



社会影响力  
SOCIAL IMPACT

EMPOWERING CHINA'S MSMES FOR  
A MORE RESILIENT,  
DIGITALLY ENABLED ECONOMY

AmCham China | Social Impact Initiative

# MSME Track Final Report

The American Chamber of Commerce in the People's Republic of China

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# Empowering China's MSMEs for a More Resilient, Digitally Enabled Economy

## AmCham China Social Impact Initiative 2020 MSME Track Final Report

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**Greg Gilligan**

Chairman, AmCham China

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AmCham China launched the Social Impact Initiative (SII) in 2020 in an effort to bring together various stakeholder perspectives and make innovative, impactful, and relevant recommendations on pressing social issues. The inaugural year of this program focused on two tracks: (1) helping China's millions of Micro-, Small, and Medium-sized Enterprises (MSMEs) recover from the devastating economic impact of the epidemic and (2) accelerating healthcare reforms as described in the "13<sup>th</sup> Five Year Plan" and "Healthy China 2030". This report highlights the key challenges and recommendations surrounding MSMEs. AmCham China recognizes the crucial role that MSMEs play in their important contribution to economic growth, vital role in global supply chains, and provision of vast employment opportunities both in China and globally.

2020 was an unprecedented year. While COVID-19 has presented challenges for everyone, MSMEs acutely felt the strains related to decreased cash flows, revenue, and demand for products and services. During the initial stages of the pandemic, MSMEs were hit especially hard when their partners and supply chains were unable to resume operations. We therefore hope that the SII will help to facilitate cooperation and dialogue between policymakers and the private sector to foster an environment in which MSMEs obtain the needed support to not only survive, but to flourish.

Indeed, through these SII working sessions, we were able to engage with AmCham China member companies, government agencies and policymakers, global experts, research institutions, and other stakeholders to discuss relevant challenges and potential solutions impacting the MSME ecosystem. This report highlights the role that MSMEs play and provides recommendations to help them effectively navigate today's digitally enabled and globally competitive economy.

Going forward, AmCham China is committed to furthering and expanding this initiative to delve deeper into the unique challenges faced by MSMEs and drive discussions that can lead to the development of solutions that will further facilitate MSME growth in China. We are incredibly thankful for the sponsors of the Social Impact Initiative, who have made this new effort possible and whose valuable input is contained within this report. We also would like to thank our partners, especially the China Association of Small and Medium Enterprises, for their support of this report. I also want to express my gratitude to the AmCham China Government Affairs and Policy team, who have worked tirelessly to bring this new program to life.



March 2021

## Background

As an independent, nonprofit organization with nearly 1000 member companies, AmCham China is uniquely positioned to develop a platform for multi-sector dialogue that bridges common principles and objectives. As a trusted organization with extensive experience in facilitating public-private partnerships to advance US-China collaborations, AmCham China is eager to utilize our capacity and platform to enable the private sector to contribute on-the-ground expertise, share best practices, and initiate thoughtful leadership regarding how their solutions and capabilities can be utilized to improve China's MSME ecosystem.

The MSME track acknowledges that micro-, small-, and medium-sized enterprises (MSMEs) are the lifeblood of China's economy, and the COVID-19 pandemic has exacerbated existing conditions that particularly challenge MSMEs. As the SII emphasizes the need to create neutral venues to initiate conversations, discuss challenges, and develop impactful policy recommendations, this report aims to (1) identify and discuss the role of the private sector in providing solutions to current issues facing MSMEs; (2) ensure the solutions can be widely implemented; (3) appreciate the value of public-private partnerships and joint efforts; (4) share best practices; and (5) offer effective government policy recommendations to promote a favorable environment for the growth and development of MSMEs. Additionally, these recommendations are in line with the State Council's proposed "stability on the six fronts" (六稳) and "security in the six areas" (六保) and facilitate high-quality economic growth in China.

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Stakeholders of the MSME track gathered for four working sessions between July and November 2020 with a focus on the following topics: (1) ensuring and enhancing financial inclusion, (2) acceleration of digital transformation, and (3) accessing international markets.

## Main Challenges

While discussing these three topics, three corresponding challenges were identified by stakeholders: (1) lack of financing channels, (2) inefficient use and slow process of digital transformation, and (3) difficulty accessing foreign markets. This report further analyzes these challenges based on experiences and insights from MSME owners and stakeholders.

Some of the difficulties MSMEs face stem from the implementation of insufficient measures, as well as a lack of necessary resources and capacity due to the inherently

small structure of MSMEs. In such cases, even when the government can push policies through, MSMEs may be unable to fully benefit from these policies due to financial, digital, and market expansion insufficiencies.

It is also crucial for these issues to be analyzed in the context of China's greater economic landscape, urban-rural geographical disparity, financial system reforms, and standing in international relations, among other factors.

## Recommendations

The SII acknowledges the immense value of the measures set forth by the Chinese government in response to the economic shock caused by COVID-19. However, with the continuous evolution of the business environment during these pressing times, the SII proposes recommendations to actively enable MSMEs to effectively navigate post-pandemic challenges with the support of the private and public sectors. The recommendations presented in this report draw from private sector perspectives and resources with an intent to aid and accelerate the government's existing efforts. Indeed, the SII hopes the government will leverage private sector perspectives when developing policy reforms, utilize private sector resources to support government-led implementation, and enhance private sector-led programs that support MSME growth.

The SII, in collaboration with its sponsors and other private sector representatives, recommends an integrated, multi-sectoral approach leveraging innovative and more sustainable solutions. In particular, the SII advocates the following recommendations:

1. Establish a more inclusive financial system for MSMEs. The Chinese government could institutionalize the credit system for MSMEs via the proposed social credit system to reduce the information asymmetry between enterprises and banks and increase the willingness of financial institutions to lend to MSMEs. In the meantime, MNCs and large enterprises could credentialize MSMEs to facilitate with credit ratings. The government could also introduce innovative financing models, such as supply chain financing, to explore new business models for MSME financing. Meanwhile, the Chinese government could also strengthen the policy support and legal protection of small financing institutions and MSMEs and promote the awareness of risk management and relevant solutions.
2. Create a more favorable business environment for MSMEs to undergo digital transformation by strengthening relevant policy support. Meanwhile, in addition to government support, MSMEs could benefit from adopting more practical solutions by getting involved in private-public partnerships. Governments can promote small-

scale pilot programs to test proposed solutions and promote the most effective ones on a larger scale.

3. Strengthen the role of the public sector to help MSMEs access new markets, leveraging existing business partnerships between MNCs and MSMEs. Doing so would require governments to emphasize updating relevant policies, improve the law enforcement mechanism, and enhance the support provided to the private sector to better catalyze MSME innovation and truly help MSMEs grow and expand.

Each recommendation within this report is supported by practical and actionable steps with specific examples and references to initiatives currently being executed by other countries and organizations. Suggested action points also incorporate existing government-led programs in China and include recommendations on how to incorporate greater private-sector participation and promote a whole-of-society strategy.



# China's MSME Ecosystem: Present Situation and Challenges

Micro-, small- and medium-sized enterprises (MSMEs) are the lifeblood of China's economy. The COVID-19 pandemic has created daunting challenges for MSMEs including but not limited to strained cash flows, significant declines in revenue, disrupted supply chains, and decreased market demand for products and services. The SII hopes to bring together both the public and the private sectors to better understand these challenges and develop solutions that can facilitate MSMEs' growth in China.

The SII has adopted the standards promulgated by various regulatory departments under the State Council in China to classify MSMEs. While these standards vary, operating income, total assets, and employee headcount are the essential differentiators.<sup>1</sup> MSMEs typically have revenues of less than RMB 500 million and fewer than 1,000 employees (see Figure 1).<sup>2</sup>

**Figure 1: SII's Classification of Micro-, Small- and Medium-Sized Enterprises (MSMEs) According to China Standards**

Industry	Operating Revenue	Number of Employees	Total Assets
Accommodation	< RMB 100 million	< 300	
Agriculture	< RMB 200 million		
Architecture	< RMB 800 million		< RMB 800 million
Heavy industry	< RMB 400 million	< 1,000	
Information transmission	< RMB 1 billion	< 2,000	
Postal services	< RMB 300 million	< 1,000	
Property management	< RMB 50 million	< 1,000	
Real estate	< RMB 2 billion		< RMB 100 million
Restaurant and catering	< RMB 100 million	< 300	
Retail	< RMB 200 million	< 300	
Software and IT	< RMB 100 million	< 300	
Tenancy and business svcs	< RMB 1.2 billion	< 300	
Transportation	< RMB 300 million	< 1,000	
Warehousing	< RMB 300 million	< 200	
Wholesale trade	< RMB 400 million	< 200	
Others unlisted		< 300	

Source: "China Issues Classification Standards for SMEs," *China Briefing*

Globally, China's standards for MSMEs are mostly aligned with other countries. The EU uses staff headcount, turnover, and balance sheet totals to classify MSMEs.<sup>3</sup> On the

other hand, the US Small Business Association (SBA) determines MSMEs by sector, and sector-specific annual revenue and number of employees.<sup>4</sup>

In August 2018, the State Council's Leading Small Group on Facilitating SME Development ( 国务院促进中小企业发展工作领导小组 ) underlined MSMEs' critical importance to China's economy. According to the Leading Small Group, MSMEs in China are responsible for 50 percent of total taxes paid, 60 percent of China's GDP, 70 percent of technological innovation, 80 percent of urban employment, and account for more than 90 percent of China's enterprises.<sup>5</sup>

The COVID-19 pandemic, which started in early 2020, continues to negatively impact China's economic growth. Despite being the only major economy to achieve GDP expansion by the end of 2020, China recorded a historic low for its GDP growth last year. MSMEs, by virtue of their size, cash flow restrictions, and asset limitations, were disproportionately impacted. According to a report by the Fudan-Ping An Research Institute for Macroeconomy released in May 2020, MSMEs in China are facing significant challenges that are unlikely to dissipate in the near term:

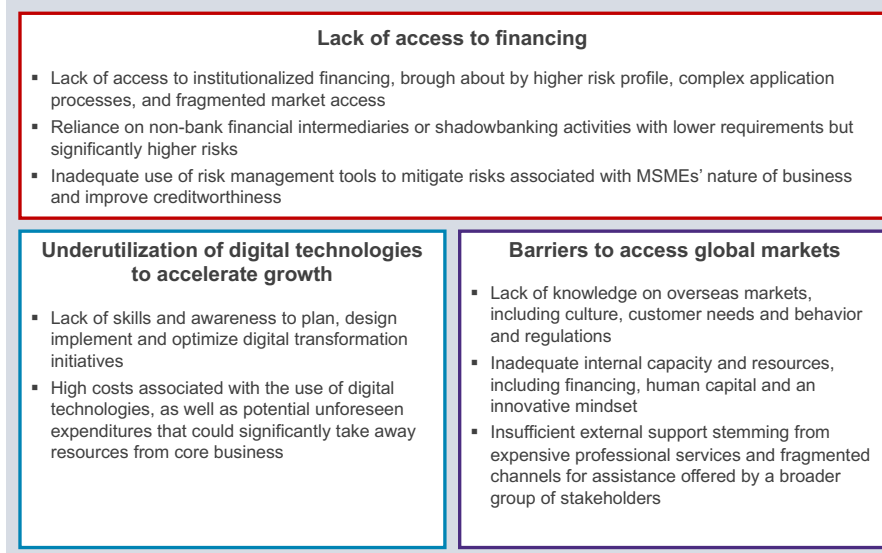
- Though gradually recovering, the Small and Medium Enterprises Development Index (SMEDI)<sup>6</sup> was down 6 percent in Q4 2020 compared with Q4 2019.<sup>7</sup>
- More than 80 percent of China's MSMEs are facing cash flow challenges;<sup>8</sup>
- Over 64 percent of MSMEs have never used internet-based financing methods.<sup>9</sup>

To offset the economic shock caused by the pandemic, the Chinese government adopted a proactive approach of rolling out nearly 100 different policies by May 2020 to support the MSME sector. These policies cover eight categories including financial support, tax and other cost reductions, and promotion of employment and productivity.<sup>10</sup> However, the effectiveness of many of these policies can be further improved. The Peking University National School of Development (NSD) estimated that, as of July 2020, only 15 percent of MSMEs in China had received financial support despite the wave of both central and local level policies introduced to ease financing difficulties.<sup>11</sup> Identified barriers hindering MSMEs from benefiting from these policies include the reluctance of banks to support enterprises with whom they do not have an existing relationship with, lack of policy awareness, and variation in needs across industries that may require more targeted policies.

After careful consideration and deliberation with SII sponsors, global experts, and policymakers, the 2020 SII identified three important challenges that, if addressed, can help MSMEs better navigate the post-pandemic business environment: 1) lack of access to financing, 2) underutilization of digital technologies to accelerate growth, and 3) barriers

to access global markets (see Figure 2). These challenges are further illustrated throughout the report with insights gained from interviews conducted with MSME representatives. Addressing these challenges will help MSMEs better adapt to a post-pandemic recovery environment.

