Development of Chinese small and medium-sized enterprises

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Abstract

Purpose – This article aims to present an overview of the historical development and current status of Chinese small and medium-sized enterprises (SMEs) examine major political initiatives contributing to SMEs’ development and draw out some experience from SME development practices in China.

Design/methodology/approach – This paper is exploratory in nature, using archives of government documents and related statistics.

Findings – The article argues that the fundamental role of the market in allocating resources and the self-operation status of SMEs should be respected, that it is imperative to encourage SMEs to optimise industrial structure, and that it is important to properly handle the government-enterprise relations and bring the role of the government in macro control into full play so as to create a fair competitive environment for SMEs.

Practical implications – The Chinese experience of SME development is of great interest to policy-makers and academics alike.

Originality/value – The article explores entrepreneurship and SME development in China from a policy-making perspective.

Keywords Small to medium-sized enterprises, Business development, China

Paper type Research paper

Introduction: development history of Chinese SMEs

Over the past two decades, Chinese small and medium-sized enterprises (SMEs) have gone through roughly three development phases, along with the development of China’s reform and opening-up. The first phase was from 1978 to 1992, characterised by the expansion of SMEs in number and scale. This resulted from the government’s encouragement of and support for the development of township, collective and self-employed enterprises. The rapid expansion of these enterprises has made great contribution to economic development and improvement of the people’s living standards.

The second phase was from 1992 to 2002. During this period, the emphasis was on the reform of state-owned SMEs and the development of non-public sectors. The government adopted various measures, such as restructuring, merger and acquisition, joint partnership, leasing, contracting and sell-off, to speed up reforms of state-owned SMEs and to gradually reduce the state’s ownership in SMEs. At the same time private-owned SMEs enjoyed rapid development along with the establishment of the socialist market economy. The phase was an important historical period for the development of Chinese SMEs.

The third phase began with 2002. In June 2002, China promulgated the small and medium-sized enterprises promotion law, which symbolised that the development of SMEs have ushered in a new era. The main mission for the government in this period was to implement the SMEs promotion law, which involves the following tasks:
to further improve policies and measures concerning the development of SMEs;
• to remove institutional barriers that hinder the development of SMEs, especially private-owned ones;
• to create a level playing field for the development of SMEs;
• to promote scientific and technological innovations and upgrading;
• to optimise industrial structure of SMEs; and
• to enhance the overall quality and competitiveness of SMEs.

On the whole, Chinese SMEs have gained a fast growth ever since the reform and opening-up, measured in terms of size, number, financial status, or profitability. Two factors played decisive roles in this period. The first factor was the speedy development of township enterprises. Most of township enterprises were small and medium-sized, and thus became a key driving force for the development of Chinese SMEs. The development of township enterprises not only provided solutions for the transfer of rural surplus labour forces to non-agricultural sectors and increase of farmers’ income, but also established a solid foundation for the accomplishment of the strategy of gradual reforms and development. The second factor was the rapid growth of non-public sectors of the economy, notably private-owned SMEs. As economic reforms proceeded, more and more people realised the importance of non-state-owned businesses, especially private-owned SMEs. From the very beginning of the reform and opening-up, the government acknowledged that the non-public sector of the economy would be a necessary and favourable supplement to the socialist public economy. In 2004 China amended the constitution to grant the non-public economy a legal status in the socialist market economy. Such a legislative move reflects China’s deepened understanding of the non-public sector of the economy, which in turn gives great impetus to the development of private-owned enterprises.

Current status of Chinese SMEs
There were about 2.4 million small and medium-sized enterprises at the end of 2001 in China, accounting for 99 per cent of all registered corporations[1]. If those SMEs such as self-employed businesses, leasehold farm households and individual partnerships that are not legal persons are also included, the number is far larger. Chinese SMEs have played an important role in stimulating economic growth, increasing employment, expanding exports and promoting science and technology innovations.

In terms of economic growth, the output value, sales revenues and tax revenues of SMEs in the industrial sector accounted for 60, 57 and 40 per cent respectively of the total of all the industrial enterprises. Since 1990s, SMEs have created 75 per cent of the incremental industrial output value. SMEs also dominated in most industrial sectors: over 70 per cent of the gross output value in the food, papermaking and printing industries, over 80 per cent in the garment tannery, recreation and sports outfit, plastic and metalwork industries, and over 90 per cent in the wood and furniture industries[2]. Despite the limitation of statistic data, in which only sufficient data about industrial sectors are available, it is rather reasonable to extend the conclusion about SMEs to the other sectors according to our common observations. For example, SMEs in the wholesale and retailing industry accounted for about 33 per cent of the total number of SMEs[3] and have played a crucial role in enhancing commodity circulation.
In terms of employment expansion, SMEs have created about 79 per cent of new jobs nationwide. Employees in SMEs accounted for a large proportion of the total employees nationwide: above 85 per cent in the industrial sectors, 90 per cent in the retailing industry and over 65 per cent in the construction industry[4]. Especially in recent years, the development of private-owned SMEs has considerably expanded employment and become a major driving force for the employment increase, which plays an active role in absorbing workers laid-off or dispersed from both state-owned enterprises (SOEs) and urban collective enterprises. From 1998 to 2003, nearly 19 million workers laid-off from SOEs were re-employed (Information Office of the State Council, 2004) and most of them went to SMEs.

