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On Perfecting the Credit Guarantee System of China's Small & Medium-Sized Enterprises

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Abstract

The poor credit and short of funds turn into main factors disturbing SMEs development. In order to solve SMEs' financing issue, to set up perfect credit guarantee tends to be more important. Therefore, it is necessary to build and perfect a legal regulation system for SMEs' credit guaranty, making best use of the government's effects on SMEs' credit guarantee system, perfecting SMEs' credit guarantee market mode, and constructing a scientific operation mechanism for the credit guarantee institution.

Keywords: Small and medium-sized enterprises (SMEs), Credit guarantee, Guarantee institution

SMEs have already become an important power for driving economic growth, creating employment, and promoting technological innovation, playing a vital role in social resource allocation. However, SMEs' poor credit and short of funds turn into main factors disturbing the development. In a financial market with information asymmetry, the guarantee system is important since it benefits the decrease of market risks and drives market development. In order to overcome the difficulty in financing for SMEs, to set up a perfect credit guarantee system tends to be extremely important.

1. Set up and perfect SMEs' credit guarantee legal regulation system

1.1 Constitute the law of SMEs' credit guaranty

In the world, the country that emphasizes on SMEs development has the special SMEs credit guarantee law, such as Korea's Law of Credit Guarantee Fund, Japan's Law of SMEs Credit Insurance Public Base and Law of SMEs Credit Guarantee commission, America's Law of SMEs Investment, and Canada's Law of Small Enterprise Loan. These special laws serve as the "constitution" in the SMEs credit guaranty legal system in a country. Considering the important effect of SMEs in national economic development, it is necessary to set up an administrative regulation that follows the Law of the Peoples Republic of China on Promotion of Small and Medium-sized Enterprises, taking it as the special law for SMEs credit guaranty, which can adjust the rights and obligations of SMEs credit guarantee institutions and SMEs, coordinative banks and governments.

1.2 Issue assistant laws and regulations on credit guaranty

According to the world experiences and China's practices, SMEs credit guaranty is merely one part of the whole credit guarantee system. Its effectiveness depends on related sectors, such as equipped laws, coordinative banks and enterprises. Here, relevant legislation is a basic pre-condition. To issue equipped laws concerning credit guaranty, such as Law of SMEs Credit Loan, and Law of Anti-Monopoly, can help to confirm financial institutions' obligations and responsibilities in guarantee business. As a matter of fact, the nature of SMEs credit guarantee institutions emphasizes on the support for SMEs. These institutions are higher risks and lower return. In operation, they are non-profitable. Therefore, the government should solve the funds collection and compensation issue together with strengthen of market regulation and prevention of risks, for SMEs credit guaranty by legislation. Meanwhile, the government must enhance the legislation in financing, technological consulting, and talents training, which are necessary for SMEs development and serve as a guaranty for realizing a profitable capitals circle and a sustainable operation of SMEs, credit guarantee institutions, and financial institutions. Besides, constitute relevant laws and regulations concerning social credit system, such as Law of Fair Use of Information, Regulations on Financial Bonds Management, and Standards for Punishing Behaviors of Escaping Banks Debts.

2. Make best use of government's effects in SMEs credit guarantee system

2.1 Exert government's dominating effect

The guarantee operation differs from insurance business. Insurance knows the probability of risks and losses by precise calculations and statistical methods. Then, it determines its costs and profits. Guarantee enterprises are different. Because guarantee items have different sums and terms, and it is hard to estimate the execution of anti-guarantee measures, together with the high separation, rate of premium can not be calculated precisely. Therefore, the guarantee operation faces higher risks. The government shoulders irreplaceable responsibilities in constituting SMEs credit guarantee system. And for a long period, the government will stay in a core and dominating position, which could not be replaced by the self-developed market mechanism. To make best use of government's dominating effect, it concerns not only funds supply, offering capitals for the foundation of guarantee institutions, but also providing necessary directions and management in fields of choosing the proper macro mode for credit guarantee system, perfecting the game rules in guarantee market, training and introducing high and medium-grade guarantee talents, directing SMEs regulating the development. Only by this way, can it form a positive platform that is right for the existence and healthy development of credit guarantee system.

2.2 Regulate government behavior in developing SMEs credit guarantee system

For present guarantee system, the guarantee institutions with government funds have advantages of capitals. As a result, in their operations, words of officials at different levels are decisive in managing and operating guarantee funds. This governance structure leads to irrational administrative interference, which may cause problems in the safe, stable, and effective operation of funds. Therefore, under present system, the effective way is to adopt a commission management for guarantee funds. It has two advantages: firstly, it can avoid government direct interference, realizing a complete market operation; secondly, make a full effective use of professionals, reducing guarantee mistakes. The commission management can improve the guarantee quality on one hand. On the other hand, it can coordinate interests among different parts. In a commission management, it is necessary to prevent the government from interfering decisions, causing guarantee mistakes, and forbid specialized institutions to merely pursue self interests, causing "inner people control" issue and a series of problems.

