Zhejiang SMEs Business Operation and Financing Difficulties Analysis and the Bank’s Coping Strategy

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Abstract: In this study, we have a research of the Zhejiang SMEs business operation and financing difficulties analysis and the bank’s coping strategy. Since the beginning of 2011, Zhejiang SMEs have fallen into business difficulties under heavy pressure from “3-shortage and 2-high”, namely, shortage of money, shortage of electricity and shortage of labor and high cost and high taxes. This even leads to the “tide of enterprise collapse”. In such a dilemma, problems of financial shortage and financing difficulties of SMEs are quite prominent. Besides, main financing channel of Zhejiang SMEs is the private credit market while loans from banks accounting only a minor proportion. Thus, enterprises have relatively vulnerable capital chain and large capital liquidity risk. Banks shall actively deal with this problem, pay much attention and strengthen risk management, strengthen asset preservation and effectively improve the risk management level of banks.

Keywords: Banks, coping strategies, difficulty, SMEs

INTRODUCTION

SMEs began to face business difficulties from the beginning of 2011. Comparing the situation in 2008 with the strike of the international financial crisis, economic situation currently is gradually restoring and no major fluctuation has occurred in fundamental level, but SMEs seem to drop into a situation worse than that in 2008. According to comparative analysis, economic depression in 2008 was mainly caused by inadequate demands due to the recessed oversea economy under the strike of the financial crisis, but difficulties of SMEs at the current stage have essential difference from problems in 2008: currently, there are plentiful internal and external demands, but more difficulties for production and business operation. These difficulties can be summed up as “3-shortage and 2-high”, namely, shortage of money, shortage of electricity and shortage of labor and high cost and high taxes, which are detailed as below:

Higher production costs: The problem of high raw material purchase price and low product selling price is quite prominent. In the first quarter, industrial production material purchase price and product selling price increased by 10.1 and 6.4% respectively, showing a gap of 3.7%. Prices of energy and raw materials rose greatly which sets forth higher conditions for enterprise to accept an order. Besides, the labor cost also rises. It is shown from monitoring data that the labor compensation per capita in industrial enterprises above the designated size in Zhejiang has increased by 25%. The labor costs of 87.5% of enterprises obviously rose up. Gregory (2011) studies the financing problems of Chinese private enterprises. Liu and Xu (2004) have a research of the four features of small and medium-sized enterprise's financing structure. Wang et al. (2008) have an analysis on financing difficulties of Chinese small and medium-sized enterprises.

More difficult enterprise financing: Currently, the SMEs bank loan interest rate has basically risen by about 30%. Calculating the disparity of the interest rates of savings deposits and loans and acceptance draft discount interest, the actual loan interest of SMEs is much higher than the normal loan interest, even more than two times of the bank's base rate. The limited bank credit funds have promoted the increasingly active private credit market. Financing interest in the private credit market has risen rapidly. In most areas of our province, private financing interest rate has risen to 25-30%. Some short-term financing annual interest rate is even as high as 50-60%.

Heavier labor shortage: With the fast economic development of the central and west regions, the economy expands gradually in inland main labor output areas. The gap between wage levels is gradually reduced. Plus the increase of living cost, the labor source in Zhejiang is reducing year by year, thus leading to heavy labor shortage problem. According to surveys of 23 SMEs professional associations in Zhejiang, labor shortage has become a universal problem for various industries.

Bigger electricity shortages: In 2011, "electricity shortage" problem has become more prominent. First, the power consumption demand has been increased. Taking Xiaoshan District for example, with some new industrial projects being put into operation successively
in the first half of year, the electricity shortage will further expand. Second, different treatments are given to different enterprises for power distribution in various places. The policy to give priority to big enterprises for power distribution will not be fundamentally changed. Thus, SMEs will suffer from particularly serious impact by electricity shortage.

**More severe export situation:** The ever-changing international situation has increased the uncertainty of external export environment. In particular, bulk commodity price trend and RMB exchange rate are hard to be controlled. Thus, enterprises are depressed on product export. By July 5, 2011, RMB had appreciated by 2.4% as compared by the situation at the end of last year. In 2011, RMB appreciation is generally expected to reach 5%. A large number of Zhejiang SMEs have pool bargaining ability so that their profit margins are quite small. As RMB is constantly appreciating, they dare not to accept medium and long term orders or big orders.

In this study, we have a research of the Zhejiang SMEs business operation and financing difficulties analysis and the bank’s coping strategy. Since the beginning of 2011, Zhejiang SMEs have fallen into business difficulties under heavy pressure from “3-shortage and 2-high”, namely, shortage of money, shortage of electricity and shortage of labor and high cost and high taxes. This even leads to the “tide of enterprise collapse”. In such a dilemma, problems of financial shortage and financing difficulties of SMEs are quite prominent. Besides, main financing channel of Zhejiang SMEs is the private credit market while loans from banks accounting only a minor proportion. Thus, enterprises have relatively vulnerable capital chain and large capital liquidity risk. Banks shall actively deal with this problem, pay much attention and strengthen risk management, strengthen asset preservation and effectively improve the risk management level of banks.

**ENTERPRISE BANKRUPTCY IN ZHEJIANG**

**Overall situation:** From January to May, 2011, judging from the absolute number of newly established and cancelled enterprises, a total of 58,426 enterprises were newly established, up 14.2% than that in the same period last year; a total of 10,505 enterprises were cancelled, up 0.56% than that in the same period last year. Among them, a total of 44,925 enterprises were newly established and a total of 7,306 enterprises were cancelled in the first four months. The quantity of cancelled enterprises basically maintained in the same level with that in recent years (Table 1).

