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SMALL AND MEDIUM ENTERPRISES (SMEs), TRADE AND DEVELOPMENT IN CHINA

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Abstract

This paper aims to describe the development trends of SMEs in China. Based on official statistics, the graphical depiction of the industrial sector structure is presented. International and regional trade patterns are briefly discussed. The industrial cluster development is highlighted as essential to the manufacturing sector growth and competitiveness. Internationalisation is important for SMEs. FDI is widespread and highly associated with manufacturing cluster development and export performance. This paper also highlights the important role played by business associations and state support institutions into SME development. Finally it discusses the various bottlenecks diminishing firms' competitiveness in the market.

JEL Classification: F14, L15

Keywords: trade, prices, SME

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Introduction

In 1980, Chinese Gross Domestic Product (GDP) was 796 billion Yuan, or 309 billion USD. In 2014, Chinese GDP stood at 17.9 trillion Yuan, or 9.5 trillion USD. This remarkable economic transformation has been led by a combination of sound government policy and the creation of a market economy. The result has been a massive expansion in the number of registered businesses, and their ability to leverage both domestic and international market opportunities.

This working paper seeks to combine available statistics on Chinese firms in order to provide a descriptive overview of the structure of the Chinese economy. Specifically, the SME sector structure, production clusters development, SMEs internationalization, ways of state and non-governmental support, as well as bottlenecks, affecting business' performance and competitiveness are discussed. Attention is stressed on the relationship between FDI, export performance, and on their effect on production technology upgrade. The SME sector growth and development success is analyzed in light of growing internationalization and greater involvement of private business in China's economy.

This working paper is structured as follows. In Section 1, data on the number of firms, their total revenues and exports in China is presented by firm size. In Section 2, the level of intra-China integration is discussed, with specific reference to China's central hubs: the Beijing-Tianjin-Hebei region, the Pearl River Delta and the Yangtze Delta. Furthermore, the level of integration with ASEAN countries is also covered. In Section 3 the role of clusters in the internationalization of Chinese SMEs is discussed, as well as the impact of ICT technologies. In Section 4, the role of foreign players in clusters and value chains is covered, while in Section 5, the institutions supporting SMEs in China are discussed. In Section 6, the contribution of internationalization to SMEs sustainable development is discussed, while in Section 7, bottlenecks to SME creation and growth are discussed. Finally, the conclusions of this working paper are summarized in the concluding section.

1. Nature of enterprises in China

1.1. Size distribution of enterprises in China

There are four main firm size categories in China: large, medium, small and micro-sized enterprises. Micro-sized enterprises have less than 20 employees and annual revenues of less than 3 million Yuan; small enterprises have between 20 and 300 employees and annual revenues of between 3 and 20 million Yuan; medium-sized enterprises have between 300 and 1,000 employees and annual revenues between 20 and 400 million Yuan; large enterprises have more than 1,000 employees and annual revenues over 400 million Yuan (see Table 1.1).

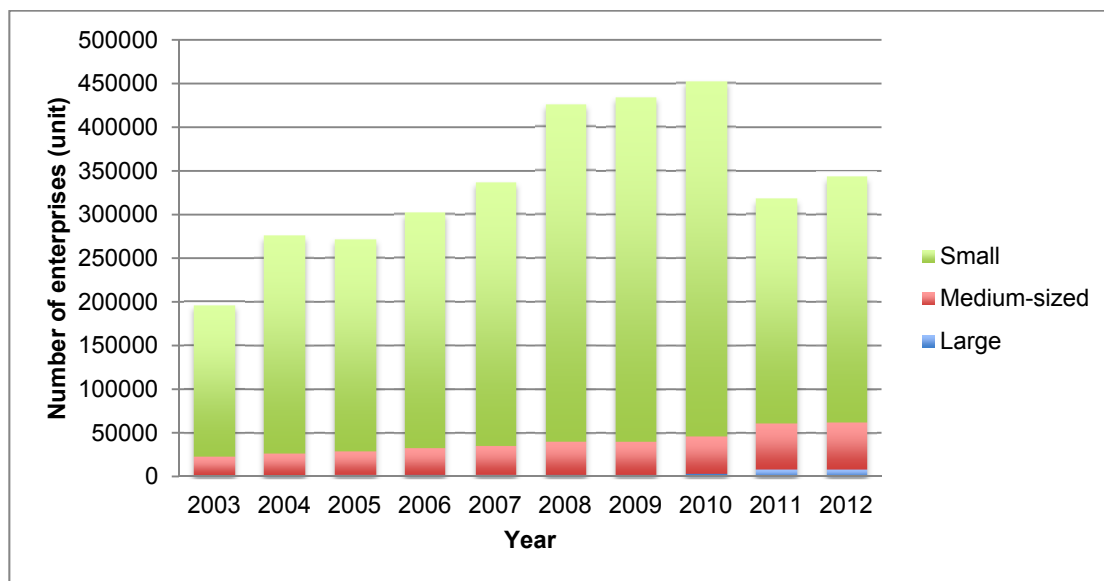
Table 1.1 - Firm size criterion in China

Indicators	Unit of account	Large	Medium-sized	Small	Micro-sized
Employees (X)	Unit	$X > 1000$	$300 \leq X < 1000$	$20 \leq X < 300$	$X < 20$
Annual Revenue (Y)	10,000 Yuan	$Y > 40000$	$2000 \leq Y < 40000$	$300 \leq Y < 2000$	$Y < 300$

Source: National Bureau of Statistics of China, <http://www.stats.gov.cn/>.

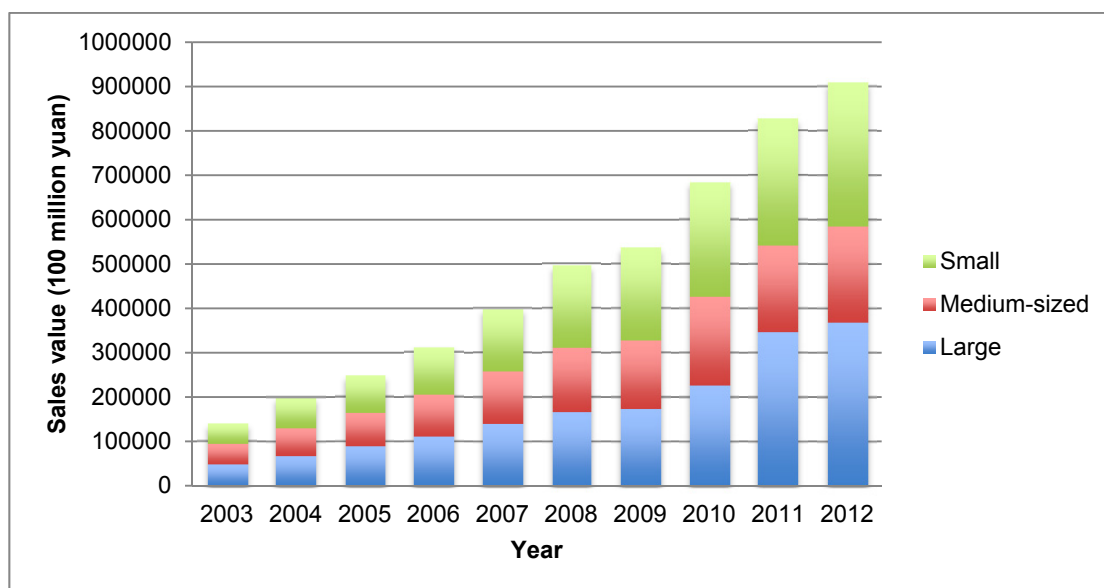
Figure 1.1, which shows the total number of firms by size from 2003 to 2012, has several interesting features. Firstly, the overwhelming majority of firms are small-sized enterprises, accounting for 80% of all firms in 2012. Secondly, the number of firms steadily increased from 2003 to 2010, but then declined sharply in 2011, presumably due to the impact of the 2008 global financial crisis. Thirdly, primarily small firms have driven the growth in the number of firms. However, plotting the value of sales using the same firm size categories paints a different picture (Figure 1.2). In 2012, large and small firms accounted for more than 30% of total sales each, while medium-sized firms accounted for less than 30% of total sales. Furthermore, the share of total sales from SMEs has fallen in the period from 2003 to 2012.

Figure 1.1 - Number of industrial enterprises by size from 2003 to 2012



Source: China Statistics Yearbook (2004-2012)

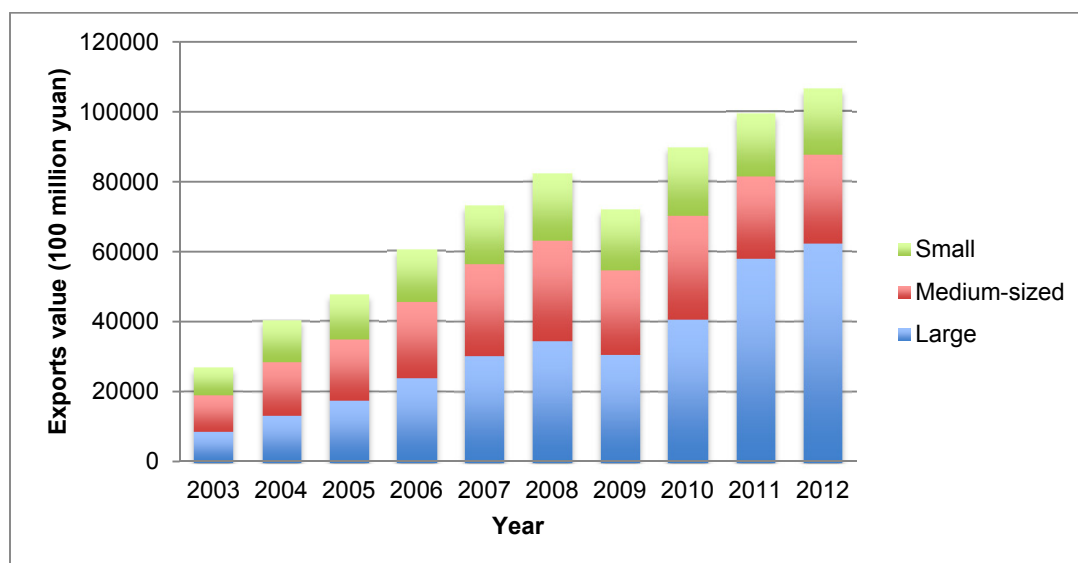
Figure 1.2 - Value of sales of industrial enterprises by size from 2003 to 2012



Source: China Statistics Yearbook (2004-2012)

Figure 1.3 shows the total value of exports from industrial enterprises from 2003 to 2012. The value of exports of industrial enterprises increased every year except for 2009, due to the 2008 financial crisis.

