

Comparative Study of Financing Channels for Small and Medium-Sized Enterprises

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Abstract. Small and medium-sized enterprises (SMEs) are key to economic growth and job creation. However, they face significant challenges in accessing funding, which is essential for their growth and sustainable development. This paper analyzes several financing methods that can be adopted by SMEs in China, including bank loan, venture capital, angel investment, crowd funding, government grants, equity financing etc. The report evaluates the advantages and disadvantages of each pathway, focusing on accessibility, cost, approval process, etc. On this basis, combined with the actual situation of listed companies in China, the analysis of different types of financing models, to provide theoretical basis for the development of SMEs in China. In addition, the report also explores the financing of SMEs in the future, highlighting the use of technology, changes in government policies, and international collaboration that can improve SMEs' financing capacity. Understanding this new development trend is that SMEs should adopt flexible financing strategies according to changes in the market environment, so as to ensure their sustainable development and make a greater contribution to the world economy. These results will provide theoretical basis for the rapid development of Chinese SMEs in the financing environment, as well as the formulation of related policies and the decision-making of investors.

Keywords: Small and medium-sized enterprise (SMEs); financing channels; bank loans; venture capital; equity financing.

1. Introduction

As shown in Fig. 1, SMEs make an important contribution to GDP, employment, innovation, and so on, and are known as the backbone of the economy [1]. Their contributions to economic development manifest in the increase of employment, rapid response to market demand and diversification of economic structure [2]. They have played a positive role in promoting the local economic development. Creating jobs is the biggest contribution of SMEs. They are highly labor-intensive and have a positive effect in reducing unemployment [2]. However, SMEs are faced with great challenges in the process of development as depicted in Fig. 2, and the biggest bottleneck of their growth and sustainable development is the difficulty of financing [3]. Accessing to adequate and timely funding is key for SMEs to operate, invest in new projects and expand their business activities. However, at present, many SMEs in China financing difficulties, mainly manifested in the lack of collateral, borrowers to the risk of higher awareness, financing channels limited [4, 5].

Traditional banking financial institutions often regard SMEs as high-risk borrowers, which makes the financing difficulties they face even more serious [6]. This is because SMEs generally do not have high credit ratings, do not have complete financial records, and their business models are unstable [6]. Therefore, it is difficult for many SMEs to meet this requirement. As a result, many SMEs are underserved and do not have access to the capital they need to scale up, innovate or compete effectively in the marketplace [7]. In order to meet this challenge, China's financial market has also emerged with new changes, in addition to the traditional bank credit, it provides SMEs with other financing methods. Other funding models, such as venture capital, angel investment, crowdfunding, and government funding, all have their own advantages and challenges. Venture capital and angel investment, for example, provide strategic guidance and networking in addition to funding [8, 9].

However, they usually require a larger stake and control over the business [8, 9]. Crowdfunding uses the power of the Internet to raise a small amount of money from many people, but it requires marketing and social engagement [10]. Government grants do not have to be repaid, but they have strict entry conditions and a strict application process [11, 12]. It is important to evaluate the impact of each financing option on different aspects of business growth, including growth potential, operational flexibility and financial stability. Comprehensive evaluation on these aspects can help SMEs generate strategies according to their own specific needs and enhance their competitiveness. This paper aims to analyze and compare different financing methods of SMEs in China and evaluate their future development. By analyzing the advantages and disadvantages of various financing ways, it is of great significance for SMEs to cope with the complex financing environment and improve the ability of diversified financing channels.

