Comparative Study of Financing For Small And Medium Enterprises (SMEs) In China And U.S.

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ABSTRACT

Financing for SMEs is a compelling issue for both China and the US. Given that SMEs in the US have been a long-standing source of innovation and driver of GDP, financing market for SMEs has stepped into a more mature stage than in China. This thesis explores the key differences in financing for SMEs in China and the US in both debt and equity financing with a comparative study based on abundant empirical case studies, literature reading and analysis, trying to identify some main takeaways from the US market for the Chinese market. However, due to different commercial environment and DNAs of the economies, different features have appeared and are playing critical roles in these two economies. It would be more crucial for Chinese policy makers to set up better-rounded law enforcement for the unique practices in China than to simply learn the practices in the US.

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Chapter 1: Problem Definition of Financing for SMEs in China

1.1 Definitions vs Essences of SMEs in China and US

Different commercial environments in China and US have laid the foundation of the different definitions of SMEs. According to an Act implemented since January 2003 in China, SMEs are defined according to their industries, revenues, number of employees and total assets. For instance, in industries, companies with less than 2000 employees and revenue below 300 million RMB are SMEs; while in the retail industry, SMEs are companies with less than 500 employees with revenues below 150 million RMB. However, apart from the dry definition of SMEs in China, the essence of SMEs is privately owned as opposed to state owned. Due to a short and rough economy development history in China, the main enterprises that control the majority of resources and government support are State-Owned Enterprises (SOEs) especially spanning finance, petro oil, water and electricity industries. According to a report made by OECD in 2009, the GDP of SOEs in China contributed 29.7% of total GDP\(^1\) while in 1998 it was estimated at 37.6%. The declining contribution of SOEs to GDP in China indicates a more important role privately owned companies and foreign investments are playing, among which SMEs have been critical in boosting employment, technology innovation and exporting. According to a report made by OECD in 2013, the SMEs in China employed 80% of total labor force, contributed 59%

\(^1\) The Economy of SOE in China by OECD
of total GDP and 68% of total export\(^2\).

In the US, according to the International Trade Commission, different institutions, including SBA Advocacy, SBA and USDA define SMEs based on the industry that they are in. In general, number of employees is less than 500 and the revenue requirement is a range from $250,000 to $25 million. According to a report issued by SAB in 2012, the nonfarm GDP contribution of SMEs in the US has been declining since 1998. In year 2010, the nonfarm GDP contribution of SMEs in the US was 44.5% of total GDP compared with a number of 50.5% in 1998. The contribution of SMEs in the US experienced sharp declining during crises after the Internet bubble as well as the global financial crisis in 2008. However, the fact that SMEs play an important role in innovation and improving entrepreneurship is still indispensable. In 1991, in the United States, small firms produced 55 per cent of innovations and provided 25 per cent of the jobs in high-technology industries\(^3\).

Despite the different definitions and contributions to GDP, the DNA of SMEs in China has been different from in US. Evolving from a planned economy in 1978, SMEs have been in an inferior position compared with SOEs and there has been significant inequality in terms of access to finance, talent and technologies. Under such harsh environment, SMEs is trying to play at the edge of an incomplete legal circumstance and seek for survival.

\(^2\) Economic Outlook for Southeast Asia, China and India 2014: Beyond the Middle-Income Trap OECD, 2013
\(^3\) OECD: SMALL BUSINESSES, JOB CREATION AND GROWTH: FACTS, OBSTACLES AND BEST PRACTICES
1.2 Definition of Financing and Cost of Financing

Speaking of finance, there are usually two funding sources, equity financing and debt financing. For companies in their early stage, debt financing would bear a much higher cost compared to equity financing. Equity financing includes mainly public offering and private placement. International venture capitals have become more and more active in China looking for potential investment opportunities, especially in technology, media and telecom (TMT) sector. Years later, public offering would be a great exit for private equity investment. However, the entrepreneurs and DNA in the financial system is still at an early stage and not mature enough to leverage all the financing channels. When we compare the cost of financing, the quantitative parameters for equity financing and debt financing are different. For debt financing, it's mainly about the benchmark interest rate set up central monetary policy makers, plus a risk premium based on the nature or the credentials of borrowers. Thus in China SMEs obviously bear a higher interest rate than SOEs due to a lack of government guarantee. Cost of financing with equity mainly relates to systematic risk that is reflected in beta. Due to a shorter history of stock market and imperfect regulations, the systematic risk in China is higher than in US.