Figure 1.3 - Value of exports of industrial enterprises by size from 2003 to 2012



Source: China Statistics Yearbook (2004-2012)

Over the period from 2003 to 2012, total exports grew steadily. Over the same period, the exports of large industrial enterprises increased, while SME exports grew at a more modest rate. In 2012, large firms accounted for nearly 60% of all exports, with medium and small firms accounting for 23.6% and 17.8% respectively.

It is important to stress that there is no 'optimal' SME share of total firm numbers, turnover, or export share. However, in so far as government policy or market conditions inhibit the growth of SMEs, the sector will perform below its potential.

1.2. Cooperation among enterprises of different sizes

When highlighting statistics by firm size, there is a tendency to view firm categories in isolation. However, the growth and productivity of large firms depend on SMEs and vice versa. Therefore, below we outline the four primary ways SMEs interact with large companies in China.

1. Subcontracting: In general, there are three types of subcontracts:
 - a. economic subcontracting: SMEs with a low wage or low cost advantage provide cheap products or labor to large firms, keeping their costs down;
 - b. professional subcontracting: SMEs with a unique skill set or specialized product provide components or services to large enterprises;
 - c. functional subcontracting: large enterprises engage SMEs that produce the same, or a similar, product in order to supplement their capacity. Functional subcontracting is typically used when large firms are required to meet large orders in a short time frame.
2. Franchising: This is a practice whereby a firm allows another one to use its business model and brand for a prescribed period of time. This usually involves a large lead firm selling the business model structure and brand rights in exchange for a certain percentage of revenue or profits.
3. Shareholding: This is a practice whereby one firm, typically the larger firm, buys shares of another firm (often a SME) to help promote its business. One of the primary benefits of such cooperation is access to cheaper capital for the SME.

4. Joint sales: This is the practice whereby one firm, typically the larger firm, provides its own distribution network to another firm (typically a SME), in exchange for a certain percentage of revenues or profits.

In the outline of the types of cooperation between large enterprises and SMEs outlined above, a common factor emerges: the leading position of the large enterprises.

2. Level of intra-Chinese and regional integration in China

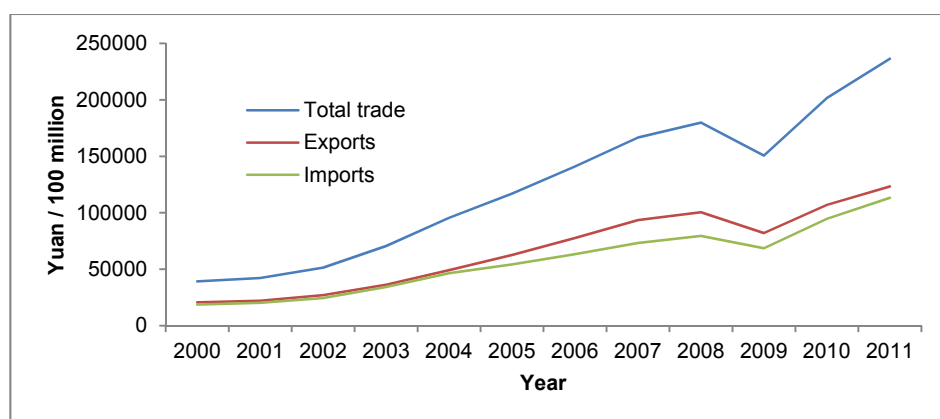
2.1. Trade growth in China

In 2013 China became the world's largest trading nation, with trade valued at 4.3 trillion USD (WTO, 2013). Figure 2.1.a outlines China's foreign trade growth from 2000 to 2011. The total value of China's imports and exports increased at an annualized rate of 17.7%, despite a 16.3% fall in trade in 2009 following the 2008 global financial crisis. Exports consistently outperformed imports, resulting in a trade surplus.

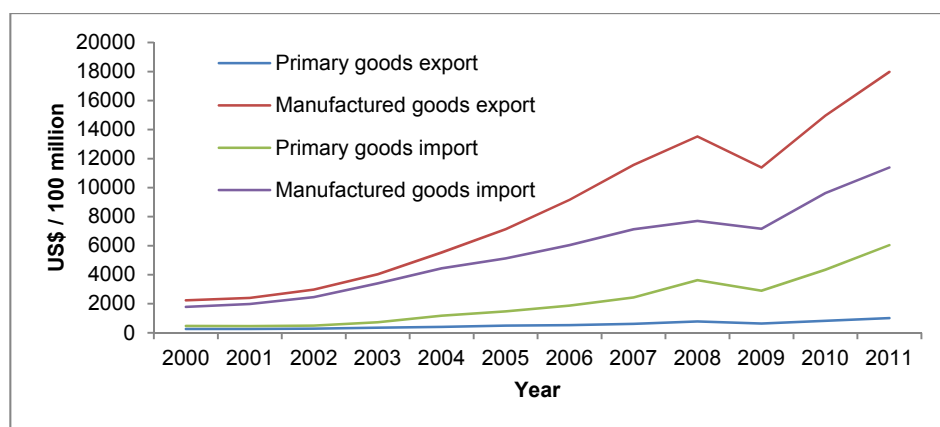
Figure 2.1.b shows the import and export values of primary and manufactured goods in China from 2000-2011. Breaking down the contents of both imports and exports shows that manufactured goods accounted for a larger percentage share than primary goods. From Figure 2.1.b, it is also clear that China's trade surplus is driven by manufactured goods, in trade surplus, compared to primary goods, in trade deficit.

Figure 2.1 - China's foreign trade from 2000 to 2011

(a) Total value of imports and exports (Yuan/100million)



(b) Primary and manufactured goods import and export value (USD / 100million)



Sources: DRCNET, <http://www.drcnet.com.cn>

2.2. Regional distribution of Chinese GDP

The proportion of Beijing-Tianjin-Tangshan's GDP to China's GDP is around 3%. This proportion was below 3% before 2004 and then gradually increased to 3.45% in 2012. Beijing played the most significant role in this zone. The proportion of Yangtze River delta's GDP to China's GDP has tended to fluctuate around the 20% mark. It increased gradually from 2000 to 2006, and declined from 2007 onwards. Jiangsu province took the lead in this zone. The proportion of Pearl River delta's GDP to China's GDP is around 11%, and it had a similar evolution to the Yangtze River delta. Combined with all of three regions, it accounts for almost 36% of China's GDP.

2.3. Regional integration with countries and economic entities in Asia

Over the last two decades, regional integration in Asia has grown at a faster pace than any other region in the world. From 1990 to 2012, intra-regional trade increased at an average annual rate of 10%, more than twice that of other regions. Moreover, ASEAN economies are now thought to have business linkages that rival other economic zones such as the Eurozone.

According to China's Ministry of Commerce, China's exports to ASEAN economies (annual growth rate of 12.8%) grew faster than its exports to the United States (annual growth rate of 11.3%) and Europe (annual growth rate of 12.7%). Together, these three regions accounted for 45.4% of China's total exports in 2013. Exports to the ASEAN region increased by 8.7%, while imports from this region grew by 2.4%. The statistics above indicate that China continues to integrate with countries in Asia.

3. The role of clusters in the internationalization of Chinese SMEs

3.1. The role of geographical proximity for clusters in China

China's industrial clusters are widely distributed in Zhejiang, Guangdong, Fujian, Jiangsu, Shandong and other provinces, and almost every province has a different degree of development of industrial clusters.

Clusters of SMEs are gradually becoming a trend of development. There are over 30 clusters in Wenzhou, each one with a considerable number of enterprises, greatly enhancing industrial competitiveness, and promoting the development of the local economy. Consequently, Wenzhou is the center of 33 kinds of products (e.g. shoes, locks, etc.). Although the size of most enterprises in industrial clusters is not large, thousands or even tens of thousands of small enterprises together account for a large share of the market.

Beyond the domestic market, clusters are also forming a new force in the international market. According to practice of Wenzhou, it is evident that clusters play an important role in the internationalization of SMEs. Some of the benefits provided by clusters are:

1. Lower costs: SMEs have the opportunity to interact with each other easily. This allows firms to build trust and cooperation among themselves, thereby reducing transaction costs. The sharing of information, such as marketing information on prices, quality, and after-sales services also reduces information search costs. Meanwhile, clusters provide the access to the effective integration of resources. Because of their geographical proximity, many companies can share the same infrastructure and specialized services provided by the auxiliary industry and government. In addition, clusters attract a large supply of cheap labor, raw materials and components. Footwear, of which China has long been a major exporter, provides a good example. Wenzhou, known as the "capital of shoes", is one of the world's main suppliers. Comparing the costs of shoes production with other countries, China has retained a competitive advantage.
2. Brand recognition: SMEs in clusters can form a "regional brand" by common advertising. This is important because individual SMEs are often unable to afford the costs associated with advertising. Therefore, clustering offers an easy way of becoming part of a "regional brand". With the development of clusters of SMEs, the country authorized Wenzhou clusters a serial of honor-ship. Until now, Wenzhou has created a number of brands, with 32 Chinese famous brands, and 16 "top 500 enterprises" in China.

