Financing of SMEs in Sweden and China engaged in foreign trade

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First Cycle
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Foreign trade SMEs financing in Sweden and China

ABSTRACT
Small and medium-sized enterprise is most advanced and vigorous in economic development. It is the main power of GDP growth, which can expand employment, promote technological innovation and strengthen the economic structure non-governmentally. But SMEs have great difficulties accessing finance all over the world. In this dissertation, we aim to compare the foreign trade SMEs between Sweden and China, find the differences between SME financing in Sweden and China, and try to find solutions to the financing problems in China from the Swedish experience. We take Sweden and China as cases, interview two companies and a bank to collect data and analyze the empirical findings with the Modigliani-Miller Theorem, trade-off Theory, Packing order Theory, Financing gap, Transaction Cost Theory and Institution economics. Through making a comparison with Sweden, we have found that the Aggregate Capital Trust for SMEs is one of the more innovative financial forms in China, and Chinese SMEs still survive through people-to-people credit.

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Aim:
 a) Solutions for SME financing problems through the empirical analysis of Sweden and China;

 b) Which forms of finance will ensure SME survival.
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c) Chinese approaches to financing SMEs.

**Method:** As the research is focused on current happenings within a real life perspective, we are going to use case study and grounded theory for most of this master dissertation to obtain the current economic information. In this research, primary data from the interviews and secondary data will be used. We first collected the data from interviews with three companies and read their internal documents. Then, we found more information in reports from the National Statistics Bureau, books and other master dissertations, etc. The analysis will be done through a comparison of those data.

**Result & Conclusions:** After the analysis, in general, we find that the transaction cost, credit and asymmetric information are the factors which influence SME financing. We conclude that Sweden has its advanced financial support system and credit system. Sweden knows holding the balance between fairness and efficiency. However, in China, the existing financial system is not conducive to SME financing. And the system loses effective allocation of resources. Now People-to-people credit is still the major financing channel for SMEs in China.

**Suggestions for future research:** The authors have not completed an in-depth survey of data in this two countries’ government departments yet, because of the constraints. So it is necessary to discuss establishing a Government-lead financial service system for SMEs with other financial departments. The system includes SME Development Fund, Fund of Guarantee, and Venture Capital for general export/import SMEs.

**Contribution of the thesis:** The transaction cost, credit and asymmetric information are the factors which influence SME financing.

**Key words:** SME, financing gap, asymmetric information, aggregate capital trust, people-to-people credit
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1. INTRODUCTION

This study focuses on the comparison of Swedish and Chinese foreign trade financing for small and medium size enterprises (SMEs). Based on the current SME financing situation in Sweden and China, we will look for common problems and seek answers to solve them.

1.1 Background

SMEs play a vital role in economic development in Sweden and in China. They offer the most economical use of capital in relation to job creation and provide the strongest growth channel for regional development. At present, SMEs are recognized as an important factor for growth in today’s regionally and globally interdependent and competitive economy. But SMEs are said to experience difficulties in accessing finance. The problem does not only exist in developing countries but also in developed countries.

Are the SMEs in Sweden facing the same difficulties in accessing financing? Finance in its different forms is clearly legislated in Sweden. In Sweden, over 90 percent of companies are small and medium-size enterprises, as most of them have less than 250 employees. The SME sector in Sweden accounts for 60 percent of total private employment (JEREMIE, 2007)\(^1\). Over the past two decades, as the Swedish government gradually began to attach importance to the development of SMEs support, their policies started to transfer their attentions from existing large-scale and traditional enterprises to small and medium enterprises. The Swedish SME sector reflected its great importance in the economy. The proportion of SME turnover accounts for about 60% of total turnover, especially those with less than 50 employees who create over one-third of total turnover. They were responsible for 57% of the gross domestic product increase in the Swedish economy. In 1998, 66% of net investment was added in the SME sector (Jacob et al, 2003). The Swedish SME sector is therefore of major importance both in terms of employment and economic contribution (Jacob et al. 2003, pp. 25-26).

In China, SMEs grow fast, playing an ever more vital role in the national economy, and has made an enormous contribution to the country's economic growth since the reform and opening up of policy. The National Bureau of Statistics of China report (2010), indicates that SMEs make up approximately 99% of all enterprise numbers, their gross value of industrial output and profits account for 60% and more than 50% respectively. The average growth achieved was 28%, annual exports generating foreign exchange accounted for 60%. SMEs have provided 75% of the employment

opportunities. The annual payment of taxes accounts for more than 50% of the total national tax revenue. A variety of evidence indicates that SMEs have become a very important economic force in the Chinese economy. However, in the process of SME development, capital shortages and difficulties in financing have not been resolved, which severely restricted SME development.

1.2 Problem formulation: research questions

More than 90% of the foreign trade companies in China are small and medium-sized enterprises. Judging from the available information, China’s SME financing problems will always be difficult to solve. However, despite difficult financing circumstances, how do SMEs sustain their survival? What factors may influence foreign trade SME financing?

1.3 Aim and Limitation

This article aims to find out:

a) Solutions for SME financing problems through the empirical analysis of Sweden and China;
b) Which forms of finance will ensure SME survival.
c) Chinese approaches to financing SMEs.

To analyze how five basic theories influence SME finance. This study will find general factors that influence Swedish and Chinese foreign trade SME financing. Since we have constraints in some fields, we cannot access the latest micro statistics for all economic sectors. Therefore backgrounds are described, current financing opportunities for Swedish and Chinese SMEs, government policy, and financing structure. As far as possible, information was obtained from the latest articles and official websites. In the enterprise survey, visits to two enterprises were done, one in Sweden and the other in China. The financial data from the two enterprises was difficult to access as this information was not openly shared by the owners. Scholars who are interested in this field should ensure enough time to collate data in detail from government, banks and enterprises in Sweden and China. As the time allowed for research was limited, we could not do further research on venture capital funds.
1.4 Disposition

The remaining paper is organized as follows.

- **Chapter 2**
  - Method
  - In this chapter, we will choose the ways that we collect data and how we use it to our analysis.

- **Chapter 3**
  - Theory
  - In this part, we will use six basic theories, the Modigliani and Miller theorem, Trade-off Theory, Pecking order Theory, Financing gap and Transaction Cost Theory and institution economics.

- **Chapter 4**
  - Review & Empirical Study
  - In the empirical work, the current conditions for SME financing in Sweden and China through interviews with banks, companies and secondary data in books and articles are described.

- **Chapter 5**
  - Analysis
  - Here we would like to discuss about our studies combined with theoretical framework.

- **Chapter 6**
  - Conclusion
  - In this part, through the comparisons, we are going to answer and give suggestions for our research questions.
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2. METHODOLOGY

In this chapter, an interpretation will be given on the choice of the research methodology and research problems for this study. The chapter starts with a clarification of the research process and the approach applied. Subsequently, we elaborate on our research strategy and analysis of the collected data. Finally, in terms of validity and reliability of the study as a whole is shown.

2.1 The scientific process perspective

A problem can be researched in many different ways, but it is critical that it be done in a scientific way. It is useful thinking of the research process as consisting of nine specific phases. There are:

![U-model](image)

Figure 1. U-model (adopted from Lekvall and Wahlbin, 2001, P.183)

Referring to the Lekvall and Wahlbin model (2001), there are different levels and steps in the research process. Following this U model, the first step of this research study is choice of the topic, of SMEs in Sweden and China engaged in foreign trade. The background to the current situation leads to the purpose of the research. The study then describes what problems in financing will be researched and the relevant theory. The methodology part designs how these questions are going to be answered. All of that is based on the data collection which is very important and must be truthful.
By working through all steps to the top from the left side to the right side, a conclusion (which answers the purpose) based on analyzing the empirical findings can be found, and the recommendations defined.

2.2 Research approach

This study aims to investigate to what extent the financial structure theories, as presented, are sufficient to explain the reason for differences in financial structures between Swedish and Chinese SMEs. According to Saunder et al. (2001), a research approach has two methods, the deductive approach and the inductive approach. The deductive approach was considered for use in this research. In order to describe general financing in the current situation for both Swedish and Chinese SMEs, and analyze the main determinants of their financial structure, this dissertation uses qualitative data (Easterby-Smith, et al. 1996) which allows the research study to examine the financial problems in detail. The primary data and secondary data gives a more nuanced explanation to how these problems are actually created, and how the SMEs cope. The combination of these two approaches facilitates the observation of SME financing problems in different dimensions, then improves the understanding of the comparison between Swedish and Chinese situation.

2.3 Research Strategy

According to Saunders et al. (2001) there are eight major scientific strategies in research: experiment; survey; case study; grounded theory; ethnography; action research; cross-sectional and longitudinal studies; exploratory, descriptive and explanatory studies. The case study strategy has considerable ability to generate answers to the “why” as well as the “what” and “how”. When the research is focused on current happenings within a real life perspective, the case study is one of the most useful strategies. Besides, we are going to use grounded theory for most of this master dissertation to obtain the current economic information.

2.3.1 Case study

Robson (2002) mentions that the case study as a strategy for doing research involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple sources of evidence. This research is a case study which is conducted by a comparison of the financing situations of Swedish and Chinese SMEs in the foreign trade industry. Its purpose is to investigate and describe the financial problems of SMEs in a development phase. Interviews were held with two companies, one from China and the other from Sweden. As research questions might be theoretical and consist of what causes the financing problems and what they will do to resolve the problems in SMEs. Based on these interviews, a comprehensive view of
the phenomena that includes information of financing in SMEs is gained.

2.3.2 Case study design

Yin (2003) defines that a research design is the logic that links the collected data and the conclusions drawn to the initial question of the study. This research questionnaire is designed to collect data following the theory. In this study, we chose two real cases to describe the financial environment of SMEs in China and Sweden, and study the reality of SMEs financing situation.

2.4 Collecting Data

Delbridge and Kirkpatrick (1994) categorize the three types of data generated by participant observation as “primary”, “secondary” and “experiential”. In this research, primary data from the interviews and secondary data will be used.