1.3 Current Situation of Financing for SMEs in China

I have been working with SMEs to help them get public listed. One issue that struck me is the fact that companies have two different sets of financial statements.
One of them exaggerates the numbers in order to get bank loans while the other one tries to minimize the profits to avoid taxes. The lack of impartial, reliable finance system in SMEs is a problem facing the current capital market in China. However, the lending to SME has been increasing. In year 2014, amount of outstanding loans to SMEs is 6.1 RMB trillion, with an improved volume since last year. Total outstanding loans for SMEs account for 51.7% of total outstanding loans, which is 0.7% higher than the previous year\(^4\). However, albeit the increasing lending to SMEs, the problems facing SMEs financing markets are quite prominent.

First of all, the market economy of China is still at a preliminary stage with limited financial products. The development of the opening of financial markets and financial innovation is relatively slow compared with US. Thus SMEs in China have fewer channels for financing. Secondly, there is a lack of credibility system in China that is impartial, powerful and informative. From individuals to corporates, it’s hard to trace their daily transactions in the traditional way in order to make a decision to lend money. Banks are concerned with moral hazard and therefore they have to invest a lot to scrutinize the borrowers. The features of financing for SMEs that they are small scales, smaller amounts while more frequency make it more costly for commercial banks to lend money to SMEs. Thus, commercial banks are not incentivized to give loans to SMEs.

\(^4\) Annual report from People's Bank of China, 2014
1.3.1 Lack of Credit System

Information asymmetry with SMEs is very severe in China because of a lack of credibility system. Due to a harsh circumstance to survive, most SMEs have fraudulent financial statements in order to either get bank loans or avoid taxes. However, building an impartial credit system is unavoidable in China. According to a report by World Bank Group, modern credit system boosts financing for SMEs.

Besides, a credit registry system for individuals is also proposed by the international organizations as it's correlated with SMEs because founders or entrepreneurs need to present personal credit history when their companies apply for bank loans. In most developed countries, Credit Registry System (CRS) is always in place to provide the basic functions including collecting, validate and merge data, generate and distribute reports and provide data security and back-up. Without CRS, lenders will find it difficult to price or determine loan tenors because they have no other choice than to rely on the information of the companies provided by the borrowers. Such information asymmetry increases costs for both lenders and borrowers because of an elevated default risk perceived. CRS is very important in boosting an economy because it significantly increases access to finance, especially for SMEs that are the innovative driver of an economy.

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5 World Bank Group, Small and Medium Enterprises, Stories of Impact, June 2013
Chapter 2: Debt Financing

2.1 Different Market Characters of Debt Financing in China and in US

2.1.1 Current Banking System in China

The Chinese central bank reports that domestic currency, bank loans accounted for 52% of “Total Social Financing” in the year 2012. The main financing channel for SMEs is still bank loans, albeit they have to bear a higher interest rate as the cost of capital due to higher risks and fierce competition.

China has experienced a relatively short history of banking yet the fast developing system. When the new government was founded in 1949 and the economic bureaus were put in place, Central Bank of China played the roles of both currencies issuing bank and commercial bank. Stock market was forbidden. It was a single one-dimension financial system. After the open and reform in 1978, new commercial banks were sequentially set up, including Agricultural Bank of China, China Construction Bank, Bank of China and Industrial and Commercial Bank of China, the so called “Big Four Banks” in China. They are all state-owned commercial banks with different objectives and industry focuses, while meanwhile formed an oligopoly financial market. Although nowadays foreign banks are allowed to enter Chinese market, their market share is still trivial compared with local big four banks. Based on a study done in China, the market share of deposit of the big four banks accounted for 75% in 2008, with a lowering market share since 1999. Big four banks had a total asset accounted for 73% in 2008 within the banking industry. According
to a study done by McKinsey, in 2014, total market share of deposit of big four banks has decreased to 73%, while more individuals deposit their money into Internet monetary funds such as Yuebao, a money market fund developed by Alibaba.

However, the influence of the oligopoly of big four banks toward interest rate is indispensable. They control most of the total lending in China, but they are very selective in terms of clients to lend capital. Most of their clients are state owned companies with standard internal control and stable operations. In order to keep a decent profit for big four banks, CBA puts a ceiling on deposit interest rate while a floor on lending interest rate. As a result, the spread of interest for commercial banks in China is kept at a high level to guarantee the profitability of state-owned commercial banks. In 1973, Edward S. Shaw and Ronald I. McKinnon from Stanford University introduced the concept of financial repression. In their theory, financial repression can include such measures as directed lending to the government, caps and ceilings of interest rate, regulation of capital movement among countries and a tight association between banks and governments. In 2011, economists Carmen M. Reinhart and M. Belen Sbrancia summarized the features of financial repression in one of their working papers, including the following five main features. First, caps or ceilings on interest rates; second, government ownership or control of domestic banks and financial institutions; third, creation or maintenance of a captive domestic market for government debt; fourth, restrictions to entry to the financial industry and finally, directing credit to certain industries. All those five characteristics have a

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strong presence in China and jack up a high yet unliberalized interest rates.

