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# A Literature Study of the Impact of COVID-19 Pandemic on the Financing of the SMEs in China

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## Abstract

Although the containment of the COVID-19 pandemic has achieved a critical victory in China since 2020, it has undeniably brought a huge impact on the economy. Especially for the small and medium-sized enterprises (SMEs) located at the end of the industrial chain, whose comprehensive strength is weak, they are generally facing severe survival challenges. Under the complex and severe situation, a financing bailout can not solve the fundamental problem, but it is an effective way to alleviate the urgent needs of the SMEs. This paper systematically reviews the impact of the pandemic on the SMEs' financing, the limitations of the SMEs' financing channels, the problems of the SMEs exposed by "financing difficulties" during the pandemic, and how to promote financing and help the SMEs strengthen and expand.

## Keywords

COVID-19, Pandemic, China, SMEs, Financing

## 1. Introduction

The COVID-19 pandemic outbreak in 2020 was the most severe infectious disease pandemic to occur globally in nearly a century. The spread and persistence of the pandemic have repeatedly updated expectations, causing a strong impact on employment, cash flow, production, sales, and other links of the SMEs, and exacerbating the complexity and urgency of financing. The pandemic is hitting both the supply and demand sides of the economy, making the impact on the SMEs persistent and showing systematic and structural characteristics. The SMEs face a major threat to their existence (Wang & Wang, 2020). In a complex and severe situation, a financing bailout cannot solve the fundamental problems of the SMEs, but it is an effective way to alleviate the urgent need. What is the

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impact of the COVID-19 pandemic on the SMEs financing? What are the limitations of financing channels for the SMEs? What are the problems of the SMEs exposed by "financing difficulties" during the pandemic? How can we promote financing and help the SMEs strengthen and expand? As the pandemic continues to spread and persist, these issues become the focus of this article.

## 2. The Limitations of Financing Channels for the SMEs

The SMEs have played an important role in China's economic development. The SMEs in China have typical characteristics of "Five, Six, Seven, Eight, Nine", that is, they contribute more than 50% of the national tax revenue, more than 60% of GDP, more than 70% of technological innovation achievements, more than 80% of the employment and More than 90% of the number of enterprises (Gu et al., 2022). The threshold and market dividend of the SMEs provide opportunities for their development and expansion. However, the SMEs are in a disadvantageous position in the competition due to their small scale and the small number of personnel, and their capital budget also faces many difficulties. Since the outbreak of the COVID-19 pandemic in early 2020, the financial industry has taken a variety of measures to effectively mitigate the impact of the pandemic on the financial market and the real economy to a certain extent, but it has also exposed the inadequacy of financial industry management in the face of emergencies (Yang, 2022). The financing of the SMEs in China is mainly indirect financing, supplemented by direct financing. As China's financial system is not perfect, the financing channels of the SMEs have various limitations (Figure 1).

