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Abbreviations

BSO	–	Business Support Office
CEO	–	Chief Executive Officer
CGAP	–	The Consultative Group to Assist the Poor
CNY	–	Chinese Yuan (the official currency code)
EU	–	European Union
GDP	–	Gross Domestic Product
HLK	–	School of Education and Communication
IGC	–	Investor Growth Capital
NPV	–	Net Present Value
PE	–	Private Equity
QLC	–	Quality Logistic Center
RMB	–	Renminbi (often used code for the Chinese Currency)
SAFE	–	State Administration of Foreign Exchange
SME	–	Small- and Medium sized Enterprise
WOFE	–	Wholly Owned Foreign Enterprise
USD	–	American Dollar

1 Introduction

This thesis focuses on the financing of Swedish SMEs, established in China, that in some way are conducting business in the field of manufacturing.

Financial research has been and still is mainly focused on companies that are listed on the stock market and those are primarily large companies. According to Ang (1991), financial theory has put more emphasis on large firms than on small- and medium sized enterprises. Some research has been conducted on privately owned SMEs and the capital structure of those companies (Newman, Gunessee & Hilton 2012). Furthermore, studies have also been conducted in order to summarize the financing obstacles encountered by SMEs as well as the corporate governance mechanisms that are significant to small- and medium sized enterprises (Duan, Han & Yang, 2009; Dalberg, 2011; Firth, Fung & Rui, 2002; OECD, 2006). In this study the writers focus on financial research conducted on SMEs, but there are some comparison with larger firms in order to get a better understanding on the differences that exist between SMEs and larger firms.

Studies have also been conducted to examine the pecking-order theory to give a theoretical explanation on the capital structure which has been a support for small businesses in scientific literature (Myers, 1984). The applicability of pecking-order theory has not been constricted to examine the capital structure but is also applicable to see how the banking system is developed in regards to SMEs. It is also shown that small- and medium sized enterprises suffer from more severe information problems in comparison to larger firms, especially those firms that have not been in existence for a particularly long time (Paul, Whittam and Whyper, 2007). Suitable data of historical performance can support the financiers to construct investment decisions that may be suitable for SMEs (Newman et al, 2012).

The interesting topic is to examine how profitable firms maintain their business financing since a strong internal financing results in a decrease for a need for external financing (Myers & Majluf, 1984; López & Sogorb, 2008; Swinnen, Voordecker & Vandemaele, 2005). Access to financing is critical to ensure that small- and medium sized enterprises can be innovative which in turn can help the growth of SMEs business (Gov.uk, 2013). The aftermath of new SMEs and the growth of already established small- and medium businesses are important key factors for the economic growth as well as for innovating and developing new products, services and techniques in the

global market. Unfortunately, the key factor for this development and innovative productivity requires an amount of financial stability. The lack of necessary financing for SMEs to help businesses grow has been brought up in many institutions to support SMEs (OECD, 2006).

This study is conducted to investigate and give an understanding on how Swedish SMEs that are established in China are financing their businesses. In Sweden we read more about how Swedish companies are establishing in the Eastern world. According to the People's Bank of China, (2012) there has been a level of improvement of financial access due to new policies and regulations initiated in 2005. A released report from CGAP state that the level of financing has improved in banking services for small- and medium sized enterprises (Sparreboom & Duflos, 2012). This drew the attention of the writers to take a closer look at this particular topic. Many small- and medium businesses are created by entrepreneurs who often have little knowledge of, and experience in, how to get access to external financing for their company. These types of small- and medium sized enterprises can benefit from further support to help turn their businesses into a more appealing and investible opportunity. Therefore, the writers studied the relevance of the financial theories to SMEs and looked at different financing sources that small- and medium sized enterprises may use to help finance their business.

Definition of SME

The current definition of SME was introduced 1 January 2005.

“The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.” Extract of Article 2 of the Annex of Recommendation 2003/361/EC”. (Ec.europa.eu, 2005)

The Bolton report (1971) and Wilson (1979) are the first of few studies, done in the field of financing, that have investigated small businesses. They found that there are differences between the financial structure of small firms and larger firms. According to Wilsons report (1979) small- and medium sized businesses are riskier than larger firms, they have to pay a higher interest as well as endure stricter conditions in comparison to larger firms.

SMEs are divided into three types of enterprises; Micro with a staff of less than 10 and a turnover of \leq € 2 million. A small enterprise is one that has less than 50 employees with

a turnover of \leq € 10 million, while a medium sized enterprise has less than 250 employees and a turnover of \leq € 50 million (Ec.europa.eu, 2005).

1.1 Problem Question and Purpose

Since the beginning of the 20th century, there are some Western corporations already established in China and ever since, China has become an important market for Sweden. China is laying the foundation with the intention of eventually competing in many areas that are important for Sweden (Regeringen.se, 2011). The main purpose of this thesis is to look at the different financing sources that SMEs can get access to when it comes to financing their business. The writers, during the course of studying for this thesis, came across various interesting issues regarding the topic and chose to conduct a study toward the financial possibilities of Swedish SMEs who are doing business within the area of manufacturing in China. Therefore, the problem the writers are looking at is;

- How are these Swedish SMEs, established in China, financing their business?

The writers will also examine what type of difficulties Swedish SMEs established in China encounter when applying for external financing. This allows us to better understand how the companies finance their business and what type of financial obstacles experienced in the field of financing.

1.2 Perspective

This thesis is written out of the perspective of the managers and producers point of view in order to provide a valuable explanation and interpretation of the financial situation experienced and the financial support needed for Swedish SMEs established in China. With information gathered it studies and analyses what type of financial obstacles are encountered. This is accomplished by using existing theories and gathering valuable and well supported information.

1.3 Delimitation

There are many different perspectives in the area of Swedish SMEs established in China. There are also different types of businesses established, but the writers decided to limit themselves to study Swedish SMEs, that in some way are dealing with manufacturing and production, located in a certain area of China. This is mainly due to the fact that it would be too broad a subject to look at many types of Swedish SMEs. The writers also chose to limit themselves to only conduct interviews with a few

numbers of representatives of SMEs and financiers. This was done because the writers felt it was more important to receive in depth, knowledgeable, more extended answers from these few respondents, rather than sending out a survey to various companies and unknown respondents. The writers have not had any personal contact with any Chinese SMEs during the work on this thesis. The reason is that the writers wanted to focus on the Swedish SMEs that are established in China. There are also difficulties in the possibility to contact and interview Chinese enterprises, especially those located in China and, as stated earlier, the interest and purpose is to focus on a specific type of SME. The knowledge regarding Chinese SMEs that the writers have achieved during the study is solely through secondary data such as scientific journals, articles and books. The questions in the empirical part of this thesis are posed in order to comprehend the financial situation and to interpret said situation as well as to analyze the obstacles that Swedish SMEs may face when establishing in China.

1.4 Thesis Outline

- In part two of the thesis the writers will present a broad presentation of SMEs background in both Sweden and China.
- In part three, the chosen methodology and data is found.
- In part four, a presentation on the theoretical framework is formed.
- In part five, the section covers a presentation about the participating Swedish SMEs and the participating financiers as well as facts about additional organizations that offer financing to Swedish companies.
- In part six, the collected data and the empirical results is presented along with the analysis.
- In part seven, the conclusion is presented.

2 Background

“Small- and medium sized businesses need access to a diverse range of finance options, including non-bank lending...” Vince, Cable. (Guardian.co.uk, 2012)

Small- and medium size enterprises are important contributors to the economy. Considering the contribution small- and medium sized enterprises bring to a country, the interest in SME financing is continually increasing. According to Myers, (2001) however, the finance researches based on multinational companies are far more common than researches conducted on SMEs. One important reason is that SMEs are usually not as well known to the public eye as most large enterprises. There is also limited access to detailed financial information to conduct studies on when it comes to SMEs. Financial obstacles often occur for SMEs when they are searching for ways of financing the business (Myers, 2001).

There are three obstacles that are considered the main reasons that SMEs are not able to obtain enough or proper financing;

*“The existence of marked **informational asymmetries** between small businesses and lenders, or outside investors;*

*The intrinsic **higher risk** associated with small scale activities;*

*The existence of sizeable **transactions costs** in handling SME financing”.* (Cressy & Olofsson, 1997)

The ability to achieve financing is important for making business investments, ensuring growth potential and maximum firm value. A lack of financing can restrict cash flow and even prevent the possibility of survival. Prior studies have emphasized the critical issues that occur in regards to SMEs and their consequences. Small enterprises usually face difficulties to obtain credit and have large transactions costs. Thus, governments have over the past decades aimed to develop a support system to help SMEs business and economic environment (European Union, 2011).

In finance literature, different theories are examined to explain the financial distress and cost of bankruptcy. There are also a number of additional studies that point to the limitation of the possibility to achieve financial support. However, further investigations in the field of SME financing determined the degree of asymmetry information's affect on SMEs. According to Mac an Bhaird (2010), small firms face different complications compared to those of a large firm, which may lead to a downturn for the firms current market value e.g. financial distress, transaction cost and cost of bankruptcy. In the field

of SMEs financing, corporations tend to be more controlled by creditors, since usually they are not listed on a capital market. They tend to have high transaction cost, and also a high level of bankruptcy is emerged from their volatility (López et al, 2008).

2.1 Swedish SMEs

According to an article by Berggren and Silver (2010) there are different behavior in different regions of Sweden when it comes to how firms search for financing, *“In the metropolitan areas, firms are more active in searching for new owners, especially professional investors. In smaller municipalities, banks dominate as the most important.”* (Berggren et al, 2010, p.230)

The Swedish economy is well known for its different form of high-legislated financial status. It continues to grow strongly in terms of enterprises and is equivalent to the EU average (Tillväxtverket, 2007). The expansion of the economy has continued to grow during the past years, through various forms of financial factors such as an improving labor market and global demand. Swedish SMEs have been an important factor for the country’s economy. More than 99 % of the Swedish enterprises are classified as small- and medium size enterprises, i.e. they have less than 250 employees. The SME sector accounts for 60 % of enterprise profit (Tillväxtverket, 2007). It is estimated to employ more people and in addition to the increased employment it is believed to produce more value on SMEs today than it did in the base year of 2005. The total value added in the SMEs share in Sweden’s economy is stated to be 58.4%. The performance of the SME sector in Sweden is significantly more than the average EU country (Europa.eu, 2012). The SME sector accounted for 66 % of Sweden’s net investment in 1998 and therefore it became Sweden’s major contributor when it came to economic- and employment issues (Jacob et al. 2003).

2.2 Chinese SMEs

In China, SMEs do not have as much access to equity markets and loans through banks (Newman et al, 2012). In China, individuals usually have high levels of savings (He & Cao, 2007) and much of these savings go to funding small family businesses in for instance agriculture and manufacturing, thus creating “informal financing networks” (Tsai, 2002). *“As of the end of 2000, less than 1 percent of loans from the entire national banking system had gone to the private sector.”*(Tsai, 2002, p.2) According to Wu, Song and Zeng (2008) there is for instance a shortage of access to external funding.

They also point at certain constraints in how the SMEs are able to develop, among them the lack of receiving long-term loans and venture capital.

The lion's share of small- and medium size enterprises in China are formed by private investors and contribute to the importance of the nation's economic growth and development (National Bureau of Statistics in China, 2012). They contribute a great deal to China's economy and have become a very important economic force as key drivers of employment with 75% of the nation's workforce employed. They have also contributed to 60 % of the country's GDP. Although SMEs are influencing China's economic growth, they receive a low level of policy- and financial support. It has restricted the development of SMEs because of the financial complications (Amcham-China, 2011). According to the indication of the Ministry of Commerce in China, 99 % of all existing enterprises in China are SMEs. China is the second major trade country to EU after the United States, with a trade of 13.1 %. The National Bureau report (2012), indicating that the total value of import and export of foreign economic relations has increased by approximately 22.5 % since 2010.

3 Methodology

In this chapter the writers present the methodological framework used for this research. The aim is to explain the chosen approaches and present available resources used to fulfill the purpose of the thesis.

3.1 Research Approach

This thesis focuses on explaining how Swedish SMEs in the area of manufacturing are receiving access to financing when being established in China and what type of obstacles are encountered. To conduct this type of study a qualitative method approach is used to give a description and meaning rather than measurement and prediction (Laverty, 2003). In order to describe the establishment and how the Swedish SMEs get access to financing as well as analyze the obstacles that the enterprises may encounter, hermeneutic phenomenology has been used as a suitable methodology. Hermeneutic phenomenology is a research methodology used to create a sense of understanding of an experience in a human's world. By eliminating the unimportant aspects in the life of an individual and identifying the meaning of great experiences in life, one can increase a deeper understanding. This can be done by using a descriptive language (Laverty, 2003).

Therefore, the writers selected these research approaches, qualitative and hermeneutic phenomenology, as suitable in order to give the reader an understanding and an interpretation of what Swedish SMEs experience in the financial world. This will be accomplished by interpreting the results from the empirical research together with the theoretical framework to give a broader understanding of the current situation.