In China, as background information, there is so called "dual-track" interest rate system, which regulates the lower bond restrictions on lending interest rate and upper bond restrictions on deposit interest rate. From Figure 1, we could see that the fluctuation of the curvatures of both interest rates is nearly identical to each other while the spread of the two interest rates is kept at a stable rate, indicating a guaranteed profit for commercial banks in China. However, the PBoC is making an effort to ease the restrictions recently. Given a benchmark on the interest rates for deposit and lending, PBoC gives commercial banks discretion a 20% premium above the benchmark of deposit interest rate in November 2014 and removed the lending rate restrictions in July 2013. From Table 1, we could see that most bank loans are made above the benchmark interest rate along the year from 2007 to 2014, indicating a less restricted lending market and more competitions among commercial banks.

Figure 1 One-year benchmark deposit and lending rates in %: January 2008 – September 2014

Note: The green (red) line is the nominal benchmark lending (deposit) rate.
Data source: CEIC and Bloomberg.
To identify the main difference, a significant disparity among banking systems of China and US is the ownership and bank types. In order to find out how substantial the influence of ownership type is toward financing for SMEs, Beck, Kunt and Peria did a survey with data of 91 banks across 45 countries. They argued in their journal that significant differences of financing for SMEs exist across countries with different development rather than bank types. Their results showed that when deciding lending terms to SMEs, banks of different ownership types and organizational structures adopt different lending technologies. To be more specific, large banks in US that hold a larger share of collateralized loans on their balance sheet are more likely to regard soft information important in evaluating loans, and are also more likely to decentralize loan approval and risk management decisions while the banks outside US tend to be the opposite. However, they find few significant correlations between lending technologies and organizational structures, including the extent, type and pricing of SME lending. Instead, they find significant differences across banks in developed and developing countries that appear to be driven by differences in the institutional and legal environment. In particular, banks in developing
countries provide a lower share of investment loans and charge higher fees to SMEs than those in developed countries. Finally, banks in developing countries also tend to charge higher interest rates on small firm loans.

2.1.2 Increasingly Important Role of Bond Market for SMEs in China

The volume of bond markets in China is significantly smaller than in the US or Europe. From the latest research done by Goldman Sachs, as of the end of the year 2014, the total volume in China’s bond market has reached 35.89 trillion RMB, a significant growth from year 2003 with 5 trillion RMB. Although China has already grown into the third largest bond market, it still has a huge disparity with the US, which has a total bond market of $26 trillion as of June 2014. Despite the fact that government bonds and central bank notes dominate the main bond products in the market, collective SMEs bonds have paved a way to get financing. Based on a research done by World Bank Group\(^8\), in year 2012, the total volume of issuance of SME collective bills witnessed significant growth, and SME private placement bonds accessed the capital markets as a new financing instrument and provided a new financing channel for SMEs. In 2012, the volume of direct SME financing bonds was RMB22,139 million, which only accounted for 0.83% of the total bond financing amount of industrial and commercial enterprises. Although SMEs still have limited channel of direct financing through bond market, the fast development of the Chinese bond market has provided more financing options to medium and

\(^8\) China SME Finance Report 2013
large-sized enterprises in addition to bank credit financing, which created pressure on commercial banks for financial disintermediation and for a further lowering of their customer mix by which they can expand towards SMEs, argued by Shi Jianping in the report. As such, bond market development indirectly promoted the development of SME financing. Furthermore, SME financial bonds dominated commercial bank financial bond financing in 2012, with a total of 18 financial bonds specifically directed towards SMEs, by which 12 commercial banks raised funds worth RMB156.5 billion. This provided a more adequate and stable source of funding for SME financial services. The role of SME financial services within bond market forces towards a mainstream model and developmental direction has been becoming increasingly clearer.