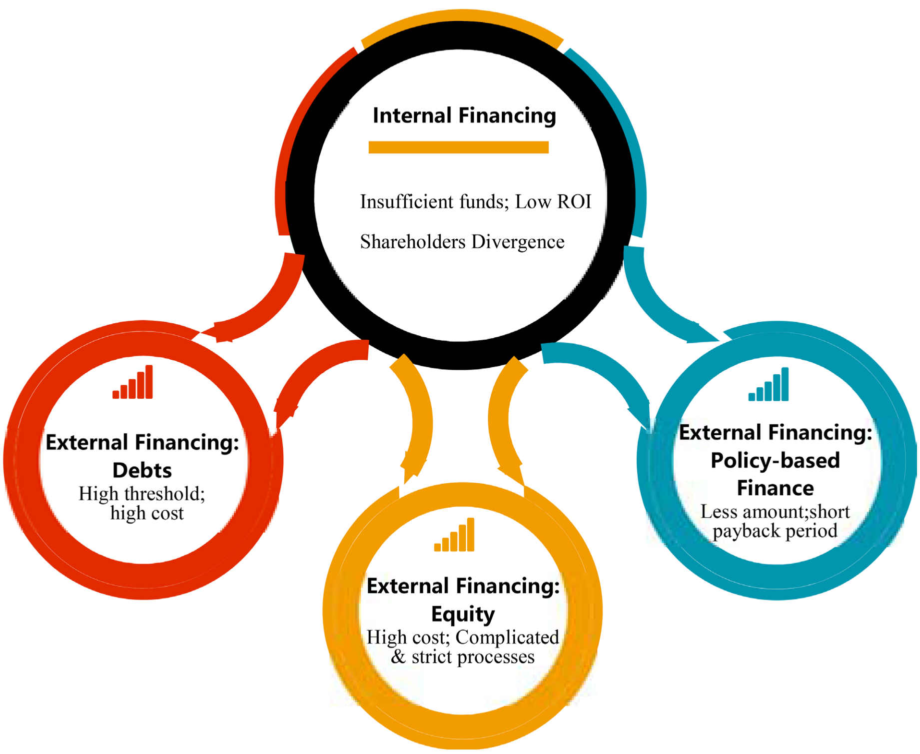


Figure 1. Limitations of internal and external financing channels for the SMEs.

Firstly, there exist limitations in the internal financing channels. The COVID-19 pandemic has significantly reduced the profitability of the SMEs, reduced the retained earnings, and the amount of internal financing cannot meet their actual needs. Cao et al. (2021) found that under the background of the continuous pandemic, the rate of return on investment was also significantly reduced, resulting in huge differences among shareholders. The internal channels could not be developed when opinions could not be unified.

Secondly, it is the limitation of debt financing. Debts financing is the main channel of external financing for the SMEs, and the specific financing categories include bank loans, institution loans, private loans, network loans, etc., but each has some limitations. The bank loan threshold is high, many SMEs do not meet the requirements. The interest rate of the Institution loan is high, the financing cost is much higher than banks, increasing the burden on the SMEs themselves. Private loans have legal risks and are not suitable for use. The reputation of the network lending is worth discussing, with frequent negative news, resulting in the SMEs dare not set foot in. Due to the relatively small scale of the SMEs, if the internal capital is tight and surplus capital is insufficient, it will be difficult to support the subsequent development of enterprises and repay the loans in the early stage. Therefore, the creditors have requirements on risks and returns of investment, and the SMEs usually rely on the third-party institutions to meet the requirements of creditors and the SMEs at the same time (Zhao, 2020). Through indirect financing, enterprises can obtain part of the capital, but the cost of financing is high. If the SMEs cannot have enough profits or capital circulation, it is easy to cause a capital chain fracture.

Thirdly, it is the limitation of equity financing. The cost of equity financing is high, the process is complicated, social funds are gradually tightened, and direct financing is more difficult. The limitation of this financing channel is that most SMEs cannot reach the GEM threshold, and the financing capacity of the New Third Board Market is lower than expected, which reduces the willingness of the SMEs to enter (Xu, 2021). Equity financing involves a lot of professional legal issues and legal risks. In addition, China lacks authoritative equity evaluation institutions to determine the value of equity, once in operation, it is easy to cause corporate structure change or hostile takeover and other behaviors. In addition, China's stock issuance system is an approval system, which has strict requirements for listed companies, and the capital market does not play a good role. Moreover, due to the large number of SMEs in China, direct financing of the SMEs is not a high proportion.

Finally, there are the limitations of policy-based financing. The main supplier of policy-based financing is the government. The limitation of this model lies in the management. Some SMEs window-dress for their own interests to deceive the government, their own strength is not enough, but can get policy loans. The amount of policy-based financing is small and the payback period is short. The SMEs, especially R & D enterprises, have a long R & D cycle and need a long-term capital guarantee, which obviously cannot meet their development demands (Yuan & Chen, 2021).

The financing of the SMEs has always been a very important issue that countries have always attached great importance to, but there has been no good solution. Coupled with the ongoing COVID-19 pandemic, the limitations of various financing channels for the SMEs have become increasingly prominent.

## 3. The Impact of COVID-19 Pandemic on the SMEs' Financing

The continuous spread and persistence of the COVID-19 pandemic have a significant impact on the financing supply and demand of the SMEs (**Figure 2**).