In terms of foreign trade and exports, the total export value of China in 2003 amounted to over US$430 billion and China was ranked fourth place in the world in the total import and export value in 2003[5]. On the list of export commodities, some bulk export commodities are mainly manufactured by SMEs, such as garments, shoes and hats, handicrafts and metal goods, light industry products, textile and toys, which are mainly high-tech or labour-intensive products.

In terms of science and technology innovation, SMEs in China have achieved great progress in technological innovation, and become the driving force for the spread and application of new technology and innovation. By the end of 2003, China established over 100 high-tech enterprise incubators, over 30 university science parks, over 20 enterprise parks for returned overseas students, over 40 service centres for SMEs’ technology innovation, and more than 500 productivity promotion centres[6]. All these institutions have provided strong support for the technological innovation of SMEs. A great number of technology-oriented SMEs locate in the areas such as Zhongguancun in Beijing, Waigaoqiao in Shanghai, and the innovation and high technology zone in Shenzhen, which contribute greatly to technology innovation in China.

Major policies and initiatives
The Chinese government attaches great importance to the development of SMEs and has integrated issues of small business development into its overall strategic planning for national economic and social development. In order to promote the development of SMEs, the government adjusted related legislations and policies step by step, and launched a series of policies and initiatives.

Preferential taxation policies
In light of both the major difficulties facing SMEs and WTO rules and regulations, the Chinese government put forward a series of preferential taxation policies. Though some of these policies were not specially targeted at SMEs, SMEs were in fact the main beneficiaries.

Income tax policies for small enterprises. Currently, the enterprise income tax rate in China was 33 per cent. In order to reduce the tax burden of small enterprises, the government lowered the tax rate to 18 per cent for those enterprises with an annual profit of less than RMB30,000 (approximately US$3,600), and to 27 per cent for those with an annual profit of between RMB30,000 and RMB100,000 (approximately US$12,000). In addition, the government reduced the value-added tax (VAT) rate from 6 to 4 per cent for those small enterprises with less than RMB1.8 million (approx. US$0.2 million) of annual sales revenues. Township SMEs were allowed to enjoy a
10 per cent discount on their payable income tax as compensation for their expenditures on social welfare that should have been paid by the government.

**Taxation policies to promote employment.** If a new urban job agency in its first year of operation is able to find jobs for urban residents, of which more than 60 per cent are unemployed workers, the agency is eligible for exemption from business income tax for three years; after the exemption period expires, if the agency is able to find jobs for unemployed workers that exceed 30 per cent of its total jobs found, then it gets 50 per cent discount on the enterprise income taxes for two years. For those new service businesses (excluding those providing advertising, sauna and massage services, and internet bars and oxygen bars) and commercial and trading enterprises (excluding those dealing with whole sale business, a mixture of whole sale and retail businesses, or other non-retail business), they are exempted from urban maintenance and construction tax (UMCT), additional education fee, and income tax for three years, provided that they employ no less than 30 per cent of laid-off workers in their total employees in the first year of operation and that they sign employment contracts of no-less-than-three-years with them. Service enterprises that meet the above requirements can also enjoy three years’ exemption of business tax.

For service enterprises founded before the preferential taxation policies took effect (excluding those in certain industries with restrictions imposed by the government on their development), they can enjoy a prescribed discount rate on their income taxes for three years, provided that the laid-off workers hired make up no less than 30 per cent of total employees and that they are offered a no-less-than-three-year employment contract. If laid-off workers become self-employed by starting own businesses (excluding those in certain industries with restriction imposed by the government on their development), they can enjoy three years’ exemption of various administrative fees imposed by the government such as registration, certificate and management fees.

**Taxation policies for high-tech enterprises.** For those enterprises that locate in the state-level high-tech industry development zones and are recognised as high-tech enterprises by the authority, they are exempted from enterprise income tax for two years counting from the year they go into operation. After the two-year exemption period, the enterprises can still enjoy a preferential income tax rate of 15 per cent.