2.4.1 Primary Data

Primary data means the data did not exist prior to the research. When in-depth information is required, an interview is one of the most common sources. The use of interviews can gather valid and reliable data that is relevant to the research questions and objectives (Saunders, et al. 2001). It can focus on SME financing problems directly and with insight. However, interviews also have limitations. This research collected the primary data through the interview process which included telephone interviews and face to-face interviews. Because of the distance and the time differences, the interview with the Chinese company had to be done by telephone when it was midnight here in Sweden. The major sources of primary data in this case study were from observations and interviews with Long Design AB Company and Swedbank in Sweden, and also the Gufeng Trade Limited Company in China. All these companies are listed by our teachers and a Swedish SME organization named Mellansvenska Handelskammaren. We first contacted them by sending an e-mail with the questionnaire attached, then we made an appointment once they had agreed to an interview. Each of the interviews lasted about one hour so as to gain enough information about financing. There were two questionnaire versions, a Chinese version for China and an English version for Sweden. The questionnaire was initially developed in English. To obtain the Chinese version, the questionnaire was translated into Chinese by an individual fluent in both English and Chinese. To ensure translation equivalence, the questionnaire was back-translated into English by another bilingual native Chinese unfamiliar with the survey instrument.

2.4.2 Secondary data

Referring to Saunders et al. (2001), secondary data includes both quantitative and qualitative data, and they can be used in both descriptive and explanatory research. Where these have been used as secondary data, this will be indicated. In this study, in order to complement the information gathered during the research, books, journals, newspapers, web-pages, legal documents and reports were considered for use.
addition, these books and articles contained full references to make sure that all areas were covered in this research. The Swedish data is mainly from Google scholar, Uppsatser, Scirus, SAGE journals online, Science Direct, Springerlink, and ISI Web of Science. And the Chinese data is mostly from CQVIP, Baidu Search Engine, and National Bureau of Statistics of China.

2.5 Analysis of Data

Referring to Yin (2003), a case study should start with a general analytical strategy. There are two types of data used in this study, quantitative data and qualitative data. Quantitative data refers to all such data and can be a product of all research strategies. And the qualitative data is associated with such concepts and cannot be characterized in a standardized way (Saunders et al. 2001). In this thesis, we first collected the data from interviews with three companies and read their internal documents. Then, we found more information in reports from the National Statistics Bureau, books and other master dissertations, etc. The cross-case figures for the same period clearly show, with a general comparison, the difference between Sweden and China in financing structures. On the other hand, the analysis will be done through a comparison of bank financing and the comparison of financing structures, associated with Modigliani-Miller Theorem, The financing gap, Transaction Cost Theory. Conclusions from these analyses will be drawn with advantages and disadvantages to find the similarities and differences against the frame of references about SMEs financing in Sweden and China.

2.6 Quality of research

The validity and reliability of data is important in research. According to Saunders, Lewis & Thornhill (2001), validity estimates the potential of the applicable method to measure what it is supposed to measure, and reliability evaluates the ability of the method to give reliable and trustworthy results from the data. With the two concepts being applied in research, the same outcome should repeat itself every time.

2.6.1 Validity

Lekvall & Wahlin (2001) stated that validity addresses whether the correct questions were asked. So as to guarantee the validity of this research, each part is written following the U-model discussed above and headed in the same direction. It is important to raise the question of whether the report on financing data reflects an accurate response to the relative question in the questionnaire. However, few Chinese articles, government information and legal documents are printed in English. A translated Chinese version might be obsolete or mistranslated by the translator. To mitigate the risk of obtaining obsolete or incorrect data we have tried to triangulate and cross-compare all country-specific material. At the same time, there is the risk that the interview questionnaires are too subjective and hide certain facts or lies.
2.6.2 Reliability

According to Yin (2003) a case study is reliable if the same findings and conclusions would be reached if another researcher were to conduct the study again. And he defined that the aim of reliability is to minimize the errors and biases in the research. The general way of approaching the reliability problem is to take as many steps as operationally possible. In addition, on the basis of Yin (2003) recommendations, a case study protocol was used to increase reliability by establishing data containing research related material, recorded interviews, articles, professor’s comments and suggestions at various stages of work. In this dissertation, all steps of the study should be followed and repeated to get rid of the errors. Three people were interviewed Lars Hård, the president of the Long Design AB Company, Luo, the president of the Gufeng Trade Limited Company and Lars Forsell, the chief of the Swedbank in Gavle. We will use the same questionnaire with two language versions for Long Design AB Company and Gufeng Trade Limited Company. A questionnaire from a bank perspective will be used in the Swedbank interview.
3. THEORETICAL FRAMEWORK

3.1 Modigliani-Miller Theorem

Modigliani and Miller (1958) argued that a company's capital structure is unrelated to the company's market value, when corporate income tax is not to be considered and a company has different capital structures but face the same business risks. They made five assumptions for the theorem:

- Companies in a tax-free economic environment;
- The company's dividend policy is unrelated to the enterprise value;
- When a company issues its new debts, the company market value with existing debt will not be impacted;
- Company has no bankruptcy costs;
- Highly developed capital market.

Modigliani and Miller made amendments to this theorem in 1963. They took the company income tax into consideration and pointed out that within the function of tax, companies will raise their market value by adjusting the financial structure in which to increase debt financing.

Zhang (2008) pointed out that the Modigliani-Miller Theorem essentially illustrated there is no link between a company's capital structure and firm value within a developed market. The theorem indicated that a company should not focus on the right side of the balance sheet in which capital structure is recorded. From the perspective of entrepreneurs, on the contrary, they should be more concerned on the left side of the balance sheet (asset column), which means operators should concern themselves about how to improve the profitability of assets. Thus Zhang made an important conclusion regarding the Modigliani-Miller Theorem stating that the maximizing value of capital depends on its use rather than its source. This conclusion can be further understood. If a company invests in high-return projects, the company will be able to obtain low-cost funding from the capital market. In turn, from the perspective of suppliers of funds, they will agree that maintaining profitability is the main reason for the security of loans. Therefore, in Zhang’s article, he argued that the core for assessment of bank loans, in the given conditions, should be to value the profitability of enterprises and their projects or business plans rather than the other.

3.2 Pecking order Theory

The pecking order approach was suggested within a financial market which produces asymmetric information (Gracia and Mira, 2008). The pecking order occurs when companies have to accept the cost for asymmetric information except for the
transaction cost of issuing new securities. Thus, new securities launched in the market could be less valued due to asymmetric information. Finally, according to Myers and Majluf (1984), some potentially profitable projects may not be launched by company managers if they have to finance through uncertain risk instruments.

Gracia and Mira (2008) pointed out that the order is led by the financing sources. As a result, to minimize asymmetric information costs and other transaction costs, according to the principle of least effort, corporations will finance new investment with internal sources first, as these internal sources provide unequaled access to information. Internal financing is mainly made from internal cash flows. Since the internal source of financing does not need signed contracts with investors, and there are no other payments, and fewer constraints, internal sources of financing are definitely the first choice. This finance is a safe short-term debt. Lastly, when it is not sensible to incur any more debt, they will use equity financing (Myers and Majluf, 1984). Cosh and Hughes (1994) suggest that SME financing behavior can be demonstrated through the pecking order theory. Frank and Goyal (2003) also agree that this approach can illustrate SME financing behaviors, in terms of SMEs being especially impacted on by asymmetric information problems, such as adverse selection and moral hazards.

### 3.3 Trade-off Theory

According to the theory, companies are willing to receive the optimum capital structure and weigh up how much equity finance and how much debt finance to issue taking into account the costs and benefits thereof. Except for partly financing with equity financing, companies also consider the advantages and disadvantages of partly financing through debt. The advantages come from the interest payment being deductible from company tax (Modigliani and Miller 1963; DeAngelo and Masulis 1980). Moreover, Jensen (1986) and Stulz (1990) commented that debt financing can free cash flow and will solve the problem of absence of cash flow. On the other hand, Kraus and Litzenberger (1973) argued the disadvantages of debt would be generated through the potential cost of financial distress, including bankruptcy costs of debt and non-bankruptcy costs. The trade-off statement in fact illustrates the rate of real corporation indebtedness reverting to an optimum point (Myers, 1984)

### 3.4 Financing gap

The financing gap is prevalent in economies around the world. It is regarded as a huge obstacle that interrupts development of small and medium-sized enterprises and can even be a difficult problem that affects the future development of the general economy for a country. Due to rapid development in innovation, the financing gap is
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becoming more and more critical in a fast-changing knowledge-based economy. The concept of a financing gap was defined by the MacMillan Committee (1933). It refers to problems when small and new businesses want to finance their small amounts of long term capital with financiers, such as banks and owners.

The opacity of firms is often argued as one of the most important reasons of financial market imperfections (Hyytinen and Pajarinen, 2005), such as the degree of asymmetric information between insiders and outsiders (Petersen and Rajan, 1994; Hubbard, 1998; Berger and Udell, 1998). Under the conditions of a credit crunch, Martinelli(1997) argued, the financing gap results from some companies which have short term debt, but insufficient credit history and a small quota of debt. Interest rates increase which leads to the credit market shrinking, which has a bad effect on lending to enterprises. When the credit market has sufficient capital, the financing gap results from asymmetric information of enterprises and ethical risk of enterprises, which argued by Stiglitz and Weizz (1981).

Organizations for Economic Co-operation and Development (OECD) in their report the financing gap: Theory and evidence, state that organizations funding SMEs have a distinctive challenge. First of all SMEs are classified through the difference of their own differing profitability and growth. Their survival is usually shorter than the big companies and they constantly generate year-to-year volatility in earnings. It is difficult to clearly distinguish the financial situation of the SMEs from that of its owners. In addition, the relationship between the company and the shareholders influence personal relations at a higher degree than in large companies. SMEs tend to be managed personally by the owners.

3.4.1 Asymmetric information

The asymmetric information problem is more serious in SMEs than in large firms. Most scholars believe that asymmetric information between banks and enterprises is an important reason for financing of SMEs. Banks and financial intermediaries as information intermediaries are considered as agents that play a major role in the financial system (Crouzille et al. 2004). Stiglitz and Weiss (1981) claimed that as borrowers hold more information on income of projects and the actual use of funds than banks within the credit market, asymmetric credit market information must be created and results in an artificial risk which is adverse to selection and moral risk. Entrepreneurs have more access to the effective information in the operations of a business than investors, including advantages and disadvantages. Nevertheless, the entrepreneur possibly has less experience in business than those in a big company in an uncertain market, which makes it difficult to classify the good firms and bad firms (OECD, 2006).