The COVID-19 pandemic has affected the supply of financing to the SMEs. Although China has won a decisive victory in COVID-19 prevention and control, the situation in developed countries such as Europe and the US is not optimistic, and the pandemic is likely to continue, which is bound to seriously affect the financing environment of enterprises. Around the world, the pandemic has had a huge impact on the global economy. It has caused havoc in global stock markets. For example, the US stock market has triggered multiple circuit breakers (Guan, 2021). The stock market is based on market confidence. If investors see the decline in market confidence, they will reduce their interest in investment, so that the financing environment of the SMEs will present a situation of few opportunities and high requirements. In China, due to the COVID-19 pandemic, the stock market has been on a downward trend since the opening of 2020. As the pandemic is gradually brought under control, the downward trend has eased, but some SMEs have been negatively affected by direct financing through securities issuance. According to the capital flow of the market (Shanghai and Shenzhen stock markets) calculated by the WIND database, the capital flow of the stock market from January to March 2020, when the pandemic was serious, was basically negative. The fixed-asset investment (excluding farmers) in

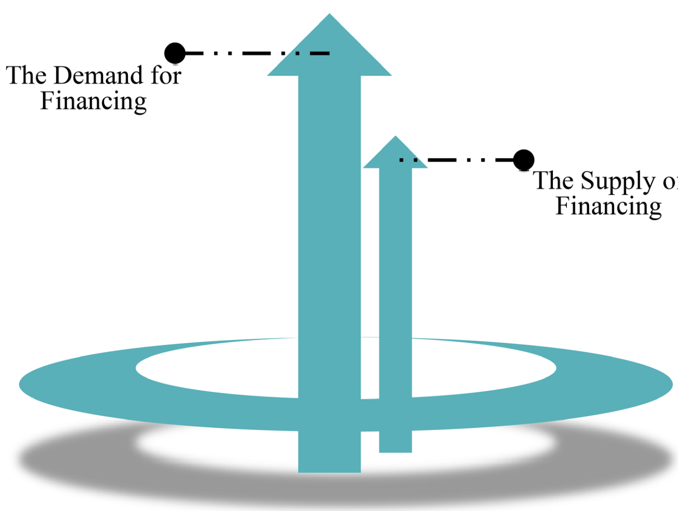


**Figure 2.** The impact of COVID-19 pandemic on the SMEs' financing supply and demand.

March was −9.5%, and the manufacturing investment in March was −20.6% (Yan, 2020). As a response, the CBRC lowered the short-term loan interest rate of enterprise loans by 0.5 percentage points, which is undoubtedly good news for the financing supply of SMEs. In general, the COVID-19 pandemic has affected China's domestic financing environment.

The COVID-19 pandemic has affected the financing demand of the SMEs. The continuation of the COVID-19 pandemic has brought a great impact on China's economy. When the pandemic was serious, large-scale movement of people was prohibited, and many enterprises could not operate normally, resulting in a slowdown in GDP growth. When there is increasing instability in the economic situation, people tend to take advantage of the disadvantages. The SMEs' investors are also cautious in gauging their financing needs due to the increased risk factors posed by the pandemic.

Small, medium- and long-term and stable funds become the key point of financing for small and micro-enterprises. In early 2020, the Institute of Inclusive Finance at Renmin University of China released the Impact of COVID-19 pandemic on the Financial Health of Weak Economies and Policy Recommendations (hereinafter referred to as the Report)[1]. The report focuses on working-class and small business owners, and uses their financial health assessment as a starting point to explore the policy demands of weak economies after the outbreak and the direction of future improvement or transformation. After processing and analyzing the results of a sample of nearly 2000 people, the report shows that workers and small business owners are less able to manage their finances and emergency management, so they need smaller and more stable loans in the face of post-pandemic recovery and funding gaps. Internet banks and non-bank financial institutions have played a more prominent role as capillaries in serving weak economies due to the requirements of pandemic prevention and control, and the obstacles of bank loan applications for small enterprises. According to the report, the first three months after the outbreak are the "life and death line" for most small and micro-businesses. The capital gap of small enterprises is concentrated in less than 1 million yuan, and they prefer medium- and long-term loans (1 year or more). Contrary to the popular belief that small business owners prefer flexible loans, more than half of those surveyed want fixed-term loans of a year or more. On the one hand, after the resumption of production for a period of time, enterprises may slow down the withdrawal of funds, and loans naturally need to be extended. On the other hand, many business owners are worried about the risk of loan withdrawal and loan termination, and they value the stability of loan funds more than the additional capital cost brought by medium and long-term loans.