3.2 Research Method

Financial research methods, techniques and sources come in various forms depending on different reasons. These can be; the purpose of the research, the aim and the specific research questions and also the data collected. As mentioned in the previous section, this study is conducted with a combination of qualitative method and hermeneutic phenomenology to provide a level of understanding that is relative and accurate for the study. During the course of the continuous research, there was no limitation to any one-research method but more a use of combination of methods and theories since there is more than one that is optimal. Together with an empirical study, consisting of various

interviews with companies and financial institutions, the writers intend to put together the results in the analysis part.

3.2.1 Research Process

The research process can be complex and contain several steps. There are different perspectives and ways to go about a research process. Therefore, in order to maintain a well-done research, an optimal process has been chosen.

The chosen approach for this optimal process is by using empirical research and also through first and secondary data. A qualitative methodology has been used and the approach is deductive. The strategy will be to use mainly an exploratory research strategy. The exploratory strategy is defined as;

” A valuable means of finding out “what is happening; to seek new insights; to ask questions and to assess phenomena in a new light”.

Three principal ways

- *A search of the literature*
- *Talking to experts in the subjects*
- *Conducting focus group interviews.”*

(Weijun, T, 2008)

The writers have in this thesis used the first point with a search of the literature when it comes to finding out information on both Swedish and Chinese SMEs, as well as a variation of the two latter points for more in depth information regarding Swedish SMEs. They have been talking to persons in high positions in the respective company who possess great knowledge and expertise in the topic of this thesis and the writers have been conducting individual interviews instead of interviewing focus groups. This is mainly due to the complexity of gaining access to enough people to form focus groups, as well as the importance of knowledge and expertise in the topic and the questions asked.

3.3 Data Collection

To find the information that is needed for the thesis, the writers have searched for relevant literature, articles and journals. These provided potential explanations and developed theories within the field of this study. Hence, it is very important to bear in mind previous authors and researchers contribution and refer to them when relevant.

No empirical research has been conducted by the writers on source data for Chinese SMEs in China. This is due to the fact that it has been difficult finding accurate data from trustworthy sources, as well as getting in contact with original Chinese SMEs. As for the information and data about Swedish SMEs, relevant literature, articles and journals as well as various websites have been used. Several interviews have been done with people at various companies and financial institutions that were found to be in relevant positions for knowledge and information. In order to obtain the relevant information about Swedish SMEs, those that are currently doing business in China, it is important to look at the individual company-level more about how they finance their companies and what type of financial obstacles have been encountered.

3.4 Primary and Secondary Data

When it comes to collecting data, the chosen option has been to collect the information mainly by using primary and secondary data.

There are several types of primary data, for example interviews, surveys and observations. The optimal choice for the writers of this thesis was through interviews that were conducted with representatives for five various Swedish SMEs and three financial institutions.

The writers received the support of a Chinese teacher at School of Education and Communication, our tutors as well as some of the respondents, to access contact information to representatives for Swedish SMEs and banks established in China. In addition, primary data is a useful tool to assist the writers to complement the study with secondary sources.

The secondary data was retrieved through articles, academic literature, journals, books, and reports that were found to be relevant for the thesis.

3.5 Selection of the Respondents

To be able to create an interesting analysis and conclusion it was necessary to interview people in both Swedish SMEs as well as people within the financial institutions with experience and knowledge in this field. The writers therefore contacted various people in SMEs and financial institutions in both Sweden and China and this resulted in interviews with a total of eight respondents.

The writers did not limit themselves by only selecting participants situated in Sweden. Some of the participants are currently seated in China. This made it more difficult for

the writers to be able to conduct interviews, due to the fact that the writers could not get face to face contact. The writers took first contact with all of the companies and financial institutions via e-mail and when possible set up a personal meeting with the respondent in Sweden.

3.6 Interviews

The writers interviewed eight respondents (see Appendix D) and conducted semi-structured interviews that allowed for some topics relevant to the subject of this thesis to be discussed. By conducting a semi-structured interview, one can make sure to collect all types of clarifications from the relevant source. This gave the respondents the freedom and opportunity to speak or write more about their experience and personal views.

The questions prepared for the interviews were designed to study the financing conditions for Swedish SMEs established in China, which was found to assist the writer's research purposes well (see Appendix F & G). The questions were not exactly the same for all of our participating SMEs but they all covered the firm's background characteristics, financial conditions, how financing is used by the company and if there are any advantages or disadvantages in financial support.

The interview questions were, as stated earlier, constructed prior to the interviews. They were aimed at helping the writers answer the problem of this thesis; how are Swedish SMEs established in China financing their business?

People learn about how SMEs can be successful in the business world through developing the business, increasing the volume of productivity as well as competing in the global market. However, what really is behind this success can only be answered directly by the companies. The answers to the questions during the interview process gave the writers a feeling of how this success is accomplished along with the relationships Swedish SMEs have with creditors. Many of the interview questions were prepared together with the theoretical part, which speaks about, for instance, corporate governance, agency cost, and the problems that may arise when using debt as financing in the company. Along with the theories, questions were prepared to answer how difficult it really is for Swedish SMEs to take credit loan from a bank and how the internal process of financing is working.

With these inquiries and bearing in mind the market where the Swedish SMEs are established, namely China, it became interesting for the writers to learn more and to see

how much of the theories used, are accurate and how related they are to real-life experiences. One main criterion was that the chosen participants needed to be involved in the business and knowledgeable about the financing of the company. This was important in order to enable the writers to gain an understanding of each of the companies' experience and the participants' personal views in order to analyze the empirical results. Some financial institutions were contacted several times but to no avail. This did not affect the study a great deal but it would have been interesting to gain further knowledge on how financial institutions can help SMEs.

Some additional questions arose during the interviews that were not prepared yet felt important to ask in order to understand more about the company and receive more information about their experiences.

3.6.1 Qualitative process

The first step in the process of qualitative data analysis is to collect data. In this process, the writers gathered all the respondents' answers. The interviews were conducted in Swedish since all the respondents as well as the writers are Swedish natives. Later the writers translated the answers from Swedish into English. After doing so the gathered information was analyzed and concluded.

During some interviews an audio-recording device was used, in order for the writers to focus on the interviewee as well as to ensure a correct rendering of the answers given and to avoid any misunderstandings or misinterpretations.

3.7 Validity and Reliability

After analysing the data, with the energy, time and knowledge that is required, it is important to check on the validity and reliability of the research results. *“Validity refers to what degree the research reflects the given research problem, while Reliability refers to how consistent a set of measurements are.”* (Explorable.com, 2011)

This can be done in a variety of different ways, including external or internal validity and statistical or instrument reliability.



According to Eriksson & Wiedersheim-Paul, 2006, the validity of the study relies on the ability to examine the ongoing research and scrutinize what is intended to be looked at. The validity of this thesis was strengthened through investigating financiers as well as Swedish SMEs that are, in some way, in the business of manufacturing and production. The empirical results and the summary of these results, where the method is used in collecting and applying the data, is responsive to the research questions which are judged to be valid. The information gathered for the study through literature, journals and other secondary data are also considered to be valid; hence the answers to the writers' questions were very similar to previous research experiences and also responsive to the purpose of this study. This is considered to be an internal validity to which degree the study is related to daily experiences (Merriam, 1998).

As for the reliability of the study, according to Brannick and Roche (1997), there is some level of ambiguity when analyzing the data in a qualitative study. This is because there is no precise execution procedure to be used for this process. The information and the analysis of the collected data are therefore conducted on an individual interpretation and do not consist of any scientific or statistical calculation.

When performing the interviews, some issues were taken into account. No questions during the interviews were considered to be too intrusive, which made it easier to receive better and more thorough information to accomplish the study. This implies that the writers chose not to ask too personal questions or any underground questions to the financial institutions and the Swedish SMEs that would make the respondents reject to answer any of the questions. Thereby the results from the interviews are considered to be reliable. The collected primary data from interviewing the chosen respondents are therefore judged to be reliable and valid based on the fact that the respondents answered the questions truthfully to the best of the writers' knowledge.

The collected data, using a qualitative approach together with hermeneutic phenomenology, consists of eight interviews. This is a small number in comparison to other studies investigating the financial area and establishment of Swedish SMEs in China. Still, the writers are aware that further investigation can be conducted to gain more knowledge on how Swedish SMEs are established in international markets. The purpose of this thesis is to capture the sense of how Swedish SMEs already established in China, this being an international market, are financed and what type of financial obstacles they are encountering. Therefore, some publicly available information and

data such as information from official websites of both the Chinese and Swedish governments have been collected to learn more about the SMEs situation. The writers have also investigated various articles containing studies on SMEs and their financing. This was done in order to learn more and to answer the research questions in this thesis. One can argue that there might exist a possible lack of real life experiences when it comes to literature reviews. Researchers and authors focus on providing theoretical approaches that sometimes are very general or sometimes too narrow. Many articles and reports in scientific journals and academic literatures are the results of long time research, investigations and experiments. This shows the large amount of effort that has been applied to similar studies and how reliable and valid such references are. The important factor in these sources of information is that since they are reliable, one will only need to choose the appropriate data needed for the specific problem and know how to apply it in a way that is relative to daily encounters to explain that problem.

The writers consider their research study to be well conducted based on Brodsky & Welsh (2008) that states that the method applied for a qualitative research study is broadly used and chosen based on previous large researches on similar study.

4 Theoretical Framework

This chapter will provide the reader with a broad background overview in the field of financing SMEs as well as various theories. The purpose is to give an explanation of the financing options available to SMEs and to understand the basic economical disciplines.

There are plenty of empirical literature on the essential problem that explain the difficulties of financing SMEs, yet there has been a lack of financial tools in which SMEs can gain access if business is to be successful (Kubla, 2001). During the financial crisis of 2008 - 2009, many companies faced a slowdown in the economic growth, including companies in China where the production of manufacturing had been weakened in the beginning of 2011 (OECD-ILIBRARY.org, 2012). The crisis had a negative impact on the performance of small- and medium sized enterprises. As an effect of the crisis, in most countries, SME loans and business loans declined due to stricter credit standards as well as undesirable forecasts (OECD-ILIBRARY.org, 2012). The key element for the SMEs has been known to be to gain access to financing. Financing is known to help the SMEs succeed in developing their businesses, creating jobs, improving the volume of productivity and competing in the domestic market and also in the global market (UNCTAD.org, 2001).

From the investors and traditional commercial banks, there has been an unwillingness to service SMEs for a number of recognised reasons:

- Financing SMEs is not profitable due to their high administrative costs, transaction cost of lending or by investing small amounts in their businesses.
- The creditors and investors consider small and medium-sized enterprises too risky borrowers. Due to “*vulnerability to market fluctuations*”, “*low capitalisation*”, “*insufficient assets*” and “*high mortality rates*”. (UNCTAD.org, 2001)
- Information asymmetry can make it difficult for banks and investors to measure value of credit of SME proposals.

(UNCTAD.org, 2001).

4.1 Corporate Governance

For many centuries, since the first documented failure of governance - the South Sea Bubble - in the beginning of the 1700s, corporate governance systems have developed and become larger and more common, and as a result have shown more attention to corporations. This is partly due to different scandals and failures that have hit firms, for example, economic crisis in different regions in Asia, the “Scandia Scandal” in Sweden and corporate failures such as Baring Banks (Iskander and Chamlou, 2000, & Eklund, 2008). The development of corporate governance system was first established as an individual field in financial economics during the last twenty years but, it has quite recently become an important system in the world of business (Iskander et al, 2000). Berle and Means (1991[1932]), are some of the first to provide a fundamental explanation in the question concerning corporate ownership and control. Others argue that because small- and medium sized businesses employ less than larger firms and the employees consist mostly of relatives of the owner, there is no need for corporate governance. However, corporate governance for a small- and medium sized business sets the roles of the owners as shareholders and the managers as directors. The corporate governance sets the rule and helps the owners and managers to direct and control the firm (Abor and Adjasi (2007).

4.1.1 Internal & External Corporate Governance Mechanisms

Corporate governance systems can be adopted depending on the mechanisms the firm’s owner wants to use in terms of influencing managers, distributing capital and furthermore creating a high value for the firm’s resources (Eklund, 2008). The mechanisms of corporate governance are divided into internal- and external mechanisms. The framework of the mechanisms come together and works as incentives to monitor managers and affect the behavior of the firm (Iskander et al, 2000).

The key in internal forces is to outline the relationship among, for example the management, board of directors and shareholders in the firm.

In developed market economies, external forces are implemented to correct and strengthen insider behavior and monitor corporations by external regulations. The external forces include regulatory systems, such as, accounting, auditing and notable policy (Iskander et.al, 2000).



Previous studies argue that companies are able to choose among the different mechanisms within corporate governance and create an optimal structure for the firm. This optimal structure depends on the area in which the firm operates. Each individual firm has its uniqueness and by all accounts the selection of the mechanisms helps to build the firm value by the optimal structure (Firth & Rui, 2012).

4.1.2 Corporate Control and Agency Conflict

For many years, the literature on corporate governance has been associated with listed companies and the situation on the separation of ownership and control (Eklund, 2008). Berle et al (1991[1932]) have discussed the problem related to the separation of ownership from control and provide a fundamental discussion associated with the relationship between investor and corporation. The focal point of Berle et al's work about the separation of ownership and control is that it is due to the fact that countries industrialize and develop their market (Mallin, 2013). Shleifer & Vishny, (1997) refer to the separation of ownership and control as the "*separation of management and finance*" and refer to it as a contract between the financiers and managers. The contract is signed by the two parties in order to specify the managers' rights with the financiers' funds and how the return on the funds are divided between the two parties. According to previous studies, for example done by Berle et al, (1932) and Lappalainen and Niskanen (2012), ownership concentration creates a positive effect on the firm's performance and improves profit and value. Jensen and Meckling (1976) indicate that agency cost is reduced in association with the separation of ownership and control.