3. Perfect SMEs credit guarantee market mode

3.1 Perfect the "one-body, two-wing, and four-level" mode

By learning from foreign experiences in supporting SMEs, China sets up a Chinese characterized "one-body, two-wring, and four-level" SMEs credit guarantee system mode gradually, after years of exploration. "One-body" means taking the policy guaranty as the subject, applying "diversified funds, market operation, corporate management, and performance support". "Two-wring" means taking commercial guaranty and private mutual assistant guaranty as necessary complements. "Four-level" means the guarantee institutions at four levels, namely the central government, the province, the city, and the county. The policy guarantee institutions possess a dominating status in China's present guarantee system, which supply policy support for government supporting SMEs development indirectly. As non-financial institutions, they are not engaged in financial operations and fiscal credit. They aim at profits by no means. What they serve are not all SMEs but those have a bright future and follow state industrial policies and can not getting loans from commercial banks. What they serve are mostly state-holding or state-participating enterprises or organizations. Commercial guarantee institutions are mostly founded by enterprises or individuals, which adopt commercial operations and pursue for profits. Offering credit guaranty for SMEs is only one business. The mutual assistant guarantee institutions are formed by SMEs, which are not long for profits and aim at solving SMEs difficulties in loans, being non-financial institutions. Most are social parties or enterprises. The government should support the development of private commercial guarantee institutions and mutual assistant guarantee institutions which grow from internal enterprises, especially in the process of private enterprise development. These two kinds of guarantee institutions evolve from market by themselves. Their operations are featured with market characteristics. They can exert the guarantee function completely. Therefore, the government should release the restricts on the internal financial innovation of private economy, protect the internal financing base of private economy, training financial media institutions for private economy, and helping private economy get necessary financial support internally.

3.2 Build re-guarantees institutions

Under present fiscal and taxation system, to adopt a re-guarantee mode can help to exert effects of finance at all levels. In the world, Japan's SMEs credit guarantee system is a typical re-guarantee mode. The central financial public base offers re-guaranty for local SMEs credit guarantee commissions. The task of re-guaranty is not to audit each loan but set up the operational rules for SMEs credit guarantee system. Local guarantee institutions follow the general guarantee rules. Provincial re-guarantee institutions serve local SMEs credit guarantee institutions and are engaged in common re-guarantee operations and compulsory re-guarantee operations. Besides, they cooperate with the Central Bank and financial sectors to regulate and supervise the local SMEs credit guarantee institutions. Form national re-guarantee institution as the "final guaranty". In order to defend risks, the counties (cities) with large economic amount can set up

branches of SMEs credit guarantee institutions. They do not form independent credit guarantee institutions. As for guarantee institutions and re-guarantee institutions, the former takes main risks and the later all risks. They should sign contracts for risks proportions. For projects with higher risks, it is necessary to realize compulsory re-guaranty.

4. Constitute a scientific operation mechanism for credit guarantee institutions

4.1 Implement the regulated membership system

Urban SMEs credit guarantee institutions can adopt qualified SMEs as members. In order to coordinate with banks effectively in operations, they can audit the qualification of members together. Provincial SMEs re-guarantee institutions can adopt urban SMEs credit guarantee institutions (include policy, mutual assistant, and commercial SMEs credit guarantee institutions) and enterprises as members. As applying loans, with same conditions, members can enjoy the priorities.

4.2 Regulate the use of guarantee funds

The special nature of guarantee business determines it is not an industry with sudden and huge profits. However, in order to survive and gain further development, the industry must form value compensation and value added mechanism. As policy guarantee institutions, although they are not for profits, they should be profitable more or less. That is the basic requirements of market economy. As for commercial guarantee institutions, the chief target is to pursue profits. So, the reasonable use of guarantee funds is an inevitable issue. At present, relevant management rules regulate that guarantee funds must save in banks or buy state debts. However, due to the lower rates, it is hard to realize value growth for these capitals. Therefore, many guarantee institutions quietly or indirectly invest their funds in capital market. Considering the fact of guarantee institutions operating funds in capital market, it is a wise policy that permits guarantee institutions to follow a reasonable investment combination, improving funds' safety and values. Surely, local government should not directly regulate the use of guarantee funds. What's more important is to cultivate professional talents who know capitals operation. Once policy permits, they can operate guarantee funds reasonably.

4.3 Form and perfect a capital compensation mechanism for guarantee funds

Presently, China has policy guarantee institutions and commercial guarantee institutions. Set up different compensation mechanisms for different credit guarantee institutions.

(1) Offer fiscal compensation for policy guarantee institutions, or determine the sum of fiscal compensation according to certain proportion. Facing compensation loss, firstly use the risks reserve funds and then the fiscal funds. For the government-funded guarantee institutions, the long-term task is to support the development of SMEs. The government can also take part of taxes from SMEs as compensation for guaranty, driving SMEs development by their own strengths. "Matters from people are used for people."

(2) For commercial guarantee institutions, the government should reduce or exempt business taxes and take out special funds as risks compensation for commercial institutions and private mutual assistant guarantee institutions. According to guarantee institutions' performances, the government can choose some as compensation objects, regulating the standards for compensation. Specific standards are determined by provincial or city governments.