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2 Organization for economic co-operation and development of OECD(2006), policy brief (November 2006)

3 Organization for economic co-operation and development of OECD(2006), policy brief (November 2006), Page18
These form a phenomenon known as the lemons problem which was first developed by Akerlof (1970). The lemon phenomenon suggests that a lender cannot have access to all information from the borrower. Therefore, the banking sector cannot completely and effectively take ownership of all of their assets, which results in credit risk arising. The lender will set a high interest rate for the credit market in which high risk SMEs prefer to obtain loans, and large firms are then reluctant to take part. Hence, in general, good firms will be displaced by inferior firms, and inferior firms will gradually dominate the market. Credit rationing is one of the ways to effectively manage credit risk.

Following the theory of credit rationing within the indirect financing channels, (Stiglitz and Weiizz, 1981), in order to maintain the need for investment in their production and operation or in new projects, SMEs loan the money from a bank as the main financial intermediary. SMEs, due to the poor direct financing channels, cannot achieve the targets of enterprise development, so a majority of them are heavily dependent on bank loans (Fan and Zhang, 2007). Thus banks will usually run with the policy of credit rationing for small and medium-sized enterprises, due to the risk in financial security, profitability and currency liquidity.

All kinds of risks will occur during the financing procedure, because of information asymmetries. The most typical is the adverse selection and moral hazard behavior. The conclusion is shown in the following table:

<table>
<thead>
<tr>
<th>Reasons for credit rating</th>
<th>Adverse selection</th>
<th>Moral hazard</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period</td>
<td>Before loans</td>
<td>After loans</td>
</tr>
<tr>
<td>Performance</td>
<td>Companies will hide the information that go against themselves, such as balance sheet and investment needs</td>
<td>After getting loans, companies will change their use of loans to invest into high risk projects.</td>
</tr>
<tr>
<td>Result</td>
<td>Banks hesitate to finance enterprises. SMEs are hard to finance.</td>
<td>Bank’s bad loans. SMEs credit is discounted.</td>
</tr>
</tbody>
</table>

Sources: Zhang (2008)

3.4.2 Adverse selection

Adverse selection is caused by the asymmetric information, such that the potential risk of non-performing loans comes from those who actively seek loans. Adverse selection is a major cause of bad loans. As the lender cannot accurately differentiate low-risk lending opportunities from high risk lending opportunities, the lender will decide not to grant any loans to borrowers. In the case of asymmetric information,
banks can only be judged from the average risk. When the interest rate increases, the low-risk lenders will withdraw from the credit market, and more high-risk borrowers come into the market where they increase the overall risk of loans funded. An increase in the interest rate will lead to adverse selection behavior. Therefore banks will prefer the use of credit rationing for refusing a small part of lending demand on relatively low interest rates (Zhang, 2006). Leaving aside the theoretical details, OECD (2006) pointed out that the core of this argument is that suppliers of finance may prefer, due to the problems of dealing with uncertainties such as agency problems, asymmetric information, adverse credit selection and monitoring problems, to provide an array of interest rates for significant numbers of potential borrowers without access to credit.

3.4.3 Moral hazard

According to the theory of credit rationing (Stiglitz and Weiss, 1981), there are two risks of moral hazard in credit markets. Staging the commitment of capital and preserving the option to abandon the project are the key characteristics in venture capital financing. The higher the risk in a project, the higher the probability venture capitalists will want to get deal (Wang and Zhou, 2002). Firstly, borrowers will make a cost comparison between default and reimbursement, in the case of having the ability to repay the loan. But ultimately they would strategically choose not to repay the loan to reduce cost. Secondly, borrowers will use the loans that they receive for investment in the projects which are impossible but can gain huge benefits if successful. If cash flows are not completely verifiable, entrepreneurs may appropriate investments. If the effort is not verifiable, entrepreneurs may shirk job responsibilities. In addition, if there are personal benefits from continuing a project, entrepreneurs may keep the project going even if it has negative expected profits (Wang and Zhou, 2002). Gompers (1995) pointed out that in financing high-risk companies with pervasive moral hazards, staged financing allows venture capitalists to gather information and to monitor the progress of projects while maintaining the option to quit. As the banks do not have complete information on the willingness of the borrowers to repay the loan, they are therefore faced with the risk of moral hazard from borrowers.

Asymmetric information between SMEs and financial intermediaries (banks) means banks face serious adverse selection and moral hazard risks, when financing SMEs. The problems of moral hazard and adverse selection often appear simultaneously in real economic phenomena (Theilen, 2002). Banks strategically choose credit rationing on SME loans for their own profitability, which causes the indirect financing gap for SMEs in the credit market.

3.5 Transaction Cost Theory

Coase (1937), in his paper The Nature of the Firm, claimed that market transactions have a price, and a cost is incurred in the operation of the market price mechanism. For instance, it is difficult to sign a long-term contract or short-term contract because of the higher cost of implementation which results from the presence of uncertainty
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and predicted difficulties. Williamson (2007) argued that transaction costs will attribute to two types of determinants. Firstly, from the perspective of the properties of the transaction, the elements consist of asset specificity, uncertainty and transaction frequency. Secondly, it is human factors such as rationality and opportunistic behavior. In summary, the determinants of transaction costs are frequency, specificity, uncertainty, limited rationality, and opportunistic behavior. North (1990) pointed out that because the goods and services have their multidimensional properties asymmetric information must exist between both sides when the transaction is running, which provides the conditions for incurring opportunistic behavior and creates transaction cost.

Yang and Zhang (2003) believe that transaction costs can be divided into endogenous transaction costs and exogenou transaction costs. Exogenous transaction costs are the costs which directly or indirectly take place within a transaction. An endogenous transaction cost is created by opportunistic behavior when different participants disagree over the benefits of labor division. Zhang (2008) suggests that the determinants of transaction costs, argued that a good level of SME credit is the key to effectively reducing the cost of financing and makes fluent financing activities, which especially reflects on the reducing of endogenous and exogenous transaction costs.

Zhang (2008) also claimed that a relatively stable social credit system can be maximized to reduce the endogenous transaction cost which is generated by asymmetric information, uncertainty, limited rationality, and opportunistic behavior. Therefore Zhang listed four specific reflections for a stable social credit system. First of all, in order to maintain a good reputation for obtaining opportunities in transactions, entrepreneurs with limited rationality will balance current benefits and future benefits. Especially for those business people with foresight, they prefer to pay more attention to their own credit and make decisions based on the long-term benefits. Secondlya trustworthy status of the individual’s credit, in a constant transaction system, will be recorded through credit ratings and will be delivered into the wider economic community. Thirdly, within a perfect social credit system and legal system, the consequences of participant’s activities and transactions will be more easily expected, which as a result, to some extent weakens the uncertainty of the future. Furthermore, since business credit plays a more and more important role in financial transactions, high transaction costs generated by asymmetric information is gradually decreasing. An effective social credit system with a complementary legal system will punish the people who break their contract, and protect the legitimate rights for those who are observant.

3.6 An overview of Institutional Economics

Coase (1998) claimed that institutional economics is starting to be researched in the transaction cost that was neglected by traditional economics. It mainly researches the structure and what effect the reducing transaction costs institutional change. Its core
concept includes institution and transaction costs. Institutional cost is defined as the regulations, rules and laws of how to trade.

In general, there are two complementary institutions in any society. One of them is the formal institution, and the other is the informal institution. Formal institution means laws, regulations to be implemented through national coercive power. Informal institution is the rules which forms in the process of values, ethics, customs and ideology evolution and is widely accepted by the public. Informal institution is the basis for formal institution and formal institution is the advanced standardization of informal institutions. The transaction cost that institutions do economic research in is the operation cost of economic institutions. In detail, transaction can be divided into two parts. One of them is supporting costs, such as the cost of rules making and implementing, the other is the cost of the transaction occurring, such as the cost of negotiation, contract signing, problem solving, etc.

3.7 Internal limitations for SMEs financing

From the perspective of differences in the financial structure between small businesses and large businesses, Hughes (1994) found that small businesses have lower fixed to total assets ratios, a higher proportion of trade debt in total assets, a much higher proportion of current liabilities to total assets and in particular a much greater reliance on short term bank loans to finance their assets, a heavy reliance on retained profits to fund investment flows, to obtain the vast majority of additional finance from banks with other sources, in particular equity, very much less important, a higher financial risk profile, as reflected in their relatively high debt to equity ratio and in their higher failure rates (Evans, 1987a, b; Storey et al., 1987; Cressy, 1996b).

In non-Organization Economic Cooperation Development (OECD) countries, the lack of integrity is considered as one of the basic causes for a financing gap. Xu (2009) argued that the lack of financing for SMEs has a very deep internal reason which is the lack of a corporate credit culture. The entrepreneur has access to better information, according to the operation of business, and likely has considerable room for sharing of information with the outside world. However, the entrepreneur has less experience in business than those in large companies, although they can operate in uncertain circumstances. Therefore, it is difficult for external financing agencies to judge if the entrepreneur makes a wrong decision. In addition, the entrepreneur may have an incentive to hide non-transparent financing information, not only with lenders but also with other outsiders such as tax authorities and regulators (Xu, 2009). In order to reduce the bank's bad debt rate, banks usually prefer to finance with large-enterprises whose transparency of information and cash flow stability is on a high level. So it is difficult to obtain financial support from banks for the opacity of information from SMEs. In the case of lack of credit, a very big barrier for SME financing is lack of transparency in the financial situation (OECD, 2006).
Moreover, in order to reduce the risk of information opacity in financing SMEs, it is quite common that banks require appropriate collateral. It is very difficult to convince banks, because SMEs in developing countries have insufficient appropriate collateral to support their applications for finance (Thai and Xu, 2009). Xu (2009) argued that most Chinese SMEs lack the abilities for Mortgage-style Security. Xu suggested that most SMEs have crude production and management levels and generally use their limited capital for maintaining normal operations rather than investing in equipment. This leads to ineffective guarantee provisions, resulting from insufficient assets that can be mortgaged.
4. REVIEW OF EUROPEAN AND CHINESE SME FINANCING

The general function of SME financing is to combine investment with financing and using investment to promote financing. The SME financing decision is a part of company investment decision, so that finance must directly support investment, which includes the coordination between amount of capital and time. Companies need to make good investment decisions leading to a good level of financial management. SME finance is an economic topic everywhere in the world. Now in this part we will describe the SME financing environment and the financing characteristics of the European Union, Sweden and China.