Further studies in this field do not support a separation of ownership and control due to the agency cost that arise from the principle-agent problem. According to Lappalainen et al, (2012) previous researchers have found that a family business falls into the category of a firm with strong ownership structure. This is because a family firm is well-informed of their business and this gives it the advantage to make better investment decisions.

As a result of previous studies, table 1 shows the ownership and control structure within three dominating markets, Europe and USA/UK (Söderström & Sandström (2003)). Furthermore, a table has been constructed from different views to specify, where China as a government-based system, lies between the two remaining countries (Chen, Firth & Xu (2009); Li, Yue & Zhao (2009); & Cao & Jianguo and Jing, (2010)). A further discussion will be approached later in the thesis.

Table 1. Ownership governance systems and supplementary instruments

	Market-based system (USA/UK)	Controlling-owner system (Europe)
Ownership and control	Diversified ownership	Controlling owner
Minority protection	Strong	Weak
Board	Potentially autonomous	Close to controlling owner
Management	Strong, autonomous	Close to controlling owner
Bank relations	Arm's length, diversified, no ownership	Close, concentrated, possible ownership
Management incentives	Central, strong	Less central, weaker
Capital structure	Lower debt ratio	Higher debt ratio
Control market	Hostile bids important	Hostile bids rare

Source: Söderström et al, (2003).

Table 1.1. Ownership governance system and complementary instruments

	Government-based system (China)
Ownership and control	State-ownership
Minority protection	Weak
Board	Potentially autonomous
Management	Low power position
Bank relations	Not close, no ownership
Management incentives	Central, strong
Capital structure	High debt ratio
Control market	Weak control

Source: Chen et al, (2009); Li et al, (2009), & Cao et al, (2010)

Agency conflict is one of the key issues within corporate governance and is built within the context of the one-on-one framework, the so called principle-agent relationship (Mallin, 2013). The agency relationship exists in all types of organizations, and on various levels such as management levels, as well as bureaus and different authorities.

The agency conflicts can result from the relationship between shareholders and managers. This type of conflict does not exist to a large extent in small- and medium sized enterprises. This is due to the fact that SMEs are usually made up of the owner who takes on the role of both single stockholder and manager of the firm. Thus, SMEs tend to have less separation between managers and ownership than multinational firms (Abor et al (2007).

Previous studies associated with a firm's ownership-structure show that companies with high level of managerial ownership and with small numbers of owners retain a high level of profit but present a low growth rate. This was shown to be the result of a lack of interest from the controlling owners. They prefer to be involved in keeping a high profit ratio instead of having the company growing (Lappalainen et al, (2012).

4.1.3 Corporate Governance associated with SMEs

In the previous section, it is stated that corporate governance is mostly associated with large and listed companies and agency conflicts exist within them. Abor et al (2007) have examined the corporate governance in the small- and medium sized sector and observes how important corporate governance is in the SME area. Some believe that corporate governance cannot be applied to SMEs since the agency conflicts do not occur in the same extent as when it comes to larger firms. Researchers have shown that corporate governance can indeed be a helpful tool for SMEs in improving the management practices, create a growth opportunity and form a better internal auditing (Abor et al, 2007). Therefore, the benefit of corporate governance mechanisms can be applied to small- and medium sized enterprises as well as large companies. For companies to grow and perform well there is a need of recourses such as strategy forms and good business operations. These come from outsiders, such as non-executive directors or external board members, which help influence the performance of the firm and create better decision making. As stated earlier, access to financing is one of the key obstacles for SMEs. Therefore, studies have shown that SMEs can benefit from outsiders' knowledge on the offered financing options. Financing strategies can also be used to deal with credit limitation (Abor et al, 2007).

4.2 Trade-off Theory

According to the trade-off theory, firms can choose their capital structure to obtain maximum firm value and outweigh the risk of financial distress associated with bankruptcy (Myers, 2001). López et al (2008) claim that in order to maximize firm value, companies can weigh up the advantages as well as the costs of issuing debt, which predicts the existence of an optimal capital structure.

Many firms do not only consider financing their business with equity financing but might also consider financing through debt, therefore it is important to balance these financing conditions in order to reach the optimal capital structure. The advantage of issuing debt can be a reduction of free cash flow difficulties. However, the cost of issuing debt can create agency conflicts and induce possible cost of bankruptcy as well as a possible cost of financial distress. This is applicable to SMEs because they may also face these types of disadvantages (Fama & French, 2002; Kraus & Litzengerger (1973); Mac an Bhaird (2010).

Moreover, Fama et al (2002) say that firms that invest more than they earn have low free cash flow but with high profit and low investment they are able to have less leverage in order to control the agency conflicts that may be generated by free cash flows. Further studies, such as the one done by Myers (1984), elaborate on the fact that SMEs can face high transaction cost. This can lead to a decline in the firms' current market value (López et al (2008).

4.3 Financing Gap

Financing is an important factor to help SMEs to start, grow and expand their businesses. There may come a time however when start-up SMEs as well as already established SMEs run into hard conditions where they need to finance new investments to expand their business and grow. Small businesses find it more difficult to access financing from banks and other creditors than larger enterprises. This financing gap is a well-established concept in fast growing economies defined by the Macmillan Committee (1933). It refers to the obstacle that small- and medium businesses as well as start-up SMEs may encounter when they want to access financing through creditors and other types of financiers. In order to be keeping up with developing products and services, small- and medium sized enterprises need financing to sustain the investments as well as growth. If they cannot maintain the financing, different and bright ideas will be lost (OECD, 2006).

According to the OECD report from 2006; “the financing gap: Theory and evidence”, financing SMEs is a distinctive challenge for organizations that want to finance them. One of many reasons why external debt providers or equity financiers monitor SMEs closely is because SMEs may have a higher risk in the eyes of banks than large firms do. To compensate for this, the bank can charge a higher interest rate from SMEs than from larger firms, which then makes it more difficult for SMEs to access financing from creditors. Banks may also avoid financing SMEs due to for example, unfinished financial products or investments, short-term debt and inflexible regulations (OECD, 2006). Small- and medium sized businesses may have a higher profitability and higher growth rate than larger firms but their survival rate is much lower than large firms. In addition, the managers of SMEs tend to also be the owners. Therefore, the relationship between the firm and its stakeholders is more a reflection of a personal relationship. Unlike large firms, these relationships are more formalized according to standards of corporate governance (Policy Brief, 2006).

4.4 Pecking-order theory

“The Pecking Order Theory is an approach to defining the capital structure of a company, as well as how the business goes about the process of making financial decisions. First developed by Nicola Majluf and Stewart C. Myers in 1984, the theory seeks to explain how companies prioritize their financing sources. The general idea is that companies will tend to take the course of least resistance, obtaining financing from sources that are readily available, and then steadily moving on to sources that may be more difficult to utilize.” Tatum, (2013)

A company is mostly likely to first use internal resources and only when this type of financing is exhausted or unavailable, the company then turns to outside investors or lenders in order to achieve the financing needed for continuing operations (Tatum, 2013).

According to López et al, (2008) one mayor influence in determining the capital structure of SMEs is the firms’ internal resources. SMEs behaviour is definitely different from that of large firms when it comes to financing.

“Firm size and profitability are both found to be related to leverage as posited by pecking-order theory”. (Newman et al, 2012)

In their article, Newman et al (2012), states that in their opinion the pecking-order theory is better at explaining the capital structure of SMEs than many other theories.

There are other researchers, i.e. Ang, 1991, Holmes and Kent, 1991 (rendered by Newman et al, 2012) who claim that a more extreme version for the pecking-order theory is used when it comes to SMEs. Holmes et al (1991) calls this “*constrained*” pecking-order and Ang (1991) calls it the “*modified*” pecking-order. This view of the pecking-order theory is based on the fact that SMEs are usually relying on financing the firm through internal sources both in the start-up phase and the development phase. The access to capital markets and the ability to make large investments in equity are limited. (Newman et al, 2012).

There is not much work being done when it comes to researching SMEs in China and how their capital structure is compared to the research on larger Chinese enterprises. Larger firms are more likely to have different capital structure than the SMEs mainly due to a closer relationship with the Chinese state, and an ability and opportunity to

avoid the capital market restraints that the SMEs are experiencing (Newman et al, 2012).

In Myers article from 1984, he describes “*an old-fashioned pecking-order theory framework*”. (Myers, 1984) Internal financing is preferred and if securities are issued, the firm prefers debt to equity. Myers, (1984), states that the pecking-order theory is good at explaining financing choices of a company.

Newman et al (2012) however believe there are other ways of explaining the behaviour of Chinese SMEs when it comes to financing. Chinese SMEs are still experiencing problems in accessing external financing which imply they may find larger obstacles on their way up the pecking- order of financing sources (Allen et al, 2005).

There is also the fact that due to the high levels of savings among the Chinese population, there is little need for Chinese SMEs to turn to financial institutions such as banks for financing (He et al, 2007).

4.4.1 Asymmetric Information

The pecking-order theory came into being as a way to handle possible asymmetric information distortions between a firm and a potential financier (Myers, 1984).

Myers (1984) also states that the theory has been more approved of as a theoretical explanation of capital structure when it comes to small business literature. This is because the pecking-order theory is aware of and considers the asymmetric information existing between managers and investors.

The asymmetric information can cause problems such as moral hazard and adverse selection. It is believed by Cosh and Hughes, 1994 and Frank and Goyal, 2003 (as rendered in Newman et al., 2012) that these problems especially affect SMEs.

Paul et al (2007) claims that for many SMEs, above all the relatively newly started, the level of asymmetric information found is remarkably higher than when it comes to larger firms. One explanation some researchers give is that there is not enough historical performance data that may help those financing companies with their investment decisions. Binks and Ennew, 1996; Cressy, 1996; Reid, 1996; Hall et al., 2000 (as rendered by Newman et al., 2012)

There is also often a very strong aversion among the owners that are also managing their SMEs to lose any control of their companies and what they are allowed to do if new financiers are brought in. (Paul et al., 2007)

Cassar (2004) also find that there are studies that show that the size of the enterprise can be related to their capital structure. Smaller companies often find it more efficient to use internal financing sources when possible before looking to financial institutions. This may be the result of a feeling of experiencing a larger cost for dealing with the asymmetry problem that may occur with potential financiers or lenders. This may leave the SME with a limited access to external financing or very large costs for external financing. (Myers 1984).

5 Swedish SMEs and Financial Institutions

There are many ways for a company to finance their enterprise and the writers will therefore show some possible financing options. The following chapter also presents the participating SMEs as well as the participating financiers. This chapter ends by explaining some relevant concepts.

5.1 Empirical Sampling

When the writers began working with this thesis they contacted Mrs Wang Wei Sönnnerhed, a teacher at HLK, asking if she knew any individuals that could be approached. She gave the writers their first contact who in turn gave them some contacts that led to more contacts. The writers also received some contacts from the supervisor, Mr. Johan Eklund. The criterion for the companies participating was that they must be Swedish SMEs that are established in China. By Swedish it is meant in this context that the SME has a parent company that is Swedish and the subsidiary is at least in some part owned by Swedish parties.

The empirical findings are the result of interviews with persons at the various companies, either in person, by telephone and in some occasions due to the logistics, by e-mail.

5.2 Participating Small and Medium-Sized Enterprises

The writers have in the following part started by presenting each participating company to give some insight in the type of company, size, and when it was established in Sweden as well as in China. The information was received through the interviews with the company representatives, each company's web-page as well as through other secondary sources. The participating parties were Mr Andreas Fälth CEO of Checkpoint China, Mr. Lars Darvall, Executive Chairman at Exir, Mr. Peter Johansson, Managing Director at Liljas Plast, Mr. Andreas Hildingsson, owner & Managing Director at Swede-Wheel and Mr. Peter Sandberg, Managing Director at Tobii. Other companies were contacted but due to logistics and the work-load they were not able to participate in the study for this thesis. The writers are also providing some maps in appendices A-C in order for the reader to get better insight in what provinces of China the participating Swedish SMEs are located in, as well as where the parent company is located in Sweden. The graph below is describing the number of employees in China for each company divided into Chinese and Swedish.