2.1.3 Shadow Banking

As mentioned before that the landscape of different types of firms in China is mainly composed of two: state-owned enterprises (SOEs) with perceived lower risks and small and medium enterprises (SMEs) with perceived higher risks. SOEs could borrow money from commercial banks with very cheap price and smooth procedures while SMEs find it difficult to access to finance at commercial banks.

Due to the harsh condition for SMEs to get financing, a new form of loans rose at the edge of legality, called shadow banking. Shadow banking is specifically rampant in the east coast of China, where lots of family owned merchants are active. The vehicles of shadow banking take deposits from individuals providing much higher
interest rate than traditional commercial banks, usually at least twice or three times than commercial banks, and lend the capital to SMEs. Because these vehicles are not registered as commercial banks, they don’t bear the regulatory burdens such as capital ratio or risk control. As a result, shadow banking became popular among SMEs. Although the lending interest rate from shadow banking is higher than from commercial banks for SMEs, it releases access to capital for the companies that need the fund the most. The industries that use shadow banking, most heavily include real estate, which the PBoC states clearly to impose harsh requirements for real estate companies to get bank loans in order to keep the housing price down. According to a report by the IMF\(^9\), the total volume of shadow banking in China accounts for 35% to 50% of GDP, and the financing speed for shadow banking is twice as much as commercial banking. Many SMEs are playing on the edge in order to get financing, but eventually they bear far more risks. However, since there’s no clear regulations or law enforcements about shadow banking, defaults had happened severely during the crisis and individuals were not protected.

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Chapter 3: Major Differences in Equity Financing

3.1 Stock Market Introduction in China

3.1.1 Regulatory Departments

The main regulatory department in China is called China Securities Regulatory Commission (CSRC), which mainly covers below responsibilities: first of all, CSRC is the sole policy maker for securities market under the supervision of the State Council, as a result, it’s empowered to even make unusual policies such as shutting down the stock market for a year and no one could challenge it. Therefore, the people or leadership in the CSRC has great influence of the overall capital market in China. Second, all the applicant companies to get public listed will have to go through investigation or scrutiny from the CSRC, which means that the CSRC has the veto power to any of the applicants. Therefore, relationship with CSRC plays an important role in whether or not your company will get listed. From some interviews conducted with listed companies in China, more than 90% percentage of the samples has a specific department within their companies to deal with CSRC and maintain a good relationship.

One of the drawbacks to have such powerful single institution as CSRC is the unpredictability of stock markets from PE/VC investors’ point of view. Since stock market was founded in China in 1950, Chinese IPO market has experienced 8 times of suspensions and resumes. The latest one started at November 16, 2012 till December 2013. During the time of suspension, nobody had any idea about when it
could be resumed and when their investments could exit. International VC/PE firms try to mitigate the risk investing in China. One of the most commonly used methodologies is Valuation Adjustment Mechanism ("VAM"), which will be discussed later.

During the suspension period of IPO in China, lots of PE firms couldn’t reach their IRR and asked the investees to pay back the capitals. This further hammers the investees as they are already in a lack of capital, and won’t be able to pay back the money at all. Lots of fallacies going on and investors are discouraged to invest in China ever since. As a result, the small and medium companies find it even harder to get investment from either private placement or public offering. After the resumption of IPO in China, the stock market has seen several surges in 2013 and 2014. Based on a study done by Alan G. Huang and Tony S. Wirjanto in 2011, the P/E ratio in China is comparable to that of the US S&P 1500 index, a broad based index covering large, middle, and small capitalization firms.

3.1.2 Current Stock Market Boards and New Trends

In order to make it easier for SMEs in the technology sector to get listed, CSRC launched the new over-the-counter (New OTC) market in 2006, in addition to the existing main-board, the second-board markets, which is usually called growth enterprise board, and SME board. The requirements for companies to get listed on the New OTC market are quite loose compared with other boards because there’s no strict requirement about their financials, e.g. profits, cash flow or total asset in the
past three years. However, the liquidity in the New OTC market is very poor because it has harsh restrictions on the initial investment for individuals, which rules out massive participants. To be able to get listed in the new OTC markets, companies have to have complied internal control and good management, which does help SMEs get into the regulated track. Then it would be easier for the listed companies to switch boards and get financing from individual investors for public offering.