**Figure 2: Key MSME Topics and Challenges Discussed in SII 2020 Working Sessions**



## Challenge #1 – Lack of Access to Financing

In line with the global call for universal financial access, China has made significant strides to strengthen its policies and institutions to promote financial inclusion. While increasingly more individuals, including traditionally marginalized groups, are beginning to access and utilize financial services, MSMEs remain underserved. According to the SME Finance Forum, an organization managed by the World Bank Group, China still has an immense MSME finance gap of \$1.93 trillion as of 2020.<sup>12</sup>

Since 2003, with the enactment of the Law on the Promotion of SMEs(《中华人民共和国中小企业促进法》), the first-ever national law to support the development of Chinese SMEs, the government has rolled out a series of policies and laws focused on promoting a better business environment for SMEs. To relieve the negative impacts of COVID-19 on MSMEs, the State Council has released additional measures, such as the Notice on Temporarily Deferred Repayment of Principal and Interest for Loans to Micro,

Small and Medium-sized Enterprises (《关于对中小微企业贷款实施临时性延期还本付息的通知》), allowing MSMEs to delay loan repayments. However, institutionalized financing channels continue to be non-existent for most MSMEs due to their high-risk profiles. Additionally, risk management tools, designed to help MSMEs improve creditworthiness, are still not widely available or accessible. As a result, MSMEs often are compelled to depend on informal and even illicit sources of financing to sustain cash flows. For instance, at the end of 2016, the scale of shadow banking in China was already quite large, with broad shadow banking exceeding 90 trillion yuan and narrow shadow banking also reaching 51 trillion yuan.<sup>13</sup> This could expose both MSMEs and the entire economy to greater risks.

### ***Importance of Financial Inclusion***

Financial inclusion refers broadly to the provision of safe, affordable, and sustainable financial services for individuals and businesses.<sup>14</sup> It has long been a priority at the international level through the adoption of multiple organizations' agendas, such as the 17 UN Sustainable Development Goals (SDG), the G20 2020 Agenda, and the World Bank's commitment to achieve universal financial access.<sup>15</sup>

Financial inclusion is an important dimension of a country's overall level of financial development as it is closely linked to poverty alleviation and inclusive and sustainable growth.<sup>16</sup> High rates of inclusion have been found to benefit economic growth and reduce economic inequality.<sup>17</sup> Many existing definitions of financial inclusion also prioritize disadvantaged or underserved segments of society. For instance, China's Plan for Advancing Inclusive Finance Development (2016-2020) (《推进普惠金融发展规划(2016—2020年)》), released by the State Council in 2015, states that the focus of inclusive finance in China is to be directed toward "small and micro businesses, farmers, urban low-income groups, impoverished groups, the disabled, the elderly, and other special groups."<sup>18</sup>

When measuring financial inclusion, the World Bank notes in its 2014 Global Financial Development Report the importance of prioritizing utility over accessibility.<sup>19</sup> Building a physical or institutional infrastructure for financial services is only the first step, it is also critical that the population feels comfortable utilizing the available financing options when needed. However, in practice, the 1) high cost of account set-up and transactions; 2) physical distance from financial institutions; and 3) distrust of financial services providers have caused considerable difficulty in achieving this objective.<sup>20</sup>

### ***State of Financial Inclusion in China***

In China, the proportion of adult bank account owners has grown from 64 percent in

2011 to around 80 percent in 2017, surpassing other upper-middle income countries and reaching the level of high-income economies.<sup>21</sup> In fact, nearly 78 percent of adults from China's rural areas are reported to hold bank accounts. Part of this success lies in its extensive coverage of traditional bank branches across urban and rural areas, boasting one of the largest financial networks in the world. The rapid growth of digital financial services (e.g., WeChat and Alipay) also provide new financial service options for domestic consumers.<sup>22</sup>

Improvement continues to be seen in banks' provision of financial services, especially in the area of financial inclusion. By the end of the fourth quarter of 2020, the balance of loans used by banking financial institutions for MSMEs was RMB 42.7 trillion, of which RMB 15.3 trillion was the balance of loans for small and micro enterprises with a total credit amount of RMB 10 million or less for a single household, an increase of 30.9% from the beginning of the year.<sup>23</sup>

China has long focused on providing financial support to MSMEs, epitomized by the many laws, policies, and regulations enacted in support of the sector.<sup>24</sup> In 2002, the National People's Congress (NPC) introduced the Law on the Promotion of SMEs (《中华人民共和国中小企业促进法》) to improve the business environment and promote MSME development in China. The law was revised in 2017 to facilitate and promote direct and indirect MSME financing. In 2014, the PBOC issued the Notice to Support SME Lending by Financial Institutions (《关于开办支小再贷款 支持扩大小微企业信贷投放的通知》) which mandated financial institutions to meet a quota of RMB 50 billion for SME lending.<sup>25</sup> Other policies released include the National Development and Reform Commission's (NDRC) (《国务院进一步促进中小企业发展的若干意见》) and the Ministry of Finance (MOF)'s Notice of Exemptions on Administrative Fees (《关于取消、停征和免征一批行政事业性收费的通知》).<sup>26</sup> The Chinese government's support to MSMEs has been recognized by multiple SII working session attendees, in which a Zhejiang-based SME noted that the Chinese government had made significant efforts in supporting the MSME sector, particularly in talent cultivation and industry growth.

However, challenges to financial inclusion still remain. A 2018 report, co-written by the People's Bank of China (PBOC) and the World Bank, notes that China still lacks a modern concept of financial inclusion that is widely accepted by other countries.<sup>27</sup> The report also notes that China is in need of more market-oriented approaches and innovative risk-managed financial products in order to promote and expand inclusion.

More importantly, the Chinese MSME sector is where financial inclusion is most necessary. According to the China SMEs Financial Service Report by PBOC and CBIRC, only 18 percent of MSMEs have a bank loan or line of credit as of 2018. Though the exponential

growth of numbers of Chinese MSMEs is accounted in this data and the amount of MSMEs receiving loans actually grew 35% since 2017, the report still shows that most MSMEs are unable to receive loans from financial institutions.<sup>28</sup> When making comparisons to other middle-income countries, China lags behind in the SME category (See Figure 3).

**Figure 3: Benchmarking Financial Inclusion in China and Select Countries**

Country	Percent of Bank Adults with a Bank Account (15+) (2017)	Percentage of Firms with a Bank Loan or Credit (2007 – 2019)		Biggest Obstacle for Firms
		Medium-Sized Firms	Small Firms	
China	80	35	14	Access to financing
Brazil	56	59	58	Tax rates
Russia	76	45	30	Tax rates
Mexico	37	37	27	Informal sector
South Africa	69	35	23	Crime and disorder
Indonesia	49	32	25	Informal sector
India	80	21	16	Corruption

Note: World Bank Enterprise surveys are available for individual country-year pairings between 2007 and 2019.

Source: "World Bank Enterprise Surveys" and the "World Bank Global Findex Database," World Bank

Currently, the negative impact of the pandemic has also further amplified the challenge MSMEs are facing. In response, various Chinese government agencies released additional policies to make financing more accessible for MSMEs, including measures to expand financing coverage, restructure loan terms, and reduce financing costs.<sup>29</sup> In addition to these national-level policies, a wide range of policies were also announced at the provincial and local level, including payment deferrals and waivers and subsidies for remote work when many parts of the country were under lockdown.

As with any national-level policy, implementation often presents its own challenges. For instance, policies that offer an extension on loan payments or low interest rates could benefit MSMEs who already had existing loans, yet they do not resolve the need of a great portion of other MSMEs who doesn't currently hold loans but desperately need them.<sup>30</sup>

This section tackles three financing challenges facing MSMEs that, if addressed, can lead to long-term resiliency and growth: 1) lack of access to institutionalized financing, 2) heavy reliance on informal financing and shadow banking, and 3) lack of risk management tools.

### ***Lack of Access to Institutionalized Financing***

In 2018, the proportion of Chinese MSMEs with access to loans only accounted for 25 percent of the total number of businesses in China with loans. Although limited access to finance is a challenge for many countries around the world, the SII working sessions identified a unique series of *proximate* (i.e., those related to the nature of MSMEs' businesses) and *distal* (i.e., those stemming from the economic system in which they operate) factors that combine to create a challenging environment for MSMEs in China.

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**“Relevant policies may be helpful for medium-sized enterprises, but micro and small-size enterprises are currently finding it extremely hard to benefit from the financial inclusion policies.”**

——An executive director from a SME consulting firm

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**“Very few MSMEs can meet the collateral requirements set by banks in order to obtain loans.”**

——A managing director from an agriculture company

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The first proximate factor centers on high risks. China does not currently have an established centralized system collecting, storing, and assessing the overall health of MSME businesses. Often times, there is an information asymmetry between MSMEs and financial institutions. Unlike public companies or large corporations, which are required to publish important business metrics, MSMEs are not required to disclose such information. As a result, banks have difficulty determining MSMEs' creditworthiness, which either results in a lower success rate of MSME borrowing in China or higher financing terms that many MSMEs cannot afford.

Even when an MSME is granted credit by a bank, the business owners often must use personal assets as alternative collateral to meet the bank's stringent requirements. Furthermore, loan applications usually involve a process that is time and resource-consuming, which could distract the owners' focus from running the business itself.

MSMEs in rural areas may find themselves in a more disadvantaged position as they have even lower access to financing than those in urban cities. Their options are usually limited as there are only a small number of financial institutions whose presence reach their community. The five major state-owned commercial banks have stringent requirements on personal credit audit, while farmers, under the current weak construction of the rural credit system, can hardly meet the requirement.<sup>31</sup> Rural MSMEs are considered

slightly profitable enterprises boasting annual sales revenues that rarely exceed this amount, making it difficult for them to even meet the minimum loan threshold set by banks.

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**“Without assets or collateral, it is impossible to get a loan. I have never heard of any MSME successfully obtaining a bank loan.”**

—A finance director from an MSME in the service industry

Distal factors, on the other hand, highlight the lack of alternative options to banks. As China's financial system is dominated by banks, capital markets are comparatively underdeveloped.<sup>32</sup> These big banks are also more likely to prioritize lending to larger, more established, and often state-owned firms, potentially crowding out funding that could be directed towards smaller, private MSMEs. Instead, MSMEs are forced to utilize smaller banks for loans with much higher interest rates which often cost double to what large banks offer to large corporations; thus, MSMEs tend to view financing from banks as a last resort rather than a part of their operational strategy. Furthermore, other sources of financing, such as P2P lenders and institutions pivoting to MSMEs, have already been closed or subjected to greater scrutiny as a result of the government's deleveraging campaign to reduce risks in the financial sector since 2017.<sup>33</sup>

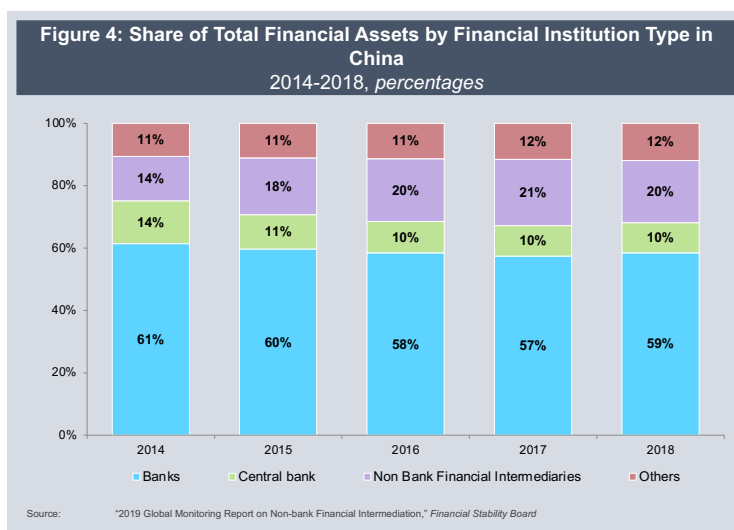
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### ***Reliance on Informal Financing and Shadow Banking***

Due to insufficient access to financing, many MSMEs are forced to turn to non-bank financial intermediaries (NBFIs) or shadow banking activities for help. Shadow banking usually refers to a system of financial entities or actors that seek to fulfill functions similar to those of traditional banks such as acting as credit intermediaries, but often skirt formal banking regulations. These types of activities may include: 1) underground lending; 2) P2P lending; 3) social lending; 4) microfinance lending; 5) pawnshops; 6) wealth management firms; and 7) underground asset management firms.

In 2018, NBFIs' financial assets reached US\$11.2 trillion, growing to a 20 percent share of total financial assets in China, from 14 percent in 2014 (see Figure 4).<sup>34</sup> On one hand, NBFIs offer MSMEs financing products with much less complicated and more expedited application processes and flexible terms. On the other hand, NBFIs are not subject to the same regulatory oversight, which can expose unsuspecting MSMEs to above-market or predatory interest rates, unregulated transactions, and outright fraud. For instance, the one-year interest rate from shadow banking sector loans averaged between





13 to 15 percent, which is about 8 to 10 percent higher than those coming from formal financial institutions.<sup>35</sup>

Increased reliance on informal financing<sup>36</sup> can put China's financial system at great risk. The number of costly civil cases brought about by lending disputes appears to be rising.<sup>37</sup>

To address the non-performing loans, the Chinese government has taken steps such as capping the interest rate on private lending to 24 percent<sup>38</sup> and encouraging regional banks and financial institutions to expand coverage in remote areas. According to a report published by the PBOC and CBIRC, the number of commercial banks open in rural areas has grown from 1262 in 2017 to 1427, and the number of village banks has also grown from 1562 to 1616.<sup>39</sup>

### **Lack of Risk Management Tools**

Risk management is about identifying business risks and adopting strategies to address or mitigate them. From a financial inclusion perspective, the goal of improving risk management is to establish the creditworthiness of an MSME by providing them with tools to mitigate the risks of taking on financing, enabling them to grow their business in a sustainable manner.