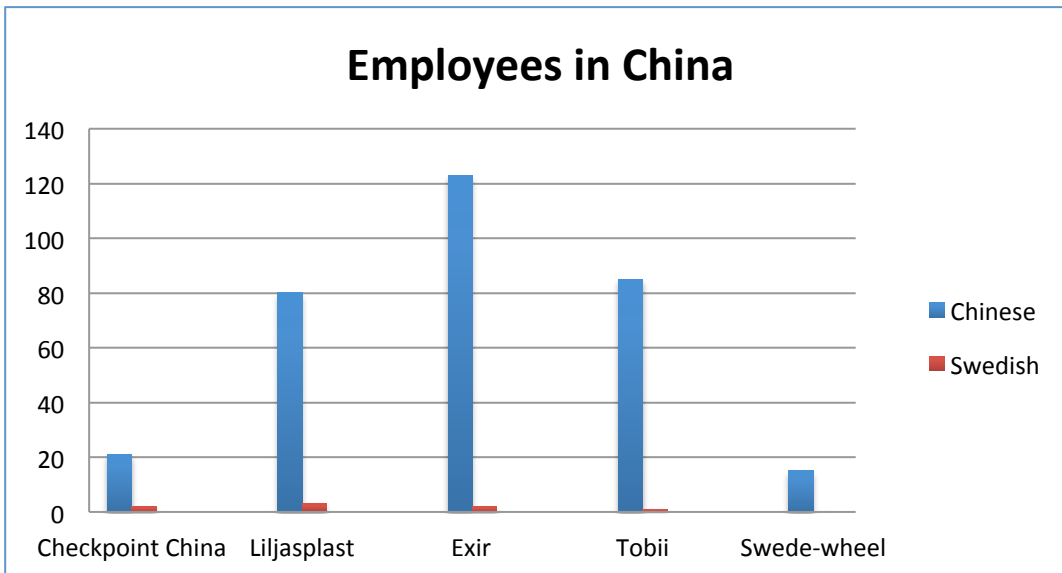


Table 2. Employees in China

5.2.1 Exir

Exir AB, established in 1985, is a family-owned company that originates from Värnamo, Sweden. In the beginning its focus was on turnery and milling and in 1992 the company was acquired by the current owner of Exirgruppen. In 2004, Exirgruppen started looking at expanding in China and they did so by acquiring a former clients company that dealt with sale of telecom and broadcasting products in Beijing, China (L. Darvall, personal communication, 2013-03-07). This led the company to establishing itself in Wuxi, an industrial city 120 kilometres from Shanghai in the Jiangsu province. This was due to the proximity to a number of suppliers.

Thus Exir Wuxi Technology Co, Ltd was born and today it has a factory that deals with manufacturing of a variety of products. The management consists of Swedish personal with a long experience of China on site (Exir China, 2013).

The staff in China consists of 123 Chinese employees and 2 Swedish. Exir China is a WOFE, a Wholly Owned Foreign Enterprise, which is 100% owned by Exirgruppen AB which in turn is 100 % Swedish owned. (L. Darvall, Personal communication, 2013-03-07).

The ratios for Exirgruppen AB seem to be in a quite good condition, where the financial solidity for the Group, in 2011-12, is about 95.17 % and has rapidly increased from the previous year when it was about 53.67 %. The cash liquidity was in 2011-12 around

661.4 % and had also increased quite a lot from the previous year. No current information is available for 2012 (Företagsfakta.se, 2013).

5.2.2 Checkpoint China

Checkpoint China was established in Nässjö, Sweden, in 2007 by Mr. Andreas Fälth who is CEO of the company. It is a privately owned company which is 100 % Swedish owned. The company expanded to China, to be precise to Cixi, in the Zheijiang province, which lies in the middle of the Golden Triangle close to the harbours in Shanghai and Ningbo in 2007-2008. (A. Fälth, personal communication, 2013-03-05) Their main focus is to conduct quality inspections of companies, factories, deliveries and products (CheckpointChina.cn, 2013). According to the company's webpage they also offer audits, inspection, sourcing and brokering. However, some 90 % of their business consists of production assignments (A. Fälth, personal communication, 2013-03-05).

Checkpoint China has Swedish financing and the shareholders' equity can be increased without further explanation. The company consist of 21 Chinese employees and two Swedes situated in China.

According to allabolag.se, Checkpoint China AB has a financial solidity in 2012-12 around 33.58 %. This has not increased much from the previous year when the financial solidity was 32.03 %. However, it has increased rapidly from 2010, when the financial solidity was 19.60 %. The cash liquidity in 2012-12 indicates a percentage of 142.43 % which is good since the short-term debt is paid back immediately by the firm.

Checkpoint China has had an increase of financing from abroad. Their production is going very well as mentioned before, 90 % of their business consists of production (A. Fälth, personal communication, 2013-03-05).

5.2.3 Liljas Plastic Ltd, China

Liljas Plastic was formed in 1964 in Hillerstorp, Sweden and has been run as a family company from the start. Its business consists of, for example production, development and moulding of prototypes. In 2005 Liljas Plastic established its own industry in SuZhou, in the Jiangsu province in China (LiljasPlast.se). Liljas Plastic Ltd is a part of the Swedish Liljas Group (LiljasPlast.se). Liljas Plastic Ltd, China is fully owned by Liljas Plast Sverige AB.



Liljas Plastic Ltd has 80 Chinese employees working in China, where 40 work in the plastic department and the remaining 40 work in the aluminium department. There are three Swedish employees in China, two production managers, one in each of the departments, and the Vice President of the company in China (P. Johansson, personal communication, 2013-03-14).

The ratios of Liljas Plastic concerns Liljas Plast AB. The financial solidity in 2012-04 indicates around 56.50 % of the company, when as the cash liquidity was 87.2 %. The gearing ratio is indicated from 2012-04 as being 0.8 (Företagsfakta.se, 2013).

5.2.4 Swede-Wheel QLC (Quality Logistic Centre)

Swede-Wheel is the leading manufacturer of wheels within industry, gastronomy, furniture, retail and health-care. It was founded by the Hildingsson family in 1942 in Hillerstorp, Sweden (Swede-wheel, 2013). It is still a family-business, 100% owned by the Hildingsson's. The company is strongly imprinted by a family culture and out of its turn-over, some 60% is export (A. Hildingsson, personal communication, 2013-03-21).

In 2002, the owners began looking at establishing in China and Swede-Wheel QLC was registered and up and running in 2006-2007. The location is Ningbo, which lies on the Chinese east coast in the Zhejiang province with one of the most trafficked harbours in the world (Swede-wheel.se, 2013). Swede-Wheel QLC is a quality- and logistics centre in China where the focus lies on end-assembly for the Asian market (A. Hildingsson, personal communication, 2013-03-21).

This part of the Swede-Wheel enterprise is a WOFE, wholly owned foreign enterprise and is 100% Swedish owned.

Swede-Wheel QLC used to have Swedish Management on site but today the Managing Director is located in Hillerstorp, Sweden, with a Vice Managing Director on site in Ningbo. (A. Hildingsson, personal communication, 2013-03-21). The employees in China are all 15 Chinese nationals.

The financial ratios for Swede-Wheel have during the past three years looked fairly good. The financial solidity has increased with approximately 5 % from 2010 to 2011. It is stated on allabolag.se that financial solidity has increased to 45.42 % in 2011-12. The results indicate a debt-to-equity ratio nearly 55 % of the firm's total capital. However, the estimation in 2011-12 shows a percentage of 104.27 cash liquidity. This implies that the short-term debt can be immediately paid by the firm (allabolag.se, 2013).

5.2.5 Tobii Technology

Tobii Technology is one of the world's leading retailers of eye tracking and eye control. The technology allows computers to know exactly where users are looking as well as makes it possible for special needs-persons to communicate better (Tobii, 2013). The company focuses on innovation and R & D. Tobii technology was founded in 2001 in Sweden and its head office is located in Stockholm. The Chinese subsidiary is located in Suzhou, in the Jiangsu province and it is the location for the company's China-based production facilities and sales office. This company also functions as a seller of goods and services to other Tobii companies in the corporation as well as to the local market in China. This part of the enterprise is a WOFE and is 100% owned by its Swedish parent company (P. Sandberg, personal communication, 2013-04-05).

Tobii has 85 Chinese employees and 1 Swedish employee, which is the General Manager (P. Sandberg, personal communication, 2013-04-05). According to allabolag.se from 2011-12, the business had 80.40 % financial solidity. This shows that Tobii is not vulnerable and the firms leverage is good (allabolag, 2013). Another positive result from Tobii is the cash liquidity estimated in 2011-12 to be 110.82 %. This indicates that short-term debt are payable immediately (allabolag.se, 2013). Tobii continues to increase its revenue growth along with many award recognitions for their work (Tobii, 2013).

5.3 Participating Financial Institutions

In order for the writers to better understand how Swedish SMEs can finance their businesses, interviews have been conducted with some financiers. The writers also found it important to see if the financiers might be responsible for any financial obstacles that SMEs might encounter.

The participating financiers were Almi Företagspartner in Jönköping and Nordea in Nässjö, both in Sweden as well as Handelsbanken in China. The representatives from these financial institutions were Mr. Thomas Eklöf at Almi Företagspartner, Mr. Martin Widfeldt at Nordea and Mr. Johan Andrén at Handelsbanken. Through the interviews and with the help of these financiers the writers received an insight on some of the options a Swedish SME has when it comes to financing their business.

Almi Företagspartner

Almi is exclusively working with SMEs and deals with four areas of business; Advisory

service, Loans, Venture capital and Incubation (Almi.se). They want to give companies the possibility to develop and their customers are found in every phase, from the idea to start all the way through to the successful company. *“This includes ideas with potential for growth in the early stages as well as existing companies that are investing in growth and expansion”*. (Almi.se)

Handelsbanken China

Handelsbanken is a well-known Swedish bank that supports both SMEs and large businesses. Handelsbanken supports the companies with the right financing tools as well as provides financial solutions for each individual company. Handelsbanken China also offers the companies working capital loan that helps the firms finance their needs for daily operations (Handelsbanken.se)

Nordea

The bank develops and markets various investment funds through the Swedish branch network in Sweden. The network hold funds such as fixed income, hedge funds and equity funds. They are distributed through Nordeas’ retail network and third parties. A very important service offered to businesses by Nordea is inventory finance. This provides management service for inventories to increase the success of a business (Nordea.com).

One important criteria for the participating financial institutions was that if a firm wanted to receive financing, it is vital that they possess enough own capital and that they are capable of repaying the loan or credit to the financiers. This is considered as being very important for the SMEs to accomplish in order to receive external financing. Further information is presented later in the Results and Analysis chapter.

Other institutional factors were looked at by the writers as well as brought up by both the participating financiers and Swedish SMEs. These were for instance Swedpartnership/Swedfund and SAFE. These financial institutions are presented further in the next part of this thesis.

5.4 Additional Financing Options & SAFE

As can be seen from the theoretical framework it is not unusual for SMEs to use internal financing primarily. There are however other ways of gaining financing and the writers will in this part of the thesis give some insight in a few of these other options. One of

the possible ways to find financing for a Swedish SME is to go to Swedfund, which through Swedpartnership can offer a loan of a maximum of 40% of the expected total costs for the project.

“Swedpartnership offers financial support to Swedish small and medium sized companies for transfer of know-how and investments in equipment, when establishing a business partnership in emerging markets.

The Swedish company should be a limited liability and have:

- *Between 5 and 249 employees,*
- *An annual turnover not exceeding EUR 50 million and/or,*
- *A balance sheet total not exceeding EUR 43 million”.*

(Swedpartnership.se)

Swedfund International AB is owned by the Swedish government and is a type of risk capital financing option. One of the criteria for receiving a loan when establishing abroad is that the company must have a profitable long-term project and be able to put up at least a third of the total investment. Swedfund is usually providing a third and are expecting to take active part in the company (Swedfund.se).

The writers will in this part of the thesis briefly mention risk capitalists and business angels but the focus is on other types of financiers.

A risk capital company is a company that convey capital to start-up companies from private investors, banks, stock exchange companies as well as other organizations (Riskkapitalbolag.com). It is not easy however to get in contact with risk capital enterprises, it is a complex process with many people involved. The investors often demand a high return and it is not unusual for other types of demands regarding the goals and control of the operations. They also are very likely to demand a very high interest-rate in comparison to other sorts of investment. A business angel (sometimes called capital angel) is *“a private investor who invests equity in unlisted companies with growth potential....”*. (Helle, 2004) A business angel can be seen as a complement to formal private equity and there are approximately some 3-5000 in Sweden. Their investment is normally 500 000 SEK but they may invest lower or higher amounts (Helle, 2004).

Other possible financiers are of course banks, both Swedish banks and Chinese banks. Another well known type of financier for SMEs in Sweden is different types of venture capital. A venture capital is *“professional investors who focus on growth companies”*.

(Helle, 2004) There are venture capital firms that have both private and public capital (Helle, 2004). Almi Företagspartner and two examples of Swedish banks are shortly presented in a previous section regarding participating financiers so they will not be further presented in this section.

5.4.1 State Administration of Foreign Exchange

The State Administration of Foreign Exchange (SAFE) is a division of the central bank of China. According to Anderlini and Wilson (2011), other researchers and authors as well as some participators, how the reserve is composed is a state secret. It is to be largely invested in US dollar assets of which the majority is in US treasury bonds (Anderlini et al. 2011).

China is very watchful over how currency is flowing in and out of the country. There are very harsh restrictions on foreign exchange, “*any transaction whose purpose is to create or transfer capital will be regarded as a capital account item. Examples of such items include foreign direct investment (FDI)...*” (Petersen, 2012) If a foreign enterprise want to exchange an eventual profit received in RMB (Renminbi) they can do so only if they can be certified from SAFE. The enterprises that want to direct invest in foreign currency, must thus be sanctioned from both SAFE as well as the Chinese government before they can invest the capital in their Chinese enterprises (Petersen, 2012).

