

**CHINA'S SMALL AND MEDIUM ENTERPRISES
IN THEIR DOLDRUMS**

CHEN Shaofeng & HUANG Yanjie

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Executive Summary

1. China's small and medium enterprises (SMEs), which account for more than 99% of China's enterprises, form the backbone of the Chinese economy. In recent months, however, many of them are operating at a loss.
2. The number of SMEs reporting either losses or diminishing marginal profits is surging. It is estimated that 20-30% of SMEs in the Pearl River Delta and Yangtze River Delta regions will shut down if there are no policy changes.
3. The SMEs' plight was largely a result of institutional lapses. Marginalized by the government's policy and financial support, the SMEs are "at a natural disadvantage in competing for loans". They are being deprived of the right of free access to sectors monopolized by the SOEs, putting them at a grave disadvantage in the Chinese market.
4. The worsening business environment deriving from credit crunch, shrinkage of external demands, and rising costs of labor, energy, raw materials and other factors of production has posed a real threat to the survival of the SMEs.
5. Chief among the economic woes that the SMEs are struggling with is the higher borrowing costs resulting from a tightening credit policy. For instance, it is estimated that 70% of the SMEs in Wenzhou, Zhejiang province, could not obtain loans and have to rely on private sources to finance their daily operations at an interest rate as high as 200%.
6. Surging costs of other factors of production such as labor, electricity and raw materials have also further eaten away the SMEs' profit. Appreciation of the Chinese *yuan* and price hikes of raw and ancillary materials attributable to high inflation have added another layer of burden on the SMEs.
7. Part of the SMEs' plight has much to do with their corporate decision-making and operations at the micro level. Many had channeled a large bulk of their

earned returns into real estate, mining, stock market and financial derivative market for short-term profits, thus resulting in huge losses.

8. The Chinese government has recognized the challenges faced by the SMEs and pledged full support, such as greater access to bank loans, tax reduction, lowering market access threshold and optimizing government procurement mechanisms.
9. Furthermore, to give more support to smaller companies, the Beijing government has redefined the SMEs and is preparing for a special conference at the national level to discuss ways to help them.
10. But without dismantling the institutional hurdles, the Chinese government's repeated promises of promoting the growth of the SMEs may turn out to be empty promises.