All the advantages concerning clusters enumerated above can facilitate the internationalization of SMEs. Currently, most clusters in Wenzhou look at the international market as their primary goal. In recent years, many traditional industrial clusters in Wenzhou have begun to cooperate with major multinational companies representing well-known international brands. This cooperation has often come in the form of multinational joint ventures. This shows the extent to which these clusters of SMEs have been integrated into the global production system. For example, Wenzhou clusters are responsible for around 70% of metal lighters sold worldwide (WMBS, 2015).

3.2. Internationalization of Chinese SMEs in the context of increased global use of the ICT

As the Chinese economy internationalizes, it is likely that Chinese SMEs will internationalize with it. The data show that the export value of SMEs has increased rapidly since 2004, reaching 4.42 trillion Yuan in 2012 (see table 3.1). However, the ratio of SMEs' exports to total exports has declined from 20.59% in 2004 to 8.16% in 2012.

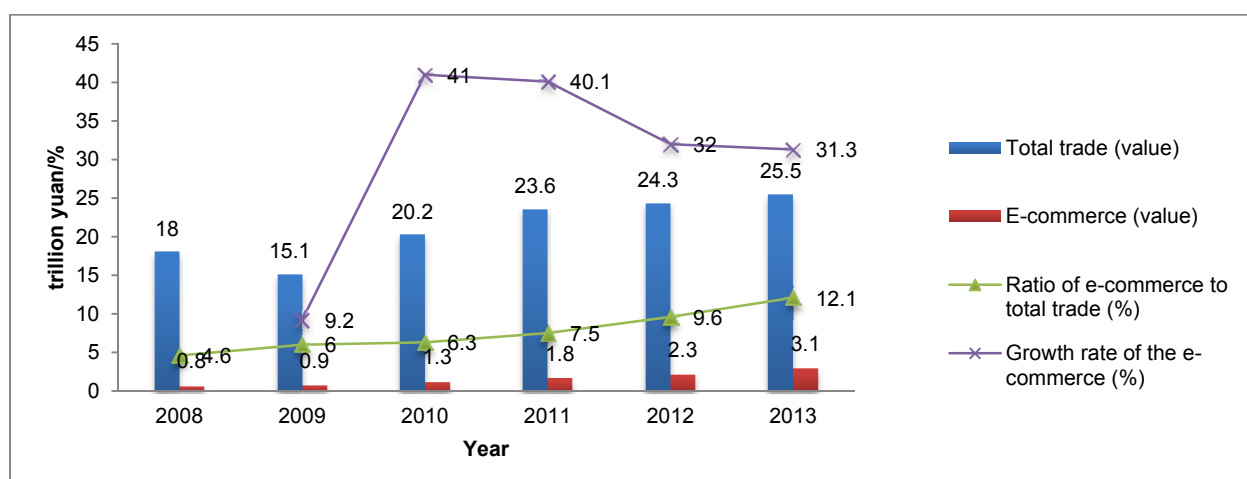
Table 3.1 - The export value and output value of SMEs

Year	Output value (100 million Yuan)	Export value (100 million Yuan)	Ratio (%)
2004	132,238.8	27,222.5	20.59
2005	160,355.1	30,087.7	18.76
2006	204,249.5	36,563.4	17.9
2007	264,319.1	43,032.4	16.28
2008	337,981.1	47,728.3	14.12
2009	372,498.9	41,519	11.15
2010	468,643.3	49,194.9	10.5
2011	492,761.5	41,417.9	8.4
2012	542,298.8	44,229.7	8.16

Source: China SMEs Yearbook

Cross-border e-commerce has developed rapidly in recent years. According to statistics of the Commerce Department, China cross-border e-commerce transactions reached approximately 1.8 trillion Yuan in 2011, accounting for 9.5% of the value of trade. E-commerce reached 2.3 trillion Yuan in 2012 and broke through to reach 3.1 trillion Yuan in 2013 (see figure 3.1). Between 2008 and 2013, the value of cross border e-commerce grew at an annual rate of 31.1%, outperforming the expansion of trade by a factor of 4.3 over the same period. Therefore, there is a tendency for further development of cross-border e-commerce, which may facilitate the internationalization of SMEs.

Figure 3.1 - The value of cross-border e-commerce and international trade



Source: China Statistical Yearbook

Cross-border e-commerce businesses have created many opportunities for SMEs. According to national statistics, more than 80% of Chinese enterprises involved in foreign trade have begun to explore the possibility of selling through e-commerce channels. And the trend of cross-border e-commerce is irreversible. For SMEs, ICT technologies have the potential to enable them to compete directly with larger enterprises. The e-commerce market often supersedes geographic restrictions, especially in the services sector, allowing SMEs to sell their products to various countries and regions worldwide. Cheaper access to information and the ability to exploit niche markets mean that SMEs are well positioned to reap the benefits of the so called 'information age'.

4. The role of foreign players in clusters and value

According to Table 4.1, Foreign Direct Investment (FDI) in China has grown rapidly during the past three decades. The total value of FDI in 1985 was 1.95 billion USD, while the total value of FDI in 2012 was 111.72 billion USD, a 57-fold increase in 27 years.

Table 4.1 - Absorption of Foreign Direct Investment from 1985 to 2012, 100million USD

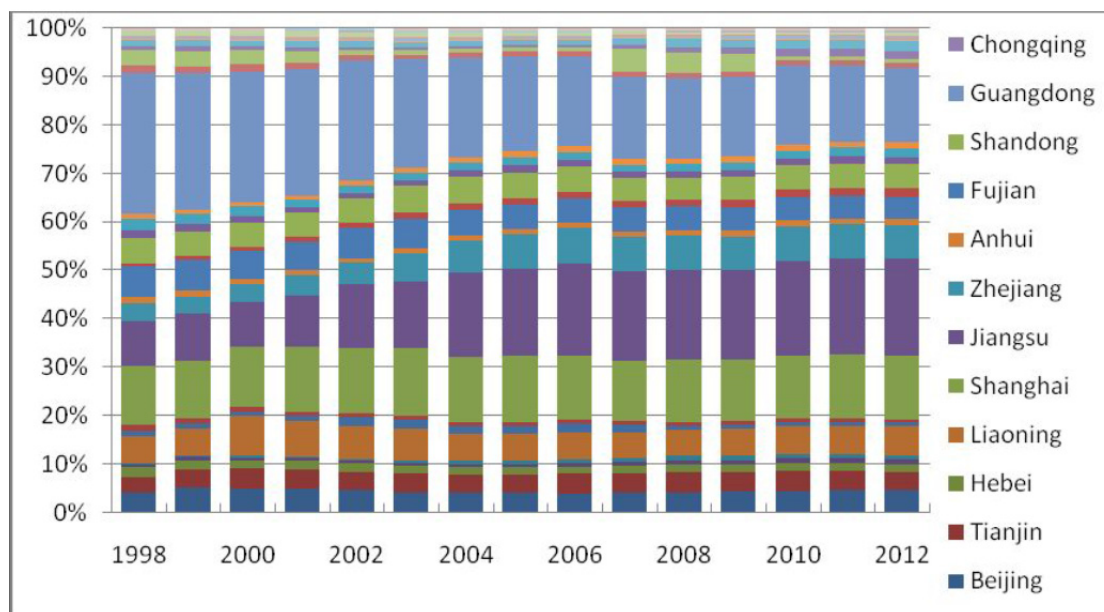
Year	Total Foreign Investment	FDI Value	Year	Total Foreign Investment	FDI Value
1985	47.60	19.56	1999	526.59	403.19
1986	76.28	22.44	2000	593.56	407.15
1987	84.52	23.14	2001	496.72	468.78
1988	102.26	31.94	2002	550.11	527.43
1989	100.60	33.92	2003	561.40	535.05
1990	102.89	34.87	2004	640.72	606.30
1991	115.54	43.66	2005	638.05	603.25
1992	192.03	110.08	2006	670.76	630.21
1993	389.60	275.15	2007	783.39	747.68
1994	432.13	337.67	2008	952.53	923.95
1995	481.33	375.21	2009	918.04	900.33
1996	548.05	417.26	2010	1088.21	1057.35
1997	644.08	452.57	2011	1176.98	1160.11
1998	585.57	454.63	2012	1132.94	1117.16

Source: National Statistics Bureau China Statistical Yearbook

4.1. The role of foreign players in clusters

Since China’s “opening up” reform, the scale of foreign investment inflow to China has increased steadily. Figure 4.1 shows the proportion of foreign investment in every province from 1998 to 2012. According to the same figure, Guangdong traditionally received the highest proportion of FDI. In 2006, Jiangsu overtook Guangdong becoming the region that received the largest proportion of FDI in China. Because Jiangsu currently receives more FDI than any region in China, in what follows we use its experience to highlight the relationship between FDI and clustering.