6 Results & Analysis

In this part of the thesis the writers will present the empirical results, as a summary of the results along with the analysis. This is followed by a more extensive analysis focusing on the research questions.

This chapter starts by the writers presenting the answers received by our participating Swedish SMEs together with a short analysis of said answers. This is done in a summary form where all the participants' answers to the questions under certain categories of questions have been gathered. This is then followed by the answers received by the participating financiers. The questions, in Swedish, to both the representatives from the participating SMEs and the participating financiers are listed in appendices F & G. However, even though the writers did not ask entirely the same questions to all of the participating SMEs, very similar questions were asked. Thus the writers feel the questions in the appendices in this thesis are adequate enough to cover all of the questions asked. As stated earlier in this thesis, the writers have chosen to keep the answers from the Swedish SMEs anonymous while the answers from the financiers are not. The final part of this chapter is an extensive analysis focused on the thesis problem; how are Swedish SMEs established in China financed and what obstacles may they experience.

6.1 Answers from participating SMEs

The writers found that there were both similarities and differences in the answers from our participants, even though the companies may appear to be similar at a first glance. The following section is a combination of the results from the empirical findings and comments and reasoning surrounding the answers to the interview-questions.

6.1.1 Ownership

The main question we posed was; is your company wholly Swedish-owned?

On the first question regarding ownership, the answers from all of our participants were that the companies, i.e. the Chinese subsidiary, are all wholly owned subsidiaries to the Swedish parent company. The SMEs are therefore 100 % Swedish owned and are classified as so called WOFE, Wholly Owned Foreign Enterprises.

Some of the answers from the participants were variations of; the company is a wholly owned subsidiary to the parent company and it is 100 % owned by our Swedish parent company. One of the companies explained the situation as follows; In the province

where our company operates there are a couple of Swedish and Norwegian companies as well as a Belgian company that know each other and help each other, for instance by cooperating through discussing opportunities for improvements, and to have the power of multiple companies in any contact with authorities.

The writers conclude from the answers given that the majority of the companies in China are still owned by their parent company in respective country. The participating SMEs have a high level of managerial ownership with few owners. According to Lappalainen et al, (2012) companies with high level of management ownership and fewer owners are able to retain a high level of profit but they might, at the same time, present a low growth rate. This is because the controlling owners prefer to be increasing the firms profit instead of having a larger growth of the company. This study is however not supported by the answers received from the participating SMEs in this thesis. They are focused both on increasing their profit and letting their company grow.

As stated earlier, the writers found that all of the Chinese subsidiaries in this study are WOFE, wholly owned foreign enterprises, and the owners are mainly the parent company of said subsidiary. This is, according to the data encountered, due to the fact that the Swedish SMEs do not wish to let go of the control and ownership of their company. Agency conflicts do not exist in the participants' small businesses. According to Abor et al (2007) agency conflicts can arise from the relationship between the shareholder and manager. Basically, the writers found that, for the SMEs participating in our thesis, the agency problem does not exist, partly due to the fact that in some of the SMEs there is no separation between ownership and management, and partly because the owners and managers are very close.

One main advantage with establishing a subsidiary as a WOFE is the fact that you do not have to share any profits or benefits according to Hill Charles (2007) (as rendered by Weilong & Xiaoling 2010). The owners of the company rather undertake all of the risks. It appears easier for a foreign company in China to be wholly owned by foreign investors than being partly owned by Chinese investors or the Chinese state due to the rigorous regulations surrounding ownership and business in China.

6.1.2 Capital angels or joint venture

Question number two was; have you ever used capital angels or considered joint venture?

When asked if they had ever enlisted the help of capital angels or considered joint venture, the participants' answers were also very similar. The answer was that none of our participating Swedish SMEs in China had ever used capital angels or joint venture. One of the parent companies was however externally financed by various risk capital companies, but the subsidiary in China is not financed through capital angels or through joint venture.

To elaborate more on the answers;

No, it has never been a question of using these types of financiers in our company.

In other companies/projects such solutions has been evaluated, but no agreements had ever been established. Today there are some possibilities which are easier to access. One type is Science Park, who can enter with capital and management with a time limit. SMEs often have a need for management. This is however nothing that has been needed for this company. When it comes to joint venture, it excludes the possibility to be wholly owned and thus has not been considered.

Another SME answered no, on both accounts. In fact, the answer given us was that using joint venture is strongly advised against and cannot be recommended.

One participants reply was that this had never been an option for them and had definitely not been interesting. They had, however, tried varieties of outsourcing the last two years, with an employee meant to be their supplier but it did not work out. They do want to keep 100 percent ownership in the Chinese enterprise.

Finally, one answer was that the parent company is externally financed by outsiders.

None of the responding SMEs had used capital angels or joint venture in China. The underlying feeling is that capital angels are not considered as a good way to receive financing. Capital angels are considered to be focusing on short-term profit and are perceived, rightly so or not, to be damaging to the company in the long run. They threaten the owners' right of control over the company. The impression the writers got from some of the respondents was that capital angels are strongly advised against. When it came to joint venture, the participants did not elaborate much. They only stated that joint venture was not an option. This can, in the writers opinion, be partly due to the fact that it can be difficult for a small business to handle the bureaucracy that comes with joint venture.

6.1.3 Difficulties/complications

The third question was; what difficulties and/or complications, if any, have you experienced regarding financing the company in China?

The writers wanted to find out if our participants had experienced any difficulties and/or complications regarding their financing and if so, what those were. Here the answers were a little bit more diverse, but all SMEs had experienced some form of difficulties; Some participating SMEs have chosen to finance the Chinese SME through their Swedish operations. The difficulties are problems with the liquidity even though there has been profitability from day one. The Chinese system of not using company- or real estate mortgages has been a complication since it means that the company needs security from the first SEK when looking for loans. It also differs when it comes to leasing. First, the entire investment must be paid to be able to get the part the bank may consider financing back.

The difficulties to finance a company in China are firstly the limitation when it comes to Swedish banks in their knowledge about China and the Chinese way of doing business. Secondly the problem is having possible assets in China which is hard to finance in Sweden and finally the lack of knowledge from Swedish companies on how to finance in China.

The biggest challenge to finance a SME is to have all the demanded criteria from a bank covered. Some governmental institutions such as ALMI and Swedfund have more knowledge of business development and can judge the possibilities better than banks.

The biggest problem is generally to have a cash-flow. The writers found during the interviews that when you set up a company in China, you put in an equity capital, divided between cash and equipment. This is called a registered capital on which you calculate a total investment of approximately 42 percent, recounted from your registered capital. This difference is the only amount you are allowed to take as a foreign loan, regardless if this is through your parent company or another financier in foreign currency. This is a limitation and usually leads to less inflow than outflow of capital for the SME. It can take up to six weeks the first time you apply for a loan, with a massive amount of papers that must be gone through and approved.

In one of the companies the answer was that they had never really seen financing as difficult because they have had an equity capital to put in the company and are allowed to use this capital as working capital. One of their advantages is that their large

customers have been European so when the Chinese subsidiary have done the actual sale, the parent company steps in by taking the order, without making any profit. This means the subsidiary sends the invoice to the parent company, thus getting paid straight away, avoiding a shortage of money.

Although the results differed among the respondents, one thing was evident. All of the SMEs had experienced difficulties, one way or another. In corporate governance it is said that in order for the companies to grow and perform well, resources are needed. Much of these resources are coming from outsiders. This is partly in conflict with the notion that SMEs that are established in China are mainly financed internally through their parent company in Sweden. The writers found out that the biggest problem appeared to be to have enough cash-flow to enable the company being profitable and having liquidity. This can be connected to the trade-off theory. According to Mac an Bhaird (2010), Fama et al, (2002) and Kraus et al (1973) equity financing is not the only option for many companies. They may also consider financing through debt and to obtain maximum firm value it is important that they balance the equity and debt financing. This can then lead to an optimum capital structure.

6.1.4 Financing

Under this part, multiple questions were gathered since the content of them were similar in the regard of financing. The questions were; how is your company mainly financed in Sweden as well as in China? What are the three most common ways of financing? Do you think there is any form of financing that is applicable to all SMEs?

When it comes to how the SMEs are mainly financed in Sweden as well as in China the answers once again were similar with most of the companies using shareholders' equity. Strong owners with equity to invest in the company seem to be a commonality among our participators. According to the participants;

In Sweden the main financing is through overdraft credit as working capital, instalment contracts on investments and shareholders' equity. In China, it is mainly financed through equity capital, borrowed means from the parent company, leasing, loans and invoice mortgages.

One of the participating companies China is selling goods and services to the other companies in the concern as well as on the local Chinese market, thus they are more or



less self-financed. Another reply was that the SME in Sweden is financed by the owners, banks and other financial institutes.

In China it seems more common that the Chinese SMEs are financed by private banking (black market) since there are even stricter rules in China when it comes to borrowing money from the bank. Private banking is a name for the black market as described in Back-Alley Banking by Tsai (2002). The state-owned banks are focused on the large enterprises so Chinese SMEs are usually not able to get financing through those banks and are left with loans from friends, family and the black market. For Swedish companies financing their operation in China, the answers rendered during the interviews states that, the financing is mainly done in Sweden even though at some points loans have been taken out. Financing in the company has been important but not critical since there has been a financially strong owner from whom temporary loans have been available when deemed necessary.

For one of our respondents, the company in Sweden was a profit-making machine. Due to certain business deals, the parent company sold their interests in its former subsidiaries in Sweden and now there is more or less only the Chinese subsidiary left. The financing at the start-up was a cash-injection of one million USD put in as registered capital from Sweden. During certain periods, there have also been loans taken out to handle the cash-flow since transportation times of goods can be extensive. The loans were taken out in both Swedish and Chinese banks.

One company is mainly financed through equity capital used as working capital in China. There has also been an ability to offer payment in advance to the Chinese subsidiary from the Swedish parent company. However, when the economy has allowed it, the Chinese subsidiary has normal payment terms from the company in Sweden.

The three main financing sources for one of the companies were private loans from the owner, shareholders' equity and overdraft from bank

In Sweden, the most common ways are equity capital, overdraft credit and instalment contracts, while in China they are equity capital, leasing and bank loans was the answer from one of the respondents while; financing is done through bank loans as well as outside investors in the parent company or through the sale of goods and services in China was the reply from another.

Mainly, the company in China is operating on its own; it is growing based on its own accord really. On- and off there have been cash-flow loans. In Sweden the enterprise would have taken out an overdraft credit, but in China this is non-existing. Leasing is

not that common in China either but it is starting to become more in use now. The company profit is re-invested the whole time, with the exception of the dividends to the owners.

Equity capital and advance payment as mentioned earlier and another are simply to borrow in a Chinese bank.

Best is to have all capital within the firm as shareholders' equity. It is a way to avoid all types of risk capital; you do not have to waste time explaining. Banks do not always see a good business idea, and on the other hand they do not always see a bad business idea. One respondent said, yes, they do believe it is applicable on every enterprise. Of course, it is important to have a relationship with the financier and to show you are moving ahead. One answer was that one can say that it is always easiest to borrow money in a bank but an alternative is also Swedfund and ALMI in Sweden. This company has, as far as the respondent remembers, worked with ALMI in one of their sister companies. The enterprise chose not to be part of Swedfund, probably because they normally take a cut of the ownership, a place on the board and they take up space in the company. This was not something that the company wanted, it did not feel right. Finally, one respondent answered that equity capital and any other internal resources that are felt to be the optimal is the best financing approach.

The financing of the participating companies are once again very similar. This appears to be due to the fact that the Swedish SMEs participating in this study have strong owners with the economic ability to invest in the subsidiary and also the willingness to be in control and not having to rely on any outside resources. This is directly linked to the pecking-order theory according to Newman et al (2012) where he states that SMEs are usually relying on internal resources to finance their business. Cassar (2004) also says that SMEs are mainly tapping into internal resources before looking elsewhere. This is entirely in phase with the findings in this thesis. Of course, the writers are aware that the selection of Swedish SMEs participating in this thesis is very modest and it is possible that with a larger selection the answers would have been more varied. It is a strong likelihood that with less internal financial resources and a weaker owner, i.e. an owner without enough capital to put in the company, the risk of bankruptcy and failure is far more probable.

The most common ways of financing was shareholders' equity, equity capital used as working capital, overdraft from banks and private loans or cash injections from the owner. Loans have also been taken out in banks, both Swedish and Chinese to handle the cash-flow on occasion but, although there are some loans taken out, the writers find that the main financing is through various internal sources which are in line with the pecking-order theory.

6.1.5 Access to financing, increasing or decreasing

Other questions the writers wanted to know the answers to were; in your experience, has access to financing increased or decreased? How many times have your company applied for external financing?

The writers found the answers to the first of these questions were ranging from it being about the same to it being more difficult. None said it was getting easier. The respondents answered;

They did not really see any problem in China when it came to receiving loans and financing for certain things but naturally it is a bit different from how it is in Sweden.

It has been getting harder to get access to financing from banks according to another participant. Maybe not in the aspect that the banks are reluctant to lend you money, but more because the government is regulating the total amount of lending allowed in order to avoid overheating. One answer was that it is still very difficult to borrow money from banks today and one opinion was that it has become somewhat more difficult, but very marginal. There is not any major difference to be seen, replied one respondent, and this enterprise has always found it relatively easy to access capital within the concern.

