

## Chapter 2

# Is Supply Chain Finance the Solution to the Financing Conundrum?

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### **ABSTRACT**

*Small and medium-sized enterprises are the major driving forces to boost China's economic growth. However, the transformation and upgrading of small and medium-sized enterprises are always subject to the scale of operation and other factors, which result in severe impediment to obtain loans or other finance service from traditional commercial banks. As the State Council reports, small and medium-sized enterprises' finance troubles were highlighted at the State Council's executive meeting and suggested China should enrich the fundraising channels for small and medium-sized enterprises. Based on the unique finance service features, supply chain finance has the potential of satisfying the large finance demand to become an effective fundraising and other finance service channel for small and medium-sized enterprises. Thus, it is vital to explore the operation process of supply chain finance in a deeper level.*

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## **INTRODUCTION**

Due to the constraints of small scale of operation, lacking in collateral and other reasons, the small and medium-sized enterprises often have difficulties in obtaining financing from traditional commercial banks. Compared to the traditional financial service, supply chain finance is effective in settling this conundrum for small and medium-sized enterprises, instead of focusing on a single enterprise's operation scale or fixed assets, supply chain finance emphasizes on the operation process and the status of supply chain core enterprises. Liu et al. (2015) indicate that the scale of financing provided by supply chain finance has reached 5.75 billion yuan with 20% annual growth rate in 2011. The emergence of online retail giants further facilitates the combination of supply chain finance and e-commerce platforms, many online retail giants have entered the supply chain finance market and made substantial success. Taking online retail giant JD.COM as an example, JD Finance successfully raised 6.65 billion yuan from investors in January 2016. Then JD.COM continued to speed up the deployment of finance services: In June 2017, JD.COM decided to push for better development of finance business by separating JD Finance from the company. Different from the traditional commercial banks, the large trading data accumulation enables the online retail giants to occupy the core position in supply chain, which is beneficial to eliminate the information asymmetry, evaluate the risks and increase the finance service efficiency. In this chapter, the authors take the Chinese online retail giant JD.COM as an example to investigate the differences between supply chain finance and traditional finance service, the authors then use a quantitative method to discuss the optimal interest rates under different situations for the online retail enterprises which are also the finance service providers in the supply chain.

As China's economy transformed into the "new normal" phase, the small and medium-sized enterprises are also in need of transformation and upgrade. Premier Li proposed the "Made in China 2025" plan in 2015, which indicates China's determination in promoting the industry upgrade in manufacturing. However, when facing the opportunity of upgrade, financing difficulty has become a longstanding problem for small and medium-sized enterprises. The following statistics illustrate this problem, according to the MSME (Micro, Small and Medium Enterprises) Finance Report, in 2017, 65 million or 40% of formal micro, small and medium-sized enterprises have the unmet financing needs in developing countries, the MSME finance gap in developing countries is estimated to be \$ 5.2 trillion, 1.4 times the current level of MSME lending. In China, the financing situation for small and medium-sized enterprises is also not optimistic, more than 43% of small and medium-sized enterprises has encountered the financing gap. In other words, traditional financing institutions like banks can only meet 57% of the financing

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