**Taxation policies for service industries.** For new enterprises that engage in transportation, posts and telecommunications, consultation, information industry and technological services, they are exempted from income tax for one year from the day they are established, and they can enjoy a 50 per cent discount on income tax in the second year. Moreover, the government grants different preferential taxation policies to enterprises attached to universities and schools, new enterprises in poor and underdeveloped areas recognised by the government, and welfare enterprises employing disabled people.

**Fiscal policies**
Since the reform and opening-up, especially 1990s, the Ministry of Finance (MoF) of China has been increasing fiscal fund inputs into SMEs and has set up several funds with SMEs as the targeted beneficiaries. These funds play an increasingly important role in the development of SMEs.

Ever Since 1999, the MoF has set up the Innovation Fund for Technology-based SMEs in order to encourage technological innovations. By the end of 2003, the MoF
appropriated over RMB3 billion (approximately US$361 million) for the fund and funded more than 4,900 innovation programmes, of which most of the beneficiaries were private-owned high-tech SMEs.

In 2001, the MoF set up the Commercialisation Fund for Agricultural Research Findings to promote commercialisation and transfers of sophisticated and practical technologies in high-tech agricultural enterprises. By the end of 2003, the MoF appropriated a budget of nearly RMB1 billion (approximately US$120 million) for the fund, which considerably contributed to the commercialisation of agricultural research findings and the development of high-tech agricultural enterprises.

The MoF has also established the Fund for International Market Exploitation by SMEs to encourage them to participate in global competition, explore international markets and expand exports.

Since 2003, the MoF has increased its budgets in some special funds to support SMEs in their establishment of service system, business specialisation and cooperation with large enterprises.

Motivated by the central government, some local governments actively adopt measures to allocate special funds to promote the development of SMEs, by supporting the establishment of a national credit guarantee system for SMEs, subsidies for SMEs’ interest payment for technology updates, and international market exploitation, etc.

Financial and credit policies
Improving financial services, adjusting credit structure and enhancing support to SMEs. Since 1998, the People’s Bank of China (PBC) has issued a series of documents, such as “Opinions on further improving financial services for small and medium-sized enterprises”, “Circular on enlarging floating band of loan interest rate for small enterprises”, “Guidance on improving financial services for small and medium-sized enterprises”, “Guidance on enhancing credit supports for SMEs with marketability, efficiency and credibility”. All these documents have initiated a series of policies and measures to improve financial services, adjust credit structure and provide diversified financial products, thus improving the business environment for SMEs.

Speeding up the development of the SME credit guarantee system and improving the financing environment for SMEs. In 1999, the former State Economic and Trade Commission (SETC) issued the “Guidance on pilot construction of the SME credit guarantee system”, which called for establishing a system to provide credit guarantee services to SMEs for indirect financing. Credit guarantee has become an effective instrument to tackle the financing difficulties faced by SMEs. In 2001, the MoF issued the “Provisional rules on risk management of credit guarantee institutions for SMEs”, which specified the organisation, business coverage, operational principles, premiums, provisions and deposits of the guarantee institutions. This document has promoted active and stable supplies of credit guarantee services for SMEs.

In 2001, the State Administration of Taxation (SAT) issued the “Circular on exempting SME credit guarantee institutions and reinsurance institutions from business tax”, which grants three-year business tax exemption to non-profit experimenting institutions nationwide that provide credit guarantee and reinsurance to SMEs. In 2004, the National Development and Reform Commission (NDRC) and SAT jointly issued the “Circular on issues relating to business tax exemption for SME credit
guarantee institutions”, which extends the preferential treatment to more beneficiaries and is expected to stimulate the development of such guarantee institutions.

Regulatory policies
In order to promote a healthy development of SMEs, the General Office of the State Council issued the “Circular on transmitting and issuing the opinion of the state economic and trade commission on several policies of encouraging and promoting the development of SMEs” in August 2000. As the first consolidated document about SME promotion, the opinion puts forward 25 policies and measures with focus on eight issues, such as propelling structural adjustment, encouraging technology innovation, enhancing fiscal and taxation support, broadening channels of financing, expediting the construction of credit guarantee system, improving socialised service system, creating an external environment for fair competition, and strengthening organisation and guidance. These policies and measures have improved the regulatory environment and accelerated the legislation process for SMEs.

In 1999, the former SETC issued the “Opinion on strengthening trainings for SME managers” to elevate the qualifications of proprietors and managerial staff in SMEs.

In 2000, the former SETC promulgated the “Opinion on several issues concerning the development of socialised service system for SMEs” in order to mobilise every quarter of the society to offer services to SMEs.

In 2001, ten state ministries and commissions including the former SETC jointly issued the “Opinions on enhancing credit management of SMEs” to encourage SMEs to pay higher attention to their credibility and enhance their credit status, and to promote the construction of the SME credit system.