Regarding the second of these questions, the writers found out that all the participating SMEs with the exception of one, had indeed applied for external financing in China;

One company had applied twice, first in the establishment phase to acquire all initial machines and some cash flow and then again when the company took a leap in business and rapidly increased the sale and needed a better cash flow.

Another company is in frequent contact with their bank and they do seek financing continuously, while a third enterprise had been seeking financing more than three times. In the situations where a loan is taken out, it is for a longer period of time. Due to it being such a bureaucratic process, the company in question does not apply for a three

week-period loan. And finally one of the enterprises answer was that they had never sought any financing.

The results received show that none felt it was getting easier to access financing. The majority of participants found it was the same or had become more difficult, one answer was that they did not find any real problems receiving loans in China while another was that it had become more difficult mainly because of rules and regulations surrounding the banks possibility to lend money. According to OECD (2006), SMEs are having difficulties in regards to the regulations connected with receiving short term loans from banks and financiers. They also state that SMEs have a higher risk that can influence the banks preference of not lending money to SMEs. This can also lead to the SMEs having to pay a higher interest rate.

This supports previous studies stating that bank relations with firms are usually not close and the control of the financial market in China is weak. The ability to receive financing from banks is regarded to be difficult for SMEs since small firms, in the banks' opinion, might not survive in the market for as long a period as larger firms. Due to this and also the capability to pay back the credit that is given from financiers, high debt ratio is taken into account. This makes it more difficult for SMEs to receive loans from financiers (Chen et al, (2009); Li et al, (2009), & Cao et al, (2010).

6.1.6 Perception of Banks

After the previous section, the writers of course wanted to know the answer to the following question; what is your opinion of banks? Are they helpful, knowledgeable?

The opinion seems to be that the banks are helpful up to a point and that they are very much controlled by rules and regulations. This appeared to be the case when it came to both Chinese and Swedish banks. The writers found out the following;

The banks are definitely knowledgeable but they are also restricted by both their internal as well as external policies. They are not the least risk-prone but instead demand full security from the first SEK.

The banks are perceived to be helpful and to serve. One of the enterprises mainly uses SEB in China and Bank of China. They believe that the banks, however, could be more proactive and offer help in various ways and conduct seminars etcetera.

One of the answers was that the company are using a Chinese bank. Swedish banks offered them to work with their partners but they went to a large Chinese bank. One

opinion was that the banks are very helpful and very knowledgeable but also extremely inexperienced and very unhelpful. It totally depends on what issues you have. A simple issue as being able to create a credit-card can be impossible with the bank being totally inflexible. If your problem is “found in their manual” on the other hand, everything is quickly and easily solved. If not, there can be huge problems.

Banks have high demands and when it comes to financing in China, the banks look at the financing in Sweden. There appears to be too much control from the top and banks are not enough business-oriented and have too controlling rules. Banks tend to be rigid in their rules, and the bankers tend to be paper pushers with the task to evaluate if the company fulfil all demands – and they have very small possibilities to negotiate.

Not all of the participating SMEs have had any extensive contact with banks, due to not having to take out loans, but the answers from both SMEs and the responding banks lead to the writers finding out that the opinion of the SMEs is that the banks have high demands and are helpful when it comes to issues they are knowledgeable of. On the other hand banks are thought of as being managed top-down and focused on regulations, not being flexible or enough business-oriented. The perception appeared to be the same regardless of the bank being Swedish or Chinese. As can be found in this thesis, there are a number of reasons for investors and commercial banks to be unwilling to service SMEs. One of those reasons is that it is unprofitable, because of higher costs involved and they are also considered too risky. Another aspect is that many banks lack information on SMEs and are therefore hesitant to issue loans. This causes moral hazard and can lead to banks not bothering to spend any time on dealing with SMEs which can be directly linked to the asymmetric information in the pecking-order theory. When looking at the answers from our responding banks the result of said answers show that SMEs indeed have difficulties receiving financing through banks. This is due to the fact that Chinese banks are keener on lending money to the state-owned domestic enterprises. The most common way for Chinese SMEs is to either loan money from friends and family or to go to the so called “black-market” for loans. Start-ups are also generally considered too risky to finance because they lack their own risk capital. The Swedish banks in our study do give loans to SMEs but it is built on strict criteria’s such as previous relationship with the bank in the domestic market in Sweden.

6.1.7 What can governments do

During the investigation for this thesis, the writers found that much of the efforts and resources of the governments in both countries seem to be directed toward large enterprises instead of SMEs. Therefore, one important question for the writers was; what do you think the government can do to make it easier for SMEs to get financing in Sweden as well as in China? Once again the writers received both similar and diverse answers;

One of the answers was that the Swedish government should not do anything in their opinion. The enterprise feels that all of the help available from the Swedish government, for instance through Business Sweden, is directed towards the larger companies. This is questioned by the respondent because the large companies have the knowledge, capacity and economy to do so much themselves. It feels the focus in on those large companies. As long as you put money in the automat, the carousel keeps turning, but when it stops it is sudden braking, even if you are in the middle of the process. If you want or need more you have to pay. There is no long-term thinking. The Chinese seems to be more aggressive. They come to Sweden in order to visit municipalities and companies, welcoming those companies to their province in China, promising this and that such as tax exemptions and benefits. Once the company is established in the province in China, it finds out the tax exemption is for a limited time but by then it is too late to pull out because of all the time, energy and money invested. China also has very high tolls on standard products and this function as punishment for foreign companies that produces said products in, for instance, Sweden and ship them to China. This forces the company to produce the item in China instead which lead to generating of jobs in China, and loss of jobs in Sweden.

The Swedish government cannot do much in China, but what the Chinese state could do, understandably they do not, is to let up the inflow and outflow of money. If you could conduct the same loans between companies, between parent company and subsidiary for example, it would facilitate much. Another alternative is to ease up on the bureaucracy surrounding the access to these loans. It needn't be as complicated as it is today.

In China, there ought to be easier access for all SMEs, both Chinese and international, to get financing through banks in order to get away from the black market. In Sweden, the government ought to ease up on the capital access for SMEs, create more

possibilities to risk-capital; access to capital in general. “Starting-a-business” courses are not good enough. From people who have entered those courses, it is understood that they are too positive on starting business without enough critical analyse of business ideas. They push people to start up businesses but seldom ask people not to start up. The governments in both China and Sweden ought to be able and willing to help with some sort of consulting operations to help SMEs getting started.

The writers feel the governments in both Sweden and China has a great responsibility to ensure the progress of SMEs, as they are a large part of the total number of enterprises in both countries. The perception of the respondent SMEs seemed to be that there is not much either of the governments is willing to do. One stated the opinion that it ought to be hard to start a business but at the same time, the feeling was that the Swedish government is focusing on the wrong types of business when helping in the way of financing. The focus, as the writers experienced from several of the respondents, seems to lie on the larger firms. Consulting operations that may help start-up SMEs was a thing that was suggested. The Chinese government was perceived to be rigid and to create obstacles for foreign SMEs. This is due to the control of the inflow- and outflow of money through SAFE, and the difficulty for SMEs to gain access to financing through banks. There is also a very high toll on standard products that China takes out and this makes it very expensive and more difficult for the foreign enterprises to keep up the production in countries outside China.

6.1.8 Exit-plan

One important aspect of a business is to be able to pull out or at least have a plan how to avoid bankruptcy. Therefore the writers wanted to know if the participating SMEs had any plan for exiting China in case of the business not succeeding. The writers therefore asked; do you have any exit-plan if your business in China does not work out? Four out of five answered that they have no exit plan;

The core business idea is to be present in China therefore the company does not have any exit-plan. One company replied that the business in China is doing exceptionally well so there is no need for any exit-plan.

The third enterprise answered no to this question, in the meaning that having to exit if things are going down the drain. One of our respondents is one of a few that have gone through the process of closing a company and it is an extremely difficult process. It took over two years to get the final stand and the final approval.

The reply from one of the companies was that they do not really have an exit-plan even though they may have wanted it now and again! They believe that since their plan in China is to keep on growing, partly because they have capital and are able to invest, which they are doing with caution, they do not have any exit-plan. The SME is slowly moving forward and is believed to be able to reverse slowly but they cannot just get out. Of course there exists a lease on their factory, but if the SME decides to exit, they just cancel the lease, wait for it to expire, let the staff go and close the account.

Only one of the respondents had an exit-plan. They said that a decommissioning plan must be a living thing. How one act depends on which phase one is in, for instance at a possible decommissioning.

Only one of the SMEs had an exit-plan, not because they felt they were not doing well but their opinion was that they required having a written exit-plan. The other participants did not have any plan nor did they consider pulling out of China for various reasons. The business for all of the SMEs appears to be going well and as stated by one of the respondents; we are a small company from Småland! The perception on the difficulty of exiting differed. One of the respondents have actually been through the process of closing a company and told the writers that it was a long process. Another respondent did not see the process to being to troublesome. It can be found from the answers that the SMEs are not thinking of quitting but instead that they are in it for the long run regardless of the possible down-turns on the way. China is thought of as a continuously profiting country to be in and it is also a gateway to the entire Asian market.

6.1.9 Currencies and SAFE

Due to the problems that may arise because of SAFE, which the writers describe more in detail in chapter 5.4.1 of this thesis, the final question was; what currency are you mainly conducting your business in? Does SAFE affect you?

There were some similarities here as well in the currencies used, but when it came to SAFE, there were a wider variety of the answers;

Nowadays, the Swedish crown is a hot topic. The strong SEK is disastrous for Swedish manufacturing. The enterprise buy everything in USD, there is also a plus on the EURO-account, due to the fact that more and more is sold in EURO in Europe. The EURO is then exchanged into USD which makes it a bit easier. The company has looked at using the “plus-Euros” to buy EUROS from the Chinese subsidiary but then

the currency risk will only be moved to the subsidiary. Speculation in currencies is conducted, but the CNY is getting stronger every year, with write-ups of a few percentages each year. This causes China's advantage to decrease since salaries and material costs increase. The company is doing business in the currencies chosen but it is not due to any strategic choice, more as a result of the world the company operates in. There is a market in Europe which makes it easier to exchange to USD or buy in USD. When it comes to SAFE, as a smaller company this does not affect the company much. One of the enterprises is using RMB (CNY), EURO and SEK. They are really working in regards to the fluctuation that has been in CNY against the EURO and SEK as well as the USD during the last few years. Even if the CNY has been more connected to USD they have chosen to have all of their business built on a base in CNY more or less. It is possible, since approximately a year back, to conduct business in CNY from abroad so this SME does have customers that have begun paying them in CNY. The problem with the Chinese Yuan is that nobody really knows what controls it.

In China, the currency is RMB and globally it is USD since much of the business is conducted through export. This company has chosen these currencies since it works well for them.

In Sweden, the currencies used are SEK and USD while they are CNY and USD in China. The affects of SAFE is evident, in such events that it does not allow for long credit periods between the parent company and the Chinese subsidiary.

When it comes to SAFE, China has been very scared of corruption where people and corporations send money in and out of the country. Therefore China does not want enterprises to be self-financed, but instead wants them to invest. These investments can then be locked. As a foreign enterprise you have one account for each currency and when you sell a product, it is extremely important that the amount on the order is exactly the same as on the invoice from the customs and the payment from the customer. The payment from the customer goes into the account, which is locked and which stays locked until you can prove that every part, the order, invoice and payment match. This means, that if the customer pays less or more than what is stated on the order and invoice, the money is stuck on the account. This is due to the SAFE. Another aspect of SAFE is if you wish to borrow money, you do so through SAFE and they then check that you do not exceed your limit before approving the loan. This is once again, connected with a lot of paperwork which may take a long time.

As the writers found out during the course of studying for this thesis, an important factor in any WOFE when it comes to dealing with currencies and the Chinese state is of course the choice of currencies and SAFE. The writers found that the choice of currencies to use is driven by many reasons ranging from where the majority of customers are located to what is more convenient when it comes to SAFE. The most common currencies appear to be EURO and USD but some also use SEK and CNY. The preference of EURO and USD is mainly because of the simplicity, the customers are located in Europe and USD is one of the largest currencies used in business and it is easy to exchange USD to other currencies and vice versa. The CNY is being used due to the fact that it is getting stronger and more business is now being conducted in CNY from abroad. Since every currency requires a separate account according to SAFE, there is quite a bit of challenge to find the optimal choice of currency for the SMEs. The SAFE restricts the in- and outflow of foreign currency and it also puts rigid restrictions on said accounts as written above. Some of the respondents have one choice of currencies in their Swedish parent company and another choice of currencies in the Chinese subsidiary and this is of course due to keeping it as easy and simple as possible.

6.2 Answers from participating financiers

In this part the writers will present the answers from our participating financiers. Some parts are accompanied by a short analysis in the form of comments and reasoning. Some of the questions are put together, when the context of them are pertaining to the same topic. The interviews with Mr Andrén and Mr Widfeldt were made through e-mail while we interviewed Mr Eklöf during a personal meeting at Almi.

6.2.1 The criteria and demands to gain finance

The first questions were; what criteria must a company fulfil in order to gain financing from you? Do you demand that the company has any internal capital and if so, how much?