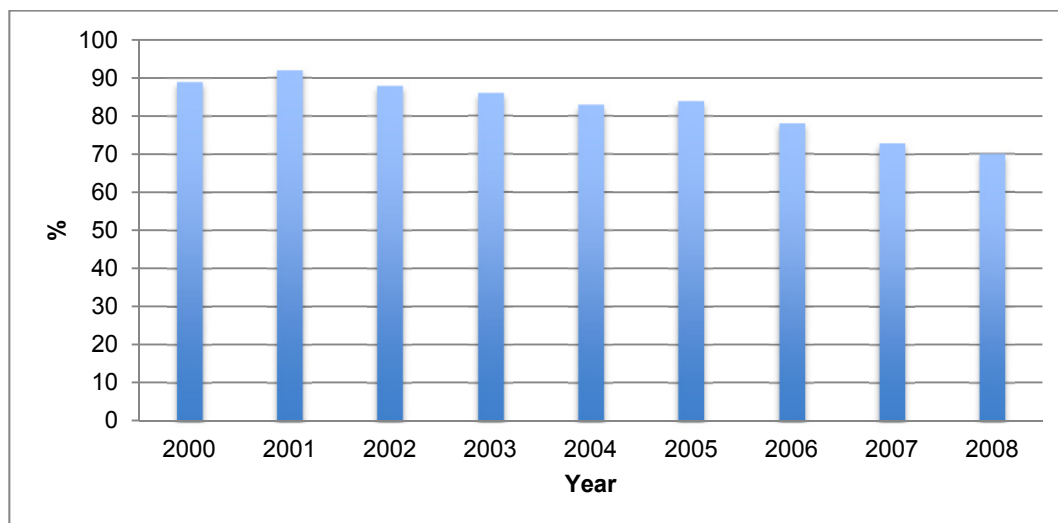
Figure 4.1 - Proportion of Foreign Direct Investment by province



Source: China statistical yearbook

Figure 4.2 shows the proportion of manufacturing related FDI in the province of Jiangsu. It is clear that the overwhelming majority of manufacturing related FDI is directed to Jiangsu, although the proportion has steadily declined from 2001. In 2008, the percentage was almost 70%. Therefore, in what follows, we will focus on FDI in manufacturing in the province of Jiangsu.

Figure 4.2 - FDI in Jiangsu’s manufacturing sector as a proportion of total FDI in manufacturing



Source: Jiangsu statistical yearbook

Table 4.2 - Manufacturing related FDI growth in Jiangsu

	Average annual growth rate of foreign investment	Average location quotient	Average annual growth rate of location quotient
Communication Equipment, Computers and Other Electronics	7.03%	1.36	6.76%
Electrical Machinery Equipment	44.08%	1.24	1.44%
Raw Chemical Materials and Chemical Products	21.28%	1.50	0.07%
Transport Equipment manufacturing	33.30%	0.72	0.44%
Special Purpose Machinery	18.10%	1.17	-3.90%
General Purpose Machinery	27.23%	1.58	-4.20%
Metal Products	13.44%	1.36	0.58%
Non-metallic Mineral Products	25.80%	0.74	-4.00%
Paper and Paper Products	22.65%	0.94	-1.10%
Textile Wearing Apparel, Footwear, and Caps	14.24%	1.60	0.73%
Textile	3.89%	1.88	-1.40%
Plastics	16.75%	1.04	-3.80%

Source: China statistical yearbook and Jiangsu statistical yearbook

Table 4.2 shows how the average annual growth rate of foreign investment is positive in all industries. There are 8 industries where the location quotient¹ is higher than 1, an indication that the level of clustering in these industries is high. However in 6 industries the average annual growth rate of the quotient is negative, even though the level of FDI growth is high. This means that the growth of foreign investment may not necessarily increase the level of clustering in these 6 industries, and that there are other invisible factors that cause the decrease of the clustering level. The average annual growth rates of the location quotient of the 6 remaining industries are positive, which could indicate that foreign investment is positively related to clustering in these industries. Therefore, the presence of a foreign investor may help or hinder the clustering of different industries.

4.2. The role of foreign players in value chains

A value chain is a set of activities undertaken by a series of firms, which results in the production of a specific product or service to the market. The concept comes from business management and was first described and popularized by Michael Porter.

In this working paper we choose three indicators, namely total assets, annual average number of employed persons and revenue, from principal business, to illustrate the role of foreign players in Chinese value chains. In the calculation of the capital output ratio and the labor output ratio, we use revenue from principal business to substitute value added of output.

Table 4.3 Different sectors represent different links

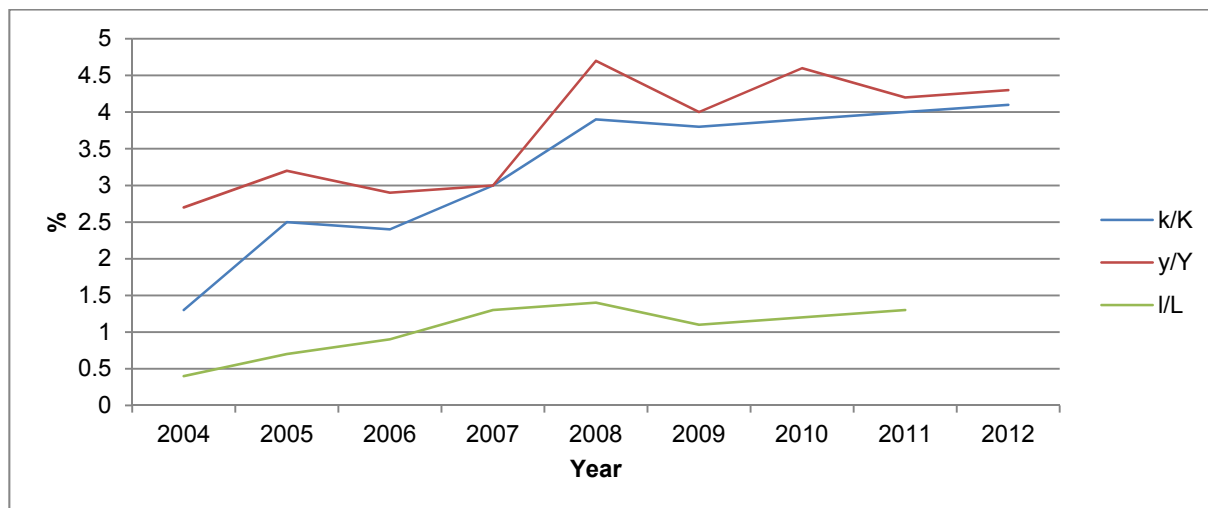
Links	Sectors
Procurement	Mining and quarrying
Inbound & outbound logistics	Transport, storage and post
Operations	Manufacturing
Marketing & sales	Wholesale and retail trades

¹ The location quotient which was developed by P.Haggett is used to measure the level of cluster.

Procurement

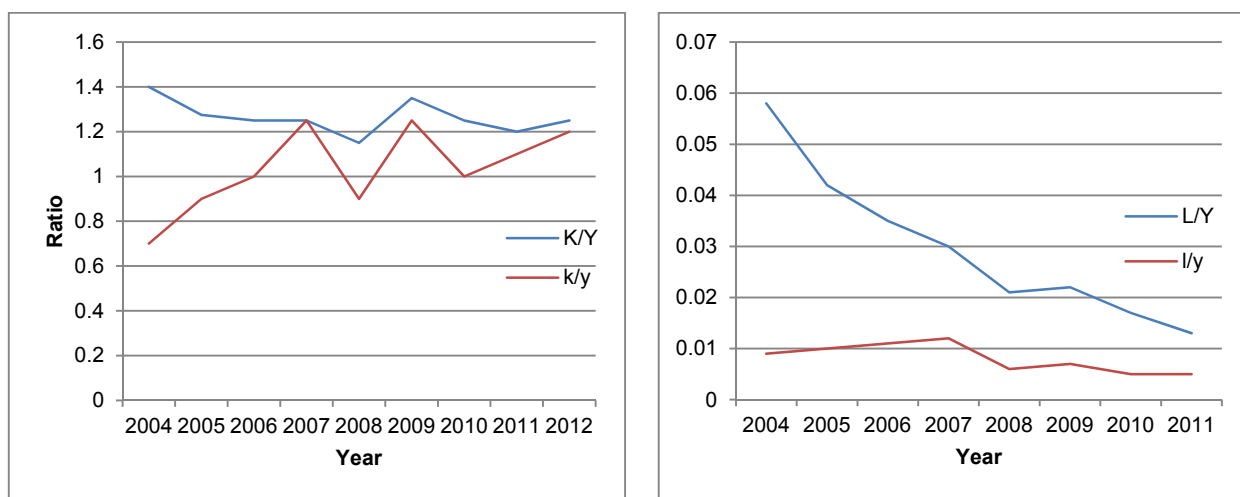
The percentage of foreign investment in mining and quarrying increased from 2004 to 2012. The ratio of k/K was higher than the l/L ratio, indicating that foreign enterprises invested more in capital than in labor. The ratio of y/Y was higher than the k/K ratio, showing that the return on assets in foreign enterprises was higher. Figure 4.4 compares the capital output ratio and labor output ratio. The ratio indicates how much capital or labor is needed to produce a unit of product, so the lower are ratios, the higher is productivity. Figure 4.4 implies that foreign players need less capital or labor input than domestic companies to produce the same amount of product. So, foreign players promote productivity in this sector.

Figure 4.3 Evolution of foreign enterprises in mining and quarrying



Source: China Statistics Yearbook 2005-2013. k means total assets in foreign enterprises, y means revenue from principal business in foreign enterprises, l means annual average number of employed persons in foreign enterprises. The capital letters stand for counterparts in all concerned enterprises. The same applies to figures following.