4.1 European financing sources for SMEs

After the economic crisis of the early 1990s, the Swedish economy, in absolute and relative terms, was growing strongly and constantly. The Swedish statistics show that it continued to grow in 2007 with a huge and increasing explosion of domestic demand and exacerbated by expansionary fiscal policy, an improving labor market and broad-based investment growth. The Swedish economy is characterized by an export-oriented mixed economy in which it owns a modern distribution system, excellent internal and external communications, and a skilled labor force. In the European Investment Fund (EIF) report JEREMIE (2007), the growth in domestic demand stimulates export activities. In common with most European countries, 99% of all the Swedish enterprises are categorized as SMEs who have less than 250 employees. In the market economy, it is inevitable that there is information asymmetry. So the high interest rates and high financing costs caused by asymmetric information obviously restricts the process of internationalization of foreign trade in SMEs. High costs of finance or limited venture capital to fund the export environment is one of the critical barriers (Morgan and Katsikeas, 1997).

4.1.1 Overview for European SMEs financing environment

Providing credit guarantee for SMEs
The European Investment Fund (EIF) is the European financial institution which is owned by the European Investment Bank (EIB) and consists of a wide range of public and private banks and financial institutions. It aims to promote the creation and development of SMEs by guaranteeing loans to SMEs and financing the venture capital funds. The EIF pays more attention to new companies with its investments, especially those focused on technology and life sciences. The Fund has two main forms of guarantee. The first form of guarantee is to provide not less than 50% of the financing guarantee for SMEs; the second form of guarantee, based on growth and environment, is to guide the set up of projects. This is aimed to provide financial
security for those SMEs with less than 100 employees, when they invest in the projects that can bring significant environmental benefits. These two measures enable SMEs to obtain more favorable loan terms and get a lower interest rate.

The European Investment Fund (EIF), in 2001, signed a commitment with Sweden to invest EUR 15 million in InnKap 3 Partners\textsuperscript{6}, a new fund belonging to a Swedish based innovations capital company. The InnKap 3 would support new enterprises which are in the start-up and early stages and involved in the fields of advanced high technology.

**Using the capital market**

Alternative Investment Market (AIM) is to date, the second board market in the region of Europe. It mainly offers financing services for newly established SMEs. AIM provides a financing market with a relatively low admission. It has no requirement for applications, such as industry sectors, capital assets and firm size, operating history, business performance and investor-owned shares. Therefore, the market regulation is more stringent in this second board than in the main board market.

**To develop funds for venture capital**

European Investment Bank (EIB) and European Investment Fund (EIF), two major financial institutions in Europe, in 1997 cooperated and established a project called European Technology Fund (ETF). This fund is managed by the European Investment Fund (EIF) and was established with EUR 250 million from the European Investment Bank (EIB). The ETF does investment in specialist venture capital funds (25% capital share) supporting the creation and development of high-tech, growth-oriented SMEs in the European Union.

**Financing through policy banks which specifically serve SMEs**

European Investment Bank (EIB) is a policy bank that was set up by the European Union to particularly provide financing services for SMEs. The EIB can provide three kinds of loans.

- **Global loans** — It is used for supporting SME investment in the industrial, services, agriculture investment and small-scale infrastructure sectors and with the EU energy and transportation development plans.
- **Discount Loans** — It is supported from the EU budget and offers discount loans for those SMEs with less than 250 employees and capital assets of EUR 75 million.
- **Amsterdam Special Action Programme (ASAP)** — ASAP is a three-year plan established with EUR 1 billion that EIB operates. Its purpose is to provide investment and financial support for the highly labor-intensive and new technology SMEs.

4.2 Swedish SME’s financing environment

Sweden has a developed economic environment which scores highly in various social and economic indicators. According to the Sweden Statistics Bureau (2009), the GDP of Sweden is USD 399.84 billion and the per capita GDP is USD 43 thousand. As the Swedish government pays much attention to SME development, the competitiveness of the Swedish economy is hardly in the top three in the world every year. Prosperity and development of SMEs not only gives new vitality to the Swedish economy but also increases employment opportunities and enhances technological innovation.

The definition of SME in Sweden
The Swedish government defines SMEs based on the number of employees in the company. Those companies which have less than 250 employees are categorized as SMEs.

Since the 1980s, the Swedish government has paid attention to the role of SMEs in Sweden, issuing many policies in the legislative and financial areas in support of SMEs. In order to expand state-owned equity in SMEs, the Swedish government encouraged venture capitalists to enter the market. The government diversified financing resources for SMEs and created a good financing environment for the market.

4.2.1 Governmental Supporting funds

(NUTEK)Swedish Business Development Agency - the Swedish Agency for Economic and Regional Growth
Different countries have different agencies to support SMEs. In Sweden, there is an agency called Swedish Business Development Agency (NUTEK). The purpose of NUTEK is to enhance trade and industry throughout Sweden, which leads to the creation of new enterprises, and helps existing companies to develop and strengthens regional development. NUTEK (2002) pointed out that the agency’s task is to promote sustainable growth throughout the country through SME financing. It can offer financial support for SME development, funding for projects in various areas and financial assistance to organizations promoting industrial development and competitiveness. Grants may be available from Government agencies or other councils for specific purposes (Catherine, 2003).

VINNOVA - the Swedish Governmental Agency for Innovation Systems
VINNOVA, a State authority, is supposed to promote growth and increase prosperity throughout Sweden. This is a very important institution which provides services for innovative SMEs. VINNOVA has the task of issuing grants to support innovations
Foreign trade SMEs financing in Sweden and China

linked to research and development, to fund the enterprises that require research and to strengthen the networks.

**INNOVATIONSBRON**

INNOVATIONSBRON is an important institution which helps with the commercialization of research-based and knowledge-intensive business ideas through the provision of grants and investment mechanisms. Its activities critically contribute to involve universities and other high education institutions in the business environment and to create a board for exchange of knowledge and experience between academics, industries, investors and the community. It finances the development of Sweden’s best hi-tech parks through a contribution of expertise, contact networks and financing.

A report (2007)\(^7\) from the European Investment Fund (EIF) shows that in Sweden there are various public institutions for SME development on a national level. The major institutions will be shown in the following figure 2.

**Figure 2: National Institutional Landscape - Sweden**

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\(^7\) JOINT EUROPEAN RESOURCES FOR MICRO TO MEDIUM ENTERPRISES INTERIM REPORT FOR SWEDEN: *SME Financing Gap Assessment* (2007), this report was compiled with the support of the Swedish Ministry of Industry, Trade and Communications and with the assistance of NUTEK, the Swedish Managing Authority for Economic and Regional Growth. Many key market participants within Sweden contributed their expertise to the process.
According to figure 2, we can conclude that those SMEs which start their business in the pre-seed period can possibly get grants of money from 6 governmental supporting agencies, such as University Holding Companies, VINNOVA, INNOVATIANSBRON, ALMI, Regional Funds and State Energy Sector. When SMEs develop in the seed period, they can get large amounts of capital from NUTEK and VINNOVA, of course only if they have huge development potential.

Other Financial intermediaries (equity financing)

Venture capital: the options range from a joint-venture partnership with a bigger or better-financed company to develop SMEs. Winborg (2000) states that it is necessary to undertake steps to develop the Swedish venture capital market. The formal venture capital market was relatively limited to some industries, such as foreign trade business. Sweden has about 200 Venturetect Investment Corporations and these companies are managing over 150 billion Swedish Krona.

Public market

● Factoring: According to Guttman (1994), many SMEs are using factoring as a way to get needed financing. It involves selling accounts receivable to a lending company, which advances 80 percentage of their value. The lender raises funds
Foreign trade SMEs financing in Sweden and China

through notes, debentures, commercial paper and short-term borrowing. This way, SMEs receive money and payment of future invoices immediately.

- **Disintermediation**: is another method of raising capital economically and quickly (Grimaud, 1995). One important factor is a drop in the cost of servicing customers directly.

- **Stock market**: This is one of the most important sources for companies to raise money. This allows SMEs to trade its shares publicly, to raise additional capital for expansion in a public market.

**Financial intermediaries (debt financing)**

**Loans**: SMEs prefer long-term debt from the bank when their own supply of capital is insufficient to meet their demand for financing. According to Winborg (2000), the bank in Sweden stipulated the valid interest rate and amount of lending for a certain period. During the period, SMEs cannot sell their assets without the banks agreement. Moreover, if the company cannot pay back the debts on time, the bank will take priority over the owners.

**Overdraft**: In comparison to a loan, an overdraft is cheaper and a good source of short-term financing for SMEs when there is a shortage of cash-flow. However, the sum of money is limited.

**4.2.2 Financing SMEs in Sweden (Perspective from banks)**

In this part, we collated the empirical data with an interview with Swedbank. The person we did the face-to-face interview with is the chief of Swedbank in Gävle, whose name is Lars Forsell.

**Swedbank**

Swedbank was founded in 1820 as Sweden’s first savings bank. Swedbank has 9.5 million retail customers and 534,000 corporate customers, with 377 branches in Sweden and 224 branches in the Baltic countries. As of March 2010 the group had total assets of SEK 1.89 billion and approximately 18,000 employees. Its aim is to make customers’ everyday lives easier through a full range of easy-to-use and competitively priced financial services for private and corporate customers. 8

**The bank’s focus**

In Sweden, banks are open for all kinds of customers. Mr. Forsell told us that all kinds of companies often do finance with the bank, it does not matter what industries they belong to or how big they are. Generally speaking, the requirements for a loan that the Swedish bank focuses on are the credit of the company and the company’s future. Mr.

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Forsell said that since over 90% of enterprises in Sweden belong to the SME sector, SMEs are the main economic dynamic to grow the Swedish economy. So SMEs are in fact very important customers to us.

Through this interview, it was established that the bank never put much focus on the capital structure of SMEs or other financial models but more attention on their business plan. Except for the company’s credit record, banks can maximize their identification of risk through assessing the companies’ equity and seeing if they are profitable or not.