Different types of SMEs have different financing demands. At present, there are three regional supply chains in the world, namely, the Asian supply chain,

[1]China Institute of Inclusive Finance, RENMIN University of China: Diagnosing the impact of COVID-19 on the financial health of weak Economies and policy recommendations. 2020-03-11 (https://www.163.com/money/article/F7EIN7NR00259D61.html).

European supply chain, and North American supply chain. The three supply chains are centered in China, Germany, and the United States. The global supply chain is deeply integrated, and the pandemic prevention and control situation abroad will in turn affect China, where export enterprises may encounter difficulties in receiving orders, fulfilling contracts, logistics and transportation channels, and tariff barriers (Peng & Han, 2020). The pandemic has had a major impact on some concentrated industries, such as cultural tourism, catering, transportation, film and television entertainment, and real estate. With the spread of the pandemic abroad, the domestic foreign trade industry has been greatly affected, consumption is expected to shrink, and brands have canceled or contracted the scale of foreign trade orders. These foreign trade industries mainly include Chinese electrical machinery, apparatus and instruments, textiles, chemicals, and so on. The SMEs in these industries have been affected by the upstream and downstream industries, as well as themselves. Whether they need to operate as usual depends on the severity and scope of the pandemic. Therefore, some SMEs have reduced financing needs for their own development. However, internet-related industries, such as software and computer industries, online education, e-commerce, and remote software, developed rapidly during the pandemic and led the GDP growth (Zhang, 2021). Compared with other industries, these industries have greater demand for capital, and companies can also profit. In addition, some medical equipment and food companies are also in immediate need during the pandemic. The COVID-19 pandemic has little impact on these companies, and these SMEs have a greater need for capital. As the pandemic in China has been gradually brought under control, the rate of resumption of work has increased and financing needs have increased accordingly.

## 4. The Problems of the SMEs Exposed by "Financing Difficulties" during the Pandemic

The capital chain and the cash flow are the primary problems (Zhu, 2020). Since the operation scale of the SMEs is not as large as that of large enterprises, their cash flow is not abundant. The long duration of the pandemic has brought financial difficulties to micro, small and medium-sized enterprises. According to the survey, 34 percent of companies can maintain cash flow for one month, 33.1 percent for two months, and only 9.96 percent for more than six months (Zhu et al., 2020). Without the continuous flow of capital, it is difficult for enterprises to continue to produce products and afford workers' salaries. With the rise of logistics costs and raw materials during the pandemic, all these have become heavy burdens for enterprises to survive. As the entire economy is affected by the pandemic, financing costs have risen further, and it is very difficult for SMEs to survive by means of debt financing.

The second problem is the single business model and relatively closed management. In terms of operation, the SMEs generally have shortcomings, and their business model cannot match the market well. Too single business model may lead to big fluctuations in profitability once market demand changes. The pandemic has shifted a lot of offline businesses to online businesses. If an enterprise had developed both online and offline business, it would not have a big impact on the sales. However, due to limited self-owned funds, financing difficulties, and limited development platforms, the SMEs can only choose a single business model in many cases.

In terms of management appointments, many SMEs integrate ownership, administration, and management rights. This does have certain advantages. Individuals can have complete control over the enterprise and the decisions they make can directly affect the enterprise. However, the disadvantage is that the important positions in the important functional departments of the enterprise are held by acquaintances and relatives, which is easy to cause management decisions cannot be well handed down. Even if there is a mistake on the job, it is possible not to make a penalty due to kindness. And because they have complete control over the business, owners may not hire people on merit, making it difficult for outsiders to bring new blood into the business. When the economic environment changes dramatically, it may be difficult to adapt quickly to the challenge.

Thirdly, it is the inadequate capacity of the SMEs to withstand external risks such as the COVID-19 pandemic. This is the inherent limitation of the SMEs. Due to the small scale, most enterprises have not established scientific and perfect systems and awareness of risk countermeasures to deal with external risks such as the COVID-19 pandemic. Out of the principle of cost and benefit, they think the cost of doing so is too high and choose to give up (Liu et al., 2020). Thus, compared with large enterprises, the SMEs often fail to cope with external risks due to a lack of sound measures to deal with risks, lack of their own funds, and insufficient emergency cash flow, which ultimately leads to limited development.