Figure 4.4 Comparison of capital output ratio and labor output ratio between national and foreign enterprises in mining and quarrying

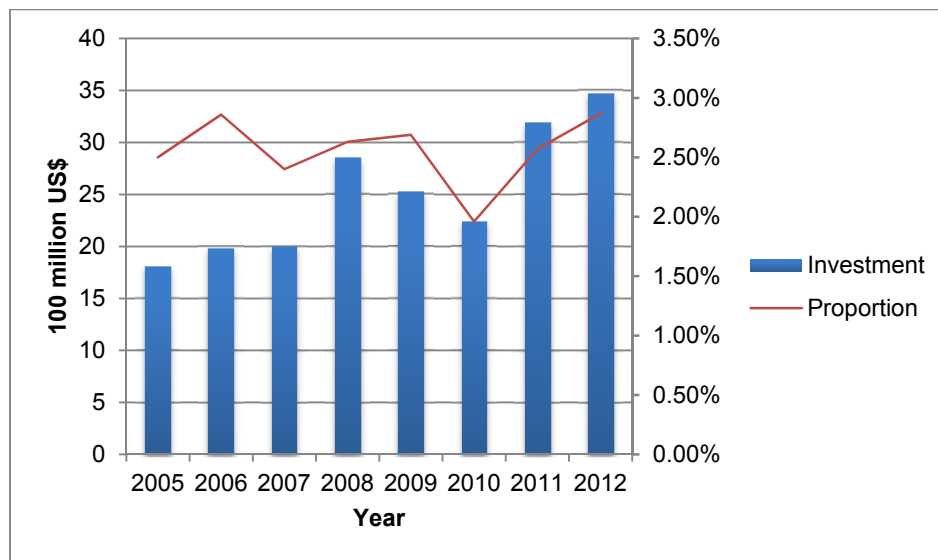


Source: China Statistics Yearbook during 2005-2013. Blue line represents domestic enterprises and red line represents foreign investment enterprises.

Inbound logistics & outbound logistics

It is clear from Figure 4.5 that FDI in transport, storage and post fluctuated over the years. In 2012, the proportion of FDI actually utilized to the total in this sector reached the highest point at 2.87%. FDI in the logistics sector in China followed multinational companies established in China. The spillover of FDI helps local logistic companies improve their equipment and management so as to boost their productivity. However, foreign players also bring more intense competition when they participate in this business.

Figure 4.5 - Evolution of FDI in transport, storage and post

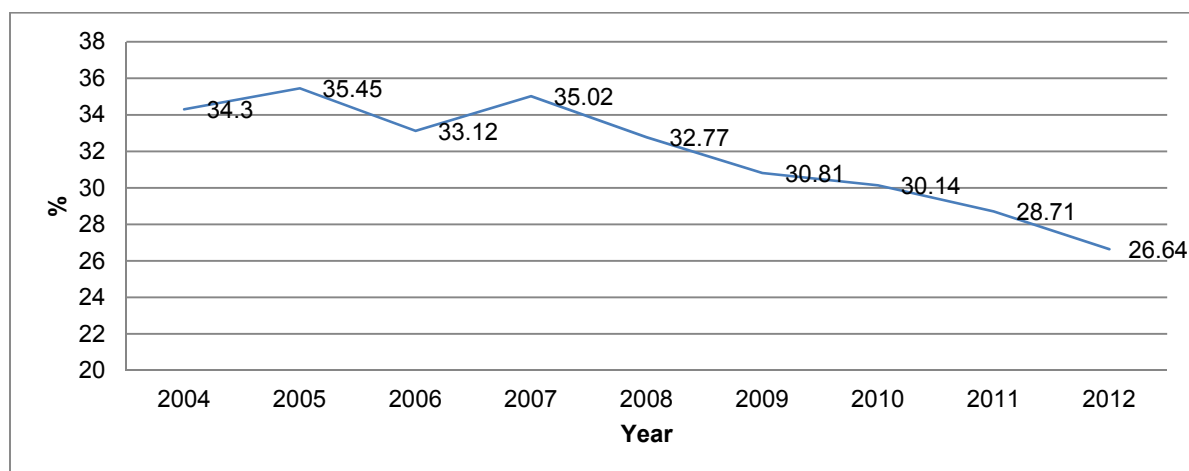


Source: China Statistics Yearbook 2005-2013

Operations

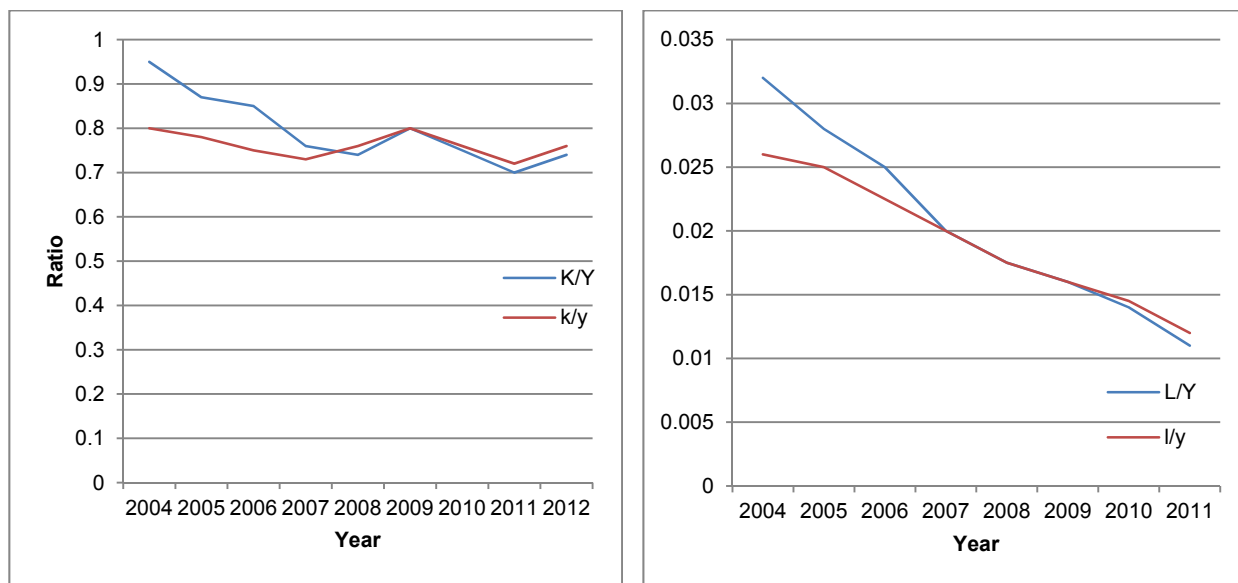
According to Figure 4.6, the percentage of foreign players in manufacturing reached 35.4% in 2005, but it consistently declined since 2006, and reached 26.64% in 2012. Figure 4.7 shows that the labor needed by foreign players was higher compared to China's domestic enterprises. The profitability of foreign players was better compared to domestic enterprises at the beginning of the period, but the advantage disappeared in 2009, when profitability of foreign enterprises declined below the respective level of domestic enterprises in China. Consequently, foreign players play little role in this segment.

Figure 4.6 - Evolution of foreign enterprises in manufacturing



Source: China Statistics Yearbook 2005-2013

Figure 4.7 - Comparison of capital output ratio and labor output ratio between national and foreign enterprises in manufacturing

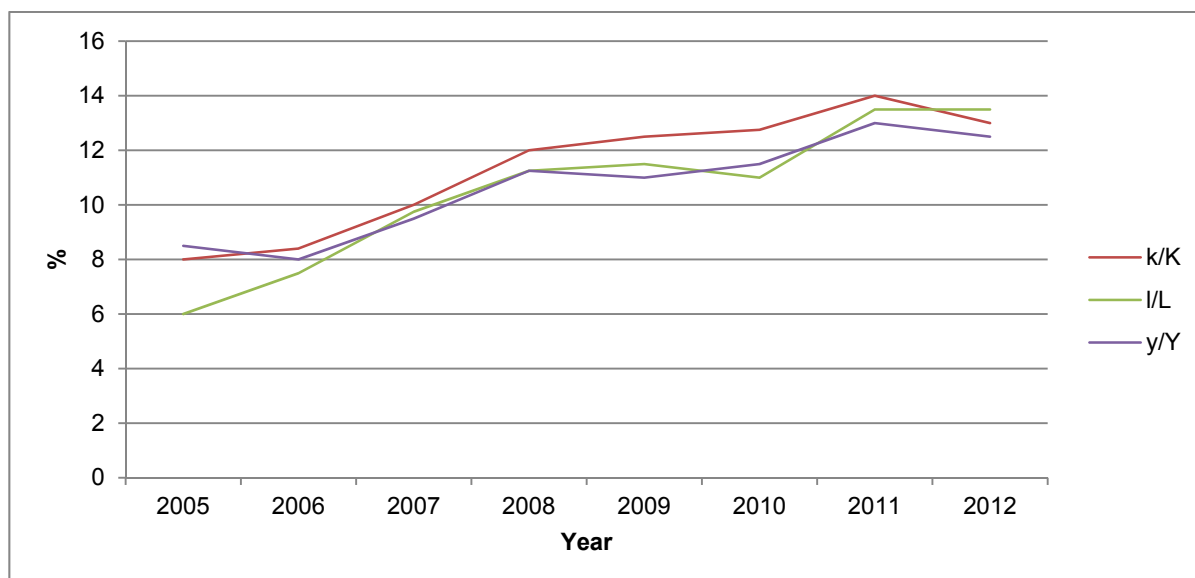


Source: China Statistics Yearbook 2005-2013. Notes: Blue line represents domestic enterprises and red line represents foreign investment enterprises.