**How banks get information about SMEs**

A Swedish company must honestly submit their annual report for their situations in every field to local government. If anyone wants to know about a company’s information, they have to pay for those reports. Under this credit mechanism, any detailed information about a company is easily obtained. The asymmetric information is not as serious a problem in Sweden so banks are willing to welcome any kind of corporations to borrow from them.

In general banks judge a company’s risk by assessing credit, records, requirements (i.e.: long-term or short-term loans), fixed assets (i.e.: house, car, equipment, etc.). The high risk company will generally get expensive loans. Banks will refer to future value of companies.

In fact, Swedish SMEs have easy access to a loan, as long as they have a detailed business plan and enough credit, which makes it clear that they will have good growth. On the other hand, SME creativity and activity will be increased by easy access to finance.

**4.2.3 Characteristics of financing in Sweden**

**Large total investment, high quality investment**

Venture capital (VC) investment has strong support from the government, since it was regarded as playing an important role in the national innovation strategy in the 1980s. The Swedish government, institutions, corporations, private companies and investors established a large number of venture capital funds, such as ALMI, Swedish Industrial Development Fund, Swedish-Norwegian Industrial Fund, Norrland Fund, and Innovation Center Foundation. Furthermore many foreign VCs were attracted into Sweden and assisted the VC market to grow into a high class market.

**Sweden has multiple investors and emphasizes international cooperation**

The Swedish investment structure has increasingly become a diversified structure in which the investors can be divided into commercial investors, private venture capitalists, venture capital management fund, the Government venture capital, foreign investors and the companies that belong to large groups. The government mainly plays a role in creating an environment so that good businesses can be combined with
a good capital market and rich people are willing to risk investment, so that outstanding people are willing to manage venture capital.

**Sweden actively improves the entry and exit mechanisms for venture capital.**
Swedish venture capital investments can be classified into three kinds: 1. investment of shares in listed or unlisted companies; 2. equity investments in limited companies; 3. and risk loans. The Swedish governmental VC institutions usually choose to take equity investments in limited companies or risk loans. Its investment includes investing in business projects or unclear projects. At present the seed fund for SMEs in Sweden has been ahead of other European countries.

The Growth Enterprise Market (GEM), also known as the second board market, is a new capital market funding source that is outside of the main board market, and is specifically for the financing of emerging SMEs and technology companies. The second board market is the best exit mechanism for venture capital. In order to develop the high-tech industry and venture capital industry, effective exit options for VCs is essential. Sweden is the financial center of the Nordic region. Sweden in 1982 set up a second board stock market, which cultivated a large number of science and technology enterprises.

**Focusing on training talented people**
Sweden attaches great importance to innovation and venture capital experts in training and introduction, and start training at the basis of innovation. Swedish children have a high level of English listening, speaking, reading and writing skills, which indicates that it is successful in training international talents and accepting foreign cultures. The Swedish government also launched The University Financing Foundation (TUFF) in 1999 for promoting the establishment of technical service relationships between Swedish universities, research institutions and SMEs.

### 4.3 The overview of the SMEs financing in China

With economic development, small and medium-sized enterprise definitions have been altered several times in various countries. According to Walter (2005)’s research, he found that only 12% of Chinese SMEs obtain their working capital from bank loans. A survey in 2002 showed that the proportion of start-up firms being financed predominantly through owner-managers’ personal wealth was 55% in which 31.5% of those firms borrowed from family and friends , and the rest were funded by banks of Rural Credit Cooperatives for loans. Since reform and open policy was carried out in 1978, Chinese SMEs have had an explosion in development, especially after China joined WTO in 2001. SME financing by own capital accumulation has been unsuitable for the fierce international market competition.

**The definition of SME in China**
China also changed the law in 1962. According to the latest standard, the medium-sized enterprise in China is defined as the enterprise whose employees range in number from 30 to 2000, total assets reach RMB 40 million to 400 million and turnover ranges from RMB 30 million to 300 million. Those which are less than the above standard are defined as small business.

Then, it was defined with some other standards like ICB (Industry Classification Benchmark). In 2003, the "Major and medium small-scale industry enterprise standard" was implemented, and it indicates that an SME is the company with sales revenue and property value averaging 500 billion Yuan.

An overview of Chinese SME development
SMEs develop at a high pace in China, and are playing a vital role in the entire national economy. They have made an enormous contribution to the country's economic growth since the Reform and Open Policy\(^9\). But in recent years, as a result of the enterprise competition's intensity and the Global Financial Crisis, many SMEs are faced with a major difficulty in accessing finance. By the end of 2008, 7.5% of SMEs went out of business due to financial problems. The production breaking lead to the cities facing employment difficulties, and about 25 million peasant laborers returned to their native villages. According to the People's Bank survey in the first quarter of 2009, the result of an entrepreneur questionnaire showed that the SME economic growth target index dropped 18 percentage points in 2009 compared with 2008, and this directly influenced the livelihood of the people and the stable development targets.

4.3.1 Financing environment for SMEs in China

Legal System
At present, China has not yet drawn up a perfect form for small and medium-sized enterprise financing in the legal safeguard system. "The People’s Republic of China Small and Medium-sized Enterprise Promotion Law" was legislated by the National People's Congress (supreme body of state power) in 2002. Its implementation began on January 1, 2003. But this law lacks the information support and the macrostructure adjustment to SMEs. So SMEs still lack the necessary finance, credit guarantees, venture capital laws and regulations.

Financial Service System
There is not a policy-type bank that serves SME financing in China. SMEs obtain their financial services mainly from commercial banks. At the same time, Chinese

\(^9\) The Reform and Opening Policy refers to the program of economic reforms called "Socialism with Chinese characteristics" in the People's Republic of China (PRC) that were started in December 1978 by pragmatists within the Communist Party of China (CPC) led by Deng Xiaoping and are ongoing as of the early 21st century. The goal of Chinese economic reform was to generate sufficient surplus value to finance the modernization of the mainland Chinese economy.
commercial banks concentrate on loans to major industries in key cities, while SME financing needs remain deficient.

**Credit Guarantee System**

In 1998, by learning from international experience, the Chinese government had promulgated a series of policies for the SME guarantee system. The intention was to establish a policy for the creation of a credit guarantee system for SMEs to set up a financing platform which was funded by local governments.

At present, the Chinese credit guarantee industry has played an important role in solving SME financing problems. Generally, the customer positioning of guarantee companies is SMEs. Many SMEs could finance their businesses through those guarantee companies’ trust products, as long as they extremely competitive in their field, are able to run a stable operation and have the ability to pay back. Different types of trust guarantee companies developed at an extraordinary pace, but most of their business is still limited to the economically developed regions.

**Venture Capital Fund**

At present the Chinese fiscal budget has established National Science and Technology innovation funds for SMEs, market development funds, the SME services structure special subsidy fund and the SME development special fund respectively. As each fund is arranged by the central budget in China, the sources of funding and support of the project is limited. At present the SME innovation fund arranges 1 billion Yuan for SMEs in its budget and the market development fund budgets 500 million Yuan every year to support SMEs.

Sui (2007) stated that at the end of 2007 there were over 400 venture capital institutions which managed over 120.5 billion RMB (Chinese currency) in China. In 2007, over 39.8 billion RMB had been invested into 741 risk projects. That means each venture capitalist would manage 849.2 million RMB on average. The development of China's venture capital industry has been run relatively fast. However, China’s venture capital industry has a short history as it was only developed in 1985, so it is still in the early stages of development. The present scale of venture capital also makes it difficult to meet the demands of the market.

**Capital Market**

In China, the stock market started to open for SMEs on May 27, 2004 (Shenzhen Stock market Sets up Small and medium-sized enterprise Board Implementation Plan). But the enterprise board's threshold is so high that only very few SMEs are able to be listed on this stock market. As at June 17, 2006, only 50 SME companies were listed on this stock market, the profession coverage is narrow in that 85% are from the manufacturing industry, and the regional distribution is imbalanced, as there are 13 provinces which do not have any companies listed on this stock market.

In order to provide convenience for SME financing and to create a normal exit
mechanism for venture capital, the China Securities Regulatory Commission set up the Growth Enterprise Market (GEM) at the Shenzhen Stock Exchange market on October 30, 2009. Currently, there are 93 companies which have listed on GEM.

People-to-people credit
Today China’s economy has maintained rapid growth, which to some extent contributes to the trend of rapid growth of Chinese SMEs. The capital that SMEs seek for development is actually a very important part of community debt. People-to-people credit has given great support to the development of SMEs in China. Generally, it is believed that people-to-people credit is private lending without formal credit and it is an informal financial activity that is outside of the national macro-control and financial supervision. Because of the wide variety of sources of people-to-people credit and flexibility, folk debit can come from individuals, businesses, and even private equity funds, or credit companies. Most SMEs accept and take this financing form.

According to the survey data of the business sector in Anhui Province in 2007, more than 80% of SMEs rely on private loans to solve cash flow problems. The Business and Financing Conditions Research (2007) from the business sector of Hebei Province shows that 41% of SMEs mostly raise finance from private loans, due to the abnormally difficult access to bank loans. The survey of the Enterprise and Industry Bureau of Hunan Province in 2008 indicated that 50% of SMEs relied on community debt. The abovementioned reports highlight the fact that SMEs in China still have a huge demand for community debt.

4.3.2 Financing SMEs in China (Perspective from banks)

Focus on large enterprise but ignore SME
Qi (2009) found that in China, many banks lack effective identification of risk in SMEs, which means most commercial banks, in terms of the capital security, will concentrate their efforts on large companies and are generally reluctant to lend money to SMEs, even though they have set up a department for SME credit. These activities directly lead to the situation that capital is over provided for large enterprises but underprovided and absent for SMEs.

Another issue that was identified was whether private enterprises receive the same treatment as state-owned enterprises on a national basis.