Apart from the direct financial risks identified above, MSMEs may face other threats including: 1) a volatile operating environment; 2) inability to adapt to market trends due to size and scalability; 3) limited capacity to scale operations by strictly relying on internal resources; and 4) vulnerability to external shocks.

As mentioned in the Plan for Promoting the Development of Financial Inclusion (2016–2020) (《推进普惠金融发展规划（2016—2020 年）》), the Chinese government continues to emphasize that improving risk management through capacity building should be a critical prioritization for MSME owners and entrepreneurs.<sup>40</sup> The Bank of Deyang and World Bank's International Finance Corporation launched a \$31 million financing and training program for women-owned enterprises in 2009, where 322 women entrepreneurs were granted microloans that amounted to US\$2 million.<sup>41</sup> The loans provided external financing that enabled the small enterprises to recover following the 2008 Sichuan earthquake, which led to more than 1,000 employment opportunities benefiting unemployed residents as well as rural and self-employed women in the area.<sup>42</sup>

While individual financing and training programs are valuable in supporting MSMEs in managing risks, participants of the financial inclusion working session also highlighted the need to build institutionalized risk-managed solutions specifically tailored to MSMEs. The participants also encourage large corporations to explore how their resources and capabilities can be used to contribute to those solutions.

## **Challenge #2: Underutilization of Digital Technologies to Accelerate Growth**

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Digital transformation (DX), or the use of technology-enabled tools to evolve some or all business segments, can enable informed decision-making, streamlined work processes, improved customer experiences, expanded market reach, and optimized cost reduction. With DX, MSMEs are in a better position to compete globally and drive sustainable growth.

The Chinese government has introduced policies to encourage digital technology adoption among businesses and more participation from the private sector to facilitate the process. As a result, China has shown a significant improvement in digital maturity over the past five years and is poised to be the biggest spender of DX initiatives globally in the coming years.<sup>43</sup> Such trend is likely to continue in a post-pandemic world where digital technology continues to be highly valued by businesses. However, the implementation of DX can be costly, and many MSMEs often need additional support in order to afford such technologies.

### ***Impact of Digital Transformation***

Digital transformation (DX) is defined as the “continuous digitalization process of a com-

pany by leveraging digital and data-driven innovation to improve existing processes, evolve business model elements, or reinvent its business models entirely.”<sup>44</sup> A study identified market growth, customer experience, and improved operations as top areas MSMEs operating in the Asia-Pacific region want to improve upon through digital transformation, and these same priorities can also be applied to MSMEs in China.<sup>45</sup>

In the Asia-Pacific region, the current top three applications to support DX are cloud solutions, artificial intelligence analytics, and video conferencing.<sup>46</sup> Within China, the top applications used for DX include AI analytics, IoT-enabled solutions, and e-commerce platforms.<sup>47</sup>

The benefits of DX are multidimensional and can deliver upside across different stakeholder groups (see Figure 5).

**Figure 5: Summary of Digital Transformation Benefits**

Company	Employees	Customers
Increased competitive advantages	Increased employee productivity	Elevated customer experience
Expanded market reach	Decreased reliance on manual labor	Increased customer satisfaction
Cost-efficient business development tools	Streamlined workloads and processes	Convenient access to platforms
Data-driven decision making	Higher income opportunities	Improved quality of products and services
Improved operational efficiency	Safer working conditions	Tailor-made content, products and services
Enhanced production and delivery	Increased flexibility in working arrangement	Greater access to value-added innovations

Source: AmCham China analysis

Aside from operational advantages, large-scale digital adoption can also generate positive gains for human development and environmental sustainability. The use of digital tools would give MSMEs greater flexibility to expand their businesses into non-traditional geographies as well as provide remote employment opportunities. DX also has the potential to bring specific positive changes across different industries. For instance, automation and robotics in the manufacturing sector can reduce worker exposure to hazardous or unsafe working conditions found in factories.<sup>48</sup> In addition, implementing AI technologies in the human resources field can reduce bias in hiring processes and

create an equal and diverse work environment for all.<sup>49</sup> From the environmental sustainability point of view, a report by the Global e-Sustainability Initiative (GeSI) reports that information and communications technology (ICT), with its ability to create new business models and enhance social connectivity, has the potential to reduce global carbon emissions by 20 percent through 2030.<sup>50</sup>

### **Digital Transformation in China**

China's focus on DX, backed by government policies and private sector initiatives, has resulted in a significant improvement in digital maturity over recent years. China continues as one of the top leaders in private spending on digital technologies, but still remain slightly behind the US and Western Europe. In 2019, IDC forecasted DX spending to increase from \$1.22 trillion in 2019 to \$2.3 trillion in 2023 worldwide, with a five-year compound annual growth rate of 17.1 percent.<sup>51</sup> However, in the face of the current economic slowdown, this forecast is expected to drop significantly to 10.4 percent in 2020. This equates to a worldwide total spending of \$1.3 trillion in 2020, with China making up 19 percent of the total share.<sup>52</sup>

Before COVID-19, China was poised to account for the second largest share of global DX spending, overtaking Western Europe. However, the pandemic proved to expedite the digital adoption process and cause those expectations to be exceeded, as China delivered the strongest year-on-year growth in 2020 with 13.6 percent, ahead of Western Europe's 12.8 percent, the rest of the Asia Pacific's 10.4 percent, and the US's 7.3 percent.<sup>53</sup> Specifically for MSMEs, digital transformation initiatives are likely to remain popular amidst the current economic slowdown, with spending expected to reach RMB 330 billion or US\$ 43.8 million in 2022.<sup>54</sup>

In recent years, the Chinese government implemented a number of measures to support MSMEs' DX efforts. The 13th National Five-year Plan (2016 - 2020) called for the promotion of innovation-driven growth of MSMEs and more specifically on their manufacturing capabilities.<sup>55</sup> The *Digital Transformation Partnership Action Initiative* (《数字化转型伙伴行动倡议》), launched in 2020 by the Chinese government, aims to encourage MSMEs to utilize DX to expedite recovery from COVID-19. The *Notice Concerning Driving the Accelerated Development of the Industrial Internet* (《关于推动工业互联网加快发展的通知》) encourages developers and digital service providers to upgrade services and lower the adoption costs for MSMEs, such as video conferencing and cloud computing.<sup>56</sup> In addition, the establishment of Cross-Border E-Commerce (CBEC) pilot zones has allowed MSMEs to widen market access, enabling broader DX to take place at the local level.

Recognizing the prospect of DX to increase economic resilience during the pandemic,

the NDRC released the *Implementation Plan for Promoting the Action of "Purging Clouds and Using Data to Empower Intelligence" to Cultivate New Economic Development* (《关于推进“上云用数赋智”行动 培育新经济发展实施方案》) in April 2020 to support economic development with the establishment of a multi-dimensional industrial internet platform, application of cloud computing and AI, the industrialization of digital technology, as well as the digitization of industries in supporting economic development.<sup>57</sup> In the plan, NDRC cites state-sponsored studies to highlight that through said developments, DX can increase revenues by up to 33 percent, productivity by 60 percent, and management efficiency by 50 percent.<sup>58</sup> The same study also estimates that DX can reduce costs as much as 34 percent for a number of business processes including logistics, labor and manufacturing.

The effects of the COVID-19 pandemic have only accentuated the need for MSMEs to incorporate DX into their existing strategies. However, implementing a successful DX requires a significant investment. Specifically, MSMEs need support in addressing their lack of skills and awareness, as well as the high cost of adoption.

### **Lack of Skills and Awareness**

Digital transformation is a complex process that not only involves moving business operations from offline to online, but also requires integration into new supply chains, industries, and even the entire digital economy. Companies must navigate the uncharted territory of industrial Internet solutions such as artificial intelligence, robotics, 5G, Internet-of-Things (IoT), and cloud computing. In order for DX to work and to ensure the smoothest transition, MSMEs would need to carefully develop a digital strategy that aligns with and is most suitable for its business objectives.

However, many MSME owners are not yet capable of creating a comprehensive DX strategy due to limited DX literacy.<sup>59</sup> Adopting the right type of DX requires a deep understanding of both business needs and types of digital technologies that brings out the most business potential. This is especially challenging for those MSMEs established before the digitalization of the global economy, in comparison with those enterprises which were founded more recently,<sup>60</sup> since they often lack the vision and knowledge needed to conceptualize how digital technologies transform businesses.

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**“Most MSMEs have never thought about or planned for digital transformation as part of their long-term business strategy because most of them are merely surviving.”**

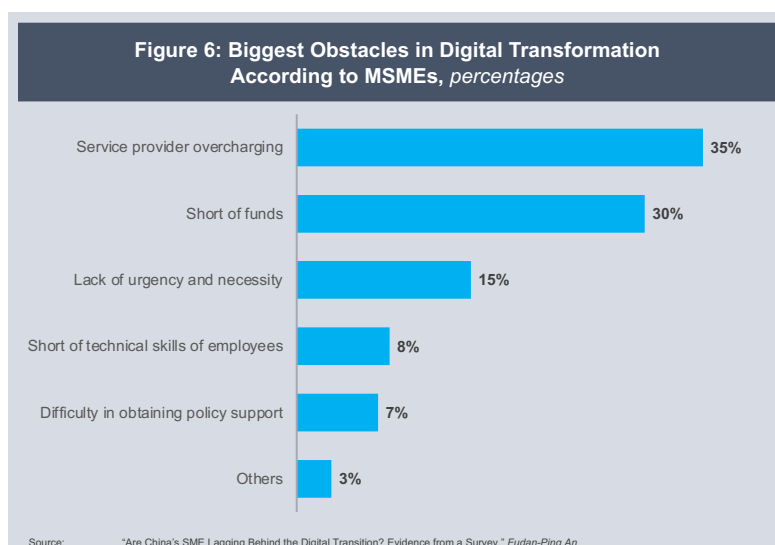
—A senior representative from a platform that facilitates msme digital transformation

Even when MSMEs are able to come up with a comprehensive plan for DX, they are more likely to encounter the next challenge of assembling a team able to execute the plan optimally. Internally, MSME owners might encounter financial or resource constraints to provide the needed training for employees to adapt to the digitalization transformation. Furthermore, as DX initiatives would require more advanced specializations, finding those who are qualified locally will also be a difficult challenge.<sup>61</sup>

### High Cost of Adoption

Implementing DX across an organization requires significant investments upfront. For MSMEs with limited resources, this would mean high opportunity costs. Aside from human capital expenses, DX also requires infrastructure upgrades, such as data storage and computing systems. However, many MSMEs do not even yet have a basic digital infrastructure, much less one that is sufficiently advanced to support digitalization.

While there are many service providers offering DX platforms, MSMEs are often dissatisfied with the price. In *Digital Transformation: A Game Changing Strategy to Alleviate the Plight of SMEs in China*, a Fudan-Ping An report conducted in 2020, two of the major obstacles identified by SMEs regarding costs include prohibitive fees of service providers and MSMEs' shortage of funds (see Figure 6 for details).<sup>62</sup> These challenges, combined with the aforementioned issues regarding the lack of access to financing, makes it highly likely that MSMEs will not have the sufficient budget to implement DX due to the high upfront and fixed costs. The report also makes aware of the additional unforeseen expenses which may incur from the DX process, another important detail for MSMEs to consider during budgeting. Furthermore, the range of DX solutions currently available



on the market may not be suitable for MSMEs, therefore, more specifically tailored digital solutions that are better aligned with smaller-sized enterprises' unique demands are needed, driving the cost of adoption even higher.

DX is resource-intensive across the entire lifecycle of planning, designing, implementing, and optimizing, which can be time- and energy-consuming for MSMEs. Allocating resources to DX means that investments and resources are being shifted away from core business processes, which may compromise their operations and potentially result in a decline in production, disgruntled employees, and inconsistent customer experiences – something many MSMEs simply cannot afford. Application of digital technologies also creates a new cost dynamic for MSMEs. For example, DX subjects MSMEs to data protection regulations, which would require increased spending to address. In addition to increased direct costs, some MSMEs may not be able to comply with all of the data use and protection regulations due to a lack of awareness or capacity, which brings potential legal troubles that MSMEs are unequipped to resolve.

Therefore, MSMEs need inclusive services from governments, MNCs, large corporations, and civil society to access human, capital, technological and other types of resources and support that are desperately needed to carry out successful digital transformations.

### **Challenge #3: Barriers to Accessing Markets**

China is a known leader in global markets, with high participation rates in the global value chain, export trade, and outbound investments. This success is primarily driven by MSMEs' export of manufactured goods, which the government has been providing continuous support for through policies such as the "Belt and Road Initiative (BRI)," the *13<sup>th</sup> Five Year Plan* (2016-2020) and the establishment of Comprehensive Cross-Border E-Commerce Zones.