Marketing & Sales

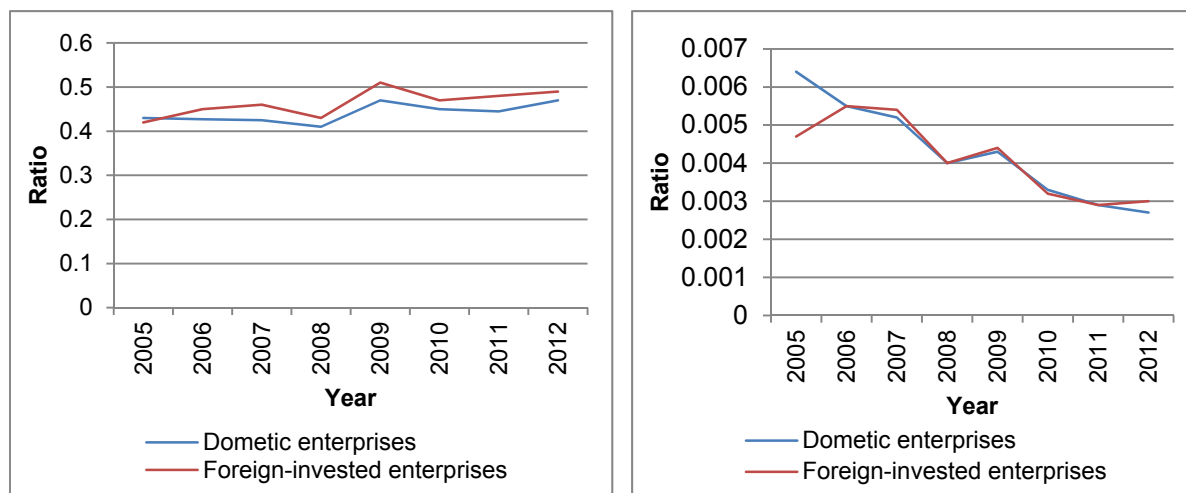
Figure 4.8 shows that foreign enterprises' assets, employees and revenue accounted almost for the same percentage. According to Figure 4.9, foreign enterprises need more capital to produce the same amount of goods than domestic enterprises. As for labor, the number of employees needed to manufacture a unit of good declined for both foreign and domestic enterprises, and they have been similar since 2006.

Figure 4.8 - Evolution of foreign enterprises in wholesale and retail trades



Source: China Statistics Yearbook 2005-2013

Figure 4.9 Comparison of capital output (left) and labor output (right) ratio between national and foreign enterprises in wholesale and retail trades



Source: China Statistics Yearbook 2005-2013. Blue line represents domestic enterprises and red line represents foreign investment enterprises.

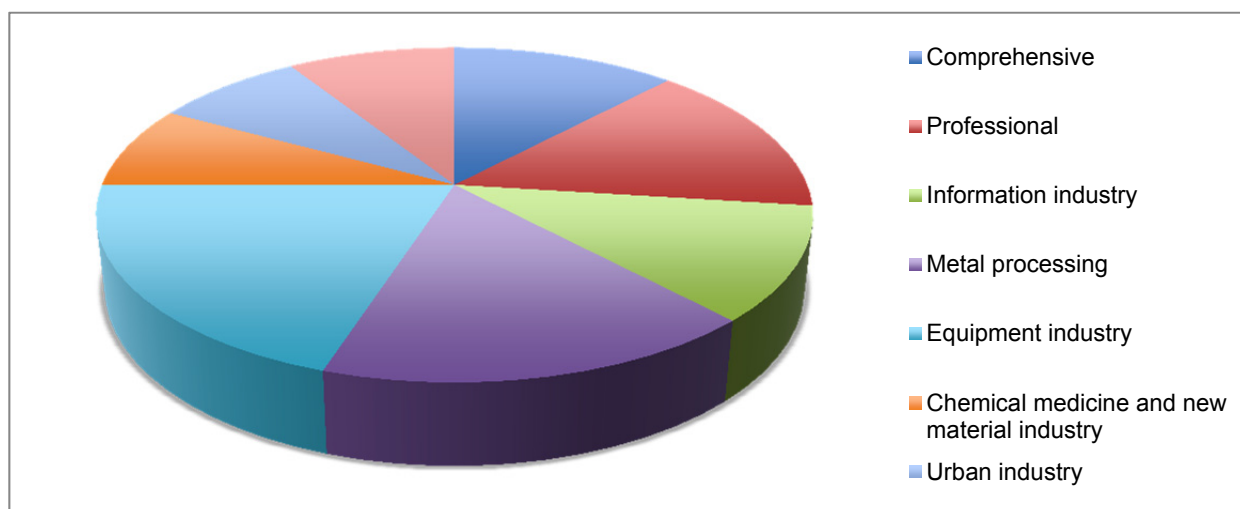
5. Institutions supporting SMEs

SME development is closely associated with the quality of supporting institutions. Section 5 introduces the role of institutions in serving SMEs, especially involving business associations as well as Trade and Investment Support Institutions (TISI).

5.1. Business associations and regional organizations

In China, typical institutions include business associations, non-profit social organizations established by business entities, public institutions and other similar organizations. Their purpose is to strengthen the relationship among enterprises, and between enterprises and governments. In addition, they play an important role in facilitating the coordination of interests among members, safeguarding their legal interests and promoting the development of their respective industries. Business associations have strong advantages on acquaintance of business, enterprises, markets, technology and human resources. With penetration of internationalization, they guide SMEs to conduct international operation and help member companies solve trade problems.

Many business associations were established when China's more complete business structure started to be built. By the end of June 2014, 71 nationwide business associations (industry associations) were registered in the Ministry of Civil Affairs, covering manufacturing sectors, as per Figure 5.1.

Figure 5.1 - Industrial distribution of nationwide business associations

Source: <http://www.chinanpo.gov.cn/index.html>

Business associations in urban (manufacturing) and services represent 40% of the total. Those in the information industry occupy one fifth, reflecting flourishing e-commerce driven by large number of SMEs. Domestic business associations provide SMEs with two fundamental functions: qualification examination of member companies and services minimizing the costs related to scale limitations.

Business associations play an important role for the development of SMEs. Firstly, they provide information on market and trade prospects, build common research and development platforms to promote industry's credibility, reduce transaction costs and costs related to pressure on a single SME.

Secondly, business associations provide support for investment and trade activities. Nationwide industry and business associations held more than 400 large exhibitions and trade fairs. They created direct value close to 50 trillion Yuan per year, expressed not only in economic value, but also in strengthening of the SME development potential in terms of improved quality of market supervision, access to finance, intellectual property rights protection, research and development.

Thirdly, business associations help SMEs handle anti-dumping suits. SMEs, with weak legal capacities were easily damaged by trade lawsuits. Chambers of commerce call on SMEs to respond positively and defend themselves. For example, the EU implemented an anti-dumping investigation against China in the Photovoltaic cell industry in 2012. China's Electronic Products Import and Export Chamber of Commerce made the statement immediately, strongly deplored trade protectionism and claimed that it would take measures to safeguard enterprises' interests. Finally, the anti-dumping suit came to an accommodation in 2013.

Fourthly, business associations promote technology upgrade and innovation ability for SME's. They accelerate marketing of technical achievement and support brands building. Trade associations organize various trainings, to help to deal with the lack of human capital resources and managerial skills.

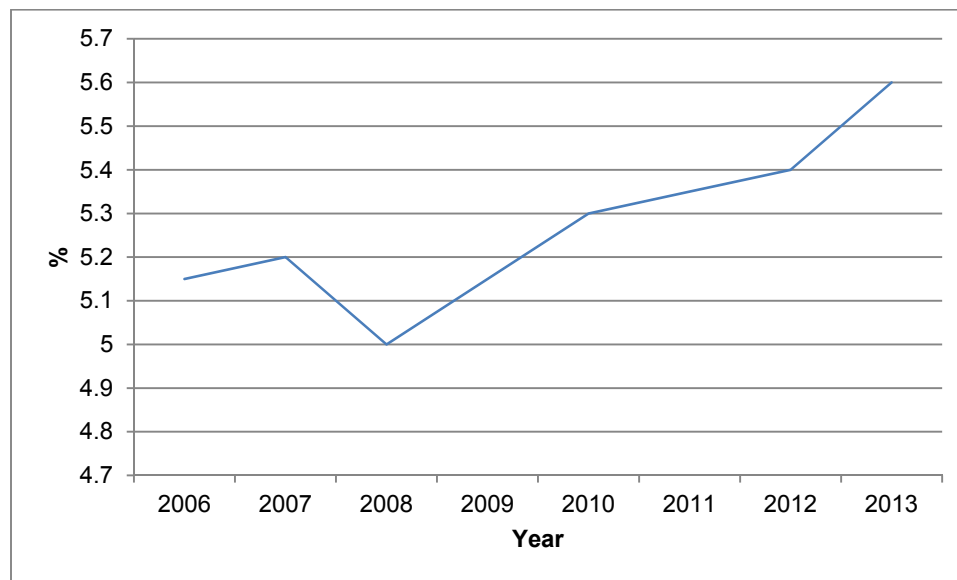
It is also important to mention regional organizations with the status of a legal entity to safeguard interests and rights and promoting business prosperity. An example of such an institution is the Wenzhou Chamber of Commerce, which plays an important role in the development of SMEs in many regions.

In particular, regional chambers of commerce act as credit intermediation agent. Difficulties with financing are among the most important bottlenecks for SMEs in China (with Investor Confidence index only 50.37 out of 100 in the fourth quarter of 2013) due to a rigid banking system and insufficient external financing. The chambers of commerce have acquired reputation and social influence in promoting mutual and joint guarantees forming credit consortia authorized by banks.

5.2. China Council for the Promotion of International Trade

The China Council for the Promotion of International Trade (CCPIT) is the biggest organization supporting investment and trade for SMEs in China. It is a non-governmental organization established in 1952 by private enterprises, institutions and public figures to promote international trade. This organization has taken part in business circles in more than 200 countries, made agreement with more than 300 counterparts, built 34 frameworks of multilateral cooperation system and led to establishment of 21 business councils. CCCPIT has offices in 17 countries worldwide, 50 domestic branches, and 826 local organizations with more than 110 member enterprises. Such a complete structure promotes SME development. CCPIT has covered 22 industries, including electronic, information and manufacturing SME clusters. Figure 5.2 shows the proportion of foreign trade having assistance from CCCPIT to total foreign trade of China from 2006 to 2013.