They do not trust SME too much.
Since a large percentage of Chinese SMEs usually belong to the private sector, legally there is no discrimination between large enterprises and SMEs. However, discrimination does exist in the financing process. If loan problems occurred in SMEs, banks would believe those companies would have insider dealing which would lead to hesitation in financing SMEs.
From a bank’s perspective, generally there are three situations for financing SMEs. Firstly, it is not worth lending to corporations with a high debt rate. The SME’s solvency is the key to assessment. Under China’s present loan assessment system, solvency is mainly reflected on asset-liability ratios or other financial indicators. SME’s have limited fixed assets and total amount of funds that were originally funded from own savings. Finally, most SMEs cannot reach the standards required by the bank. However, it is more profitable to lend to big companies. In truth, a large number of bank loans often focus on a minority of quality customers. Finally, providing collateral is a prerequisite for enterprises to obtain loans. In order to mitigate risk of bank loans in China, banks specifically require mortgage collateral. They insist on guaranteed collateral, no collateral which means no loan.

4.3.3 Characteristics of SME financing in China

Narrow channel of financing for SMEs
As a consequence of the high entry requirements for securities, an imperfect venture capital system, and barriers to market entry of corporate bonds, it is very difficult for SMEs to raise money through the capital market. Until the Growth Enterprise Market was set up in 2009, the venture capital system lacked comprehensive legal protection and policy support so it was difficult for VCs attempting to exit, so it was also hard for SMEs to do equity financing.

Few credit supports
Banks are reluctant to lend to SMEs due to the high transaction and monitoring costs. At the same time, SMEs with low credit ratings and only a few mortgage assets, will find it difficult to get bank funding.

SMEs have much short-term liabilities
SMEs usually have a larger proportion of current liabilities and lower proportions of long-term liabilities.

In order to apply for loans, SMEs do guarantees for each other.
If an SME wants to get finance from a bank, they must first have a guarantee. Once a company has suffered losses because of bad management, it will trigger a chain reaction of a guarantee crisis. If an SME needs short-term debt, they lend between each other or resolve their problem through internal financing or community debt.

Lacking own capital
China's non-public enterprises from small to large, from weak to strong, which develop mainly on their own accumulation and internal source of financing, that greatly restricts a company's rapid development in becoming stronger and bigger. They do not recognize the importance of issuing corporation bonds and external equity financing.
4.4 Case Study

In this empirical part, we are going to use two companies. One of them is a Swedish import SME called LONG DESIGN AB Company (an import business company). The other is a Chinese export SME named GUFENG TRADE LIMITED COMPANY (an export business company). Both companies work within the foreign trade industry sector, which makes it much easier to compare their financing environments.

4.4.1 Long Design AB Company

4.4.1.1 Introduction
Long Design AB was established in 2005 and is a design and product development company that manufactures and imports from Asia, mainly from China. It works with different ranges of home furnishings (home decoration) and leisure goods (sport items). Its main activity is to develop the product and import its own products. It also helps other companies find new manufacturers for their existing and new products. Long Design AB Company is a SME which has 10 employees and its average turnover is Euro 0.37 million.

4.4.1.2 The significance of finance for Long Design AB Company

Through the interview with Lars Hård the president of Long Design AB, the financial factor was established to not be the most important factor for Long Design. He pointed out that as a foreign trade business, the company paid more attention to its marketing development and then the second most important factor is production or research & development. Even though the financial aspect is not the most critical element for the development of the company, Mr. Hård also claimed that finance, marketing and production are the three keys for developing, like the three legs of a table.

From the perspective of investment needs in recent years, Long Design AB invested mainly in production development, which accounts for 50% of their investment. 49% of total funds had been invested in marketing development. Finally, only 1% of capital was used for the education and training of employees.

4.4.1.3 The financial status of Long Design AB Company
In general, Long Design AB frequently uses finance for the development of the business but the amount applied for each time is not very big. Of course, the amount applied for depends on how big a project they are going to do. Long Design AB raises 100% of capital required through short-term liabilities. This company gets external loans from banks and it is easy to get 100% of the loans applied for.

Figure 3: The financial structure for Long Design AB
Mr. Härd advised that their most important financing form is company profits, which comprises 40% of their capital. The own financing by family or friends was as important as profits in the beginning when the company was started, which accounted for 40% as well. The last one is bank loans (20%). Bank loans are usually not a big problem for the company, since they can raise funds fast in the financing process where application procedures are not so complicated. Banks usually reply within a week or even 2 or 3 days.

4.4.2 Gufeng Trade Limited Company

4.4.2.1 Introduction
Gufeng Trade Limited Company is a SME that mainly does export business to southeastern countries, especially the Philippines. It has been trading for 7 years since 2003 and exports several items including handcrafted articles, clothing and shoes, kitchen supplies, appliances, etc. The company has less than 50 employees and its average turnover is Euro 2 million per annum.

4.4.2.2 The significance of finance for Gufeng Trade Limited Company
For Gufeng Trade Limited Company, production is considered as the most important factor. Luo, the president of the Gufeng Trade Limited Company, advised that the financial factor is the second most important item for his business. The third one is marketing development. Luo believes that only the quality of products can maintain his reputation on a good level. Luo also explained that financing is critical for purchasing items and materials from other providers so that they can satisfy the demand from foreign customers. Thus, from the view point of investment needs, 80% to 90% of capital raised is invested in production (purchasing materials). The rest will be used in staff training.
Foreign trade SMEs financing in Sweden and China

4.4.2.3 The financial status in the Gufeng Trade Limited Company

We found that the company does not require financing very often. When it is necessary to raise finance, the financing gap will generally rise to approximately 3 million. In China, if SMEs want to loan from commercial banks, they must provide their assets as collateral. But generally speaking, SMEs do not have many kinds of fixed assets to offer as collateral, and they usually can only raise 50% to 60% of the total amount that they require.

The company believes that it is difficult to raise finance with a bank, since it has to suffer a lot of unnecessary and over-elaborate formalities in valuing collateral offered to the bank. The whole procedure of financing from a bank will take anywhere between one and six months. So 90% of liabilities are short-term loans in the company.

![Figure 4: The capital structure for Gufeng Trade Limited Company](image)

Sources: Gufeng Trade Limited Company (2009)

The Gufeng Trade Limited Company receives its external financing mainly from people-to-people credit (50%). Only 10% of funding is from commercial banks. The form of company profits followed with 20%, while own financing and funding from partnerships account for 20%. (Figure 4)
5. **ANALYSIS**

In this chapter, the empirical findings described above will be analyzed. The analysis aims to provide the foundation for conclusions and recommendations with the theory, by answering the research questions of the study.

### 5.1 The comparison of bank financing of SMEs between Sweden and China

There are two different attitudes to SMEs from bank in Sweden and China.

<table>
<thead>
<tr>
<th>Attitude</th>
<th>Evaluate point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Swedish bank</td>
<td>Willing to loan</td>
</tr>
<tr>
<td>Chinese bank</td>
<td>Hesitate to loan</td>
</tr>
</tbody>
</table>

**Figure 5**

Banks in Sweden welcome the opportunity to finance any kind of companies, no matter whether they are large companies or small firms. Most of the banks prefer to pay attention to business plans and judge whether firms have a future. In other words, banks in Sweden put more focus on the left side of the balance sheet. On the contrary, Chinese banks usually hesitate to loan money to SMEs. The interviews with Long Design AB. and Gufeng Company highlighted that it is obvious that Swedish SMEs can more easily raise finance from a bank than a Chinese SME (compared with Figure 3 and Figure 4). Though Gufeng Company has a huge demand for financing from banks, it can only get 10% of financing gap from a bank since it has only a few assets available for collateral. If firms want to borrow from a bank, they must provide their collateral which the bank focuses on for guarantees. Chinese banks are more concerned with the right side of the balance sheet than the left.

According to the Modigliani-Miller Theorem (1963), debt financing can raise a company’s market value within company income tax. And referring to Zhang (2008), the firm value should focus on the left side rather than the right side of the balance sheet in a company’s capital structure. Moreover, Zhang (2008) stated the maxim value of capital depends on its use rather than its source. In other words, banks should be more concerned on the potential profitability of assets no matter what debt the SME already has.

In addition, referring to Martineli (1997), the financing gap is a distinctive challenge for SMEs. The financing gap is regarded as a huge obstacle that interrupts the development of many SMEs. During the research, we found that the financing gap is
not a big problem in Sweden. Mr. Hard (the president of Long Design) stated that because all businesses in Sweden must disclose all information pertaining to their businesses to the government, and anyone can read many kinds of reports about any company, Banks can get all of the information from the government about the company through the annual reports submitted by SMEs. The company cannot hide any secrets from the bank, because all information must be open to the public. So, the foreign trade SMEs can get a loan from bank in a short time.

However, SMEs in China prefer to hide the true financial situation and keep their business plans secret. The president of Gufeng Company advised that if we were not college students and had no relationship with Jiang (the author’s cousin), he would not have spoken to us about Gufeng’s financing situation. Hence, the financing gap between the bank and SMEs will grow wider. As figure 4 describes, Gufeng has only 10% of its funding from banks. As a result of information opacity, the profitable capacity of SMEs and willingness to repay cannot be accurately judged by financial institutions. In order to mitigate the risk of uncertainty in financing SMEs, banks need a long time to examine and verify whether the information from the company is true or not. Under such a vicious circle, SMEs will face more and more difficulties in financing.

Compared with Sweden, there is a suggestion that banks in China could provide financing to SMEs using the Modigliani-Miller Theorem in reality. In the meantime, all SMEs information should be honestly open to banks. The free market economy is still in the early stages since it was established in 1992 and China began privatization in 1978. Combined with the current status of China, the economic mechanism has suffered from market failure (spontaneity, aimlessness and lag) in many economic fields.

How do SMEs raise finance without a bank?
China is a country that has a high degree of bank concentration, which means China’s four main state-owned banks (Industrial and Commercial Bank of China, China Construction Bank, Agricultural Bank of China and Bank of China) determine the financial system in China. In the highly competitive banking market, banks are lacking information on SMEs and have no idea about how SMEs use loans. Therefore the lack of information causes much moral hazard. In the competitive banking market, it is very difficult to raise interest rates. So in order to increase profits, banks prefer not to spend time and cost to understand SMEs’ situations. In this case, Long Design AB did not mention the people-to-people credit, but Gufeng Company discussed People-to-people debt. The method of People-to-people credit has supported Gufeng’s financing by 50%.