As China's MSMEs facing increasingly intensive competition in the global value chain, new strategies will need to be developed to become more innovative and introduce better value propositions. The pandemic, in combination with the prevailing digital shift, have prompted a rapid increase in demand for digital commerce platforms, allowing MSMEs to explore high-frequency business-to-consumer (B2C) e-commerce models.<sup>63</sup> Both the Chinese government and the private sector have provided support for cross border e-commerce infrastructures, taxes, and more cost-friendly logistical services, enabling more MSMEs to expand their global market presence. However, several barriers still exist that are hindering MSMEs' success rates for participating in global trade, which include insufficient market knowledge, capabilities, resources, and external support.

### Internationalization as Key to China's Future Growth

As the world's largest exporter of goods and services since 2009, China remains a global leader in international trade.<sup>64</sup> Chinese MSMEs are an integral part of the country's participation in international trade, making up nearly 80% of China's total exports in 2019.<sup>65</sup>

Realizing the important contributions MSMEs have on economic growth, the Chinese government is placing significant policy focus on encouraging MSMEs to access international markets.<sup>66</sup> For example, the BRI, introduced in 2013, promotes the development of Eurasia through infrastructure, trade, and investment,<sup>67</sup> which in turn enables ease of trade for MSMEs; China's *13<sup>th</sup> Five Year Plan* (2016-2020) supported MSME growth in high-tech sectors.<sup>68</sup> Additional policy support for MSME exports includes preferential income tax rates for low-income enterprises and tax exemptions for lending to MSMEs.<sup>69</sup>

Digital technologies has created new opportunities for both large corporations and MSMEs. For example, digital technologies have provided easier paths for MSMEs to reach new international markets, mainly through business-to-business (B2B) and business-to-consumer (B2C) cross-border e-commerce. Global e-commerce markets reached US \$25.6 trillion in 2018 and China ranked third in total sales with US \$2.3 trillion next only to US and Japan, China was already the global leader in B2C with US \$1.3 trillion in sales (see Figure 7).<sup>70</sup>

**Figure 7: Global E-Commerce Sales**  
2018, US\$ billions

Country	Total E-Commerce Sales	B2B E-Commerce Sales	B2 E-Commerce Sales
United States	8,640	7,542	1,098
Japan	3,280	3,117	163
China	2,304	943	1,361
South Korea	1,364	1,263	102
United Kingdom	918	652	266
France	807	687	121
Germany	722	620	101
Italy	394	362	32
Australia	348	326	21
Spain	333	261	72
Top 10	19,110	15,772	3,338
Global Total	25,648	21,258	4,390

Source: "Global e-Commerce hits \$25.6 trillion – latest UNCTAD estimates," United Nations Conference on Trade and Development



The Comprehensive Cross-Border E-Commerce (CBEC) pilot zones, another measure introduced by the government, enable MSMEs to adopt digital tools and diversify foreign market access through new products and services. The CBEC pilot zones conduct policy experiments via integrated services in customs, taxation, foreign exchange, logistics, and financing.<sup>71</sup> As of 2020, the State Council has approved five batches of 105 comprehensive pilot zones for CBEC, covering almost all provinces across China.

These various measures allow China to further strengthen its international trade leadership position, enabling MSMEs to focus on R&D and reduce overcapacity issues resulting from local market saturation. These policies would also allow the country to shift value propositions from low-cost labor to high-quality innovative products, thereby evolving and sustaining China's competitive edge. Through broader market access, Chinese MSMEs will be in a better position to weather any geopolitical storms, which could result in tightened regulatory policies.

While these government measures have created a more friendly environment for MSMEs to access global markets, MSMEs still require additional support to successfully capture business opportunities abroad. Specific challenges for MSMEs to address include: 1) lack of market knowledge, 2) insufficient internal capacity and resources, and 3) inadequate external support.

### ***Lack of Market Knowledge***

Global markets are widely divergent, thus, different customer needs, product types, marketing and sales strategies, as well as foreign cultural norms and local regulations will all need to be taken into account. Additionally, MSMEs would also need to navigate the increasingly complex global business environment. As such, it is important for business leaders to have a deep understanding of target markets abroad and the broader global dynamics in order to effectively capitalize on international business opportunities.

However, a study found that limited access to market data and insufficient understanding of the local political and regulatory dynamic remains a top challenge for MSMEs in developing strategies for international expansion. Moreover, the study shows that lack of market knowledge also increases MSMEs' perception of risk, reducing their likelihood to consider entering new markets as a way to grow their business.<sup>72</sup> During our interviews, some MSME owners said they will definitely lose their competitive edge when expanding abroad as local market knowledge is their key advantage.

MSMEs typically rely on limited open-source information when exploring international expansion. For MSMEs that have already established a global presence, the global value chains (GVC) they are a part of provide another potential channel for overseas market information. However, many China MSMEs are in low value-added positions within

GVCs, often as original equipment manufacturers (OEM), making it difficult for them to maximize the benefits of learning through the other partners in their network. Furthermore, as they are more likely to not have a market-facing role in the value chain, first-hand acquisition of knowledge of other markets is also severely limited.<sup>73</sup>

As China continues to integrate into the global economic system, more MSMEs are becoming interested in expanding globally. However, SII working session participants highlighted that the decision to penetrate markets abroad should be carefully considered, as it may not be the optimal decision for every company. Participants noted that to make this decision, MSMEs must take into account the potential international demand for the products they offer, the upside of overseas expansion vis-à-vis focusing on domestic markets, and their willingness to go through an arduous and resource-intensive process of internationalization.

### ***Inadequate Internal Capacity and Resources***

Access to capital is a critical requirement for global market expansion. Unfortunately, as documented in this report, a lack of capital and access to financing often limits the ability for MSMEs to grow. Categorized by banks as high-risk entities both locally and globally, MSMEs suffer from shortages of funds and lack of access to financing, thus hindering MSMEs' capability to invest in growth.

Finding talent in local market and abroad is another daunting task for MSMEs. Global expansion requires a unique set of skills and a good grasp of overseas markets, however, MSMEs often have limited knowledge of international operations. When companies are assembling a team that meet these requirements, they may find that, in the tide of globalization, there are insufficient international professionals familiar with target markets, resulting in intensified competition and a skill-demand mismatch.

MSMEs also face greater competitive pressure from MNCs and large corporations when pursuing overseas markets. To stay competitive, MSMEs should focus on improving their innovation capabilities such as leveraging digital technologies to make processes and production more cost efficient, improving public-facing channels, and expanding the product suite. However, it is important to consider the implications of allocating internal resources to innovation initiatives, which, as previously mentioned, could result in reduced capacity in conducting core business operations due to MSMEs' limited available resources.

### ***Insufficient External Support***

To address the inadequacies in market knowledge and resources, MSMEs often look to external support for assistance. Professional service providers offer help in conducting

businesses abroad, while management consulting and law firms offer expertise (e.g., regulatory compliance, due diligence, background investigation, market analysis, strategy development) to address knowledge constraints about overseas markets. However, these professional services are often very expensive for MSMEs to afford. Furthermore, working session participants also noted that in certain cases, different consulting firms may give out conflicting recommendations, leading to confusion and making such services counterproductive.

There are also solutions providers that support day-to-day management operations, such as customs clearing, tax settlements, and logistics. However, while integrated services are already offered on most e-commerce platforms where they act as intermediaries, MSMEs in other industries have to tap into separate third parties to address their needs due to fragmented market offerings.

The support coming from alternative sources, such as different government agencies, academic institutions, non-profit organizations, and large corporations, also remains fragmented. MSMEs can actually benefit greatly from an institutionalized platform to learn about the nuances of other markets, share best practices with other MSMEs, and expand their networks for new business opportunities.

As for setting up cooperative networks with other companies of similar size and nature to jointly enhance capabilities, MSMEs in China expressed a certain extent of cautiousness and aversion, stating a high risk that their internal practices will be studied and replicated by peers. As barriers for entry in the industry are low due to type of participation many MSMEs have in GVCs, they are worried that sharing practices with peers may lead to creation of new competitors in the industry.<sup>74</sup>

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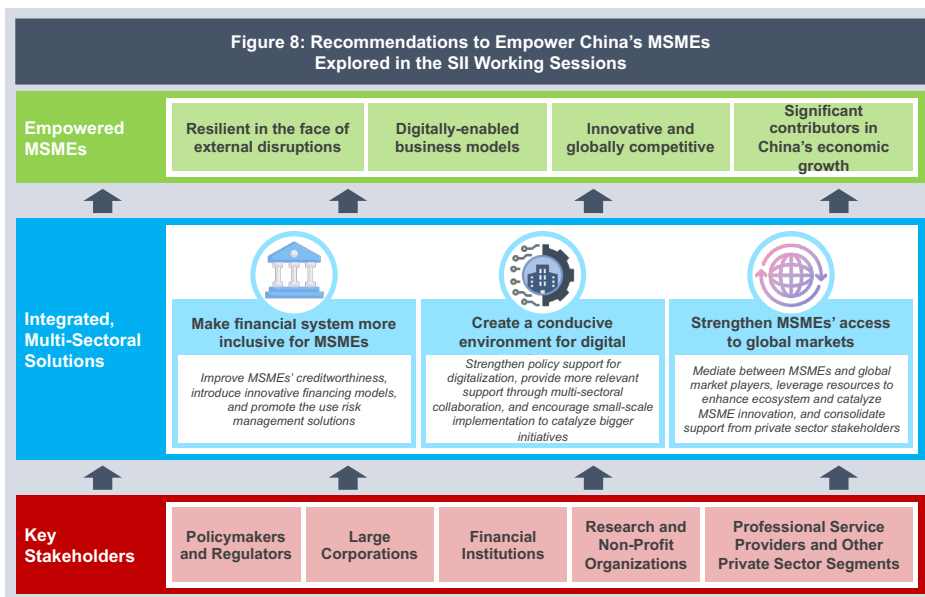
**“The biggest barrier for MSMEs to go abroad is cultural differences, including a difference in market rules. However, risks come with opportunities. In relatively mature markets like the US and EU, with comprehensive procedures and formalities, the risk can be predictable if companies ensure to follow all procedures.”**

—— an MSME that provides business and legal support for companies to go abroad

## An Integrated, Multi-Sectoral Solution

The economic downturn brought about by the COVID-19 pandemic has significantly impacted MSMEs, particularly those that lack the resources to drive growth. Given the significant proportion of China's economic system that MSMEs represent, their recovery should be prioritized. However, growth alone should not be the only focus in the process of revitalizing MSMEs in the post-pandemic era, China also needs to develop a more robust MSME sector that is more resilient in the face of black swan events and other disruptions, better integrated into the global supply chain, and more capable of sustaining business operations with sufficient support.

The Social Impact Initiative believes that the existing measures introduced by the government through the *13<sup>th</sup> Five Year Plan*, along with many other policies such as the BRI and the revised *Law on the Promotion of SMEs*, already provide a solid foundation to empower MSMEs. However, collective action between the government, larger corporations, financial institutions, research and non-profit organizations, professional service providers, and other segments of the private sector is needed to further accelerate MSMEs' development and ultimately the country's economic growth. As such, AmCham China, with its member companies, recommend an integrated and multi-sectoral approach that leverages innovative and more sustainable solutions from both the public and private sectors to achieve common goals (see Figure 8).



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## Recommendation #1: Make Financial System More Inclusive for MSMEs

China has made important progress expanding access to financing, outpacing many peer countries at similar levels of development.<sup>75</sup> *The Law on the Promotion of SMEs*, issued in 2002 and revised in 2017, specifically highlights financial inclusion for MSMEs.<sup>76</sup> The SII believes that to fully adopt a financially inclusive society, it will be beneficial to develop a financial system that is fully supportive of MSMEs, with a large portion of this responsibility coming from MNCs.

In order to improve MSMEs' access to financial services, enhancing creditworthiness should be explored. The existing social credit system, which includes MSMEs' credit ratings, needs to be further developed and integrated into financial institutions' processes. MNCs are able to offer assistance in this field by sharing risks as guarantors for MSMEs, or by providing supplementary MSME transaction data as proof of business stability. Widespread adoption of alternative financial models backed by strong policy support, such as supply chain financing and credit guarantee schemes, as well as increased adoption of risk management solutions across all stakeholders could help distribute the risks associated with lending to MSMEs.

### ***Improve MSME Creditworthiness***

#### *Institutionalize China's Social Credit System (SCS)*

The State Council released the *Planning Outline for the Construction of a Social Credit System (SCS) (2014-2020)* in June 2014 to establish and manage a comprehensive social credit system covering both individuals and entities for the country by 2020.<sup>77</sup>

The SCS is currently regulated by a combination of national laws and regulations, such as the *Administrative Penalties* (《行政处罚法》) and *Licensing Laws* (《许可证法》) and *State Council OGI Regulations* (《政府信息公开条例》). In terms of implementation, the National Enterprise Credit Information System (NECIPS, 国家企业信用信息公示系统) and "Credit China" ("信用中国") were created to collect, share, and disclose credit information on a national level. Furthermore, some government agencies, as well as city-level and provincial-level governments, are also building respective systems supported by local regulations.<sup>78</sup>

On a policy level, improvements to the country's credit information system are likely to benefit MSMEs. Ideally, financial institutions could use different portals to have better visibility on their regulatory and business performance. However, interoperability remains limited as the data platforms are still in nascency, with the exchange of data

between national and local platforms still fragmented.<sup>79</sup>

In addition, the system's data coverage at present still lacks a comprehensive accounting of business and financial information needed for lenders and banks to successfully evaluate an MSME's loan application. For now, enterprises are only encouraged to share business information that may be useful in improving their ratings.<sup>80</sup>

For the SCS to become truly effective in achieving its goal of aiding financial risk assessment, focus should be given on ensuring data comprehensiveness, integrity, and interoperability. The SII recommends that regulators and policymakers continue to more deeply explore different business performance metrics that could be included in evaluating credit scores. Financial institutions could also benefit from a more transparent assessment process that aids in better understanding of the rationale behind enterprise ratings, which would be helpful as they conduct their analysis of MSMEs' creditworthiness.