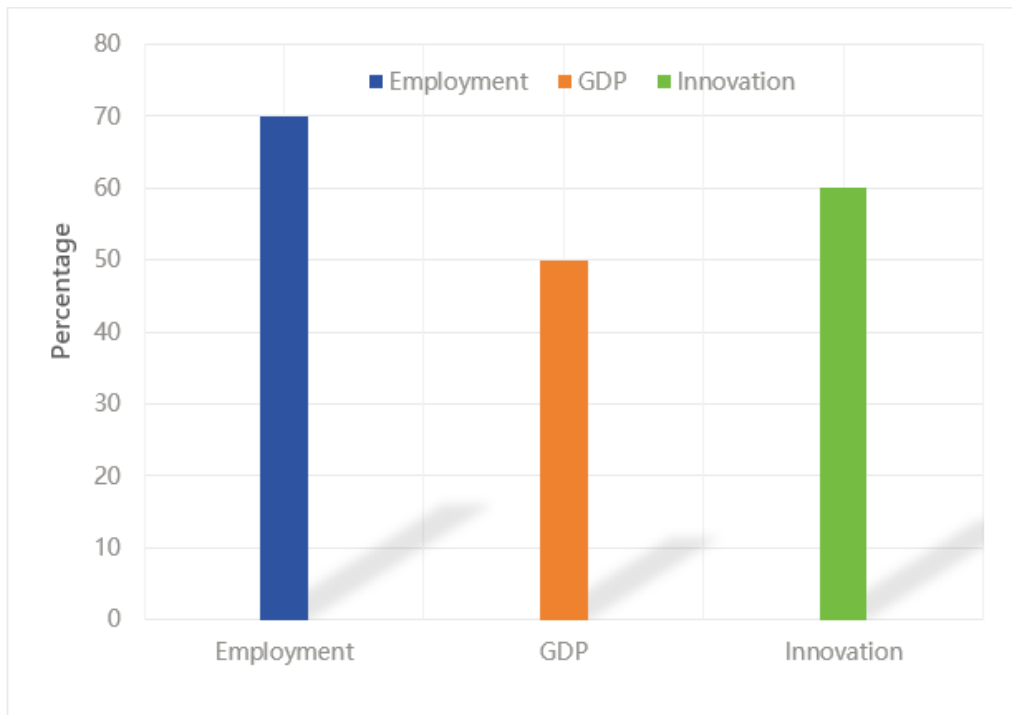


Fig 1. Economic contributions of SMEs.



Fig 2. Financing challenges faced by SMEs.

2. Financing Channels

SMEs need all types of capital, from liquidity for day-to-day operations to liquidity for expansion and innovation. However, they also face difficulties: many SMEs lack sufficient guarantees to apply for loans from traditional banks. The narrow financial background and high risk usually lead to poor credit evaluation. The interest and charges associated with different financial plans are high. Lengthy and complex approval procedures can delay obtaining the required funds. Understanding these challenges is key to evaluating the effectiveness and convenience of various financing methods. Among them, bank loans are the main, but the conditions are more stringent. Venture capital provides the necessary financial support and strategic support for the development of enterprises, but it also requires a certain equity structure and holding structure. Angel investors typically give money and mentoring in the early stages. Crowdfunding is raising small amounts of money from many people through an online platform. Government grants are non-reimbursable grants that are often used to promote innovation and development. Equity financing refers to the sale of equity shares to raise money, which is an alternative to traditional bank loans.

Different channels have different access ranges. The traditional bank loan conditions are harsh, the guaranteed conditions are harsh, under normal circumstances, SMEs are difficult to get loans. Venture capital and angel investment are easier to obtain for companies that have more room for growth but are highly competitive and highly screened. If the business has compelling content or products, crowdfunding is easier. Companies can receive government funding if they meet specific criteria but require a complex application process. Equity financing is easier to access, especially for companies that show strong growth potential and are willing to share equity. Besides, financing costs vary widely. Bank loans usually have lower interest rates, but they come with collateral. Venture capital and angel investments do not have cost of capital, but it will result in dilution of equity. Crowdfunding comes with platform costs and possible returns or share fees. Government grants do not have to be repaid, so they are a cost-effective way to invest. Equity financing also requires no debt repayment, but it dilutes its equity and potentially shares future benefits with investors.

Another critical factor is the approval process. The approval access of traditional bank loan is cumbersome, focusing on credit and collateral of SMEs. Venture capital and angel investing require a lot of careful research and negotiation. Crowdfunding can be established and recognized quickly, but SMEs have to make a huge effort on markets. Government grants involve detailed recommendations and lengthy evaluations. Equity fundraising involves full disclosure of financial information and negotiations with potential investors, which can be time-consuming. The approach to risk management is also different. In traditional bank loan, the bank takes a risk and reduces it with collateral. In venture capital and angel investment, investors have to take big risks in order to achieve high returns. Crowdfunding shares the risk for many small investors. Because the government provides financial support, government funding is minimal for business. Equity fundraising involves sharing risk with investors who have a strong interest in a company's success and often providing them with strategic guidance to reduce that risk.

In certain channels, equity control has an important role. Traditional bank loans do not have any effect on property rights. Since investors tend to seek control and influence, venture capital and angel investment have a significant impact on the ownership structure. If it is based on stock financing, rather than reward-based financing, it will have an impact on the ownership structure. Government grants have no effect on ownership. Equity financing refers to giving up some property rights and control rights in order to obtain more funds, so as to have a certain impact on the company's business decisions and strategic orientation. Each channel supports the cause in a different way. In addition to financing, traditional bank credit has limited support for the economy. Venture capital and funds provide strategic guidance, industry contacts, and business development support. Crowdfunding has built a user base and has been recognized by the market. The government funds innovation and development programs. Equity financing will provide valuable business insights and relationships to drive growth and development.