Figure 5.2 - The amount of foreign trade facilitated by CCCPIT from 2006 to 2013



Source: Annual report of China Council for the Promotion of International Trade

6. The contribution of internationalization to SMEs' sustainable development

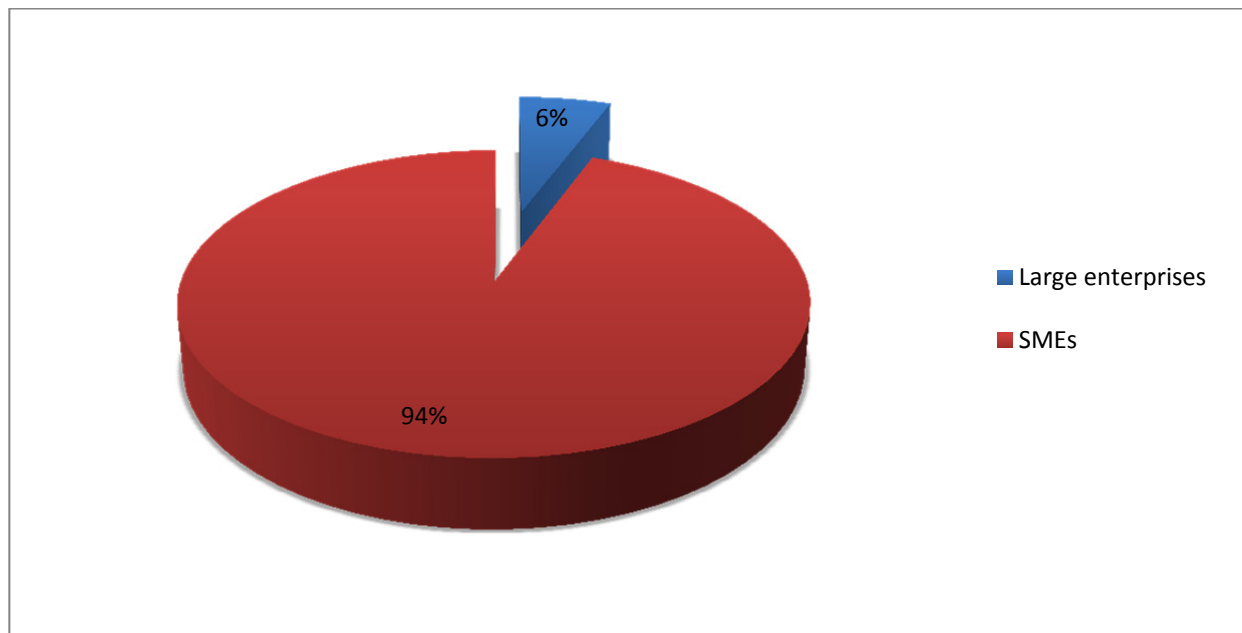
In this section we stress the importance of production and capital internationalization for SME development. Specifically, we discuss the role of SME export activities for business development in China. We provide some statistical data on SME internationalization, including exports and FDI.

Expanding business to international markets may affect the development of SMEs in several ways. Regarding sales, international activities may lead to increased sales and profits for firms. As for product development, worldwide competition may improve product quality and extend its lifecycle. From the business development perspective, entering the international market can reduce the manufacturing cost, which would improve the competitive position of enterprises. In term of services, internationalization may create the incentives for an enterprise to pay more attention to customer needs and preferences. Therefore, internationalization may contribute to a higher rate of growth and improved enterprise performance. In addition, involvement in international trade activities may stimulate SMEs to develop attitudes for technological innovation and management quality enhancement. While trying to enter international markets, SMEs can acquire important experience in building and maintaining business relationships with more experienced companies, which already possess advanced technology and managerial knowledge.

According to a study of the U.S. Small Business Administration, participation in international activities can increase productivity and financial capacity of SMEs by 20% and 9%, respectively, compared to enterprises not involved in international trade. Identically, a survey launched by the Chinese Ministry of Commerce reveals that exporters pay higher wages and offer better jobs to employees.

As for foreign investment activities, FDI plays an important role for SME development, similarly to international trade. Figure 6.1 shows the share of SMEs among Chinese enterprises that attracted foreign capital in 2012. The majority of these enterprises, accounting for 94.3% of the total, are classified as SMEs. In 2012, there were 53,673 foreign-invested SMEs, with total assets amounting to 9,163.2 billion Yuan - which account for 53.2% of total assets of enterprises engaged in FDI activities.

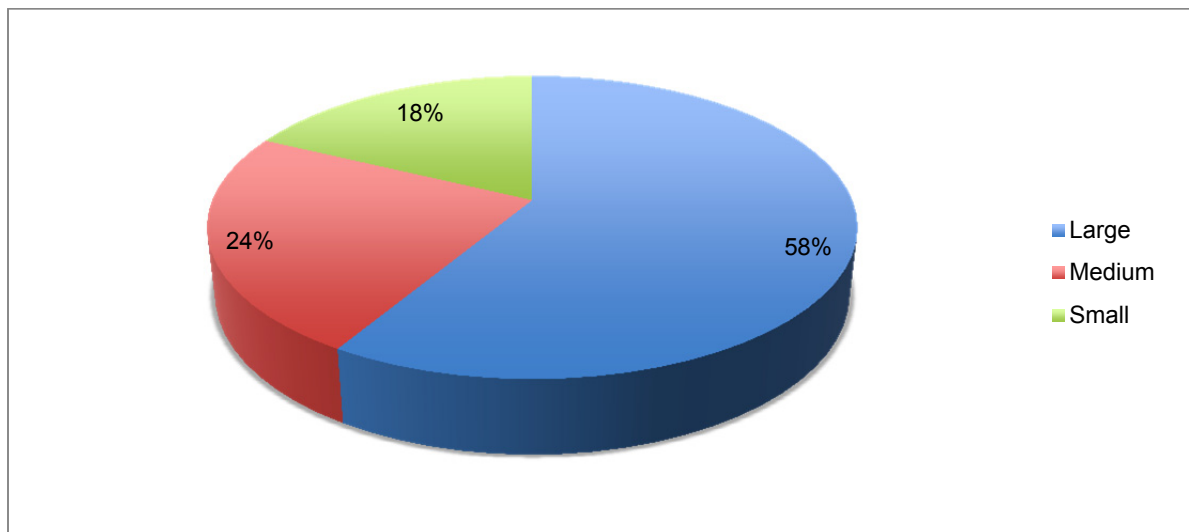
Figure 6.1 - Proportion of enterprises participating in FDI activities by size in 2012



Source: China SMEs yearbook 2013

Export statistics for 2012 show that exports of small- and medium-sized enterprises amounted to 1,901.8 billion Yuan and 2,521.2 billion Yuan, respectively. The share of small- and medium-sized enterprises together accounted for 41.4% of total export sales in the manufacturing sector (see figure 6.2).

Figure 6.2 - Share of large-, medium- and small-sized enterprises in export sales

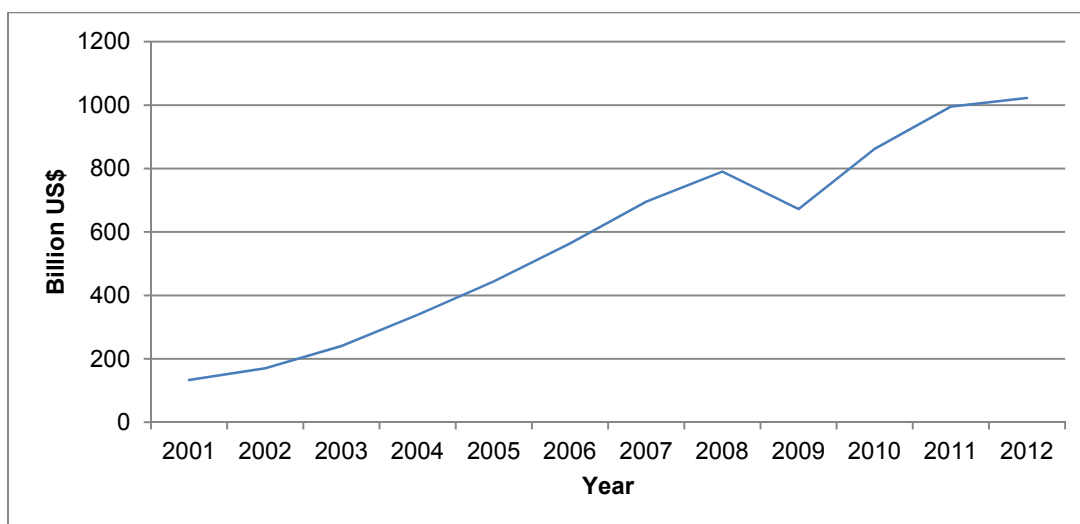


Source: China Bureau of Statistics

6.1. Contribution of internationalization to product competitiveness

Internationalization does not only help enterprises to expand their business, it also opens domestic enterprises' access to foreign advanced technology and experience, therefore affecting product competitiveness. FDI and export competitiveness are tightly related. FDI affects China's SMEs through capital supply, technology spillovers, business network, and trade infrastructure improvement. Since Chinese SMEs are often capital constrained, FDI plays a very important role for enterprises' performance and competitiveness on international markets. Figure 6.3 shows that exports of enterprises participating in FDI activities increased from 133.23US\$ billion in 2001 to 1,022.62US\$ billion in 2012. This increase represents an average annual exports' growth rate of 60.68%.