**Causes for enterprise bankruptcy:** According to the actual situation, enterprises in Zhejiang go bankruptcy mainly because of the following reasons:

- The first reason is the separation of enterprise funds from the equity to invest in hot projects and projects with fast rate of capital recovery. Comparing the difficulty and uncertainty for enterprising, SMEs, especially these with a larger size, invest large amount of productive capital directly or indirectly into the real estate or the capital market, rather than using them for enterprise physical operation.
- The second reason is the excessive expansion and poor management. The great numbers of SMEs have poor capital strength and they suffer from high financing cost. The capital chain has been operating overloaded for a long time. Thus, capital shortage will immediately appear in case of a slight capital liquidity reduction. On the other hand, some enterprises with relative strong strength expand too fast in order to achieve large scale. As a result, they have even more obvious capital chain problem.
- The third reason is that SMEs have relatively poor ability to deal with the large pressure in external economic environment. High inflation, deflation liquidity and resources and energy shortage will still co-exist for long-term in a certain period. Challenging by the external economic environment, SMEs, especially small and micro small enterprises, have to suffer from extremely large business operation difficulties due to limited entrepreneurs’ decision-making and judgment ability and relatively narrow enterprise management idea.

Based on the above analysis, we think that the bankruptcy of some Zhejiang SMEs is apparently a common feature of capital chain rupture, but basically, this is because that these enterprises excessively expanded their scale in the business development process; eager to make profits, they failed to be dedicated to their main business and the enhancement of their own core competitiveness; thus, they fell into business difficulties because they could not deal with impacts from external economic environment changes.

**FINANCING DIFFICULTY OF ZHEJIANG SMES**

**Overall capital situation:** Judging from the sufficiency of current capital, according to enterprise prosperity survey, enterprises with current capital tension accounted for 19.3% in the second quarter in 2011, up 3.3% than the previous quarter; SMEs current capital and financing property indexes were only 95.2 and 97.7, all falling into the recession level, down 6.5 and

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**Table 1:** Quantity of enterprises cancelled from Jan. to Apr. in recent 5 years in Zhejiang

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of enterprises cancelled</th>
</tr>
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<tbody>
<tr>
<td>2007</td>
<td>7410</td>
</tr>
<tr>
<td>2008</td>
<td>8059</td>
</tr>
<tr>
<td>2009</td>
<td>7251</td>
</tr>
<tr>
<td>2010</td>
<td>7610</td>
</tr>
<tr>
<td>2011</td>
<td>7306</td>
</tr>
</tbody>
</table>

Zhejiang provincial administration for industry and commerce
First, strengthen the industry monitoring to identify and deal with enterprise risks. Enterprises in Zhejiang invest significantly in the real estate industry. The state’s real estate control policies are not expected to be released in a short term. Therefore, the bank should actively concern the real estate investment situation of the enterprise and at the same time pay attention to hidden risks brought by enterprise’s diversified investment and excessive expansion to prevent risks caused by poor enterprise management and capital chain rupture.

Second, pay attention to mutual guarantee among enterprises and establish effective warning mechanism. Mutual guarantee is a universal phenomenon among Zhejiang SMEs. To effectively control risks of mutual guarantee, the bank shall understand the operation situation of all associated enterprises, pay attention to credit risks brought by business change of mutual guarantee and deal with enterprise risks. Enterprises in Zhejiang which has a big hidden trouble. Once an enterprise suffers from capital chain rupture, this would trigger the financial difficulties of a series of enterprises.

Equations to sum up, problems of financial shortage and financing difficulties of Zhejiang SMEs are quite prominent. Their financing mainly relies on private credit market while bank credit accounts only a small proportion. Their capital chain is relatively vulnerable and their capital liquidity risk is quite large. These are prominent problems in the business operation of SMEs.

CONCLUSION

Through analysis, we can see that banks must actively deal with business operation and financing difficulties of Zhejiang SMEs so as to effectively control credit risks. Banks may take the following main coping strategies:

- First, strengthen the industry monitoring to identify and deal with enterprise risks. Enterprises in Zhejiang invest significantly in the real estate industry. The state’s real estate control policies are not expected to be released in a short term. Therefore, the bank should actively concern the real estate investment situation of the enterprise and at the same time pay attention to hidden risks brought by enterprise’s diversified investment and excessive expansion to prevent risks caused by poor enterprise management and capital chain rupture.

- Second, pay attention to mutual guarantee among enterprises and establish effective warning mechanism. Mutual guarantee is a universal phenomenon among Zhejiang SMEs. To effectively control risks of mutual guarantee, the bank shall understand the operation situation of all associated enterprises, pay attention to credit risks brought by business change of mutual guarantee.
enterprises and establish an effective warning mechanism to prevent adverse impact on the bank.

- Third, strengthen enterprise survey before loan and optimize quality of credit clients. Carry out sufficient survey of enterprise before granting a loan. The bank account manager must get to know the real business investment and financial status of the enterprise, the comprehensive quality of the enterprise owner, the company management and other various factors and ensure high quality of credit clients to control credit risk prevention from the beginning.

- Fourth, improve fault treatment efficiency and strengthen asset preservation measures. In case of a bad loan, take effective asset preservation measures in a timely manner. Pay attention to enterprise repayment source. For mutual guarantee, in particular, pay close attention to the repayment subjects of liability and implement liabilities of associated enterprises to minimize the bank loss.

REFERENCES