

# Novel Coronavirus Pneumonia's Impact on China's SMEs Financing and Countermeasures

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## Abstract

In order to solve the financing problems of SMEs, combined with the immature financial market situation of China's SMEs. In this paper, the SME financing theory is used to complete the analysis. Through the SME development index (SMEDI) in the third quarter of 2020, this paper analyzes the survival and financing situation of SMEs under the influence of the epidemic situation, and helps to optimize the financing mode and ways of SMEs from the aspects of internal governance structure reform and improvement of SME financing system. The results show that the design scheme proposed in this paper can better optimize the financing mode, effectively reduce the financing cost of small and medium-sized enterprises, and provide certain theoretical support for improving the financial market system by optimizing the social credit guarantee mechanism.

## Keywords

Financing Issues; Financing Efficiency; Innovation Path; SMEs.

## 1. Introduction

The recent outbreak of COVID-19 has had a severe macroeconomic impact on the world. The prolonged epidemic has dealt a severe and immeasurable blow to domestic SMEs (Small and medium-sized enterprises). As the anti-risk ability of SMEs is weak, they are more prone to capital chain breakage, financing difficulties, and expensive financing in the face of the epidemic. Therefore, this paper analyzes the root causes of SMEs' financing difficulties and puts forward pertinent suggestions to promote SMEs' development and the real economy based on the general economic environment at home and abroad and the current financing situation of SMEs.

## 2. The Impact of the Epidemic on SMEs

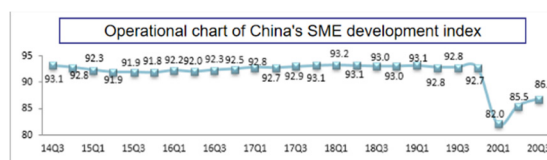


Fig 1. Operational chart of China's SME development index

China's SME Development Index (SMEDI) for the third quarter of 2020 was 86.8, up 1.3 points from the second quarter, but below the boom threshold of 100 for nine years in a row since the third quarter of 2011. SME development is under pressure, according to data released by the China Association of Small and Medium Enterprises on October 11.

Sub index	2020 Q3	2020 Q2	Increase (Q3-Q2)	
Total index	86.8	85.5	↑	1.3
Total index	100.9	99.3	↑	1.6
Comprehensive operating index	95.5	93.7	↑	1.8
Market index	77.8	76.6	↑	1.2
Capital index	101.4	100.5	↑	0.9
Input index	81.2	79.2	↑	2.0
Benefit index	61.6	59.8	↑	1.8

**Fig 2.** Sub index table of SMEs development

In the third quarter, the capital index was 101.4, the financing index was 88.7 and the liquidity index was 85.6, which shows that the capital constraint of China's SMEs has improved to some extent, the economic stability of SMEs has established a positive trend. The foundation of recovery has been further consolidated. However, the input index for the third quarter was 81.2, still at a historical low. Simultaneously, it should also be noted that the current international environment remains complex and severe, with global epidemics still spreading, external demand shrinking, protectionism and unilateralism prevalent in some countries, and globalization experiencing a backlash. SMEs are still experiencing more production and operational difficulties, heavy burdens, financing difficulties, rising costs and a shortage of orders, and business pressures.

### 3. Analysis of the Current Status of SME Financing in the Light of the Epidemic's Impact

As a major force in China's national economic and social development, SMEs play a great role in China's economic development process. However, due to the relatively small size of the enterprise, compared with large enterprises, many of its own problems also determine its poor financing capacity, the main reasons are as follows.

(1) Poor capital structure and high asset-liability ratio of SMEs. Most SMEs have simple capital sources, and once the capital chain is, the enterprise's daily production and operation activities will be significantly hit. Compared with some large enterprises, SMEs generally start with insufficient investment capital. SME founders plan to engage mainly in small, less demanding operations, so initial capital is likely to be severely undercapitalized.

(2) Poor creditworthiness of SMEs and difficulties in securing financing. In the past, some enterprises have often evaded debt with malicious intent, leading many financial institutions to distrust SMEs, especially in the current form, where the financing difficulties of SMEs have become more pronounced, not only for internal reasons, but also for external environmental factors such as the socio-economic environment, market conditions and financial services.