One of Handelsbankens criteria is that a company need to be a customer in one of their domestic markets (the Nordic countries and Great Britain). An approval for financing in China is also necessary from the responsible office in said domestic market.

Nordea on the other hand says that the company must show that they have repayment ability and that their balance sheet is in order.



Almi has one fundamental criteria and that is credibility regarding repayment-capability. The cash flow is very important to Almi and they are looking more at the personal capability, if the person asking for financing gives a credible and trustworthy impression or not. In contrary to the banks, Almi do not have any demand regarding securities.

For Handelsbanken, it is a requirement that all companies establishing in China have their own capital. This is according to Chinese rules a necessity for being able to establish the subsidiary. The equity capital is contributed at the time of establishing.

According to Nordea this is very much adapted to the individual. What is important is the general impression. A strong enterprise that has been active for some time, manages to be fully financed since one can see so called excess value in their existing assets. For a newly started enterprise though, a large private contribution is usually a criteria, otherwise the company will considered to be too weak.

Almi does not really require for a company to have any equity capital. On the other hand, Almi has a requirement to complement the market and a bank is always the main financier with the exception of Micro-loans.

To see what is demanded from SMEs in order to receive financing the writers looked at the answers from the participating financiers and the criterions from one of the banks is that the company must be a customer in one of the domestic markets and to gain approval for financing in China, an approval from the responsible office in said market is needed. The other bank as well as Almi requires that the company is able to repay the loan. The bank demand that the company has its own capital since this is a necessity according to Chinese rules. Almi look very much to cash flow and personal capability of the entrepreneur. When the cash liquidity of a company is high enough one knows that the company is capable of repaying its loans whenever required to do so.

6.2.2 How often are SMEs financed by outside financiers

One of the questions was; do you finance SMEs often? Why or why not?

Mr Andrén at Handelsbanken China ensures that they provide financing to many SMEs. The bank is very strong within the SME segment at their domestic markets and this in turn leads to the presence of many customers within this category of companies in Shanghai, China. According to Nordea, their respond was “this is what we do”.

When it comes to Almi, Mr Eklöf states that they always finance SMEs since these are the only type of enterprises they deal with. It is very unusual that they finance SMEs with more than 100 employees.

6.2.3 Financing SMEs

Questions regarding the financing of SMEs were posed to find out the following; how common is it with financing newly started SMEs and already established SMEs respectively? Is there any difference in how you finance a new start-up or an established SME? Is there any difference in demands/criteria if the company in question wish to establish in Sweden or abroad?

Generally, all SMEs in China have difficulties receiving financing through banks according to Johan Andrén. Chinese banks prefer giving credit to state-owned large enterprises. Since Handelsbankens model of financing is completely built on the relationship between the company and the bank at the domestic market, their customer-profile in China is not too different from that in their domestic markets. Therefore their internal credit mandate prohibits them from financing start-ups in China. This criterion states the same for any company that wishes to establish in Sweden or abroad.

According to Nordea, since newly started companies often lack “risk capital” it is difficult to finance them. Concerning the differences in demand and/or criteria that might be evident regarding the company’s wish to establish in Sweden or elsewhere, Mr Widfelt states that he usually handles enterprises in Sweden, some of which have subsidiaries abroad. However, there is not much financing involved in these subsidiaries as far as Nordea is concerned. The Bank’s market share is approximately 25 % in regards to financing SMEs in Sweden.

According to Mr Eklöf from Almi, there is no major difference in financing already established SMEs and new start-up SMEs; it is more or less equally common to finance both types. However, they only offer loans with straight amortization that usually are with five or six year’s instalments. To finance new start-up SMEs or already established SMEs mainly depend on if you are looking at volume or amounts. If you are looking at volume there are more established SMEs receiving financing whilst there are more start-ups if you are considering amounts. A company is considered a start-up or newly started for around three years.

Also, Almi states that there are no major differences in their demand or criteria if a company wants to establish in Sweden or abroad. It may be more difficult to assess the possibilities abroad since it is another market. On the other hand, if the enterprise is established in the domestic market and is considered stable before establishing abroad, it is easier to assess. One possible scenario is that the SME is a bit weak on the domestic market and therefore wishes to give it a go on another market abroad. This is, however, not an ideal enterprise for financing according to Mr Eklöf. If they are not making it with a stable cash flow, or having the prospect of growing in the domestic market there is little indication that they will succeed abroad.

6.2.4 The demands/criteria for the size of the company

One question was; is there any difference in the demands/criteria when it comes to the size of the company and if so, what are they?

There are no criteria's for size as far as Handelsbanken is concerned. The only criterion is that the responsible office in the domestic market has given approval of the company. A built up relation in the domestic market is the only real demand and it is this relation that enables any financing in China.

Mr Widfeldt from Nordea says that there is no demand or criteria on the size of the company. The important factor is, regardless of company, the repayment capability.

In the case of Almi, Mr Eklöf also states that they are only dealing with SMEs and it is very unusual that they are financing SMEs with more than 100 employees.

One interesting aspect of the financing of SMEs was to see if there is any difference in getting external financing between a start-up and an established SME and also, does the size of the company matter. There is according to the answer received from ALMI, no major difference in financing of start-ups or established SMEs, both are more or less equally common. ALMI only offer loans with straight amortization regardless of the age of the company. Handelsbanken does not offer financing to start-up SMEs at all. This is because their internal credit mandate prohibits them from doing so. Nordea finds it troublesome to finance start-ups because of the lack of risk-capital. One can clearly see that it is very hard for a start-up SME to find financing through a regular bank in Sweden as well as in China.

When it comes to size, it clearly does not matter as far as the banks are concerned. They are more concerned with the company's repayment capability

regardless of size. Almi on the other hand are only dealing with SMEs and rarely finance any with more than 100 employees. From this one can see that the most important aspect is neither size nor age but how capable the company is to repay any eventual debts to their financiers.

6.2.5 Failure to establish & repayment

The writers also wanted to find out the side of the financial institutions in case of an established Swedish SME in China not making it and asked the following question; what happens if the establishment does not work? Who is paying?

Normally, the office that is responsible in the domestic market has deposits for the credits. In case of a company failing paying their credit in China, the problem is usually regulated between the parent company of the Chinese subsidiary and the responsible office in the domestic market according to Handelsbanken.

Banks always strive to have collateral for their lending and hopefully the credit is covered by said collateral. If collateral is missing, Nordea will make a loss.

Almi have strict rules regarding the failure of establishment and repayment. They do not automatically write off loans. When an enterprise receives financing through Almi they are compelled to manage the payments otherwise it may lead to bankruptcy for the company.

6.2.6 Increase or Decrease of SMEs finance seeking

Finally, the writers also wanted to find out if there, in the opinion of the financiers, had been an increase or decrease in the number of SMEs seeking financing; in your experience, is there an increase or decrease in the number of SMEs seeking financing for establishing abroad?

According to Handelsbanken, there has been an increase. The larger enterprises with reason to establish in China are already there and have been for many years. The wave of establishing companies that are occurring now is mainly within the SME segment. These enterprises are establishing in China in order to service global customers, often as sub-contractors.

Nordea has no opinion on whether or not there has been an increase or decrease for SMEs that seek finance to establish abroad and Mr Eklöf from Almi says he has not experienced either an increase or a decrease. For them, financing of SMEs abroad is not a very common occurrence.

6.3 Analysis

In this section the writers present the extensive analysis as a discussion of the empirical findings concerning the research question since it is important when analyzing the empirical data that this is answered. The writers will start by analyzing the empirical results, regarding the questions that are related to the research problem, emanating from the interviews with the participating SMEs and financiers. The empirical findings will also be connected to the theoretical framework of this thesis.

6.3.1 Ownership and Financing

What can be found from the empirical findings is that the main financing appear to be through internal sources such as shareholders' equity and various forms of official and unofficial loans from parent company to subsidiary. This is obviously due to the fact that there are strict rules and regulations regarding the in- and outflow of currencies and other restrictions stemming from the SAFE and also due to the fact that there are difficulties still when it comes to accessing loans from banks. It is important for any company to find financing but especially important when it comes to the small- and medium sized companies. This is not only because they are smaller and have less financial opportunities in comparison with the large enterprises, as the writers have clarified earlier in the thesis. This is above all because the area of SMEs is consisting of over 60 % of enterprise profit in Sweden and according to UNCTAD, SMEs are more likely to succeed in developing their businesses and creating jobs when getting the possibility of external financing rather than having to rely on strong owners. Schleifer et al (1997) also states that corporate governance is an important framework that assures the SMEs receiving a larger share of capital than they might otherwise have received. The state administration of foreign exchange is a division of the Chinese central bank that regulates the WOFEs ability to conduct business. In order for a SME to exchange any eventual profit, they must be certified from SAFE. Also any direct investments in foreign currency must be sanctioned from both SAFE and the Chinese government according to Petersen (2012). The writers have discovered during the course of the studying for this thesis, that regarding the Swedish SMEs studied, the ownership is an important aspect of the company's existence. Their optimal structure, by all accounts, is to be independent from any outsiders. The optimal structure can, as Firth et al (2012) claim depend on the area of business.

As Lappalainen et al (2012) claim in their study, ownership concentration creates a positive effect on the firm performance and it improves the profit and firm value. The writers find that this is in line with what they have incurred during this study. All of the participating SMEs are more or less owned by a few and they are profitable both in Sweden and in China. Also, a family business is related to having a strong ownership structure. As the writers found out, the family-owned business that participated is well-informed, and has full control and that gives it an advantage when it comes to decide any and all investments being made. The writers also found that the findings made by Paul et al (2007) that there often is a very strong aversion among the owners of SMEs to give away any control of management of their company, appear to be accurate. As one of the participants answered, they do want to keep their ownership 100% in the Chinese subsidiary. The answers from the other SMEs were similar; there was not much interest in bringing in outsiders. This is also why there was some scepticism against institutions such as capital angels and Swedfund. These institutions demand control and part ownership which the participating SMEs are against.

The writers experienced that cash flow was very important for the SMEs as written in the empirical findings where for instance one of the participating SMEs stated that the biggest problem was to have a cash flow. This is supported by Fama et al (2002), Kraus et al (1973) and Mac an Bhaird (2010) who state that if a company issues debt, they can reduce the difficulties that can be assorted with cash flow. The cost of doing so can however create agency conflicts and may even induce the risk of bankruptcy.

It became very clear to the writers that the pecking-order theory is very much applicable to the empirical findings. It states that SMEs are usually using internal sources through all of their phases and according to Newman et al (2012) there is a limitation for SMEs to accessing capital markets and to make large equity investments. This is very much in line also with what López et al (2008) writes in their study, that the SMEs' internal resources is a mayor influence in determining the capital structure of the firm.

This is also something that the writers agree with when analysing the empirical findings. As stated earlier, the main financing especially for the Chinese subsidiaries were through internal sources.

6.3.2 Obstacles and Difficulties

In the empirical findings the writers found that there are indeed obstacles and difficulties facing a Swedish SME establishing and established in China. The writers did not find one single obstacle but instead there were a few different ones. However, all of the participating SMEs had a notion of difficulties and obstacles that either they had experienced first-hand or had knowledge of.

One difficulty is that the company need security or collateral from the first SEK if they wish to take out a loan in a bank. This is according to one of the participants, due to the Chinese system that is not using company- or real estate mortgages. The writers also discovered when interviewing representatives for the banks, that the Swedish banks, whether situated in Sweden or China, demand collateral from the Swedish parent company in order to give out loans to the Chinese subsidiary. This confirms that there are difficulties and obstacles when SMEs are looking for loans in banks. The banks also have high demands on the companies, one of the banks demand that the company that wishes to establish in China has its own capital, this is a requirement according to Chinese rules and of course this may make it more difficult for a small- and medium sized company to have the opportunity to make the establishment. Access to financing is one of the key obstacles for SMEs (Abor et al 2007). As the writers have previously written, the access to external financing is very limited for SMEs and therefore a strong owner is more or less a prerequisite for an SME being able to establish itself on the global market. Studies have also shown that SMEs can benefit from outsiders' knowledge when it comes to offered financing options (Abor et al, 2007). As can be seen, however, the owners and managers of the SMEs in this study are reluctant to bring in outsiders and do not generally consider making contact with outside financing options with a high regard. The financing gap refers to the obstacle that SMEs may encounter when they want to access external financing. This is a well-established concept in fast-growing economies according to the Macmillan Committee (1933). This concept is well founded in this thesis from the empirical findings that support the difficulties the SMEs experience when trying to access external financing. In the case of financing through banks, a SME may be perceived as riskier than a large firm, due to for instance the perception that SMEs have a lower survival rate, even though they often have higher profit and growth rate than large firms. Also, the personal relationship between the SME and any external financier is much more important than the

relationship a large firm has with its financiers. This relationship between SMEs and their stakeholders is more of a reflection on a personal relationship according to a report from OECD. This is something the writers could verify in their interviews with the financial institutions. Handelsbanken demand that all companies that wish to establish abroad must be a customer in one of the banks domestic markets and Almi is looking more at repayment-capability as well as the person asking for a loan giving a reliable, trustworthy impression.