Figure 6.3 - Exports of enterprises participating in FDI activities from 2001 to 2012

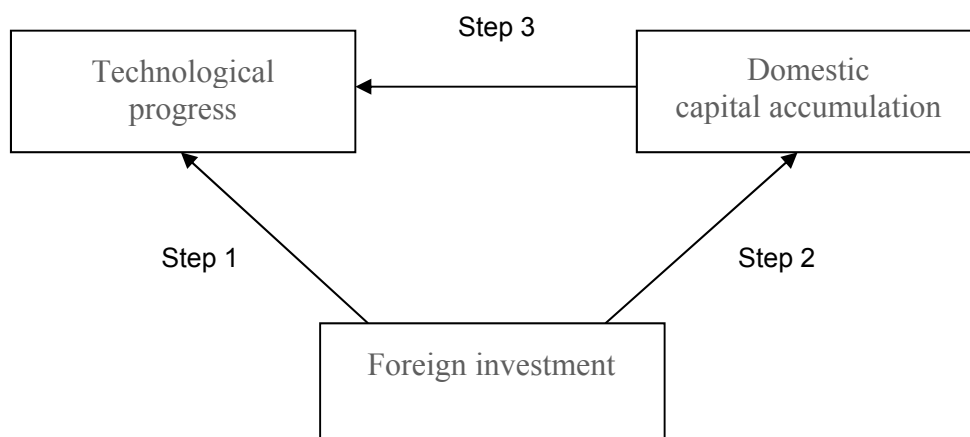


Source: China Bureau of Statistics

6.2. Contribution of internationalization to enterprise technological progress

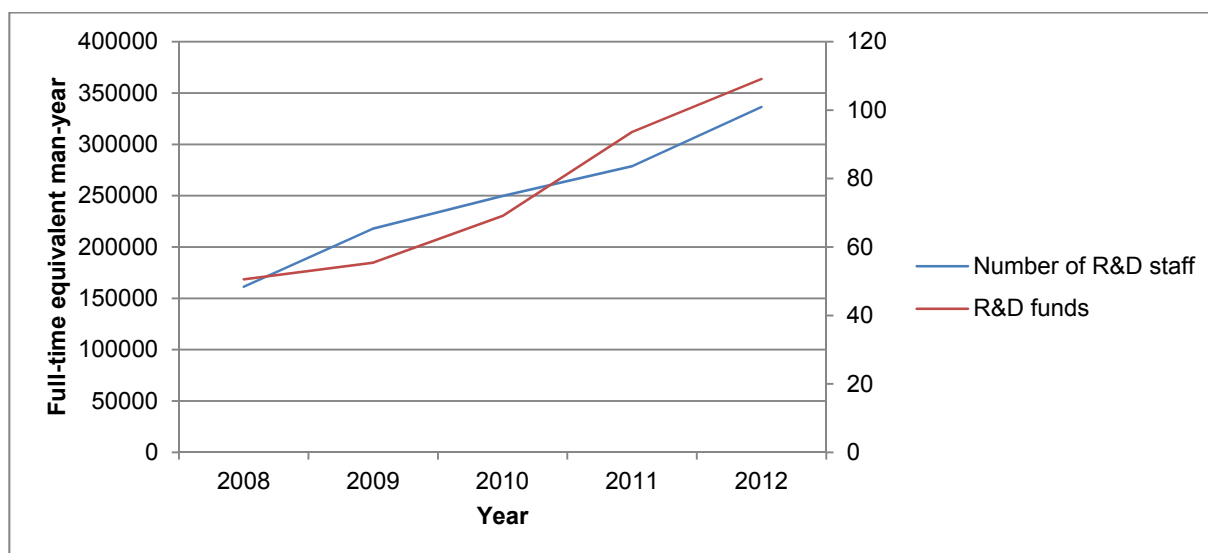
Below we focus on the effect of FDI on technological progress related to production capacities. Internationalization may affect production technology upgrade in many ways. Figure 6.4 depicts the channels of influence of foreign investment on technological progress.

Figure 6.4 - The mechanism of foreign investment influence on technological progress



We represent schematically the foreign investment affecting technological progress through a direct effect on one side and a crowding out effect on the other. The advanced management experience and production technology are absorbed through FDI. In competitive markets, enterprises participating in FDI activities outperform their competitors with low-technology production (step 1). Accumulated domestic capital stimulates new domestic investment (step 2). Both FDI and the domestic investments, along with advanced technology absorption, promote technological progress in production processes (step 3).

Figure 6.5 - Research and development (R&D) indicators for enterprises involved in FDI



Source: China statistical yearbook 2008-2013

Figure 6.5 shows the research and development (R&D) related indicators of enterprises participating in FDI activities from 2008 to 2012. Specifically, the number of R&D staff and R&D related spending increased significantly. In 2008, the number of R&D staff was 161,415, and it increased up to 336,479 in 2012, at an average annual growth rate of 27.1%. The R&D funds increased from 50.56 billion Yuan in 2008 to 109.13 billion Yuan in 2012, at an average annual growth rate of 29%.

7. Bottlenecks for SME creation and growth chains in China

According to China's State Administration for Industry and Commerce (SAIC), at the end of 2013 the number of registered SMEs had reached 45.641 million, which accounted for 99% of all registered enterprises in the country. However, SMEs in China have short average lifetime. We analyze below the bottlenecks for SME creation and growth (the so called "missing middle" phenomenon).

Among the most important obstacles for business development, SAIC lists the lack of technology and talents; the lack of financial capital; complexity of procedures related to business opening; the lack of information and infrastructure, and insufficient legal assistance to business.

7.1. China's state policy aimed on SMEs support

Historically, China's government has attributed a higher importance to large state-owned enterprises than to SMEs when designing state business support policies. However, an important policy shift towards favoring the SME activities and development has emerged in recent years. We list below some examples of state support policies intended to facilitate SME activity.

7.1.1. Reducing market entry barriers

The importance of SME participation in the range of manufacturing sectors of the Chinese economy is recognised. With regard to other sectors, traditionally, the state-owned sector occupied 99.5% of Tobacco industry, 97% of Coal Mining and Dressing, 94% of Petroleum and Natural Gas Extraction, 92% of Electricity and Heat Production and Supply industry, 73% of Petroleum Processing and Coking, 71% of Water Production and Supply. To enter these industries, an enterprise needs substantial capital and financial investment, which is not affordable for an SME. We believe that opening a discussion on this issue is important. Expansion of the range of the SMEs activities would eventually lead to further SME development and growth.

7.1.2. Tax

In China, enterprises are subject to multiple taxes (corporate income tax, value-added tax, sales tax, etc.). The fiscal burden relative to other business figures is more important for SMEs than for big companies due to SMEs' lower financial capacity.

Value-added tax and sales tax for SMEs were gradually reduced in the last 10 years. Additionally, a number of state fees were eliminated, e.g. business administration fees, quality inspection fees, etc. However, the strict criteria defining small and micro enterprises limit the number of SMEs benefiting from these policies.

7.2. Financing

SMEs are often capital constrained. Direct financing (through bonds, shares and FDI) can help attract capital faster and at a lower cost. However, in China, the cost of entering the stock market is high and associated with complex approval procedures. Even though since 2004 a SME board market exists in the Shenzhen Stock Exchange and, since 2009, Growth Enterprises Markets are organized, indirect financing is still the most common choice for a large number of SMEs. This includes borrowing money from other private entities. Furthermore, increasing the loan interest rate of financial institutions has pushed SMEs towards alternative sources of financing in recent years.

To conclude, bottlenecks in SME creation and growth in China are closely related to the Chinese market environment. The economic system with dominant state-owned enterprises attributes less importance to SMEs. Moreover, entry barriers in monopoly industries are difficult to break; and tax payments substantially increase the costs for SMEs. It is hard for SMEs to obtain loans from commercial banks and financial institutions, which results in grey private money lending and high interest rates. Besides, some problems inherent to SMEs themselves, such as management conflicts and an inefficient organization structure, also hinder SME development and growth.

Conclusions

China's spectacular economic and export growth over the last two decades tremendously affected SME development. In the period from 2003 to 2012, the number of firms doubled, and business figures increased significantly. Specifically, according to official statistics, sales grew tenfold, and exports fivefold. By 2013, the number of firms registered as SMEs has reached 45.641 million, which represents 99% of all enterprises in China. Among them, small-sized enterprises account for 80% of the total, and one third of total sales of the sector. SMEs are steadily growing both in terms of size and value of domestic and export sales. However, the SMEs' share in total manufacturing exports declines.

Many SMEs are integrated in production cooperation network with large enterprises. Identically, a high level of intra-China regional cooperation is observed in recent years. Many manufacturing enterprises are organized within production clusters, which provide competitive advantages due to reduced fixed costs of business activities.

Economic success is partly explained by growing openness and a gradual transition to a market economy. Foreign players' role in China's economic development is significant. Since 1985, the FDI inflow has increased significantly, and is estimated to have attained 111.72 billion USD. Industrially developed regions with developed export-oriented sectors, such as Guangdong, Jiangsu, or Shanghai, attract the most significant share of the total value of FDI. FDI is seen as an important source for production technology upgrade and productivity increase due its technology, managerial skills and business information spillovers.

Importantly, business associations and state support institutions have played a significant role for SME development. They have played a crucial role for providing business with necessary financial and physical capital support, by intermediating loans for business development. Non-governmental associations and government-led chambers of commerce provide resources for the creation of business relationships, the development of business infrastructure, information support, and international promotion assistance for SMEs.

The statistics in this paper show the expansion of SME activities, which we expect to grow further in the future. For the moment, big government owned enterprises dominate the economic landscape in China. However, the observed success of SMEs - in terms of high economic growth and increasing income level observed over the past decades - indicates that more importance should be put towards supporting SME development in order to keep the Chinese economy competitive.

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