By enabling access to the SCS, thereby reducing information asymmetry and associated risks, financial institutions' willingness to lend to the MSME sector will likely increase significantly, particularly in regard to smaller banks that may not have enough resources to conduct due diligence. These improvements could be supplemented with an updated data security regulatory framework for financial institutions, as the adoption of a central database that includes sensitive business and financial data increases risk and vulnerability to data breaches.

#### Enable MNCs and Large Corporations to Credentialize MSMEs

While China's SCS is still in its early stages, MNCs and large corporations have an important role to play in boosting MSME creditworthiness by providing supplementary data and complementary support. For instance, MNCs could support MSME loan applications indirectly; since many MNCs already have access to a significant amount of financial and operational information on MSMEs in their value chains, they could play an important intermediary role in connecting MSMEs with financial institutions. Further on, MNCs could also act as guarantors for MSME loan applications.

Several MNCs have already operationalized pilot programs using a similar approach. Some companies have supported lending programs for MSMEs by legally sharing the data collected from commercial activities of MSME clients hosted on their platform with local intermediaries willing to provide loans. The data on MSME activities serves as evidence of MSME business operations and credit information for further investigation by third parties and qualified financial institutions.

## Recommendation #1: Make Financial System More Inclusive for MSMEs

### Country Case Study: Japan's Credit Risk Database (CRD)

In Japan, information asymmetry is being addressed by the private sector through the *Credit Risk Database (CRD)*.<sup>81</sup> The database, founded as a venture of the Ministry of Trade and Industry and the Agency for Small- and Medium-Sized Enterprises, was built to acquire and aggregate data for a more accurate assessment of MSMEs, thereby addressing hurdles in MSMEs' access to finance. It contains industry-related data, as well as company-specific information on more than three million Japanese MSMEs. Access to the database is exclusive for members which, as of 2020, composed of more than 150 credit guarantee corporations, financial institutions, credit rating agencies, and government organizations (see "SII Spotlight: Japan's Credit Risk Database (CRD) Association").

The CRD provides financial indices based on MSME performance, which allows lending institutions and intermediaries to conduct comprehensive financial assessments, including probability of default. As a result, MSMEs in Japan now have better access to

#### SII Spotlight: Japan's Credit Risk Database (CRD) Association

**Collects financial and other business data on SMEs from member companies, processes the data using a credit risk measurement model, and returns assessments of SMEs' business situation to members**

##### Process

- CRD collects SME data from members, including financial/non-financial data and default information under the Small and Medium Enterprise Basic Law
- CRD stores, cleanses and consolidates data for use
- CRD provides members with data on client SMEs through a broad range of services

##### Services Offered

- Scoring – Provides creditworthiness of borrowers
- Statistical information – Offers statistical data on a range of financial indicators
- Sample data – Delivers anonymous SME data from financial statements
- Management consulting support system – Helps members diagnose financial condition of SME clients

##### Membership

- 51 Credit guarantee corporations
- 98 Private financial institutions
- 15 credit-rating agencies
- 5 government institutions utilizing the platform for research
- 3 government-affiliated financial institutions

Source: "Credit Risk Database," *Credit Risk Database Association*

finance, with many of them able to borrow from banks without the need for collateral. MSMEs with good credit ratings can also apply for more loans at lower interest rates, while those with relatively poor ratings have to incur higher interest rates and a lower borrowing cap. Consequently, guarantee fees were also determined through the CRD, where MSMEs with the highest rating are only charged 0.5 percent credit guarantee fees and those with lower ratings are charged as much as 2.2 percent.<sup>82</sup>

### ***Introduce Innovative Financing Models***

MSMEs are reliant on traditional bank financing models that are, at times, inapplicable to their unique nature. Consequently, the requirements to secure financing also do not fit the MSME profile, rendering them unable to comply. This is particularly the case for newer, innovative, and fast-growing MSMEs with a higher risk-return profile. Traditional financing models will continue to be crucial for MSMEs but there are opportunities to broaden the range of financing models and explore new solutions that are specifically tailored for MSMEs. The Social Impact Initiative recommends that the government, through financial sector regulators, explore the viability of “supply chain financing” and “credit guarantee schemes”.

#### *Supply Chain Financing*

Through supply chain financing (SCF), financial institutions can act as intermediaries and pay suppliers’ account receivables in place of the customer or debtor in advance of the due date, giving suppliers faster access to working capital. This model specifically applies to MSMEs that act as suppliers of corporate buyers, as well as for smaller firms that banks typically are unable or unwilling to serve using traditional financing models.

SCF is not only beneficial for MSMEs, but also for large corporate buyers in terms of improving working capital management and reducing supply chain disruptions. Known models of SCF consist of several options that aim to finance suppliers by using invoices, inventory flow, and receivables as intermittent collaterals.<sup>83</sup>

#### *Expand China’s State Financing Guarantee*

The government could also explore the option of expanding the State Financing Guarantee, originally introduced in 2018 to ensure loan payments, either partial or in full, reduce loss on bad credit. Its objective is to share the credit risk of lending to MSMEs, thereby encouraging financial institutions to provide credit without the usual collateral or guarantor. Similar to SCF, this guarantee eases collateral requirements and unloads risk from financial institutions. The country’s CGS, with an initial capital of RMB 66.1 billion, was initially funded by the central government with support from financial institutions.<sup>84</sup> As of 2018, the loan amount covered by the fund reached RMB 32.6 billion for



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more than 25,000 borrowers.<sup>85</sup>

Although the State Financing Guarantee fund has created first steps to support MSME financing, more work is needed for it to become fully institutionalized. First, the government can look to intensify promotion of the service to increase MSME awareness. Next, additional capital allocated to the fund could help its capabilities in guaranteeing loans for a larger percentage of the MSME sector. The availability of the service could also be further expanded by establishing more partnerships with financial institutions and re-guarantee corporations at both the provincial and local level.

### SII Spotlight: The World Bank and the FIRST Initiative's Principles for Public Credit Guarantee Schemes (CGS) for SMEs

**Developed a tool with 16 principles that is intended to become a standard for governments designing, implementing and evaluation a public CGS for SMEs**

#### Legal and Regulatory Framework

- Establish the CGS as an independent entity
- Provide adequate funding and keep sources transparent
- Promote mixed ownership and treat minority shareholders fairly
- Supervise the CGS independently and effectively

#### Corporate Governance and Risk Management

- Clearly define the CGS mandate
- Set a sound corporate governance structure with an independent board of directors
- Design a sound internal control framework to safeguard the operational integrity
- Adopt an effective and comprehensive enterprise risk management framework

#### Operational Framework

- Clearly define eligibility and qualification criteria for SMEs, lenders, and credit instruments
- Ensure the guarantee delivery approach balances outreach, additionality, and financial sustainability
- Issue partial guarantees that comply with prudential regulation and provide capital relief to lenders
- Set a transparent and consistent risk-based pricing policy
- Design an efficient, clearly documented, and transparent claim management process

#### Monitoring and Evaluation

- Set rigorous financial reporting requirements and externally audit financial statements
- Publicly disclose non-financial information periodically.
- Systematically evaluate the CGS' performance and publicly disclose the findings

Source: "Principles for Public Credit Guarantee Schemes (CGSs) for SMEs," World Bank

To assist in the expansion and improvement process of the fund, China could utilize the *Principles for Public Credit Guarantee Schemes (CGSs) for SMEs*, a tool developed by the World Bank and the FIRST Initiative<sup>86</sup> to help countries design, implement, and evaluate a public CGS for MSMEs.<sup>87</sup> The tool offers 16 development principles covering the legal and regulatory framework, corporate governance and risk management, operational framework, and monitoring and evaluation (see “SII Spotlight: The World Bank and the FIRST Initiative’s Principles for Public Credit Guarantee Schemes (CGS) for SMEs”).<sup>88</sup>

#### *Empower MNCs to Establish Direct or Indirect MSME Financing Channels*

During the SII working session discussions, participants noted that financing options for MSMEs do not necessarily need to come directly from banks or other financial institutions – MNCs or other large corporations are able to provide financing options directly.

Another potential role the government or MNCs could take is to develop a platform that brings private lending institutions into the formal financing ecosystem. For example, the Saudi government created a funding channel called The Monsha’at Financial Portal,<sup>89</sup> a digital platform that connects small business owners and entrepreneurs seeking funding with various financial institutions and development organizations. The platform’s objectives are to enable SMEs’ access to finance, reduce transaction costs for financial institutions therefore providing capital to SMEs, and increase financial inclusion in rural areas.

Financing through the Monsha’at Financial Portal takes many forms, including debt, equity, and guarantees. With more financial institutions competing on the platform, the likelihood of MSMEs being able to choose from more attractive financing packages increases.<sup>90</sup> This means that, aside from potentially obtaining lower interest rates for loans, MSMEs can also find potential investment opportunities from different entities. As of 2020, the funding platform has attracted funding participation from more than 25 banks, development organizations, and other non-bank financial institutions, and has received over 250 financing requests from MSMEs.

#### ***Promote the Use of Risk Management Solutions***

##### *Strengthen Policies for Business Risk Management*

The burden of risk management does not need to be wholly dependent on MSMEs. Strengthened policy support and legal protection for small-scale financial institutions and MSMEs hold great potential in increasing the accessibility and availability of financing options. Policy support could decrease risks associated with lending to MSMEs, while legal protections could help facilitate loan processing. Furthermore, as the government implements continuous improvement to the existing enterprise SCS, respon-

**Recommendation #1: Make Financial System More Inclusive for MSMEs**

sible agencies should seek to make the assessment process more transparent. This will equip MSMEs with more information regarding the makeup of their credit score, and thus be able to more easily address any issues.

Apart from connecting MSMEs to various financing channels, MNCs can also lead the development of enterprise risk management solutions that allow MSMEs to record, manage, and share their financial and business information, thus, improving creditworthiness. Some MNCs, in their role as corporate buyers, can deploy these tools within their internal supplier networks, while MNC service providers can implement these customized solutions on a larger scale by offering them directly to MSMEs at more affordable rates.

**Improve the Financial Literacy of MSME Operators**

Improving access to MSME financing requires more than just the provision of credit lines. MSMEs often lack awareness and knowledge of financing options, hence, struggles to understand how to access different financing sources.<sup>91</sup> The government could, therefore, strengthen MSME capacity development programs that focus on financial literacy and growing the ability to manage business risks, given their importance to procuring financing.

Existing financial literacy programs by the People's Bank of China can be upgraded with training and education in corporate and financial management, marketing, and adoption of digital technologies.<sup>92</sup> Enhancing these skills will allow MSMEs to better manage their business operations and financial performance, which could help lower their risk profiles, making them more likely candidates for loans from formal financial institutions. Furthermore, by embracing digital applications and best practices for risk management, MSMEs will be in a better position to address or respond to losses, improve their operations, and have a better understanding of their operating landscape.

**Risk Management Solutions Case Studies**

Micro Disaster Risk Insurance (MicroDRI),<sup>93</sup> a micro insurance product specifically developed for Philippine MSMEs, ensures business interruption coverage (e.g., loss of assets, disruption of the value chain) in the aftermath of natural and man-made disasters (typhoons, floods, fire, theft, and workplace accidents) by providing financial payouts of a specific sum. Through MicroDRI, MSMEs, whose business continuity capacity are disproportionately affected in the aftermath of disasters, are provided with an accessible financing option to fund resumption of business operations. As a risk management solution, MicroDRI secures capital investment (e.g., equipment, infrastructure, crops) enabling MSMEs to recover from investment losses incurred due to damages. Currently, the insurance product covers more than 10,000 MSMEs and is endorsed by the Philip-

pine Department of Trade and Industry.

In another example, a global food corporation acts as a facilitator for its supplier MSMEs to access financing. Many of the company's downstream customers are agricultural MSMEs, which are often unable to meet typical collateral requirements. To address this, they created an in-house department that facilitates connections between MSMEs and financial institutions, as well as its own credit rating system for MSMEs that can supplement a loan application and reduce the information gap between the bank and the MSME. This company is also working with their MSME partners to negotiate directly with financial institutions to obtain loans for MSMEs and share in the financial risk.