People-to-people credit is excluded from the normal financial system. The government has developed a few laws and regulations to control such financial innovation in the system. People-to-people credit interest rates can be appropriately
higher than bank interest rates, but cannot exceed 4 times that of the normal interest rate. Otherwise, the excess part of the interest rate is not protected by law. It cannot be denied that People-to-people credit greatly improves the efficiency in use of capital. Currently, it has become a major financing channel for SMEs.

The People-to-people credit can be explained by institutional economics. People-to-people credit is a basic transaction institution in China. It solves the asymmetry information problem between banks and SMEs. Every quarter commercial banks have to make their financial statements available to the public, but SMEs have to pay for the information. However, the information between borrowers and lenders is relatively symmetric in community debt. Borrowers can usually be friends, neighbors, some institutions with relationships, etc. The required mortgage for a loan will be low.

5.2 How SMEs survive in China without governmental venture capital funds?

Sweden situation
There is no doubt that Swedish venture capital funds provide an important support mechanism for SME development. The structure of the Swedish venture capital market is diversified. It includes commercial investors, private venture capitalists, venture capital management funds, the government venture capital, foreign investors, venture investment companies. Furthermore, the Swedish government adopts an open attitude towards foreign capital. According to the Swedish Venture Capital Association (SVCA) statistics, in 2004, 70% of venture capital was from foreign investors. Currently, Sweden has attracted venture capital firms from the United States, France, the Netherlands, Israel and many other countries. Foreign capital brings new technologies and new employment opportunities for enterprises, but also provides financial support for SMEs’ scientific research changing into technological innovation.

China situation
Supported by the Chinese government policy, various innovative financial products in SMEs services have been rapidly developed. To a certain extent, innovative financial products solve the financing difficulties for SMEs. The Aggregate Capital Trust of Small and Medium-sized Enterprises is one of innovative financial products that has been promoted in recent years.

According to Yang’s (2010) definition, the Aggregate Capital Trust of Small and Medium-sized Enterprises is a kind of trust-oriented financing service that is guided by local government fiscal capital for SMEs. It aims to attract and collect social capital and then centrally provides financing support for a group of SMEs through developing business projects. Here is the basic operation model of the Aggregate
First of all, based on support policies, government will classify and determine qualifying SMEs.

Second of all, the demands of financing of qualify SMEs will be collected by a professional trust consultant institution and then they will together form projects of financing.

Thirdly, a trust institution will guarantee, name and issue the projects from SMEs they intend to finance. The projects for financing will be rated based on their cash flow projections. The trust institution will determine the class of each project and the amount of financing for the beneficiary, beneficiary income and beneficiary risk allocation. Finally, those projects for financing will be issued to governmental fiscal capital (the special funds), guarantee companies, venture capital institutions, or other social investors.

Fourthly, the trust funds that were raised through the Aggregate Capital Trust will be used to provide loans to SMEs.

Compared with traditional financing, they have advantages of low mortgage, low interest rates, high credit, and low financing cost of similar bank interest rates. Nevertheless it can support millions in financing demands at once from SMEs. Individual enterprises can reduce systematic risk and expected loss rate when they do finance, by means of aggregate capital, to a certain extent.

From the perspective of market acceptance, those projects for financing can get credit
Foreign trade SMEs financing in Sweden and China

from government and trust institution guarantees. First of all government will choose qualifying SMEs based on necessary requirements, which is a step to raising a government guarantee. Trust institutions will guarantee the financing projects based on SME cash flows and credit rating. Transaction costs will largely reduce, not only for investors but also for SMEs.

5.3 Comparison of sources of financing

<table>
<thead>
<tr>
<th></th>
<th>Internal source</th>
<th>External source</th>
<th>Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Swedish SME</strong></td>
<td>Profit, own savings</td>
<td>Banks, governmental institutions</td>
<td>Short-term liabilities</td>
</tr>
<tr>
<td><strong>Chinese SME</strong></td>
<td>Profit, own savings</td>
<td>Banks, non-normal financial institutions</td>
<td>Short-term liabilities</td>
</tr>
</tbody>
</table>

Compared with the above figure, the SMEs from the two countries internally finance through their profit and own savings. In the two cases of foreign trade SMEs in Sweden and China, we find that the internal source is the most important source for financing, which involves 40% of the total amount being own financing and 40% in company profits for Long Design AB Company, while Gufeng Trade Company has 20% in company profits and own financing & funding from partnerships generally accounts for 20% of the total source.

Mr. Hård of Long Design AB emphasized that his business is mainly financed by his business profit and he said that only by having stable profit accumulation can they ensure enough free cash flow. On the contrary, the Chinese SME, Gufeng Company’s president told us that when they meet a financing gap, possibly RMB 3 million, they usually consider taking a loan from a bank a rather than company profits.

According to Myers and Majluf (1984), in order to reduce the cost from asymmetric information and other transaction costs, companies will generally take internal source financing as the first form, then issue relatively safe debt, when the debt cannot be run more, finally, they issue equity financing. Since the asymmetric information and transaction costs occur in the process of financing, internal source financing can solve this problem. Internal source financing is low risk, has no information opacity and no transaction costs for a contract.

Nevertheless, when SME internal sources cannot meet the demand of self development, SMEs should consider an external source. Modigliani and Miller (1963) pointed out that within the function of tax, companies will raise their market value by adjusting the financial structure in which to increase debt financing, when company income tax exists. In our case, by comparing with figure 3 and figure 4, debt financing is one of the essential financing ways for each enterprise. Affected by variances in the
market environment, government policy etc., transaction costs will possibly rise, which brings unknown risks for the company’s operations. SMEs will choose short-term loans to lower their transaction costs. In China, as information for credit record of entities is not uniform and political corruption exists, adverse selection will exist in normal institutions and there is moral hazard for entities. If SMEs choose normal ways, transaction costs must be raised. Thus, abnormal institutions become the main force for SME financing. We can conclude that the external financing environment has largely affected the pace of development of SMEs.
6. CONCLUSION

6.1 Summary for Sweden

6.1.1 Advanced financial support system and credit system

From the above comparative analysis, it is not difficult to conclude that the Swedish government has made a positive intervention impact on SME development. Apart from legislation, professional institutions, such as NUTEK, INNOVATIONSBRON, VINNOVA, have been set up to support and guide small enterprises. There are a vast number of intermediary institutions that provide special services for SMEs. Swedish commercial bank loans, venture capital, government funding and security financing, etc. have built a big financial support system for Swedish SMEs. Most companies are based on the awareness of credit, make their information open and accept fair competition under the credit system. The banks treat SMEs and large enterprises equally. Under the advanced economic environment, the opportunities to attract foreign capital will always be increasing in Sweden, so that Swedish SMEs will have more opportunities for communication with other SMEs from different countries. Hence, the opportunities allow more and more innovative technologies and services to be created in industries. According to the interview, there is no discrimination between large companies and SMEs. In Sweden, whether a company borrows from bank or the government, all of their actions are based on trust.

6.1.2 The trade-off between fairness and efficiency

Although Sweden has its advanced financial support system, it should have its potential risk in mind. Such a perfect financial support system is operated by the government, so the government has to give a big budget to support the fund. High taxation supports this perfect SME financing system. In fact, the high tax rate will limit a firm’s cash flow. The president of Long Design AB advised that he had complained about high tax but on the other hand, high taxation generates high welfare for the nation.

6.2 Summary for China

6.2.1 The existing financial system is not conducive to SME financing.

China's financial system is based on state-owned enterprises as the main target. In China, in the absence of a perfect credit system, SMEs do not open their information to the public, since they are under big competitive pressure from both domestic and international competitors. When SMEs are insolvent they possibly do not pay back the debt to the bank. Banks do not dare lend to Chinese SMEs. If loans are made, high
interest rates and mortgage lending will apply. The security, liquidity and profitability are the three key operating principles used by a bank. Since the asymmetric information problem is serious, banks are hard pushed to reach a balance between security, liquidity, profitability and bankruptcy. Collateral and guarantees are considered to ensure maximum security for bank capital. In this way, banks could effectively prevent the liquidity crises and ensure that a dramatic fluctuation in the economy is avoided.

### 6.2.2 Loss effective allocation of resources

It is quite common that Chinese SMEs face serious problems in financing with banks. In order to ensure the security of capital, banks have strict financing conditions for small firms. As a result of the information opacity, banks cannot gain in-depth knowledge of a firm’s operating conditions and does not actively pursue potential profitable customers so many SMEs will be left outside the door. Under this situation, even the firms which have a bright will not be financed by the banks and could be forced out of the capital market. The capital will finally not be used in an effective form. SME development in China is more difficult.

### 6.2.3 The Aggregate Capital Trust of SME development will become an innovative financing channel for SME in China.

Aggregate Capital Trust of SMEs has become a sophisticated financial service product for SME financing since 2008. It not only provides timely financial support for SMEs, but allows all relevant party to acquire the benefits they need. But currently, the SME Capital Trust transaction structure is relatively simple. If it could be developed to use a variety of financial instruments based on the existing model and create risk-benefit change-oriented mechanisms for different kinds of participants, such as options, it could possibly be extended to other businesses so that it creates a bigger platform for SMEs. Based on existing maturity operation models, through addition of innovative financial elements, the Aggregate Capital Trust of SME will become an effective financial service product and promote the development of SMEs.

### 6.2.4 People-to-people credit is still the major financing channel for SMEs in China.

China's four major banks till have monopolies in the Chinese financial market. China still has a high degree of bank concentration compared to the United States, Japan, Germany and other developed countries. However, SMEs are still a big part of the corporation structure in China, which means financial structures cannot match corporate structure. It is very difficult for SMEs to obtain loans from the big banks, which constrains development of SMEs. However, China's economic growth and private capital has accumulated gradually. This provides a source of funding private
People-to-people credit, to some extent reduces the SMEs’ financing gap suffering and improves efficiency in the use of capital. In recent years, the scale of People-to-people credit has continued to expand and static data is hard to account.

6.3 Suggestions

In general, we find that the transaction cost, credit and asymmetric information are the factors which influence SME financing.