Many SMEs adopt diversified financing channels in order to meet the needs of diversification and reduce risks at the same time. For example, a new technology company could raise money from angel investors and then start doing business, making prototypes. When the prototype of the product shows promise, the startup can market test and pre-order through crowdfunding. During this period, they can also ask the government for grants to support scientific and technological innovation. When the enterprise grows and achieves a certain influence, it can look for venture capital to promote the further development and expansion of the company. Finally, to obtain long-term strategic growth, it can attract a large number of capital and strategic partners through equity financing.

3. Comprehensive Financing Strategy of Xiaomi Corporation

Xiaomi Corporation, founded in 2010, is a high-tech company that specializes in smartphones and internet services. From the beginning, Xiaomi used various financing channels to grow quickly and become one of the top smartphone manufacturers in the world. This case study details how Xiaomi achieved rapid growth and expanded globally by flexibly utilizing various financing methods. Initially, Xiaomi relied on angel investments from founder Lei Jun and his extensive network. These early funds were crucial for product development and team building. For example, at the outset, Lei Jun personally invested a significant amount of money and raised additional investments from his friends and early supporters. With these funds, Xiaomi quickly launched its first smartphone and gained initial market recognition in a short period. This early success caught the attention of venture capital firms such as IDG Capital and Qiming Venture Partners.

In the following years, Xiaomi raised hundreds of millions of dollars through multiple rounds of financing. These funds were not only used to expand production but also to strengthen marketing efforts and support international expansion. For instance, to enter the Indian market, Xiaomi invested heavily in market research and localized operations. As the company grew rapidly, Xiaomi began using traditional bank loans to meet daily operational and short-term financial needs. By collaborating with multiple banks, Xiaomi secured stable short-term financing, ensuring liquidity and operational flexibility. Additionally, Xiaomi effectively utilized its online platform for crowdfunding to test market reactions and raise funds for new product launches. This not only raised the necessary funds but also increased user engagement and brand loyalty. For example, Xiaomi successfully launched several smart home products through crowdfunding, which received enthusiastic responses in the market. As a high-tech company, Xiaomi also benefited from various subsidies and tax incentives provided by local governments. These policies included R&D subsidies and industry support funds, which helped reduce R&D costs and promote technological innovation.

In 2018, Xiaomi went public on the Hong Kong Stock Exchange, raising over \$4 billion through an Initial Public Offering (IPO). This IPO provided Xiaomi with ample capital to support further international expansion and new technology development, significantly enhancing its global competitiveness. The success of this IPO not only marked a major breakthrough for Xiaomi in the capital markets but also laid a solid foundation for its future development. By flexibly utilizing various financing channels, Xiaomi achieved rapid growth and expanded globally. Its comprehensive financing strategy not only ensured sufficient funding support at each development stage but also effectively diversified financing risks, enhancing market competitiveness and innovation capability. Xiaomi's success demonstrates that SMEs can overcome financing challenges and achieve rapid growth and sustainable development by cleverly utilizing multiple financing channels. For SMEs, understanding and fully leveraging the advantages and disadvantages of each financing method is key to formulating effective financing strategies and enhancing market competitiveness.

4. Future Prospects

This paper examines the challenges within the financing environment for SMEs in China and suggests potential solutions. The adoption of financial technologies like P2P lending and blockchain has offered more convenient and efficient financing options for SMEs. These technologies streamline the

application process, cut costs, and open access to a broader range of investors. Additionally, more comprehensive grant programs, tax incentives, and subsidized loan schemes can further support SMEs. Establishing a digital financial platform can enhance trust and transparency between SMEs and potential investors, fostering a more inclusive financial ecosystem. In today's complex market environment, integrating traditional financing methods with innovative ones is crucial for the development of SMEs. Continuous research and development tailored to the specific needs of SMEs is vital to ensure their sustainable growth. Moreover, increased international cooperation and cross-border fundraising opportunities can provide SMEs with greater access to capital. This highlights the importance of SMEs leveraging new trends and developing flexible financing strategies that align with market conditions.

5. Conclusion

To sum up, SMEs play a significant role in economic development, yet they frequently encounter financial challenges. Traditional bank credit is widely used by SMEs but often comes with stringent conditions that many cannot meet. Venture capital and angel investment are essential for business growth, but they usually require equity stakes and some control. Crowdfunding, based on social participation, demands significant market engagement. Government grants are a cost-effective form of support, but the application process can be complex. While equity financing has its advantages, it can lead to equity dilution. Each financing method has its own set of benefits and challenges, impacting the growth of enterprises differently. To meet diverse development needs, SMEs must strategically navigate these financial pathways. By understanding the complexities of various financing options, SMEs can make informed decisions to secure the necessary capital for sustainable growth. This study emphasizes that SMEs should fully leverage their potential to better contribute to economic development. With the evolving financial landscape and innovative approaches, SMEs have the opportunity to overcome traditional financial barriers. Therefore, to seize more development opportunities, SMEs must continuously adapt, promoting economic growth, employment, and innovation.

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