## A New Financial Service Mode for MSMEs Empowered by Technology

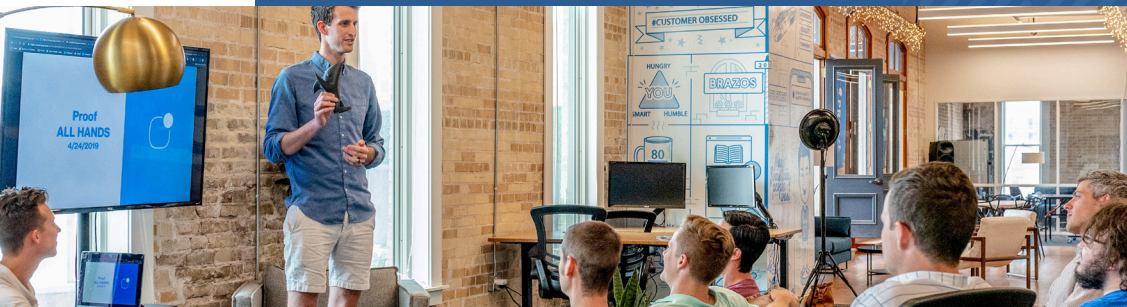
As economic development enters a new stage and forms new patterns, MSMEs (micro-, small-, and medium-sized enterprises) are presented with new challenges. First, the difficulties MSMEs face in terms of financial access is converging with the downward pressure on the economy; in addition, the risk appetite of banks is decreasing, making access to finances even more challenging than before. Second, a structural deviation now exists in the finance supply, specifically, a large amount of credit funds is being supplied to larger-sized MNCs (multi-national corporations), reducing the suitability of finance for MSMEs and thus, forming a crowding-out effect.

One of the difficulties in financing for MSMEs lies in risk control, which is reflected in two aspects. First, it is tremendously difficult to improve the effects of risk control. Due to the lack of management and standardization in their submitted forms, it is nearly impossible to accurately conduct credit assessment on MSMEs using the information they are provided. Second, it is also difficult to maintain a steady balance between risk control effects and costs. That is, if the conventional method of manually collecting information and conducting credit assessments on MSMEs is used, the cost of risk control will be substantially increased.

In response to this dilemma, Tongdun Technology has launched a financial service marketplace solution for MSMEs. It utilizes the data shared by the government and the smart tools of technology companies to create an innovative “platform set up by the government, developed by technology companies, and registered by SMEs”. Prior to the launch, Tongdun Technology has already reached strategic cooperation with enterprise services in Hangzhou, Tangshan, Xiamen, amongst many other major Chinese cities.

Ma Junqu, co-founder of Tongdun Technology, explained that during the pandemic, Tongdun’s financial service solution was crucial for MSMEs as it fully utilized the advantages of digitalization, online platforms, intelligence, and non-contact services. Based on its accurate analysis of MSMEs, the marketplace was able to make timely and innovative adjustments that allowed MSMEs to easily access the financial services they needed even while their business was stagnated.

In 2019, the *Tangshan Integrated Financial Service Marketplace for MSMEs* was established, spearheaded by the Tangshan Municipal Government and Tangshan Bank with the support of Tongdun Technology. The solution integrates, processes, and mines internal and external data from banks and government agencies to build models and make analyses of such as complex networks and rule engines to con-



duct data correlation analysis. Risk control modeling is then used to obtain the credit score of each MSME and generate a corporate assessment report. A financial service model which combines “Internet + government affairs + finance + big data risk control” and “online + offline” services integrates multi-party resources, breaks down information, and bridges the communication gap between government agencies, financial institutions, MSMEs and other parties, allowing the demand of MSMEs to “seamlessly match” with financial supply and effectively solves= issues of false information, low credit, and insufficient trust that once existed in the financing process.

In the State Council’s seventh major inspection on 43 practices of pandemic prevention and control along with economic and social development, Tangshan Integrated Financial Service Marketplace for MSMEs was given a public commendation, which attracted a great deal of attention.

The financial service marketplace has emerged as a convincing solution, however, whether or not it will take off and truly make a difference in financing for MSMEs – only time will tell. Nevertheless, MSMEs contribute greatly to the high-quality development of China’s economy, and thus, more exploration on solutions to help MSMEs will continue on in the near future.

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## Recommendation #2: Create a Conducive Environment for Digital Transformation

The SII is in full support of the government's initiative to introduce the *Digital Transformation Partnership Initiative*, released by NDRC in May 2020.<sup>94</sup> The SII views it as a good starting point to accelerate digital transformation (DX) for MSMEs. Moreover, MNC representatives expressed interest in participating in similar future efforts should the government decide to expand the platform to a broader set of stakeholders. Multi-sectoral support will significantly enhance MSMEs' awareness of digital transformation benefits and incentivize MNCs to cooperate to achieve the initiative's objectives. Using this platform as a springboard, the SII recommends: 1) strengthened support from the policy level; 2) provision of more relevant solutions through multi-sectoral collaboration; and 3) small-scale implementation to catalyze bigger initiatives.

### ***Strengthen Policy Support for Digital Transformation***

A successful DX strategy involves effective coordination of the seven dimensions – access, use, innovation, jobs, social prosperity, trust, and market openness.<sup>95</sup> Identified dimensions will function harmoniously when anchored within a robust policy framework supporting DX. In the process of policymaking, it is necessary to consider policies and regulations that are agile, fit-for-purpose and, at the same time, recognizes the complex and rapidly changing needs of MSMEs, which will therefore contribute to a more enabling business environment for DX.

### ***Continue Strong Government Support, with Increased Focus on Fiscal Policies***

The SII recognizes the government's efforts in creating favorable policies for MSMEs, especially that of the *Digital Transformation Partnership Initiative*. The initiative's primary objective is to help MSMEs build resilience through digitalization that will enable them to minimize the negative impact of disruptive events, such as the COVID-19 pandemic. It aims to provide a diverse range of support across different industries to accelerate digital adoption among MSMEs, including infrastructure support, consulting services, professional training, and targeted financial assistance.<sup>96</sup>

SII participants are optimistic that the government will continue to support MSMEs in the post-pandemic era. To make existing programs more inclusive, working session participants suggested the government explore new fiscal policies that would make DX more attractive and cost-effective for MSMEs, such as tax relief schemes and subsidies.

The government can also provide indirect financial support and increase MSME digital capabilities through incentivizing large corporations, technology providers, and e-com-



merce operators to implement programs that empower MSMEs to embark on their DX process.

Digital transformation consists of the fusing between physical and digital entities, and China's regulatory framework is still in the process of catching up in this aspect. For MSMEs in the manufacturing industry, specifically, the shift to smart manufacturing requires reliable internet connectivity and efficient algorithms.<sup>97</sup> The government's aggressive policy-supported 5G network expansion nationwide proved to be a strong start in supporting DX. Leveraging the generated momentum, the government could reevaluate policies that would allow private MNCs to contribute resources to establish a robust ICT framework that ensures consistent network connectivity, strong data privacy and security, and provide technological solutions tailored according to MSMEs' needs. Furthermore, existing regulations can be modified to ensure a balance between encouraging innovation and upholding regulatory mandates. MSMEs will greatly benefit from increased flexibility to innovate and the adoption of digital technologies, services, and products appropriate to each of their specific needs.

Data security policies and regulatory processes also need to be updated to be applicable to actual data use. With the *Draft Data Security Law* (《数据安全法 (草案)》),<sup>98</sup> *Draft Personal Information Protection Law* (《个人信息保护法 (草案)》),<sup>99</sup> and *Draft Guide to the Building of the Framework of Data Security Standards in the Telecommunications and Internet Sectors* (《电信与互联网行业数据安全标准体系建设指南 (草案)》)<sup>100</sup> still in the legislative process, the government could roll out interim measures on data management, which could include a dedicated data sharing mechanism to bridge the gap between the data demands of small enterprises and available data resources. To enable seamless data exchange, working session participants proposed for the government to explore the use of blockchain and big data technologies.

#### Clarify Relevant DX Policies and Promote Awareness among MSMEs

Providing clarity around the specifics of DX-enabling policies is also important to maximize benefits. Since the supervision and regulation of digital entities are different from physical entities, the government should clearly identify the roles and responsibilities of all regulators involved in oversight of DX, as well as the implementation guidelines for the regulation of the digital economy. The government could also improve coordination between relevant departments to reduce administrative burdens, avoid duplication of responsibilities, and streamline regulatory approval procedures.

Though there were a wide range of policies introduced to support MSMEs, many MSME owners often found them challenging to understand, apply, and fully maximize, leading to the underutilization and underappreciation of these government policies. Moreover, complicated application procedures can cause unnecessary burden for MSMEs. Thus, it



## ***Recommendation #2: Create a Conducive Environment for Digital Transformation***

would be helpful from the MSMEs' point of view if the government places emphasis in promoting policy awareness and delivering information in a more straightforward and inclusive manner, such as in the form of policy briefings, which could then be published in various government portals that are relevant to MSMEs.

### ***Examine and Address DX Impact on Broader Business Environment***

DX not only affects the entities undergoing the process of moving operations from offline to online, but also the broader business environment. New supply chains will be created, while many industries will inevitably converge and new ones will emerge. As such, the government should consider looking into the business segments impacted by DX and analyze how they can be restructured or reinforced to cope.

Human capital significantly contributes to enabling an environment for DX. Beyond the business environment, the government should also consider how MSME DX will impact other sectors of society as a whole, and potentially enact applicable reforms that will allow them to adjust and cope with this evolution. For instance, DX is already impacting the labor market as business process automation decreases the need for a manual labor workforce. Policymakers need to reevaluate education policies that can accommodate retraining or upskilling of displaced workers and create new policies to satisfy the demand for specialized talent in the labor market. According to a study that measures the MSME DX capacity in the manufacturing industry, MSMEs with highly educated staff are more likely to drive efforts to upgrade manufacturing capacity with smart technology.<sup>101</sup>

### ***DX Policy Framework Case Study***

Japan's Society 5.0 is Japan's national digital transformation strategy that goes beyond industrial DX applications and policies for the digital economy.<sup>102</sup> The Japanese policy-making approach recognizes that DX will penetrate through all aspects of society and these policies must tackle these challenges from all angles. This strategy ensures that all relevant perspectives are considered; more inclusive and impactful solutions are brought to the whole of society including MSMEs; as well as a balance of economic development and solutions to social issues. In a world where technology's role in society and the economy is ever-changing, addressing the need for relevant, agile, and fit-for-purpose policies are especially crucial (see "SII Spotlight: Japan's Society 5.0 Policy").

### ***Provide More Relevant Solutions through Multi-sectoral Collaboration***

#### ***Encourage Broader Participation in the Digital Transformation Partnership Initiative***

Building upon the objectives of the *Digital Transformation Partnership Initiative*, the government could benefit from extending the existing platform to a broader set of

**SII Spotlight: Japan's "Society 5.0" Policy**

Japan's science, technology and innovation (STI) policy framework envisions a sustainable, inclusive socio-economic system, powered by digital technologies

**Key pillars**

- Infrastructure
- FinTech
- Healthcare
- Logistics
- Artificial Intelligence

**Policy integration**

- Fifth Science and Technology Basic Plan (FY16 to FY20)
- Comprehensive Strategy on Science, Technology and Innovation (2017)
- Japan's Growth Strategy 2017

**Policy Priorities**

- *Urban and Rural Development:* Realize diverse lifestyles through the development of independent, prosperous societies through the peaceful co-existence of humans and nature
- *Disaster Risk Reduction:* Use digital technologies to maintain and manage essential infrastructure and rapidly share vital information across organizations
- *Financial Reforms:* Efficiently allocate financial resources across societies
- *Public Administration Reforms:* Establish social safety-nets to protect communities

*"A human-centered society that balances economic advancement with the resolution of social problems by a system that highly integrates cyberspace and physical space."*

Source: Society 5.0, Cabinet Office, Government of Japan

stakeholders. This enhanced platform could enable MNCs, local companies, industry associations, and other private sector entities to participate and integrate their resources, developing innovative solutions that accelerate MSME DX. Involving private sector stakeholders, particularly MNCs, can potentially provide MSMEs with support from the broader business community.

For MNCs and other private sector entities, the open platform can help them connect with more MSMEs, enabling MSMEs to gain better understanding of the digital transformation challenges they may face. This would help MNCs determine the insights they can share that would be most valuable for MSMEs, and for solutions providers to develop offerings that are more relevant to their needs. The SII advocates for a whole-of-society approach that integrates digital transformation support efforts with existing platforms to promote resource sharing and lower digital transformation costs for MSMEs.

*Collaboratively Develop more Relevant DX Insights and Solutions for MSMEs*

Digital transformation can be adopted in multiple areas of the business, including go-to-market approaches, offerings and value propositions, and delivery models – a complex undertaking that many MSMEs are unequipped to deal with. Furthermore, there is

## Recommendation #2: Create a Conducive Environment for Digital Transformation

rarely a one-size-fits-all approach to digital solutions that optimizes business processes, as different business models and industries experience varying sets of challenges, which is why MSME DX requires specific, tailor-made solutions.

MSMEs often view the currently available recommendations and insights about digital transformation to be too general or inapplicable to their specific needs. MNCs, on the other hand, frequently possess first-hand experience and expert knowledge about digital transformation in the context of China, and are thus well-suited to offer insights and advice to MSMEs. The *Digital Transformation Partnership Initiative* could therefore become the main matchmaking channel between MNCs and MSMEs to facilitate knowledge transfer. Through the platform, MNCs that are more likely to have successfully incorporated digital technologies in their business can share their learnings to help MSMEs develop strategies for digitalization, including which business areas to prioritize, which solutions can be adopted, and how to achieve goals with a great degree of success. Partnering MNCs and MSMEs that belong to similar industries or have complementary business models can ensure that MSMEs are receiving customized training, recommendations, and consulting services that are applicable and useful. The uniqueness of this activity would also promote awareness of the government's valuable efforts in supporting MSMEs' digital transformation and economic development.