An effort CSRC is trying to make currently is to switch the system of IPO from scrutiny to registration system. As mentioned before, scrutiny means that the CSRC has veto power to stop companies from IPO, while registration doesn’t. Under the registration system, regulatory departments will not substantially investigate into the companies that have applied for an IPO to verify about their financial statements, which will be done and judged by investors instead. Due to a much less sophisticated investor body in China, the scrutiny system has helped investors avoid junk companies. However, with the scrutiny system, listed companies tend to play a good role before getting listed, but tend to abuse the system after getting listed. With the new registration system, regulatory department will put more energy on the after-public regulations and make sure about the information disclosure and severe punishments for any abuse, which will help keep the listed companies with compliance of regulations.
3.2 Special Practice in China

3.2.1 Valuation Adjustment Mechanism ("VAM")

VAM is an agreement between investors and invested companies, by which VC/PE firms are able to exercise the right to adjust the value of the companies under some conditions whether or not the invested companies have met the conditions. The conditions include both financial performance and non-financial performance, such as governance or R&D achievements of the companies. If the conditions are met, investors shall invest in equity with lower price, and in case companies fail to meet the conditions, investors are eligible to cash compensation or require the company or shareholders to repurchase the equity that the investors have injected. It is widely used in China yet there's no explicit law or regulations to provide guidance to such practice. China Venture Capital Association made an investigation regarding VAM among the VC/PE firms in China from May to August in 2014, and here are some major findings. First of all, VAM is very widely used, 100% of RMB funds are using VAM and most of them are signed against management team of the companies rather than the investee companies. More than 40% of VC/PE firms in the investigation have used VAM in more than 50% of their portfolio companies. It is agreed that VAM is very important, but not critical or decisive. It's not a must to sign VAM in the contracts. Compared with law enforcement risks, VC/PE firms are more concerned with execution risks. The duration for VAM is usually ranging from one to three years. The wager for VAM is usually shareholder ownership, cash flow and mainly shareholder repurchase. More than half of the investee companies have
violated VAM and have disputes with VC/PE firms. The main arguments revolve around failure for IPO and shareholders incapability to repurchase.
**Chapter 4: Innovative Financing Methods**

**4.1 Public-private Partnership (PPP)**

By definition, public-private partnership (PPP) is a government service or private business venture, which is funded or operated through a partnership of government and one or more private sector companies. From a journal written by Albert P. C. Chan; Patrick T. I. Lam; Daniel W. M. Chan, M.ASCE; Esther Cheung; and Yongjian Ke, there are mainly three types of drivers for PPP based on a literature review. Equitable risk sharing is the primary reason because of government regulations towards several high-risk industries. SMEs face enormous financing risks, operating risks, regulatory risks, among others. Partnering with government helps mitigate some of the regulatory or financing risks facing SMEs. Substantial risk transfer would be achieved through this partnership. The second type of benefit is the efficiency imposed by private sector companies to achieve cost savings, enhanced asset quality and service level. PPPs are claimed to enable the public sector to harness the expertise and efficiencies that the private sector can bring to the delivery of certain facilities and services traditionally procured and delivered by the public sector. Finally, PPP is catalyst for the economy in a sense that it encourages corporations, enhances social development and boosts business opportunities.

On PPP projects where the cost of using the service is intended to be borne
exclusively by the end user, the PPP is, from the public sector's perspective, an "off-balance sheet" method of financing the delivery of new or refurbished public sector assets. On PPP projects where the public sector intends to compensate the private sector through availability payments once the facility is established or renewed, the financing is, from the public sector's perspective, "on-balance sheet"; however, the public sector will regularly benefit from significantly deferred cash flows. Usually PPP happens in infrastructure and real estate industries that the government plays an important role while the expertise from private sector could be leveraged. Stepping into the 21st century, the bottleneck effect of infrastructure shortage for the Chinese economy emerged and imposed budgetary pressure on the Mainland Chinese government. The investment in infrastructure development could not be completed by the Chinese government alone Sachs et al. 2007 which provides a good business opportunity for the private investors. One typical example in China of PPP is a real estate project called Shantou Coastal New Town in a city in southeast China that the government signed an agreement with Citic Group, a conglomerate covering banks, security firms, real estate, media, etc, to provide 50 billion RMB to set up a residential center in Shantou. Real estate is deemed as a high-risk industry by government and the lending to real estate SMEs is strictly restricted. In this case, Citic has a background of state-owned ownership and regarded much less risk. However, this arose a new way of thinking as SMEs in similar industries to seek for PPP with government. However, Cheng Chen, Michael Hubbard and Chun-Sung Liao expressed some concerns about the accountability of
PPP in their literature. When the PPP project is for government, e.g. a high-speed road, revenues of the project come from consumers directly. However, Where there is choice, the success of the investment depends on attracting paying users. This necessarily creates tensions in PPP planning: on the one hand, consumer choice is celebrated for putting pressure on providers charging tolls to maintain quality and convenience. As Fischer (2011) points out, toll charges should not be so high as to exclude users but not so low as to make them ignore alternatives. On the other hand, choice is a problem since it limits tolls, and traffic forecasting for new roads is hazardous with a tendency to ‘optimism bias’ (Standard & Poor’s, 2004). As a result, providers may seek guarantees from government of minimum traffic levels in order to counteract risk arising from choice, e.g. in Chile’s 1990s toll road program (Fischer, 2011).