Fourthly, it is the transformation difficulty of the SMEs. Due to the low starting point, the SMEs still follow the traditional business model and follow the original management system, instead of actively transforming. Indeed some enterprises want to embark on the path of digital transformation. However, due to the low status of small enterprises in the capital market and financial institutions and the difficulty in implementing credit review, they cannot control the right to speak when allocating resources. Without the funds needed for development and transformation, enterprises can only passively accept the market environment (Yang & Yang, 2020). Due to the continuing impact of the pandemic, many SMEs have suffered from rising costs, declining profits, tight cash flow, and difficult and expensive financing, making it more difficult to transform.

## 5. The Financing Strategies of the SMEs under the Impact of COVID-19 Pandemic

The SMEs should improve their comprehensive strength. The COVID-19 pandemic is a huge test for the survival of enterprises. Large enterprises can effectively cope with the crisis due to their strong assets, abundant cash flow, and good risk prevention measures. But for those SMEs with relatively weak assets, insufficient cash flow, and imperfect risk management systems, are faced with the test of life and death. In the face of the pandemic, it is essential for the SMEs to strengthen themselves. Only when the SMEs let investors see the strong market development potential can investors have the confidence to provide funds. The SMEs should be prepared for a prolonged or regular pandemic, strengthen product innovation and R & D, and prepare for market expansion during the pandemic. Through the improvement of its product research and development, enterprise management, and business development capabilities, the majority of investors realize that this is a high-quality the SME that can create value with the economic recovery (Xiang, 2021). In terms of financing capacity shaping (**Figure 3**), the SMEs should do the following (**Table 1**): First, the brand influence, the popularity, and the reputation should be excellent, so that investors can see the

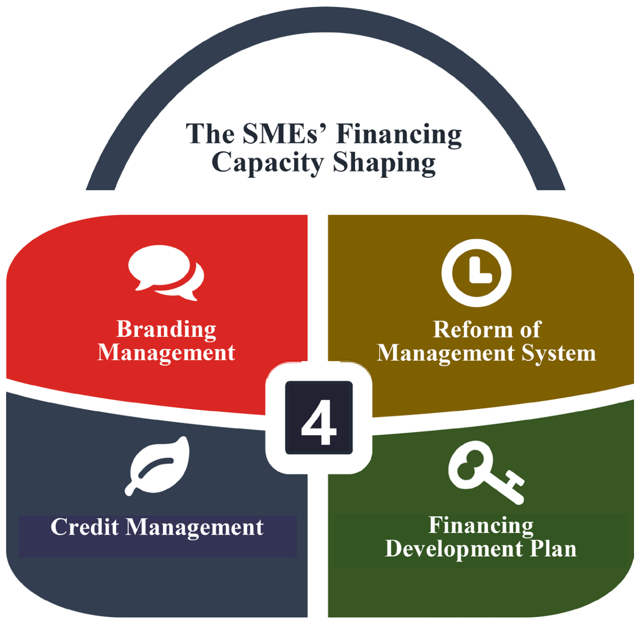


**Figure 3.** The approaches of the SMEs financing capacity shaping.

**Table 1.** The specific practice of the SMEs' financing capacity shaping.

| Approach | Specific Practice |
|---|---|
| Branding Management | Build strong brand influence, visibility, reputation, let investors see the market value of the enterprise |
| Reform of management system | Bid farewell to extensive mode and adopt modern system |
| Credit Management | Strengthen enterprise market credit maintenance, legal person credit construction, staff credit awareness and so on |
| Financing Development Plan | Fine management of financing scale, repayment plan, work docking, etc., to conduct high-quality and efficient financing docking |

market value of the enterprise (Zhang et al., 2021). Second, the SMEs should bid farewell to extensive mode and adopt modern systems in the management system. Third, the SMEs must strengthen credit management. This includes market credit maintenance, legal person credit construction, employee credit consciousness, and so on. Fourth, the SMEs should emphasize enterprise financing development planning. Only through fine management of financing scale, repayment plan, and work docking, can high-quality and efficient financing docking be carried out.