Furthermore, the government's contributions could come in the form of data sharing and data analysis to assist MSMEs in making informed decisions. The government could also provide a database that houses information on credible technology service providers and assessment tools that help determine optimal DX strategies.

### Singapore's Go Digital Program

Singapore's Go Digital Program implemented by the Info-Communications Media Development Authority (IMDA) is a prime example of a government initiative that supports MSME digital transformation with multi-sectoral stakeholder participation. The program highlights the importance of expert advisory and collaboration with MNCs to develop tailor-made digital transformation solutions for MSMEs. Through the Go Digital platform, MSMEs can follow roadmaps that are specific to their industry, as well as connect with industry leaders and associations to gain valuable insights as they undergo digital transformation. It also allows MSMEs to choose among vetted solutions providers and leverage their services at lower cost (see "SII Spotlight: Singapore's SMEs Go Digital Program").<sup>103</sup> Similarly, Australia's Entrepreneurship Program connects MSMEs with expert advisory and facilitation services that support business improvement and innovation, with the aim of providing MSMEs with the capabilities and networks to grow with the help of innovation.<sup>104</sup>

## Recommendation #2: Create a Conducive Environment for Digital Transformation

### SII Spotlight: Singapore's SMEs Go Digital Program

Utilizes network of industry leaders, technology solutions providers, financial institutions, and subject matter experts to help SMEs build digital capabilities to seize growth opportunities in the digital economy

#### Services Offered

- **Industry Digital Plans** – 13 sector-specific roadmaps that provide SMEs with step-by-step guide on digital transformation and relevant training for employees
- **Pre-Approved Solutions** – Recommended digital solutions that are proven to meet SME needs, which can be adopted with up to 80% grant support
- **Start Digital, Start Right** – Helps SMEs that have not yet to digitalize to get started with foundational digital solutions in areas of banking and telecommunications
- **Grow Digital** – Offers business-to-business (B2B) and business-to-consumers (B2C) e-commerce platforms that SMEs can use to access global markets
- **Digital Resilience Bonus** – Incentivizes adoption of pre-defined digital solutions, beginning with the food services and retail sectors
- **SME Digital Tech Hub** – Provides cost-free digital consultancy to SMEs in need of expert insights in specialized areas such as artificial intelligence, cybersecurity, data analytics and Internet-of-Things

#### Results

- As of September 2020, more than 50,000 SMEs have adopted digital solutions as identified in the program

Source: "Helping SMEs Go Digital," Info-Comm Media Development Authority

### Encourage Small-Scale Implementation to Catalyze Bigger Initiatives

Pilot programs have been proven to minimize the risk of failures and maximize the benefits of innovative solutions. As industry leaders, MNCs can leverage their industry expertise to initiate small-scale pilot projects that test MSME digital transformation models. The process of implementing pilot programs will be advantageous for MSMEs as they explore and validate different strategies before pursuing the most efficient option, which enables MSMEs to manage risk of failure and financial loss in a better manner. For the government, the results of the programs will contribute to reforming existing policies and updating regulatory processes, thus, MSME DX pilot projects can serve as prototypes to validate policy solutions. Ultimately, pilot programs will provide stakeholders with the proper context and real-time experience to avoid hastened, one-size-fits-all strategies, policies, and regulations.

As an example, MNCs could explore by building an "innovation lab"-type platform for MSMEs that integrates the use of digital technologies to redefine their business process

## Recommendation #2: Create a Conducive Environment for Digital Transformation

and optimize operations. An “innovation lab” is a collaborative platform typically established by large enterprises where employees work with third-party experts, designers, and academics to develop new products or business models that leverage new business strategies and digital technologies. In this suggested “DX enablement innovation lab,” MSMEs will take the role of employees and MNCs will act as third-party experts. To enrich testing and evaluation capabilities, academics and research institutions could also be invited. This approach will be ideal for DX solutions providers that want real-world evaluation of their products. MSMEs, on the other hand, will benefit from the expert guidance from experienced MNCs and an increased DX awareness.

As policymaking supplements MSME innovation labs, the government could adopt an approach to policymaking that is similar to Sweden’s “policy labs.”<sup>105</sup> The name policy “lab” comes from the idea that experimentation is a key element in creating policy solutions, and a platform like this one is crucial for developing a regulatory framework that employs the participation of representatives of various competencies from different sectoral backgrounds. Policy labs are relevant to MSME DX pilot projects because they were primarily designed to formulate an agile approach to developing regulatory frameworks that stimulate innovation. It aims to address existing regulatory policies that are lagging behind the fast-paced technological advancements, while also avoiding the temptation of employing quick but irrelevant solutions. A suggested application would be for the policymaking body to collaborate with MSMEs and MNCS to test DX pilot programs, how the existing regulatory framework will react, and validate possible policy reforms in a safe environment (see “SII Spotlight: Sweden’s Policy Lab”).

### SII Spotlight: Sweden’s Policy Lab

An emerging trend in public policy and regulatory development that leverages a creative, technology-enabled, data driven, experimental and user-centered approach in developing demand-oriented policies

#### Basic Principles

- Focus on user demands
- In-depth understanding of the problem
- Early tests and prototyping
- System approach, system thinking

#### Innovations in Policymaking

- Use of experimentation and prototyping
- User-centered approach
- Promotes multi-stakeholder collaboration and co-creation

#### Benefits

- Pushes policy development in the right direction
- Enables innovation and smart policy making in a small scale and with low risk
- Facilitates learning process for knowledge and capacity building
- Promotes sustainable solutions
- Endorses policy reforms that recognize the role of digital disruption in society

*Policy Labs are neutral meeting spaces of stakeholders from commerce, academe, and government to discuss, create or improve policies and regulations impacted by digital technologies*

Source: “What is a policy lab?,” Vinnova



## Capacity Building for MSMEs and Entrepreneurs

China is entering a new era of digital commerce, which brings both challenges and opportunities for many industries and enterprises. There is an increasing gap between digital marketing talents and the high demand from the fast growing cross-border e-commerce, which will directly affect the future development of digital marketing in China.

### *Developing digital marketing talents to go global*

Google Digital Marketing Talent program was launched in 2020 to help bridge the talent gap by providing Google's free high-quality digital marketing training to young students and professionals. The training contents include digital marketing, data analysis, overseas knowledge, and product application skills, amongst many others. Google also matches MSMEs with hiring needs to talents who have successfully completed the training program, to help talents better navigate the job market and the company to upgrade their capacity to explore overseas markets.

### *Partnering with industrial associations/economic parks/local government to support business going global*

Google has partnered with various industrial associations, economic parks, and local governments to give free support to MSMEs to conduct business overseas during the COVID-19 pandemic. This includes training on industry verticals like textile, food, light and industrial products; supporting SMEs in preparing for on-line trade fairs such as Canton Fair, China International Fair for Trade in Services and East China Fair; as well as working with local governments to train local exporters in key export cities.

Google has partnered with associations and governments to provide the following services:

- Courses on B2C cross-border retail and B2B marketing ideas and methods
- Training on how to prepare for online exhibitions and to conduct live broadcasts on online platform
- Online or offline 1-on-1 Q&A sessions to help companies solve overseas marketing issues
- Google also develops growth plans for local B2B and B2C cross-border e-commerce companies.



What we have achieved :

- Since its launch two years ago, Export With Google has trained over 43,000 individuals from 36,000 different companies
- The Google Digital Marketing Talent program has attracted more than 30,000 individuals to sign up, 14,000 individuals to participate, and over 800 job positions filled in more than 120 companies
- In 2020, over 100 free online training events were held

## Recommendation #3: Empower MSMEs to Access Global Markets

The SII recognizes that MSME participation in international trade is wholly endorsed by the government with policy-level strategies, government-led support services, physical support infrastructure, and a successfully developed entrepreneurial ecosystem. The SII's recommendations revolve around suggested activities that MNCs and other private sector stakeholders can execute to reinforce government-led initiatives that leverage MNCs' existing business relationships with MSMEs. Ultimately these recommendations are built around promoting private sector engagement in government-led measures that boost MSME participation in international trade.

Specifically, private sector stakeholders can establish their role in the MSME support system by fostering linkages between MSMEs and international trade gatekeepers, leveraging resources to stimulate MSME innovation and host collaborative spaces, and serving as single points of contact for MSMEs seeking support and assistance.

### ***Mediate between MSMEs and Global Market Players***

MNCs, with their access to domestic entrepreneurial networks and international business organizations, can foster cooperation among entities by acting as arbitrators between MSMEs and overseas chambers, as well as foreign enterprises. For instance, MNCs can organize a network of MSMEs with good standing that they can endorse to international industry associations. The objective of this vouching system would help MSME suppliers more easily enter the global supply chain system and find potential export buyers. Furthermore, this platform could be expanded to facilitate "matchmaking events" and trade fairs. In summary, both MSMEs and buyers would benefit from this platform, as it provides them with a network of trusted partnership opportunities.

These mediation services can also apply to MSMEs exploring operation expansions overseas. MNCs can provide reliable contacts and access to business networks in foreign markets, which provides MSMEs with relevant information on unique business practices and socio-cultural context, as well as aid in setting up operations abroad. Moreover, having access to business networks overseas would allow MSMEs to identify new business opportunities and design suitable business strategies appropriate for specific foreign markets.

Trade associations, collectively representing MNCs, could also venture into bilateral trade arrangements with other countries. For example, the Singapore Indian Chamber of Commerce & Industry (SICCI) proposed for India's Gujarat government to set up a Special Economic Zone (SEZ) for Singapore MSMEs.<sup>106</sup> The proposal included expansion



### Recommendation #3: Empower MSMEs to Access Global Markets

of trade opportunities in the proposed SEZ by providing infrastructure, logistics solutions and technology enabled services. This model is unique as it supports MSME overseas expansion (i.e., Singapore MSMEs setting up production facilities in India), while at the same time provides employment opportunities to the host country (i.e., manpower needs of production facilities will be provided by India) (see “SII Spotlight: Singapore Indian Chamber of Commerce & Industry”).

**SII Spotlight: Singapore Indian Chamber of Commerce & Industry**

A business association for Indian-owned businesses in Singapore with over 1000 members mostly SMES. Connects, enables, advocates its members interests in local and international markets

<b>Strategic Goals</b> <ul style="list-style-type: none"> <li>Helping SMEs in bringing their businesses to the local and international market</li> <li>Representing the interests of the Indian business community in Singapore</li> <li>Promoting entrepreneurship and forging connections</li> <li>Assisting start-ups and helping in digitization and capability development</li> </ul>	<b>Support Services Offered</b> <ul style="list-style-type: none"> <li>Business advisory for government grants</li> <li>Capability development seminars and training programs</li> <li>Trade documentation for export goods and direct shipments</li> <li>Business matching (local and international)</li> <li>Mission trips for overseas business development</li> <li>Networking sessions</li> </ul>
<b>Core Values</b> <ul style="list-style-type: none"> <li>Focus – Driven by Member Needs</li> <li>Leadership and Advocacy</li> <li>Innovation</li> <li>Development &amp; Empowerment</li> <li>Collaboration</li> <li>Connections</li> </ul>	

Source: Singapore Indian Chamber of Commerce & Industry

#### **Leverage Resources to Enhance the MSME Ecosystem and Catalyze Innovation**

A focus on innovation could cement China's MSMEs' place in the global competitive space, helping them shift away from the reputation of manufacturing mass-produced goods, imitating products, and copying business models from abroad. In fact, government-led policy reforms and strengthened intellectual property (IP) enforcement mechanisms have established a stable foundation to cultivate innovation-driven growth.

Moreover, the establishment of government-controlled facilities, such as industrial parks and economic zones, has enabled MSMEs to have access to basic infrastructure (e.g., roads, energy, water, and sewage), security, business services, affordable land, technical training, and other cost-efficient amenities without the need for costly individual capital investment, all of which are immensely valuable to the growth of MSMEs.

MNCs can help optimize the business environment for MSMEs by leveraging these existing government strategies. For example, MNCs can invest in integrating robotics and AI into supply chain and logistics solutions. These services will complement the government's Cross-Border e-Commerce (CBEC) zones, which have been the main point of access so far for MSMEs to conduct cross-border trade. One way to restructure supply chain solutions for MSMEs is to explore cost-sharing models for transport, storage, and warehousing services, which enables consolidation and encourages optimal productivity and efficiency. Finally, upgrading support services will allow MSMEs to operate at scale and cater to larger supply chain requirements.

MNCs can also invest in technology-enabled shared facilities for MSMEs to promote innovation and global competitiveness. To further enhance this, trade associations such as AmCham China could organize entrepreneurship and innovation competitions for MSMEs to catalyze, incentivize, and facilitate innovation and collaboration amongst MSMEs. Within this platform, organizers can engage incubators and accelerators to enable and train MSMEs with the capacity to adopt and leverage IP rights (IPR) as a business strategy.<sup>107</sup> Organizers can also expand the platform for MNCs to share their knowledge on IPR creation, protection, and management, as well as partner with legal service providers which can assist in application procedures.

