Financing Constraints of Enterprise—Based on RMB Included into SDR

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Abstract. Beijing time December 1\textsuperscript{st} 2015 at 1 am, International Monetary Fund formally announced that add RMB into SDR (Special Drawing Right), the decision is to take effect on October 1\textsuperscript{st} 2016. Considering the financing constraints most China’s listed companies have, we think that the decision will impact the status quo. This paper is centered around the financing constraints of enterprises, based on RMB included into SDR.

Introduction
In March 2015, the economic division of central party school held a seminar about the current macroeconomic situation and tasks. The scholars believe that in the short term, China’s macroeconomic is faced with six challenges including financing constraints and enterprise plight, which will exert greater downward pressure to future economic growth. Thus we need to push forward reform that make market play a decisive role in the resource allocation as soon as possible, create relatively stable macroeconomic environment [1].

On November 30\textsuperscript{th} 2015, IMF officially announced to add RMB into the SDR basket, the SDR basket accordingly expanded to five kinds of currency including the dollar, euro, Japanese yen, the pound and RMB. RMB weights 10.92\% (the dollar 41.73\%, euro 30.93\%, Japanese yen 8.33\%, the pound 8.09\%). The decision is to take effect on October 1\textsuperscript{st} 2016.

Hengfeng bank institute executive director Ximiao Dong states that RMB join the SDR basket contribute to achieve a breakthrough in the field of multilateral-use of RMB, international investment and financing, cross-border asset allocation, the international monetary system, etc. [2]

In the face of the serious financing constraints problem that listed companies especially small and medium-sized enterprises in our country are confronting at present, we have reason to regard RMB join the SDR will alleviate the dilemma to some extent.

Current International Monetary Conditions
The dominance of dollar in the current international monetary system has been principal source of imbalance of the global financial order and economic structure. Whether the dollar hedge tide in the 2009 financial crisis or the federal reserve swing hike expectations recently, we can see that monopoly of international reserve currency for dollars has not only exacerbated the global financial turmoil but also forced countries around the world to pay for the Wall Street's moral hazard and lack of the U.S. government regulatory, which is unfair and inefficient. As China's growing to be the world's second largest economy, it’s getting more and
more important in global governance. It has become a trend for RMB joining in the SDR and sharing responsibility of the other four currencies. Though the weight assignment of dollar is very small and still resides in the monopoly status in this weigh change, RMB all the same has taken an important step forward international monetary system and it’s also a good opportunity established for international monetary system reform.

Table 1. Billion Yuan—Data from People’s Bank of China.

<table>
<thead>
<tr>
<th>The annual current-account RMB settlement amount</th>
<th>Project</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Trade in goods</td>
</tr>
<tr>
<td>2009</td>
<td>3.2</td>
</tr>
<tr>
<td>2010</td>
<td>438.0</td>
</tr>
<tr>
<td>2011</td>
<td>1560.6</td>
</tr>
<tr>
<td>2012</td>
<td>2061.7</td>
</tr>
<tr>
<td>2013</td>
<td>3018.9</td>
</tr>
<tr>
<td>2014</td>
<td>5897.4</td>
</tr>
<tr>
<td>Total</td>
<td>12979.8</td>
</tr>
</tbody>
</table>

**Financing Situation**

**Financing Constraints**

Our country is in economic transition period at present, the impact of internal cash flow on the enterprise investment decision, has an important function and meaning for China's enterprises.

1) **Small capital market**: The capital market faced by the listed company of our country is small, Compared with foreign capital market system, China’s saliently features imperfect on stucture. The development idea “thought much of stock-market, thought little of bond market, thought much of national debt, thought little of enterprise bond” led to seriously structure-abnormal and inefficient capital allocation using, have significantly affected on dispersing risks of market and rational disposition taking of financial resource.

![Multi-level capital market structure in China.](image)

2) **Not high profitability**: Profitability of enterprises is not high, however, real estate, finance, energy industry are obviously stronger than weak manufacturing.

3) **Overweight financial expenses proportion**: Some reasons like financial expenses proportion is overweight, brought about low level of enterprise internal cash flow. According to pecking order rule, the choices of financing modes should be ordered by internal retained earnings, debt financing and external equity financing. In other countries with well-developed capital market, the stock financing/ bond financing ratio is about 1:4. But in the past ten years
before 2002 in China, bond financing stayed trivial in total social financing, which gradually improved after 2005 [3].

In the financing structure of our listed companies, external financing makes up a large proportion, some companies are even totally reliant on it. As an important approach for enterprises to finance, internal financing has several advantages: low costs and high profits. Therefore, enterprise will have difficulties in surviving and developing in an intensely competitive market without internal financing. In middle and small-sized enterprises overseas, internal financing occupies a certain position. For example, internal financing basically takes up more than 55% in the enterprises of the main western developed countries, more than 82% in the US and the UK, of which ratio is further increasing. From 70 ~ 90 s of the 20th century, the ratio of enterprises in the US raised from 62% to 82.5%, the UK from 58% to 68.7%, Germany from 53% to 65.8%, even Japan with bank sponsor system, raised from 29.5% to 49.6%. While in our country, internal financing might takes up about 3%, external financing is the overwhelmingly dominant form, in addition to this, stock financing accounts for a large proportion, bond financing relies on loans especially short-term ones, the circulation of the bond is precious little.

