

EXAMINING OBSTACLES TO SMALL BUSINESS GROWTH IN RURAL CHINA

Lack of capital, financial expertise, and market knowledge are frequent restrictors of growth

CONTEXT

Over the past few decades, the percentage of China's population living in poverty has fallen by unprecedented levels, with nearly 750 million people moving out of poverty between 1990 and 2015.¹ Despite these dramatic improvements, China has continued to face economic inequality, and ranks within the bottom third of all countries for inequality among its citizens.² This inequality is most prevalent when comparing China's rural and urban populations—a dichotomy resulting from differences in access to economic opportunities and seen most starkly in the availability of employment (or lack thereof) in more rural parts of the country. The relative absence of economic opportunities in rural China has been exacerbated by a lack of access to financial services. Only 14% of small Chinese firms have a loan or line of credit—nearly half of the average among other G-20 middle income countries (27%)—and 22% of Chinese companies saw access to capital as their biggest obstacle, compared to 10% for other G-20 middle income countries.³ Lack of access to capital and economic inequalities point to a need for lending to micro-, small-, and medium-sized enterprises (MSMEs)—particularly in more rural parts of the country. It is in this context that Opportunity International has worked to provide MSME owners with access to credit, which in turn create jobs in rural China.

RESEARCH OVERVIEW

Despite monumental progress in reducing poverty levels in China over the past few decades, economic inequality—largely linked to access to employment and credit—remains a serious concern. With support from the MetLife Foundation, this study seeks to gain a deeper understanding of the business goals, challenges, and conditions currently facing rural Chinese entrepreneurs.

RESEARCH FINDINGS

- ▶ **For Financial Inclusion:** Lack of capital was the most consistent barrier to business growth, according to rural Chinese MSMEs.
- ▶ **For Financial Institutions:** Chinese entrepreneurs value trust and are highly reliant on their personal networks for business advice and support. MFIs should cultivate meaningful, trust-based relationships with their clients.



Pig farmer He Xiaohong in one of her newly-renovated piggyeries

THE RESEARCH PROJECT

With support from the MetLife Foundation, a research team from Opportunity International (assisted by Chinese interpreters) interviewed a total of 46 clients from four Opportunity International China (Opportunity China) branches in April 2018. The purpose of this research was to gain a deeper understanding of MSMEs across the main sectors served by Opportunity. The research team employed three distinct methodologies aimed at understanding the past, present, and future of clients' businesses: Business Journey Mapping, MSME Self-Assessment, and Strategy Mapping, respectively. Findings from this study provide important insights about the goals, needs, and abilities of business owners in rural China.

RESEARCH FINDINGS

This research identified common strengths and weaknesses among Chinese rural MSME owners that impact their ability to succeed in a challenging business environment. Reviewing these findings also resulted in a number of recommendations for Opportunity China and other organizations looking to serve MSME owners in northern Jiangsu:

Finding #1: Rural Chinese entrepreneurs have a strong desire to grow, but gaps in business knowledge and practice often made this difficult. Nearly every MSME owner participating in the study expressed a desire to continue expanding their business, with expansion articulated most commonly in terms of acquiring new assets such as land, buildings, and equipment. More than three quarters (77.5%) of respondents gave themselves a 4 or 5 (out of 5) for “Have an expansion plan in place.” While many participants expressed significant ambition in expanding their businesses, the most clearly expressed constraint to business growth was lack of access to capital. The research team also identified poor practices in financial accounting, marketing, and market assessment as significant growth limitations. For example, only 7% of businesses said that they had an accountant and asset depreciation received the lowest score of any question from the MSME self-assessment.

Recommendation: Provide clients with access to additional training and resources. A digital database of available, quality resources and connections to government, academic, and

sectoral training opportunities would reduce dependence on potentially unreliable local sources and provide clients with a competitive advantage.

Finding #2 Many of OI China’s clients rely on their personal social network for key parts of their business. Friends, family members, and neighbors were the most common external source of knowledge and often served as significant advisors in business strategy and technical expertise. What’s more, few MSME owners mentioned taking formal courses or accessing digital or print resources. In relating to their employees and customers, entrepreneurs prioritized trust—the vast majority (85%) of clients rated themselves as a 5 out of 5 for trustworthiness, and all clients rated themselves as a 4 or above. This prioritization of trust makes sense, as many business owners rely on dedicated relationships with a small number of buyers in running their enterprises. However, these preferences often led to suboptimal operations and increased business risk. For example, Yu Lei was forced to close his first business, a clothing manufacturing business, in 2010 after a single major customer did not pay for an order. He has since reopened his business and is hoping to scale significantly in the next couple of years—basing the majority of his decisions on conversations with two current major clients.

Recommendation: Center customer care and engagement around the traits valued by clients, namely trust. These values should be incorporated into efforts to clarify loan procedures and strengthen client-loan officer relationships; clients should see their loan officer as a trusted member of their personal social network.

Finding #3: The ability of business owners to respond to the unstable business environment in rural China varies substantially. External shocks such as environmental disasters, disease, and government restrictions can have major impacts on rural Chinese businesses. Nearly one quarter (22%) of Chinese MSMEs participating in the business journey mapping exercise reported that they had either lost their business or faced serious growth issues as a result of government restrictions. Certain skills and business practices provide OI China’s clients with a better ability to weather these shocks and respond to increased difficulties. For example, Zhang Wei transitioned from his plastic pellet business (after it was outlawed) to furniture construction after conducting a market analysis and sending his two sons to study business and specialize in online sales.

Recommendation: Differentiate clients by sector, region, and business size instead of loan size (current practice). Train staff to use these differentiators to pinpoint key areas for technical assistance to MSME owners.



Yu Lei at his clothing manufacturing business

¹World Bank Poverty & Equity Data portal. <http://povertydata.worldbank.org/poverty/country/CHN>

² Based on the Gini Coefficient, a standard statistical measure used in economics to measure distribution of income or consumption. World Bank World Development Indicators. <https://wdi.worldbank.org/table/1.3#>

³ Bai, Dangwei, et al. “Toward Universal Financial Inclusion in China: Models, Challenges, and Global Lessons.” World Bank Group and People’s Bank of China. February 2018. <https://openknowledge.worldbank.org/bitstream/handle/10986/29336/FinancialInclusionChinaP158554.pdf?sequence=9&isAllowed=y>