


Appendix Y

SME Financing: International Best Practices



SME Financing
INTERNATIONAL BEST PRACTICES
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Fundamental Considerations

- Appreciation of the Importance of SMEs
 - Technology-Based
 - Traditional
- Cultural and Economic Factors of Society
- Supportive Legal/Regulatory Framework
- Access to borrowings
- Equity:
 - Government
 - Non-government - foreign and domestic

Importance of SMEs

- To the Economy
 - Job creation
 - Innovation
- To Society
 - Management
 - Ownership
- To Individuals
 - Wealth Creation
 - Accomplishment

Cultural and Economic Factors

- Entrepreneurship
- Support of family and friends
- Competitive advantages
- Education
- Government programs of support
- Relationships to large companies

Legal and Regulatory Environment

- Laws allowing formation of a new company
- Number of regulatory approvals
- Time and difficulty of required approvals
- Honesty and transparency of regulation

Legal and Regulatory - Best Practices

Basic Principles

1. Simplify the formation of companies and investment funds by eliminating barriers and regulations
2. Require disclosure to relevant parties
3. Protect the interests of stakeholders with general laws

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Laws to Protect Stakeholders

For Example:

1. Workers protected by general labor laws
2. Investors protected by laws establishing rights and enforcement
3. Customers and suppliers protected by contract laws
4. Environment protected by law

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Access to Financing

- Borrowings
- Equity Financing

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Current Sources of Borrowings

- Banks
- Informal Lenders

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Current Government Support

- To encourage bank lending to technology-based SMEs, cities and provinces have formed credit guarantee companies
- Loan guarantees are generally not available to businesses that are not high tech
- Each credit guaranty company operates independently

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Best Practice for Credit Support

International best practice suggests desirability of

1. Uniform and consistent practices
2. Common credit standards and regulations
3. Central re-guaranty program as incentive
4. Marketing and promotion

(continued)

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Best Practice (Continued)

5. Need for training of guaranty personnel
6. Risk management and central data base
7. Lenders who are not banks

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Loan Related Facilities

- To support a lending program, a Credit Reporting System should be developed
- A secondary market for the guaranteed portion of loans would be helpful
- A micro loan program could serve small startup companies with very small loans

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Increasing Availability of Equity

- In China, equity currently available from:
 1. Friends and family
 2. Foreign investors
 3. Government-funded venture capital funds (primarily for high tech companies)
- Almost no domestic private equity invested

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Reasons for Equity Shortage

- Equity investors seek highest return consistent with the risk of the investment
- SME investments are difficult to evaluate
- SME investments take time to mature
- They are often difficult to liquidate
- In China, major institutional investors (pension funds and insurance companies) are not allowed to invest in private SMEs

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Equity International Best Practice

- To encourage investment in SMEs, most countries have programs that either:
 1. Increase potential returns to investors or
 2. Reduce risk of loss
- A pilot program could test the potential for attracting equity in China
- We have suggested a specific program, with sample regulations.

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Importance of Training

- In both credit guarantee companies and equity investment funds, management training is needed, and is not available.
- **New materials and courses must be developed and offered to fulfill this need.**

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Recommendations (1)

- Current programs should be available to high-growth traditional businesses as well as technology-based companies
- Credit can be increased by a combination of training, consistency of operation through an association of guaranty companies, and establishment of a national credit guaranty company by the central government.

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Recommendations (2)

- Non-governmental sources of equity financing can be attracted by a pilot program in which government would improve the profit opportunity or reduce the risk of loss to private investors.

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Recommendations (3)

- Laws and regulations should be modified to encourage financing:
 - The Company Law still inhibits financings
 - The Investment Funds Law is required if domestic funds are to be as attractive as foreign funds
 - Laws and financial institutions should be changed to make it easier for an investor to sell its investment as the company develops.

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Recommendations (4)

- Training programs are required in all aspects of SME Finance:
 - Training of loan officers
 - Training of loan guarantee officials
 - Training of investment fund managers
 - Training of entrepreneurs

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Recommendations (5)

Our recommendations will be described in more detail later in the Forum