Small and Medium Private Enterprises and their Financing Constraints in the People's Republic of China

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摘要

在內地的中小型私人企業在為投資項目而籌集資金上，往往遇上以下的問題：中小型私企往外籌集資金的成本會遠高於使用企業的內部資金的成本。原因有二：(1)**資本市場存在著一些缺陷，例如交易成本，資訊不對稱（**Asymmetric information**）和管轄代理問題**(Agency problem)**。**(2)**歷史上，借貸政策的偏差問題難以在短期內靠現在的金融改革而解決。加入世界貿易組織之後，內地的金融制度將會慢慢演變成漸近西方發展國家的體制，但這種發展不會完全解決因為資本市場的缺陷所造成的外部集資成本偏高的問題。中小型私企將面對更強烈競爭，勢必大大削低它們的營利及累積內部資金的能力，所以入了世貿組織後，中小型私企所面對的集資困難將會更大。**

According to the celebrated Modigliani-Miller theorem, financing an investment project via internal or external funds is a matter of irrelevance should capital markets be perfect. However, in the presence of asymmetric information and agency problems, imperfections prevail in the real-world capital markets, making the costs of external financing much higher than those of internal financing. This may lead to under-investments for cash-constrained firms. Private enterprises in the People's Republic of China particularly face this under-investment problem in that they normally have difficulty in obtaining enough external funds to exploit profitable investment opportunities.

The essence of the Modigliani and Miller theorem is that a firm's capital structure and financial policy can be replicated by individual investors on their own accounts in perfect capital markets. Financial structure (liquidity, leverage, dividend payments, etc.) as such creates no firm value and thus an enterprise should regard internal and external funding as perfect substitutes of each other.

In the real world, capital markets are far from perfect. Three factors, namely, transaction costs, asymmetric information, and agency problems, attribute to a well-documented financial hierarchy wherein firms prefer internal financing to external financing via debt and equity. First, transaction costs of issuing debt and equity can be high. These costs include compensation for underwriters, registration fees, taxes, and accounting costs.

Second, asymmetric information can generate significant cost disadvantages of external financing. Management of a firm typically has information about the return of its project which is unavailable to outside investors. Because investors cannot distinguish between good and bad projects, they price every issue as if the project return was average. This implies that a firm with a good project is obliged to issuing under-priced securities, thereby resulting in higher costs of external financing than those of internal financing. Asymmetric information between enterprises and potential suppliers of external funds is also the source of adverse selection and/or moral hazard problems in credit markets. Increases in interest rates cause enterprises with good investment prospect to leave the applicant pool (adverse selection) or induce enterprises to switch to riskier projects (moral hazard). As a result, potential lenders may prefer to ration credit. All these suggest that external financing, in the presence of asymmetric information, is either rationed or available at a premium.

Third, the presence of agency problem may also induce a cost premium to the use of external funds. Under the asymmetry of information, managers of an enterprise may pursue their own interests at the expense of the stockholders and bondholders. This conflict of interests can boost the cost of obtaining external funds as outside shareholders attempt to control management behavior through the use of audits, budget control, and incentive systems designed to align the managers' interests with theirs. These actions impart a cost premium to the use of outside equity, reflecting both the direct costs of monitoring management and the losses of profit opportunities due to reduced management flexibility. Debtors also face similar risk as management actions may dissipate enterprise resources and erode the value of existing debt by undertaking excessively risky projects. Debtors as such may demand covenants which restrict management behavior in various ways. These restrictions and the monitoring required for contractual enforcement constitute the agency costs of debt.

As external funds are more costly, academics propose a pecking order framework which suggests that enterprises finance their funding needs in a hierarchical fashion, first using internally available funds, then followed by debt and outside equity. When internal and external financing are imperfect substitutes of each other in the presence of capital market imperfections, investment decisions of an enterprise will be constrained by the availability of internal funds. Moreover, financing constraint impacts different enterprises unequally. Small and medium enterprises are expected to face an even higher cost in accessing external funds as compared with large and well-established enterprises. Therefore, small and medium private enterprises end up being more dependent on internal funds in financing their investment.

As economic conditions in a transition economy such as China are different from those in developed market economies, the role of internal financing in determining the level of investment can be different from what may apply to firms in developed economies. The capital markets in transition economies are either not available or underdeveloped. Therefore, enterprises in transition economies are all heavily dependent on bank credit, which is probably the only source of external funds, for financing fixed investment. Banks are mainly owned and controlled by the state even though decentralization and devolution have been carried out rapidly in the other sectors of these economies. Since the non-state sectors in these economies were much smaller than the state-owned sectors before the implementation of economic reforms, the allocation of credit was always biased in favor of state-owned enterprises. Such a 'lending bias' in favor of these large state enterprises will continue even though the banking reform has been carried out.

Small and medium private enterprises in China are not totally helpless despite the fact that they have more difficulty in obtaining external finances as compared with large and established enterprises. Small and medium private enterprises are relatively more efficient than their

efficiency, they may be able to generate large enough cash flows to finance their fixed investment. Moreover, these small and medium enterprises can also borrow from the informal credit market, notwithstanding the fact that they

banking institutions.

In the future, there are two major factors that will substantially change the current status quo. First, China’s expected entry into the World Trade Organization will lead to a substantial elimination of trade barriers such as tariffs and quotas, which may erode the profits of these small and medium enterprises in the non-state sector when imported products are supplied at lower prices. In this case, they may be unable to generate enough internal funds for fixed investment in a more competitive environment.

Second, reforms in the financial sector may not improve the supply of external funds to small and medium private enterprises in the non-state sectors. Current reforms in the financial system are pushing the state banking system to operate in a more efficient way and pay more attention to the risk management in credit allocation. When the state banking system is operating more like those in developed market economies, small and medium private enterprises in China may face similar constraints in accessing external funds due to capital market imperfections. Moreover, as more foreign banks will be allowed to take Renminbi deposits, the supply of loanable funds to small and medium private enterprises through the informal credit market, which is expected to be replaced by formal credit market, will be reduced as well. When small and medium private enterprises receive less credit from both the formal and informal credit markets in the next wave of financial reforms, they may find it difficult to finance their fixed investment. An active government policy on small business development which helps them to obtain external funds may be a necessary component of the overall economic reform.