4.4 Form risks guarantee funds and re-guarantee funds system

To defend, control, separate, and resolve risks, and the risk compensation mechanism are important rings for the normal operation of guarantee institutions. China is a developing country. SMEs face more risks in development. The risks compensation funds of guarantee institutions are far from sufficient. The government should, or together with banks and enterprises, sets up risks guarantee funds and re-guarantee funds, for the sake of supporting SMEs development and insuring the normal operation and development of guarantee institutions. In this aspect, experiences from Taiwan are valuable. In Taiwan, SMEs credit guarantee funds serve as guaranties for SMEs. SMEs credit guarantee funds are non-profitable financial organizations. All qualified SMEs can get services from these organizations. The functions of credit guarantee funds include: execute the government's policy of supporting SMEs; exclude barriers in front of SMEs in applying for loans; improving the wills of financial institutions serving for SMEs; helping to enlarge the assisting effect of relevant assistant institutions.

4.5 Build a scientific guarantee risks internally-control mechanism

SMEs credit guarantee institutions should construct a scientific guarantee risks internally-control mechanism, defending the reverse selection and moral risks.

(1) Build risks conservation system. It is widely accepted that credit guarantee industry faces high risks. It is necessary to take strict measures to identify, defend, control, and separate risks, controlling risks under an acceptable standard. The guarantee institutions should build the risks reserve funds system, withdrawing reserve funds and using for compensations according to certain percentage along with the business development. Withdraw reserve funds according to 1% of surplus in current year and certain percentage of after-tax profits. As the risks reserve funds are above 30% of registered capitals, the excessive part can be taken as capitals.

(2) Set up a risk-sharing mechanism. The core of credit guaranty relies in guarantee institutions' strong ability of defending risks. They can realize the upgrade of credits and enlarge the credit. At present in China, there is no positive "interests and risks-sharing" cooperation between guarantee institutions and commercial banks. In order to escape from risks, most commercial banks provide lower credit line for guarantee institutions. Some even ask guarantee institutions to mortgage all assets. Foreign guarantee institutions can offer five or twelve times of self capitals as loans, while in China the number is only two times. Learning from foreign experiences, China should adopt a risks-sharing mode in which all partners share risks. Firstly, guarantee institutions and SMEs sign contracts about the percentage of duties; secondly, guarantee institutions and commercial banks follow the "interests and risks-sharing" principle. The guarantee percentage should be controlled between 70% and 80%; thirdly, as compensations for debts happen, guarantee institutions and re-guarantee institutions share the compensations according the percentage between 30% and 70%.

(3) Set up an anti-guarantee mechanism for guaranteed enterprises. Guarantee institutions should require guaranteed enterprises to perform mortgage anti-guaranty, pledge anti-guaranty, or credit anti-guaranty. Measures for guaranties should be flexible, operational, practical, and lawful. Guarantee institutions should examine enterprises' ability of fulfilling contracts. Anti-guaranty contracts should confirm the relationship between the principal contract (loan contract) and the assistant contract (guaranty contract), the relationship between the guarantee contract and the anti-guarantee contract, the rights and obligations, the punishments, the payment, and the term.

(4) Strengthen enterprise leaders' consciousness of responsibility. For enterprises that have no sufficient mortgages and can not provide effective anti-guaranty, the legal person and the financial manager can take certain percentage of responsibility for paying loans off.

(5) Strengthen regulation and supervision on guaranteed projects. After offering guaranties for enterprises, guarantee institutions turn into potential creditors or owners of all assets of enterprises by taking relevant legal and economic duties. Therefore, guarantee institutions can join in the governance of enterprise to certain degree. They can appoint a financial supervisor to control the enterprise finance, or advance suggestions by understanding enterprise's business management and financial conditions. By this way, they can adopt risks prevention measures timely. All activities that may impact the interests of guarantors should get permission from guarantee institutions firstly.

4.6 Build a positive cooperation relationship with coordinative banks.

Credit guarantee institution is to separate banks' risks instead of taking all risks from banks so that banks can get stable profits without taking any risk. Therefore, SMEs credit guarantee institutions and banks should establish relevant rules, such as the form of guaranteed responsibility, the times of guaranteed funds, the scope of guaranty, the percentage of responsibility, the credit evaluation, the liability of contract breach, and the conditions for compensation, forming a positive mutual coexistence relationship. In form, credit guarantee institutions conflict with financial institutions. But in nature, they are on one side: separate enterprises' credit risks in financing and maintain the social credit chain. The interference of guaranty turns the former loan relation between commercial banks and enterprises into the relation among commercial banks, enterprises, and guarantee institutions. Guarantee institutions separate commercial banks' loans risks. The assets of commercial banks get higher safety, which improve their confidence in lending capitals to SMEs. As a result, SMEs can get loans easily. It is a "win-win" result for commercial banks and guarantee institutions. Therefore, as for present guarantee funds, invite professional talents in local financial institutions to join in the board or the commission, studying the countermeasures for promoting SMEs development together, constituting a reasonable credit risks-sharing mechanism for financial institutions and guarantee institutions, and finally forming a "three party" pattern including enterprises, guarantee institutions, and banks. This pattern is an ideal and effective way solving SMEs' difficulties in financing.

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