Germany's Central Innovation Program for SMEs (Zentrale Innovationsprogramm Mittelstand) grants funding for MSME-led innovation projects.<sup>108</sup> The program promotes collaboration and encourages innovation projects to be carried out in partnership with R&D institutions, with the ultimate goal of providing multi-sectoral support for MSME innovation and global competitiveness (see "SII Spotlight: Germany's Zentrale Innovationsprogramm Mittelstand").

Shanghai's Municipal Government released the Regulations on Encouraging the Establishment and Development of Foreign-funded Research and Development Centers in 2020 to attract foreign investors to set up R&D centers in Shanghai.<sup>109</sup> MNCs should leverage this opportunity to invest in an open innovation platform for MSMEs, which helps promote innovation by providing facilities, equipment, research and development sites, and professional guidance to MSMEs and innovations teams. Government-mandated support services are also available within these R&D centers, including customs support, preferential taxes, rental subsidies, and cross-border financial services facilitation. MNCs can also explore recreating innovation platforms in other municipalities that have established MSME clusters.

MNCs can also contribute to upgrading individual digital capabilities of MSMEs, which will help MSMEs increase their understanding of digital transformation advantages. Upgrading MSME digital capacities improves productivity, reduces costs, expands scale

## Recommendation #3: Empower MSMEs to Access Global Markets

### SII Spotlight: Germany's Zentrale Innovationsprogramm Mittelstand (ZIM)

Central Innovation Program for SME - A funding program implemented by Federal Ministry for Economic Affairs and Energy (BMWi) for German MSMEs to develop innovative products or improve existing processes with public and private non-profit research and technology organizations as collaborators

#### Funding Distribution

- MSMEs receive 25-55% of project costs (max. €380,000)
- Research institutes receive 100% costs (max. €190,000).

#### Funding Schemes

- Feasibility Studies
- Individual Projects
- Cooperation Projects
- Innovation Networks
- International R&D Projects

#### Program Objectives

- Provide long-term financial support for MSME-led innovative products processes, and technologies
- Encourage implementation of R&D results into marketable innovations
- Sustainably increase the innovative capacity and competitiveness of MSMEs
- Reducing technical and economic risks related to R&D
- Promote industry-science collaborations
- Assist in technology transfer between collaborators and participants
- Support MSME economic growth

Source: "ZIM – Germany's largest innovation programme for small and medium-sized enterprises," *Federal Ministry of Economic Affairs and Energy*

of production, and enhances capacity for innovation, laying out the foundation for global competitive advantage. To support this effort, MNCs can invest in developing ICT infrastructure upgrades critical for e-commerce operations, which is maximized when integrated in existing economic zones and industrial parks with enabling ecosystems. Technology support can also come in the form of designing "going global" apps for MSMEs that best fit their business models and internal structures. Financial services can be embedded that include traditional trade finance, credit services, and even investments through subsidiaries. The same app can integrate resources for financial assistance and subsidies. Technical support can come in the form of training MSMEs in essential skills needed for e-commerce including digital marketing, website building, search engine optimization, and data analysis.

### Consolidate Support from Private Sector Stakeholders

For the purposes of having a single point of resource for MSMEs seeking to expand to the global market, MNCs can establish linkages and organize summits with government agencies, legal services, consulting agencies, research institutions, industry associations, business networks, and other MNCs, to establish a platform that integrates existing resources and provides a channel to propose solutions. In addition to providing access and convenience for MSMEs, this would also improve public accessibility and aware-

ness of existing government-led support services, as well as scale existing campaigns and services through the private sector's network and resources, ultimately increasing impact and influence.

MNCs can contribute greatly by establishing a single channel for knowledge, more specifically, sharing best practices (geopolitics, laws, social security) to help MSMEs respond to risks. This channel could also host capacity-building activities that include information on maximizing participation in trade shows, utilizing e-commerce, developing export intelligence, accessing online market information for specific country and regional economies, and emphasizing on how MSMEs can adopt good governance practices to help them grow or attract additional investors. The goal of MNC training and knowledge sharing is to help MSMEs understand the requirements of developing sector-specific products according to international market demand.

This one-stop-shop could be a physical venue, a web-based portal, or a mix of both. Physical venues would be best established near industrial parks and CBEC zones where there are higher concentrations of MSMEs to generate greater impact. A web-based version, on the other hand, could ensure wider coverage and increased accessibility.

The *New Export Nation Consortium*, a program led by the Japan External Trade Organization (JETRO) in collaboration with private and public stakeholders including chambers and societies of commerce and industry, local governments, and financial institutions, specifically aims to support overseas business development for MSMEs.<sup>110</sup> The program leverages the individual expertise of partner organizations and enables provision of consultation and advisory services for strategic business planning; ultimately establishing international linkages, business deal mediation, and legal and administrative assistance. The program also holds business meetings where participants are able to discuss government measures relevant to the export industry. Export consortia is an efficient approach that allows cooperation between MSMEs, addressing the lack of market knowledge and financial resources to penetrate and establish presence in the export industry (see "SII Spotlight: Japan External Trade Organization's New Export Nation Consortium").

## Recommendation #3: Empower MSMEs to Access Global Markets

### SII Spotlight: Japan External Trade Organization's New Export Nation Consortium

A regional multi-sectoral collaborative platform led by Japan External Trade Organization (JETRO) providing comprehensive support measures for Japanese MSME business development in export trade

#### Support Services Offered

- Provide expert consultation and advisory on export processes
- Facilitate access to overseas markets
- Assist in addressing MSME-specific issues in export trade

#### Multi-sectoral Participation

- Ministry of Economy, Trade and Industry (METI)
- Ministry of Foreign Affairs
- Minister of Agriculture, Forestry and Fisheries (MAFF)
- Japan External Trade Organization (JETRO)
- Japan Food Product Overseas Promotion Center (JFOODO)
- Organization for Small & Medium Enterprises and Regional Innovation
- JAPAN (SME Support, JAPAN)
- Nippon Export and Investment Insurance (NEXI)
- Japan Chamber of Commerce and Industry (JCCI)
- Association for Overseas Technical Cooperation and Sustainable Partnerships (AOTS)

Source: "Introducing the best practices of 100 companies working on overseas expansion using JETRO," *Japan External Trade Organization*



## Supporting MSMEs Going Abroad

MSMEs are in a far less advantaged position to explore overseas markets and achieve digital transformation compared to larger companies. It has become even more difficult with the recent pandemic and uncertain economic developments, as many export companies are facing sharp drops in their orders and some are even on the verge of bankruptcy. MSMEs therefore need to quickly understand the "real needs" of users and their changes, accurately grasp market trends, and formulate effective marketing strategies in order to see success. Though there is a substantial growth in online business opportunities, many export companies have insufficient online experience, pay little attention to online business, are restricted by the online platform traffic or are unfamiliar with the credit status of online buyers. Therefore, their progress in digital transformation is slowed down and drastically restrained.

### *Providing market insight to understand the market potential for different MSMEs*

Google has the wealth of resources for analyzing global market activities and business trends. Google Market Finder and Google Trends are able to provide unique insight for MSMEs to shape their business strategies towards different markets and client groups. Google compiles useful reports on overseas market trends. For example, the WeChat account for Google Marketing Business School publishes industry reports/briefings and the CXO interview series to share insight and inspire countless industry professionals.

### *Empowering MSMEs with digital tools, platform, and knowledge*

Google's digital tools create marketing strategies for MSMEs to connect with untapped global markets. Google Ads solutions (such as Search and Youtube) enable MSMEs to better attract and engage with their target users and foreign buyers. Online exhibition playbook designed by Google provides MSMEs with crucial knowledge to prepare for online trade fairs during the COVID-19 pandemic. Google Export Experience Centers are established in key export cities to better serve potential customers through on-site support and training for Google Ads.

- Through the use of Google tools, clients are able to carry out precise marketing strategies, target specific customer groups and merchandise, make quick adjustments, discover potential categories, optimize supply chain decisions, and improve customer experiences comprehensively. In doing so, they are able to achieve significant growth despite many unfavorable factors.



- On May 15<sup>th</sup>, Google hosted a livestream event on how to prepare for online trade fairs. There were **5.8K** attendees in total, out of which over **90%** believed that the event was effective in preparing them for online trade fairs, and over 91% agreeing that they are more aware of the importance of digital marketing after the event.



## Supporting MSMEs Going Abroad Through Reliable International Logistics Service

The robust growth of cross-border e-commerce is fast changing the traditional way of doing international business. It enables small and medium-sized manufacturers to reach more markets and customers globally. However, cross-border logistics services remain a challenge faced by SME in ensuring fast and reliable customers experience globally.

Unpredictability and uncertainty as a result of long-haul transportation and customs procedures in different countries and territories hinder the SMEs' ability to provide trusted services to overseas customers, and impact their competitiveness and sustainable development.

The international logistics service provider worked in close collaboration with the pilot customs across the country to introduce more efficient customs clearance approaches for B2B exports of Chinese cross-border e-commerce companies. Simplified declaration and prioritized inspection improved the efficiency and cut the cost for SME customers to export in large quantity.

The logistics service provider also introduces new online declaration tools facilitating SMEs to submit relevant data of low-value Type C goods and formally declared Type D goods. The new tools improve efficiency and accuracy of data submission as required by the customs and thus speed up the export process.

SME exporters benefit from more simplified customs clearance experience and faster clearance procedures. As a result, they can count on more reliable and predictable international transportation to deliver the goods to overseas destinations. Against the backdrop of the COVID-19 pandemic, cross-border e-commerce plays a positive role in ensuring people's well-being and restarting worldwide economies.



## Setting High-Level Strategic Goals to Fulfill MNCs' Corporate Social Responsibility

Corporate responsibility is an essential part of Intel's culture as a leading technology company. As part of its core strategy, Intel always integrates corporate responsibility into business operation, such as continuously investing heavily in environment protection, supporting development of female employees, and achieving gender pay equality globally, and others.

2020 is an important milestone as Intel closes its corporate responsibility goals for the last decade and is also a new beginning as Intel launches new goals for the next decade. In the past decade, Intel achieved almost all goals in addressing climate change, promoting inclusiveness and improving social impact, and others. In its latest Corporate Responsibility Report, Intel detailed all efforts and achievements, among which Intel has achieved nine major goals in environmental sustainability.

### *Intel 2030 RISE Strategy and Goals*

Intel's purpose is to create world-changing technology that enriches the lives of every person on earth. It drives Intel to promote innovative ideas and technologies in broad social responsibility areas and promote sustainability. Following the idea of inheriting and developing corporate responsibility, Intel sets up new ambitious 2030 RISE strategy and goals for next decade.

Intel is committed to accelerate the adoption of responsible, inclusive, and sustainable practices in key areas in our operations and supply chain, and across the technology industry and society:

- **Responsible:** Drive to even higher levels of safety, wellness, and responsible business practices in our own operations and supply chain, including acceleration of responsible minerals sourcing practices. We will also collaborate with others and revolutionize how technology will improve health and safety through strategic healthcare, manufacturing, and transportation initiatives.
- **Inclusive:** Advance diversity and inclusion at Intel, including doubling the number of women and underrepresented minorities in senior leadership roles. Together with a broad range of stakeholders, we will strive to make technology fully inclusive and expand digital readiness for everyone.
- **Sustainable:** Continue to invest in reducing our own environmental footprint, including goals for absolute carbon emissions reductions, 100% renewable energy use, net positive water use, and zero total waste to landfill. We will also take on the challenge together with our customers and others to achieve carbon neutral computing through improved product energy efficiency and



sustainable design—and the increased application of technology solutions to reduce emissions in high-impact industries.

- **Enabling:** Accelerate the ways in which we will enable progress through our technology and the expertise and passion of Intel employees.

### *Intel Combats COVID-19*

Intel, as a core member of tech industry, actively engaged in fighting against COVID-19. In addition to zero employee infection in China, Intel overcame many barriers and ensured timely delivery of 90% orders, helping with the stability of industry chain and supply chain. Globally, Intel invested a total of \$60 million for COVID-19 fight, including \$50 million for the Pandemic Response Technology Initiative and \$10 million donation for communities, and cooperated with 100+ organizations on near 200 projects.

We see smart technology plays an unprecedented role in the COVID-19 fight. From saving life, reducing pain of patients to protecting medical workers, from production and testing of medical devices, hospital informatization to virus research and medicine development, and from remote education, remote meeting to everything on cloud, our way of work and life changed remarkably. All these are supported by cutting-edge technologies.

Intel, as a leading tech company, joins hands with partners to combat COVID-19 and drive economic and social development, including:

- Intel, Lenovo and BGI Genomics partnered to accelerate the analysis of genomic characteristics of COVID-19.
- Intel helps HY to use AI-powered CT imaging solution in the diagnosis of COVID Medical -19 and assist doctors to rapidly handle CT research report with AI neural network model.
- Intel's AI deep learning technology allowed mask manufacturers to rapidly deploy production lines for 24x7 automatic and efficient operation.
- Intel-based robots have been deployed in many Chinese hospitals to transport medical supplies and surgical equipment to reduce human-to-human interactions.
- As a founding sponsor of Open COVID Pledge, Intel also gives COVID-19 scientists and researchers free access to Intel's vast worldwide intellectual property portfolio – one of the world's largest.

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