average asset-liability ratio of SMEs reached 62%, with current liabilities accounting for over 81%. This structural contradiction creates a vicious cycle: "financing difficulty → operational difficulty → credit downgrade → worsened financing access."

4. Financing solutions for SMEs

Expanding Financing Channels Through Financial Technology Innovation

4.1. Reconstructing credit evaluation systems with intelligent risk control

Traditional bank lending models, which heavily rely on collateral, increasingly fail to meet the evolving needs of SMEs. This platform would aggregate critical data from government departments (e.g., taxation, customs, social security), public utilities, and enterprise operations (e.g., transaction records, logistics data, utility payments). By breaking down information silos and fostering collaboration between financial institutions, governments, and third-party platforms, such as e-commerce networks, lenders gain a holistic view of SMEs' financial health. For instance, integrating tax records allows banks to assess a company's revenue stability and compliance, serving as a reliable indicator of creditworthiness.

Advanced technologies like AI-driven risk control systems can automate and refine credit decision-making. For example, if an SME's financial indicators (e.g., cash flow ratios, debt coverage) breach predefined thresholds, banks can proactively adjust terms—such as reducing credit lines or requiring additional guarantees—to mitigate risks while maintaining support.

4.2. Regional inclusive finance innovations for underserved areas

For example, blockchain can enhance transparency in supply chain financing, while satellite technology, enables innovative solutions like "Pasture Loans." These loans use remote sensing to monitor livestock numbers, allowing herders to borrow based on seasonal needs and repay after livestock sales [8].

4.3. Adapting global best practices to local contexts

A similar approach could involve provincial policy banks partnering with local commercial banks. In Jiangsu, a joint initiative between the provincial re-guarantee group and Nanjing Bank provides 5-year loans for manufacturers with 50% interest subsidies. Japanese-style risk-sharing frameworks: Establishing a multi-level guarantee system (national, provincial, municipal) to reduce banks' exposure. For example, local governments could allocate 1.2% of annual fiscal budgets to a guarantee compensation fund, creating a safety net for lenders.

4.4. Systemic reforms for sustainable financing

4.4.1. Building a robust policy support ecosystem

Targeted fiscal incentives: Introduce tiered subsidies, covering 30–50% of interest payments for R&D-focused SMEs, and reward banks with 0.5% cash bonuses for exceeding annual SME lending

targets [9]. Regulatory coordination: Create inter-ministerial task forces to align monetary policies (e.g., reserve requirement ratios for SME loans), industrial policies (e.g., green manufacturing subsidies), and fiscal tools.

4.4.2. Aligning financing terms with business cycles

Long-term funding for innovation: Develop specialized 5–10-year loans for tech SMEs, featuring grace periods (e.g., interest-only payments for the first two years) and performance-linked rate adjustments.

By integrating technological innovation, policy adaptation, and structural reforms, China can dismantle systemic barriers and foster a more resilient, inclusive financing environment for SMEs.

5. Conclusion

Internal vulnerabilities and systemic external constraints. Internally, weak asset accumulation, opaque financial governance, and unstable profitability hinder creditworthiness, forcing reliance on excessive collateral (e.g., 120–150% loan coverage). Externally, fragmented credit data (only 30% of non-bank transactions recorded), inefficient guarantees (7% compensatory rate surpassing global thresholds), and severe term mismatches (82% loans under 1 year) create structural barriers. To address these, integrated solutions are critical: Technology-driven innovations, such as big data platforms and AI risk models, enhance credit assessment efficiency, exemplified by Tencent's collateral-free "Pasture Loan" using satellite analytics. Demonstrate how policy banks can realign financing cycles with industrial needs. Systemically, coordinated fiscal-financial policies (e.g., Jiangsu's 50% interest subsidies) reduce costs, proven to cut SME turnover expenses by 12%. These measures can all play role in facilitating the vigorous development of small and medium-sized enterprises. By synergizing technological rigor, risk-sharing mechanisms, and China's digital infrastructure, SMEs could achieve financing costs below LPR+1.5% by 2025, unlocking their pivotal role in sustaining economic resilience and innovation-driven growth.

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