In 2001, the former SETC and the General Administration of Quality Supervision, Inspection and Quarantine jointly issued the “Opinions on enhancing SME quality supervision” to build up quality of products and strengthen quality management of SMEs.

Lessons from the Chinese experiences
SMEs play a significant role in promoting fast and healthy economic and social development. In retrospect of the development of SMEs in China, it is well recognised that the subjective initiative of SMEs should be brought into full play to boost their internal driving force for development on the one hand, and the laws of the market economy should be respected and the institutional barriers hindering the growth of the SMEs should be removed to create an enabling external environment for the common development of all enterprises of varied ownership on the other hand. The following are experiences obtained from the past two decades’ practices implemented by the Chinese government.

The economic laws and the fundamental role of the market in allocating resources should be respected to guide SMEs to a sound track of industrial development. One important reason for Chinese SMEs to score such a great achievement since the reform and opening-up was launched lies in the right strategy that encouraged SMEs to develop in accordance with their unique nature, instead of following the outdated practices of coercing SMEs to concentrate on heavy industry. SMEs are blessed with such unique nature as small investment, fast yield, flexible operation and quick adaptability to market changes. They can only achieve robust development when the
government can abide by the objective laws of the market economy, bring the role of the market in allocating resources into full play, consider the development needs of SMEs and guide them to the sound track centring on the light and tertiary industries.

The self-operation status of SMEs should be fully respected, so as to facilitate the establishment of a sound mechanism of self-investment and self-development of SMEs. The fast development of SMEs, especially private ones, has become the most dynamic facet of the Chinese economy. In some areas, private SMEs have become the backbone of the local economy. This should be attributable to the relaxed environment provided by the government to SMEs in the process of reform, opening up and the improvement of the market economy. Meanwhile, the role of SMEs as major players in the market has been brought into full play. They adapt themselves to the requirements of the market economy and adjust their development strategy and industrial structure to formulate a healthy mechanism of self-governance, self-determination and self-development, thus boosting their development initiative and dynamism. This is the overriding reason for the rapid growth of China’s SMEs, the private ones in particular, since the reform and opening-up program was started.

It is imperative to encourage SMEs to optimise industrial structure and enhance their competitiveness. Chinese SMEs have gained an amazing expansion in terms of number and scale. A group of SMEs have stood out and some of them have even grown into large enterprises or conglomerates. For example, Haier Group, Lenovo Group Ltd (formerly known as Legend Group Ltd), UFSOFT Co. Ltd and Wanxiang Group Corp. were all SMEs at the beginning, and now become internationally well-known large enterprises. On the whole, however, most of SMEs still hang around at a low level of development. One important reason is that Chinese SMEs have a short period of development and still pursue the extensive mode of growth. Therefore, their management philosophy, style, industrial structure and product mix do not meet the demands of market competition. It is still a demanding issue confronting SMEs as to how to meet the requirements of the market reform, enhance industrial structure and transform the extensive business mode into an intensive one. Therefore, it is a fundamental way for SMEs to adapt themselves to the WTO requirements and market competition by strengthening institutional capacity in management, technology and personnel training, enhance overall qualification and build up vitality and competitiveness. This is important experience summed up from the rapid development of SMEs since the reform and opening-up.

It is important to properly handle the relations between the government and enterprises and bring the role of the government in macro control into the full play so as to create a fair competitive environment for SMEs. Neither private nor state-owned SMEs can develop without government support. SMEs are often in an unfavourable position in market competition, have difficulties in competing with large enterprises and remain vulnerable to market risks, which result from their nature of business, i.e. small size and weak capacity. Taking into account both the nature and important role of SMEs in the economic and social development, the Chinese government has transformed its functions in line with the requirements of the market economy and improved its way to support SMEs. While facilitating the strategic restructuring of the economy and implementing the strategy of nurturing large enterprises and conglomerates, the Chinese government has issued policies to relax control over SMEs and adopted various effective methods, with the ownership reform as the focus,
to accelerate the reform of state-owned SMEs. Evidence has proven that the vitality and competitiveness of SMEs and the comprehensive and coordinative social and economic development can be enhanced, only if the government adopts appropriate economic policies that are in line with the nature of SMEs, properly handle its relations with enterprises, exercise macro controls of appropriate intensity and timing, and create a more fair, open and enabling external environment for enterprises of varied ownership.

Notes
1. NBS (2003). The census was taken in 2002 with December 31, 2001 as the statistical end.
2. NBS (2001). The census was taken in 1996 with December 31, 1995 as the statistical end.
3. NBS (2003). The census was taken in 2002 with December 31, 2001 as the statistical end.
4. NBS (2003). The census was taken in 2002 with December 31, 2001 as the statistical end.

References