The government should strengthen the public services of financing. First, financing costs for the SMEs should be further lowered (Lai, 2022). The communication costs should be reduced and the matching degree and precision of financing should be improved. Scientific policy research can be carried out according to the economic losses of various industries affected by the pandemic, so as to propose reasonable financing service policies. Interest repayment costs can be reduced by lowering tax rates, credit enhancement standards can be appropriately relaxed, and the bank review period can be shortened to accelerate the speed of funds in place. Second, the government helps to enhance the credibility of the SMEs (Luo et al., 2020), and makes use ovarious risk compensation mechanisms such as loan risk compensation, guarantee subsidies, etc., to exempt the capital investment institutions from future worries (Qi & Liu, 2021). The government should provide better financing support policies, especially for the assessment of the actual impact of the pandemic risk on enterprises in various industries. Flexible credit policies should be adopted instead of blindly withdrawing loans, cutting off loans, or restricting loans (Li, 2018). For enterprises with tight cash flow, the existing loan repayment term can be postponed. Fourthly, special subsidy funds can be set up by national or local finance based on the situation of the pandemic. From the perspective of the whole industrial chain, comprehensive financial subsidies can be used to alleviate the development dilemma of the industry (Qin & Gui, 2021). In addition, financial resources within the industry can help to support peer enterprises to overcome difficulties.

The credit system of the financing market should be further improved. It is necessary to perfect the credit guarantee system, set up professional institutions to provide credit guarantees for the SMEs, and strengthen the normative role of administrative power through the three-dimensional combination of laws and regulations, policies and mechanisms, and then through effective guidance, scientific management to effectively play the role of market financing (Chen & Qin, 2020). At present, due to the impact of the pandemic, relevant industries are suspended, resulting in abundant idle capital and private wealth, but there are no good investment opportunities and channels. Financing management institutions should take advantage of the pandemic to solve the financing difficulties of the SMEs. We should not rely solely on banks as a single financing channel, but should develop a diversified financial service system, and the direction of diversification is based on the improvement of the credit system to introduce the private liquidity restrained into the financing market during the pandemic (He, 2021). In line with the principle of controllable risks, objective returns, and laws to follow, private capital should be integrated to improve the financing difficulties of the SMEs during the pandemic emergency.

Encourage the SMEs to introduce foreign investment as appropriate. Countries around the world are suffering from the negative impact of the COVID-19 pandemic. China should work with entrepreneurs and investment institutions from all over the world to attract high-quality foreign technology and capital through the policy of "bringing in" under the principle of unity, cooperation, mutual benefit and progress, and guide foreign capital into China's financing channels in a planned, legal and systematic way (Du, 2022). For example, the New Third Board Market can be used to help high-quality SMEs to obtain financing through IPO (Wang & Ji, 2021; Wang, 2020). The SMEs can also carry out new financing ways such as private equity financing under the effective supervision of laws and regulations (Shi, 2020).

Promote the improvement and maturity of the venture capital. Venture capital is a kind of financing behavior in which professional investment companies or investment consortiums exchange funds for the equity of start-up companies. The venture capital has become one of the important financing ways for the SMEs to grow stronger through government guidance, social participation, and market interaction in China (Zhou, 2022). In the special period when the pandemic continues, we need to further leverage the financing role of venture capital and promote cooperation opportunities for the SMEs in science and technology, service, and asset-light operation that are suitable for venture capital financing, so as to help them tide over difficulties.

## 6. Conclusion

The spread and duration of the COVID-19 pandemic have caused great damage to the development of the SMEs. Therefore, the government should formulate reasonable laws and regulations from the overall point of view to regulate financing behavior. Banks and investors should appropriately improve the efficiency of financing services based on the credit investigation system, reduce the overall cost of financing, and enable the SMEs to get timely financing assistance in rational management, so as to alleviate the negative impact brought by the pandemic. By stimulating the vitality of the SMEs, the economic fundamentals would be boosted, and the task of economic development in the face of the ongoing COVID-19 pandemic could be effectively accomplished.

## Funding

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## Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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