(3) Inadequacies in the internal governance structure of SMEs. SMEs' operation and management are still relatively backward, and it is common for many of them to have incomplete financial statements. When they go to formal financial institutions for financing, the financial books' completeness and clarity are the review's principal basis. Since the vast majority of SMEs are at the stage of relying on guidance or innovation for growth, they cannot form a set of scientific and institutionalized management systems. As a result, compared to large enterprises, SMEs have more financial management problems, which all exacerbate SMEs' difficulties.

(4) Vulnerable to the macroeconomic environment and external market factors. The current COVID-19 epidemic and trade war have brought a more significant impact on the survival and development of SMEs in China, mainly manifested in the substantial contraction of global consumption, commodity circulation and reduced market demand, import and export of

international trade decreased, resulting in a massive decline in business and profits. At the same time, SMEs are facing a management crisis and capital operation crisis. Many enterprises have taken corresponding measures after the emergence of the epidemic, such as streamlining organizations, layoffs and salary cuts, bringing enormous pressure on enterprise operations, with external and internal crises forming a corresponding vicious circle, posing a massive threat to the stability and development of enterprises.

## **4. Programme Design to Improve the Efficiency of SME Finance**

### **4.1. Sound Financial Management System**

(1) The core of enterprise management is financial management. SMEs are still with an imperfect financial management system, which they need to improve. The investment in innovation and the expenses of each part and each department of the enterprise's production process need to implement standardized management to maximize the efficiency of using funds. Furthermore, for the company's accounts, payable, prepayments, accounts receivable, and prepayments can be applied flexibly. Finally, small and medium-sized private enterprises should strengthen their audit and supervision functions and play supervisory authority by establishing an internal audit institution.

(2) SMEs should strengthen their construction. In the face of the epidemic, SMEs should continue to enhance the awareness of honesty and law-abiding, operate in good faith, cultivate good credit of enterprises, and adhere to "establishing enterprises with honesty and developing enterprises with trust." They should establish an enterprise brand, especially the integrity of the brand. Also, the corporate governance structure and the modern enterprise system have to be established, which can be realized from several aspects: first, improve and standardize the enterprise routine system, sound financial management system; second, with the help of influential events to publicize the good reputation of the enterprise, create a good impression of corporate credit; third, build a good corporate credit culture, integrate credit management into the entire management of the enterprise, starting from essential management, establish the concept of honesty and credit first, and standardize the behavior of all employees.

(3) Innovation is a necessary condition for an enterprise to develop well. Therefore, traditional SMEs must change their mindset, establish a sense of innovation, learn advanced technology, actively introduce innovative technology and equipment, increase investment in talent, accelerate the pace of scientific and technological innovation and enterprise optimization and transformation, reduce operating costs and enhance the competitiveness of enterprises, so that naturally they will get more investment.

### **4.2. Widening Access to Finance for SMEs**

(1) SMEs are more suitable for equity financing due to their high risks, lack of business information and low operating capacity. China has now formed a multi-level financial market system consisting of the Main Board, the SME Board, the ChiNext, the New Third Board and the Science and Technology Board, and the equity financing system is gradually becoming perfect. In terms of path selection, we should further promote the market stratification of the New Third Board, and optimize issuance and financing, while reforming the trading system and establishing traditional and hybrid market maker trading mechanisms according to market stratification. At the same time, from the New Third Board pilot, establish a transfer convergence mechanism, so that all levels of the capital market to achieve interconnectedness. At the same time, SME financing should not only focus on the domestic market, but also go international, and SMEs with the right conditions can go to the Hong Kong growth enterprise market and the Nasdaq market in the United States to raise funds, opening international capital to Chinese SMEs' financing channels.

Simultaneously, however, most SMEs in China are still in the growth or start-up stage, and their development is not stable. Therefore, risk control of enterprises cannot be neglected, penalties for violations of the law should be strengthened, the exit mechanism of the capital market should be improved, and excellent SMEs should obtain equity financing channels.