The writers found through their interviews that none of the participating financiers bothered about firm size when it comes to the SMEs. This was not an important criterion, as far as the banks were concerned and Almi rarely finance any company with more than 100 employees. So how then does this fit with the quote above? The writers have described in this thesis that SMEs are usually using internal sources; therefore the need for external financing is not as great as when it comes to larger firms. As the writers also found out when conducting the interviews, the SMEs are and have been profitable but yet they have on one occasion or another found themselves in cash flow difficulties.

All of the participants agree that cash flow is important for them. For the SMEs it is a requirement in order to be able to conduct their daily business and for the financial institutions a healthy cash flow is an indication that the company has a strong repayment capability.

7 Conclusion

In this final chapter the writers will present their conclusion that is the result of this master thesis and the study conducted.

The purpose of this master thesis was to examine how Swedish SMEs, within the field of manufacturing and production, established in China are financing their business and what type of financial obstacles Swedish SMEs encounter when accessing financing. Furthermore, a discussion has been carried out throughout the study. A qualitative study together with hermeneutic phenomenology has been conducted to give the reader an understanding and an interpretation of what Swedish SMEs experience in the financial world.

The qualitative study show that four out of five participating Swedish SMEs established in China have looked for financing from banks, some more than others. Small- and medium sized enterprises can be perceived as riskier than large firms. However, the study shows that the main financing appears to be through internal sources such as shareholders' equity and unofficial loans from parent company to subsidiary. Some participating SMEs seem to have more difficulties in accessing capital for their business, due to the bureaucratic process in China.

In China, the government regulates the amount of money available for loans to businesses, due to this fact there seems to be no close bank relation with the companies. Therefore, the banks are reluctant to lend capital to SMEs. This is due to the lack of Swedish banks' and financiers' knowledge about China and the Chinese way of doing business. Even though receiving finance from banks in China is a bureaucratic process and very much controlled by Chinese regulations from the government, some participating Swedish SMEs feel that Chinese banks are more helpful up to a point but on the other hand extremely inexperienced and not business-oriented. The Banks are highly demanding and require the company to fulfil all the demands. One of the Chinese banks' demands, according to Chinese regulations, is that the enterprise that wishes to establish in China has its own capital. Swedish SMEs indeed face difficulties receiving financing through banks due to the fact that Chinese banks rather lend money to state-owned domestic large enterprises. The Swedish Banks and financiers that have participated in this study are on the other hand more willing to lend capital to Swedish SMEs under one criteria; repayment capability. The cash flow of the small business is also important.

As it is stated in the thesis, corporate governance is an important framework that supports the SMEs in receiving better capital structure; however the country's governance is also an important aspect. The governmental support in both countries is more leaning towards larger firms. In Sweden, small- and medium sized enterprises may have the possibility to get support through Swedfund which is governmentally owned. In China, due to heavier state-ownership, there is a need to ease up on the capital access for SMEs and cut back on the bureaucracy surrounding the access to financing from banks.

Our results indicate that one major factor of the main financing for Swedish SMEs established in China appears to be through internal sources. The participating Swedish SMEs appear to have financial stability in the parent company which enables them to finance their business.

The writers stress that the empirical results in this thesis show that these findings demonstrate that different enterprises appear to have different needs in terms of the financing they seek from financial institutions. However, it is clear that SMEs do experience obstacles when externally financing their business either through banks or governments or other financial institutions. This is a core fact because of the strict regulations SMEs encounter when applying for financial support.

Finally, one can argue that there is a clear need for governments in both China and Sweden to be more willing to develop better regulations to support SMEs wanting to seek financing. These conditions need to be established to ensure that the market function efficiently and banks receive clear financial information about SMEs to be less hesitant when issuing credit to the companies. Yet, for the participating Swedish SMEs it is found that the preferable way to finance business is through the profit they gain from their business and the shareholders' equity.

8 Further Research

In this section the writers will give examples on further research to be done based on this thesis.

The writers think that further research can be conducted based on this thesis. This can be done by for example expanding the number of participating companies within the same field or by conducting a study on SMEs within a different field such as IT. It would also be interesting to conduct research on a more varied sample of SMEs with both successful and less successful companies in the sample.

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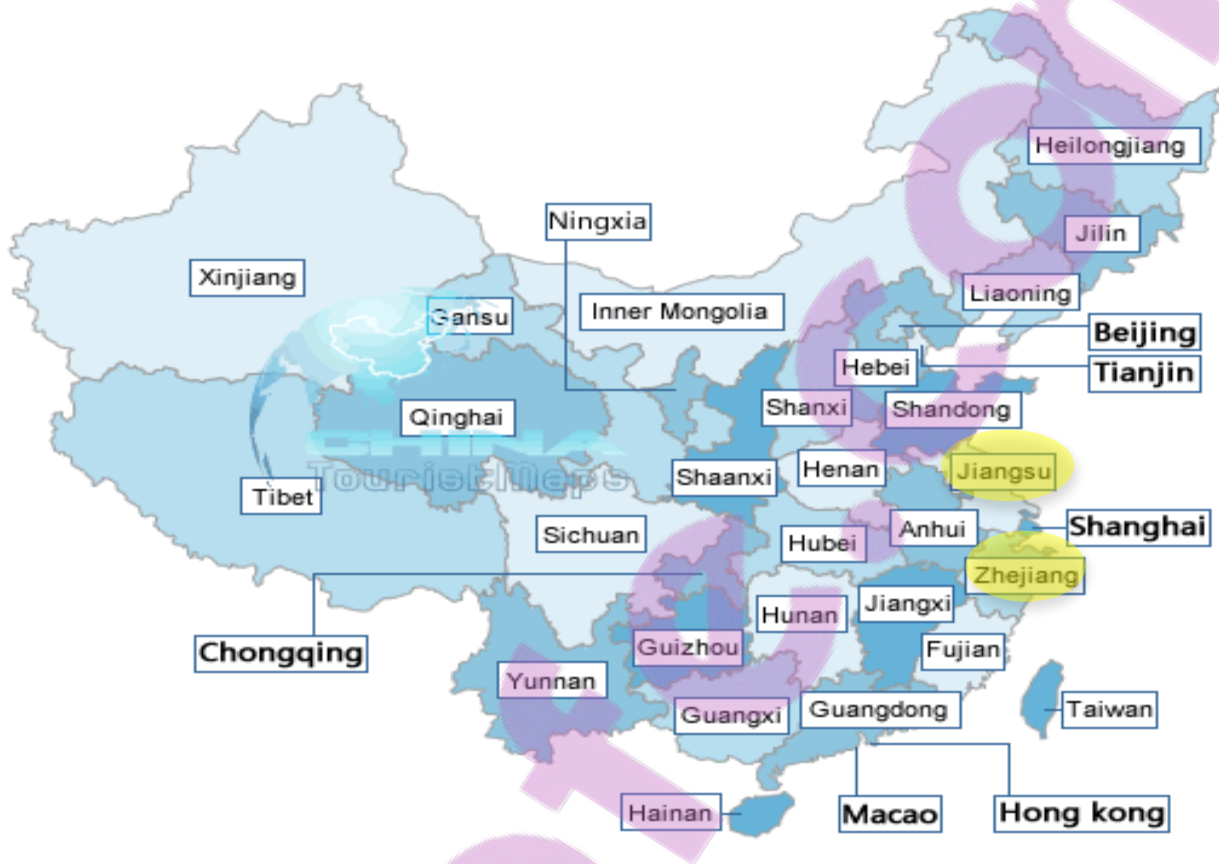
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Appendices

Appendix A: Map of China and its provinces

Provinces in China with the two provinces where our SMEs are situated highlighted.



Source: China tourist Maps

Appendix B: Maps of cities

Maps showing where the five Swedish SMEs are situated in China

Map 1 Jiangsu province



Source: China highlights

Map 2 Zhejiang province



Source: Google Map

Appendix C: Map of Sweden

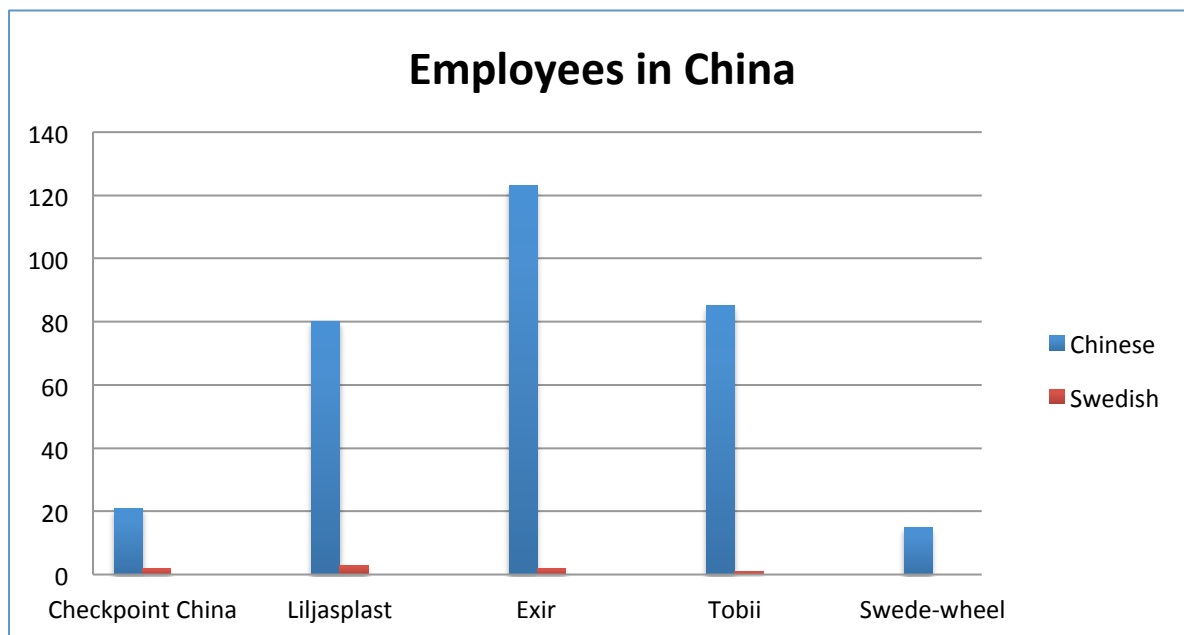
The map of Sweden, also showing location of parent companies



Appendix D: The respondents along with the dates of the interviews.

<u>The respondents from SMEs</u>	<u>Date</u>
Checkpoint China: Andreas Fälth, CEO	5 th March 2013
Exir: Lars Darvall, Executive Chairman	7 th March 2013
Liljas Plast: Peter Johansson, Managing director	14 th March 2013
Swede-Wheel: Andreas Hildingsson, Owner and Managing director	21 th March 2013
Tobii: Peter Sandberg, Managing director	5 th April 2013
<u>The respondent financiers</u>	<u>Date</u>
Almi : Thomas Eklöf, Business and Finance Advisor	18 th March 2013
Handelsbanken China: Johan Andren, General Manager	22 th March 2013
Nordea: Martin Widfeldt, Office Manager	16 th April 2013

Appendix E: Number of Employees in China



Appendix F: Questions for the Swedish SMEs (in Swedish)

1. Hur ser ägandet ut i ert företag? Helt svenskägt eller delvis kinesiska intressen, och om så, hur stor del kinesiska intressen?
2. Har ni tagit ”hjälp” av så kallad capital angels eller övervägt joint venture?
3. Vilka svårigheter/komplikationer har ni upplevt gällande finansiering av ert företag i Kina?
4. Hur finansieras ert företag huvudsakligen i Sverige så väl som i Kina?
5. Har det ändrats till det bättre eller till det sämre när det gäller att få tillgång till finansiering?
6. Hur upplever ni bankerna? Är de hjälpsamma, kunniga?
7. Vilka är de tre vanligaste finansieringssätten?
8. Vad anser ni att staten kan göra för att underlätta för SMEs att få finansiering? I Sverige? I Kina?
9. Hur många gånger har ert företag sökt finansiering?
10. Tror ni att det finns någon form/typ av finansiering som kan tillämpas på alla SMEs? Vilken typ av finansiering anser ni är den bästa för ert företag och varför?
11. Har ni någon exit-plan om det inte skulle fungera i Kina?
12. Vilken valuta gör ni oftast affärer i? Hur påverkar valutavalet ert företag? Påverkas ni av SAFE?

Appendix G: Questions for the Financiers (in Swedish)

1. Vilka kriterier måste ett företag uppfylla för att få finansiering från er?
2. Kräver ni att företaget har något eget kapital för att få finansiering och i så fall, hur stort?
3. Är det någon skillnad på krav/kriterier när det gäller storlek på företaget och i så fall vilka?
4. Finansierar ni ofta SMEs? Varför? Varför inte?
5. Hur vanligt är det med finansiering till nystartade SMEs respektive etablerade SMEs?
6. Är det någon skillnad på hur ni finansierar ett nystartsföretag eller etablerat företag?
7. Är det någon skillnad på krav/kriterier om företaget i fråga vill etablera sig i Sverige eller utomlands.
8. Vad händer om de misslyckas med sin etablering? Vem betalar?
9. Upplever ni att det har blivit en ökning eller minskning i antalet SMEs som söker finansiering för etablering utomlands?
10. Har ni statistik på fördelningen av nystartade respektive etablerade SMEs ni finansierar som vi kan få ta del av?