6.3.1 Chinese SMEs should do self-help.

In order to solve the financing problems of SMEs, all economic entities have to adhere to their behaviors. Credit-based business should first be considered by managers. They should also have a forward thinking view for long-term development rather than short-term benefits. Furthermore, corporations use internal financing sources, including accumulation of asset. Traditionally, SME awareness of asset accumulation is poor, so they do not take into consideration long-term development, and however still heavily rely on external funds. Therefore, they usually have low survival rate. Lacking in endogenous financing, SMEs will not only increases the cost of external financing and the debt burden, but also increase the risk of corporate financing. Those SMEs with weak anti-risk ability should get together to be a large and strong anti-risk enterprise.

6.3.2 To set up governmental special institutions for SME financing is imperative

Building a special system is the key to breaking barriers in financing small and medium-sized enterprises. In Sweden, the diversified investment channels give SME development a strong financial support. SIC supports financing for those creative SMEs that provide innovations. ALMI and NUTEC provide consulting services for SMEs and guide them on how to finance and how to develop their business. All of these policies gave us an inspiration that China should keep on doing revaluations for domestic financial institutions. Some government institutions should set up and design more flexible and creative service products for SMEs, such as equity financing, long-term loans, venture capital and especially consulting services. The policies should focus on supporting knowledge-based and export-oriented SMEs. For foreign trade SMEs, institutions should provide a detailed trade program to help businesses make good use of export and international investment opportunities for continuous development.

6.3.3 Tax incentives and subsidy are the most direct way of financial assistance. It is conducive to the accumulation of funds for SMEs.

Since 1984 the German government has offered a special favorable tax policy for
SMEs. The current preferential policies include zero business tax or an increasing business tax threshold 1.5 times more than before for SMEs. It increases the equipment depreciation rate of SMEs from 10% to 20% and reduces income tax to 19%. New enterprises can get more tax reduction. The Swedish government offers a subsidy of 15% of machinery and equipment investment for the SMEs which have less than 15 employees and a turnover less than Euro 4 million. In China, as a result of the huge amount of SMEs, it would be impossible for the government to give a subsidy for each SME. Thus, it is necessary to set up an SME loan guarantee scheme. Through government guarantees, SMEs can obtain long-term loans from banks and the interest rate is lower than capital market. The difference will be subsidized by the government.

6.3.4 It should establish an international operations support system as quickly as possible.

An international operations support system should be set up as quickly as possible, comprised of the central government, local government and intermediary organizations, to promote foreign trade as part of SME business development. The central government should establish policies and special budgets to encourage SMEs to carry out international operations. At the same time, it should improve the foreign trade development fund for SMEs by exploring international markets and use of the policy-oriented funds. Local government should optimize the trade environment, simplify approval procedures for SMEs, co-ordinate SMEs and provide services. Intermediary organizations should obtain a variety of useful information from international markets for SMEs and provide foreign trade business training for fostering entrepreneurship.

6.3.5 Future research

The authors have not completed an in-depth survey of data in this two countries’ government departments yet, because of the constraints. By comparing the current situation of financing in Sweden and China, we can conclude that the financing environment for SMEs in Sweden is much better than that in China. Other researchers can do further research in the relationship between bank market structure and SME development, and venture capital in trust service products.

It is necessary to establish a Government-lead financial service system for SMEs with other financial departments. The system includes SME Development Fund, Fund of Guarantee, and Venture Capital for general export/import SMEs.

Banks will generally value SMEs through a company's project feasibility report and the value of the enterprises fixed assets, then decide whether or not to finance SMEs. Now more and more local banks are being set up in the cities, which aim to service SMEs as their positioning and strongly support financial service for SMEs.
References:

Foreign trade SMEs financing in Sweden and China


Foreign trade SMEs financing in Sweden and China

Advantages:


Foreign trade SMEs financing in Sweden and China

Foreign trade SMEs financing in Sweden and China

Publications.


Web-Pages:

Foreign trade SMEs financing in Sweden and China

   http://www.nutek.se/information/act_org_busfin.htm
Appendix 1

(Company interview) The interview questions for
Swedish Small and Medium size Enterprise (SME)'s financing circumstance
Focus on Swedish foreign trade SME's financing problems

Thesis Title: Foreign trade SMEs financing in Sweden and China

Aims brief
We are the students from Business Administration and Economic Department in Gavle University. This is our thesis questionnaire corresponding to the solutions to financing problems that are influenced by forms of financing, financing gap.

Authors
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Liwen Mai kaka-1122@hotmail.com

We hope you are interested in this topic and your help is appreciated!

1. Company Brief:
The name of company: _______________________________________________________
Number of employees: _______________________________________________________
Year of establishment: _______________________________________________________
Turnover, (Million SEK): _______________________________________________________
Export share (%): _____________________________________________________________
Which industry the company belongs to: ___________________________________________
Main business (product): _____________________________________________________

2. How important are these factors involved in exporting? By writing the number 1,2,3,4 and 5 (1=The most important; 2=The second important; 3=The third important …).

Human Resource
Financial
Production
Research & Development (R&D)
Marketing

And could you talk about how important the financials are in your company?
__________________________________________________________
__________________________________________________________
__________________________________________________________

3. How many times had your company applied for financing? Could you tell us approximately how big share of the application can receive? How often do you succeed?
__________________________________________________________
__________________________________________________________
__________________________________________________________
4. Choose your company’s main financing sources by writing the numbers 1, 2 and 3 etc. (1= your main source; 2=the second important source; etc.). Also please write alternative’s percentage of your total financing.

<table>
<thead>
<tr>
<th>Source</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own financing (family or friends)</td>
<td></td>
</tr>
<tr>
<td>Funding from business suppliers</td>
<td></td>
</tr>
<tr>
<td>Company profits</td>
<td></td>
</tr>
<tr>
<td>Equity from the owners</td>
<td></td>
</tr>
<tr>
<td>Sale of fixed asset</td>
<td></td>
</tr>
<tr>
<td>Capital from the bond market</td>
<td></td>
</tr>
<tr>
<td>Venture capital from business angel</td>
<td></td>
</tr>
<tr>
<td>Venture capital from risk capital funds</td>
<td></td>
</tr>
<tr>
<td>Bank loans (business bank)</td>
<td></td>
</tr>
<tr>
<td>Government agencies (policy bank)</td>
<td></td>
</tr>
<tr>
<td>Regional fund loans</td>
<td></td>
</tr>
<tr>
<td>Loans from other sources</td>
<td></td>
</tr>
</tbody>
</table>

5. When and what form did your company use in financing lately? Why did you choose this financing way? How long did your company spend in that financing process?

_____________________________________________________________________
_____________________________________________________________________
_____________________________________________________________________  

6. Please list 2 or 3 main sources in short-term and long-term loans. Also please write the proportion of short-term vs. long-term loans in total liabilities. (Such as Loans from credit institutions, Check account, Debt from group companies, Trade payables, Accrued income and expense)

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term liabilities</td>
<td></td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td></td>
</tr>
<tr>
<td>Short-term liabilities: __%</td>
<td>Long-term liabilities: __% (Total: 100%)</td>
</tr>
</tbody>
</table>

7. Choose your company’s investments needs for recent years. Please, fill out the proportion of the investment needs realized. Or could you provide other information related such line graph, pie chart etc. (1=very low, 2=low, 3=neither high or low, 4=high, 5= very high)

<table>
<thead>
<tr>
<th>Investment</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings</td>
<td></td>
</tr>
<tr>
<td>Production equipment</td>
<td></td>
</tr>
<tr>
<td>Product development</td>
<td></td>
</tr>
<tr>
<td>Marketing/market development</td>
<td></td>
</tr>
<tr>
<td>Education and Training</td>
<td></td>
</tr>
<tr>
<td>Others ________________________</td>
<td>(Please list the other example) __ __ %</td>
</tr>
</tbody>
</table>

8. What do you think about the overall financial conditions for trade business in Sweden?

_____________________________________________________________________
_____________________________________________________________________
9. What do you think about the following statement?
   (1=Strongly disagree, 2=Disagree, 3=Neutral, 4=Agree, 5=Strongly agree)
   __SMEs have limited financing forms. Most of them can go by internal financing, such as family, friends, profit, selling assets etc..
   __Most of SMEs should hide some business information, when they apply credits.
   __Most SMEs are willing to keep their own information in opacity, such as turnover, capital structure, balance sheet, debt information etc.
   __SMEs are very hard in financing with commercial bank because of the asymmetric information
   __Bank can not identify the real risk from SMEs, so bank will set a relative high interest rate for all of SMEs. But most of the SMEs with high risk still accept.
   __Many SMEs prefer to invest in high risk and huge profit projects, rather than go to return debts.
   __Many trade SMEs are lacking of collateral for guarantee.
   __Sweden has its special government intermediaries for providing financial services for SMEs and runs many policies for promoting the development of SMEs.
   __A majority of foreign trade SMEs are not stable in their business.
   __Those large companies with high credit are not willing to provide guarantees for SMEs.

10. What is the challenge do you think for SME’s financing?

11. What policy do you think the government could do for SME financing? And what is your best financing form? Or do you have any other suggestions?

12. In order to get financing from financial institutions, what is your business plan generally focus? And what experience do financial institutions pay much attention into?

Appendix2

(Swedish bank interview) The interview questions for
Foreign trade SMEs financing in Sweden and China

Swedish Small and Medium size Enterprise (SME)'s financing circumstance 
Focus on Swedish foreign trade SME's financing problems

**Thesis Title:** Foreign trade SMEs financing in Sweden and China

**Aims brief**
We are the students from Business Administration and Economic Department in Gavle University. This is our thesis questionnaire corresponding to the solutions to financing problems that influenced by forms of financing, financing gap.

**Authors**
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Liwen Mai kaka-1122@hotmail.com

We hope you are interested in this topic and your help is appreciated!

1. Does Swedbank often do financing for SMEs? Does credit rationing exist?
2. If the bank does not supply finance for SMEs, what are the general reasons maybe?
3. Does asymmetric information exist?
4. Can Swedbank clearly identify the risks of firms?
5. Will a high interest rate be built to most of companies which have low credit?
6. What do you think about the moral hazard?
7. Can you show us the proportion between loaning to SMEs and loaning to large firms?
8. Does Swedbank have special treatment for SME financing? Such as some negative conditions for SMEs.

*Postscript:* The questionnaire has two versions, Chinese version for China and an English version for Sweden.