4.2 Mezzanine Financing

While debt financing or equity financing both bear some risks of either cash flow default or residual risks. To mitigate the risks and increase flexibility of investors, mezzanine financing was created. It’s a way of financing that gives debt investors the option or warrant to purchase an amount of equity of the invested company. Thus there is a trade-off between interest rate of debt and equity ownership. It provides the invested company the benefit of cheaper financing than pure debt while maintains entrepreneurs original control interest in ownership structure.
According to some relevant research, mezzanine financing was primarily focused on such areas as real estate and growth capital transactions\(^\text{11}\). However, after the recent financial crises, mezzanine financing has been gaining more presence especially among SMEs in Europe and US. The increasing prominence of mezzanine financing has burgeoned the market on the fund raising side as a number of financial institutions entered into mezzanine financing such as the Bank of Boston Capital. In China, according to a research done by China Venture, the total mezzanine fund raising in 2013 was $200 million and accounted for less than 0.3% in year 2013 among all types of fund raising\(^\text{12}\). The total transaction volume of mezzanine in China is even less than the average size of deal of mezzanine in Goldman Sachs in US\(^\text{13}\).

Industries that mezzanine funds invest in China are 48% in real estate, 23% in infrastructure, and 18% in mining while in US it’s across all industries. Legal system for mezzanine is not set up yet in China. So far there are only five acts that cover some edges of mezzanine, including Law of Commercial Banks, Regulations on Insurance Funds Investing in Equity, Regulations on Debt Converting Into Equity For Corporations, Preferred Stock Experimental Act and Law of Securities. All the legal documents have touched upon mezzanine and grant the legality of such funds, however no specific regulations of execution or disputes solving are enforced.

4.3 State Venture Capital Fund

In January 2015, Chinese government announced a new fund of Government

\(^{11}\) Practice Note, Minority Investments: Overview (http://us.practicallaw.com/1-422-1158)


\(^{13}\) Guangdong Development Securities, 2012, Comparative Study of China and the US Direct Investment
Venture Capital Guide Fund of 40 billion RMB (about 6.45 billion USD) to mainly invest in seed round innovative technology start-ups, which will become the largest government VC fund. This fund includes both government sovereign and private sector investors. The main purpose setting up this fund is to boost emerging industries in China, especially biotechnology and finance, as the government believes that emerging industries will transfer into new engines for the economy eventually. The economy growth in China was driven by government investment in infrastructure and real estate, which is not a sustainable growth model. With the new government fund, private sector economy with more innovative companies will be encouraged and invested, reducing the reliance on public sector. Before the new fund, China has set up government VC funds in both central government and more than 30 provinces. Up to 2012, there were in total 89 guide funds with a volume of more than 45 billion RMB. In July 2007, Chinese government first set up a State Venture Capital Fund (SVCF) based on the Israeli Yozma model and proposed four forms of public venture capital schemes including fund of funds, co-investment, VC investment subsidy and VC comforting subsidy. However, the intervention of Chinese government of startups or financing to SMEs is arguable as some scholars believe government should leave it to the venture capital market and minimize its influence. Based on a study done by Brander in 2010 about the performance of high-tech startups funded by government venture capital with different level of interventions, the greater the intervention is from government, the worse performance of startups and lower exit value. However, the situation in China is different and might not be
applicable because of the control of funds, talents, and market policies imposed by central government yet they adopt decentralization of empowering local governments.

Compared to China, the US venture capital market relies more on private sector than on the government.
Chapter 5 Conclusion

Compared to US, China still has a long way to go with financing for SMEs especially in the innovative financing domains such as mezzanine or PPP. The special characteristics in Chinese financing market such as shadow banking or VAM are hindering a healthy financing market. With a different market DNA, however, China should not simply imitate what US has and implement into Chinese market. Nonetheless, it is demonstrated that Chinese government and economic authorities are making great effort to reform the market to make it more transparent and fair, and the rights of both investors and fund-raisers would be better protected.
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