(2) Venture capital is a type of equity capital used by professional investors to invest in new and fast-growing competitive businesses. For some companies that are just at the initial stage, venture capital can quickly help them get through difficult times. Venture capital will help optimize resource allocation and improve the efficiency of capital use after entering SMEs. Besides, venture capital will significantly improve SMEs' efficiency and attract social capital to reinvest in them, thus promoting their all-round development, forming a virtuous circle, and promoting the national economy's sustainable and effective growth.

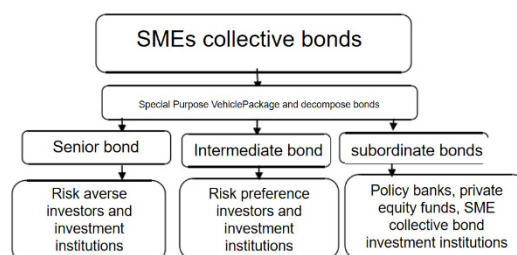
(3) The supply chain financing model is an effective way to solve small and medium-sized enterprises' financing difficulties. Through the cooperation of supply chain finance mode, the financing difficulties of the core position enterprises and the majority of small and medium-sized dealers in the supply chain have been solved. By using the core enterprise's credit qualification and asset guarantee, the downstream small and medium-sized dealers can get loans from financial institutions quickly, effectively and at low cost, which solves the financial problems of the development for small and medium-sized businesses, and makes the core enterprises in the supply chain, financial institutions, downstream enterprises and SMEs to achieve an all-win situation. All the enterprises in the supply chain are connected into a whole through the supply chain financing model. The core enterprise's credit and assets are pledged to provide effective security and collateral for the downstream SMEs, help the downstream SMEs obtain loans from financial institutions quickly and effectively, so that SMEs can get out of the financing difficulties.

(4) Under the P-CBO (Primary Collateralized Bonds Obligation) model, the issuance of pooled bonds for SMEs led by policy banks support SMEs. The SPV (Special Purpose Vehicle) packages the bonds, breaks them down, and classifies them into senior, intermediate, and subordinate bonds according to their risk level.

The senior SME pooled bonds would be sold to conservative investors. The intermediate bonds could be sold to investors with a higher risk appetite, and the subordinate SME pooled bonds would be sold to SME-supporting policy banks or private equity funds willing to take on "high risk, high yield." In this way, the P-CBO model allows the SME pooled bonds' internal rating to be done without contributing to their credit enhancement costs.

At this stage, common SME pooled bonds are subject to significant constraints as investors consider SMEs' higher credit risk. Especially at the credit enhancement level, traditional guarantee agencies require SMEs to pay higher guarantee fees and need specific collateral, increasing SME pooled bonds' issuance cost. On the other hand, P-CBO (Primary Collateralized Bonds Obligation) model carries out internal credit enhancement, reducing SMEs' financing costs very well.

The P-CBO (Primary Collateralized Bonds Obligation) model is adopted for issuing SME pooled bonds, and special SME pooled bond investment institutions should be set up in each locality. The P-CBO Department of Financial Inclusion, Small and Medium Enterprises Administration, Development and Reform Commission, Market Supervision Administration, commercial banks, guarantee companies and private capital can jointly initiate and set up, operate and supervise, so as to form a pooled bond market to effectively support SMEs, better promote SME incubation and listing, and accelerate supply-side reform.



**Fig 3.** Issuing SMEs collective bonds with P-CBO model

### 4.3. Improving Credit Guarantee Mechanisms

Improve the credit guarantee system, develop and improve SME credit guarantee institutions, and make them operate efficiently. To solve SMEs' financing difficulties requires the cooperation of regulations, policies, and mechanisms to use market means to manage the economy, rather than just policy inclination. On the one hand, the government should play the role of macro-guidance, providing directional grasp, guidance, and management to establish the credit guarantee mechanism, making the entire credit guarantee mechanism improved with transparency, legalization and proceduralization. The government can establish an open information website, require SMEs to regularly provide accounting statements and other information audited by accounting firms, strengthen the construction of internal control, improve the risk control system, optimize internal management, and improve financing security. Use cloud computing, big data, and other scientific and technological means to collect information and credit evaluation of relevant enterprises to speed up a credit evaluation system's construction. According to the enterprise's specific conditions, adopt appropriate credit evaluation methods to prevent and control risks and establish a complete and standardized credit guarantee system.

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