Since China's capital market development is relatively slow and direct financing channels are relatively narrow, outside financing of many enterprises only point to bank loans. However, the credit resources are limited. In a nutshell, there is widespread financing bottleneck of listed companies in our country.

Effects of Financing Constraints

4) External system environment: One reason of our financing constraints is external financing institution. Only after the company satisfied certain conditions can it go for equity financing, or it can but finance for debt. High requirements of debt financing lead the companies to choose the bank loans, while the lack of the mortgaged property stifles some companies in the cradle. Though there are choices between debt and equity financing according to the external financing environment, because of the transformation cost of external financing way and rule-restriction of the system, our listed companies are suffering external financing constraints. The constraints may displays different characteristics from companies abroad and impact on investment - cash flow sensitivity [4].

5) Inner corporate governance: The theoretical basis of corporate governance effecting company investment is agency cost theory put forward by Jensen and Mecking (1976), which explained that the enterprises did not only exist asymmetric information problems but also had difficulties in managing [5]. The subject of agency can give rise to the correlation of investment and cash flow, and different enterprises have variant investment - cash flow sensitivity, extremely similar to the positive performance of financing constaints model under the asymmetric information condition. A high degree of corporate financing constraints prove that the enterprise is suffering serious information asymmetry and lacking of fund, so long as cash shows up, it’ll be used to invest totally. No more fund is provided for managers to squander in this condition, so when the degree of financing constaints is high, though the subject of angency exist, there is still no influence on the behavior of corporate investment. At this very moment, the information asymmetry is impressing the enterprise chiefly, appearing as high investment - cash flow sensitivity. While if the enterprise has a slight degree of financing constraints, there is little effect of asymmetric infomation, it can easily obtain external finance and keep little dependence on inner cash flow.
6) Companies' operating capacity: In practice, external financing would require the enterprise to meet the condition in net asset, sales revenue, net profits, operational cash flows and ROE. Generally speaking, enterprise scale is closely correlated with financial strength, management efficiency. The bigger the company is, the more financing channels and lower financing cost it has, while the small-scale companies have trouble in entering the external capital market. At the same time, great scale give the company more flexible schedules, considering the cost, it trend to use internal fund, while the small one will be faced with more competitive pressures. Even if it want to use external financing, which is more expensive, it’ll not give up the investment opportunity. The banks, creditors and shareholders would like to choose the companies with better cosolvency and higher profitability, as a result, these companies have stronger external financing capacity than the others [6]. On the other hand, the promotion of companies’ liabilities level will also cut the investment spending.

The Financing Under Sdr

RMB included into the SDR means deep influence for China’s finance market, generally speaking, the influence is positive, especially with the RMB internationalized, it has longtime impact on Chinese enterprise’s resource allocation methods and efficiency of resource allocation [7].

Making financing by RMB possible

With the status of RMB promoting, RMB assets will become the important composition in international finance investment. Chinese local enterprises can release RMB loans and bonds towards abroad by more preferential interest, which brings more opportunities for difficult financing enterprises. Surely, we must realize that the companies released bonds in international market need powerful strength and credit. Some people think, international finance can’t solve the Chinese difficult financing problem, because small and medium-sized enterprises which are difficult in financing in China still can’t finance in international market. Whereas, with the large companies finance turning to international market, releasing resources occupied in home, then this will provide opportunities for medium-sized companies [8].

Reducing exchange rate risk

Since the degree of internationalization of RMB is low, China’s enterprises had to deal with continual exchange transactions and hedging, still taking on the exchange rate risk in oversea investment. But with RMB into SDR, RMB’s status in international trade and investment significantly raised, meanwhile more international trade and investment will settle accounts by RMB [9]. Later, China’s enterprise invest in aboard efficiently and the exchange rate risk gradually would disappearing.

Adjusting finance strategy

It is predictable that financing market is about to take some changes in the current system. Therefore, financing strategies of China’s enterprises need adequate adjustments. Analyzing the outcome of above-mentioned financing events and Chinese enterprises condition, CFO could adjust investment and financing strategies from short-term repayment risk, foreign currency depreciation risk, cash flow, national policy background and so on.
Forcing Domestic Financial Reform

It would boost RMB internationalizing process by inclusion accelerating domestic finance reform. IMF rated two conditions for one currency included into SDR: one is this country’s good and service trade volume reach the top; the other is this currency could freely use. Five years ago, IMF refused RMB included into SDR basket due to RMB can’t meet the second condition [10].

Realizing RMB freely use needs capital account liberalization, exchange rate free floating decided by market, and enough free flowing finance assets [11]. For clearing away obstacles of RMB into SDR, China had mend finance reform pace largely and carried out constant reform.

On August 11th, 2015, central bank declared to improve formation mechanism of the RMB central parity and promote medium price linkage with yesterday’s closing price. In the last two days of new price quotation published, the RMB-Dollar exchange rate of depreciation range is separately 1.9% and 1.6%. This movement changed opaque exchange rate formation mechanism, then making exchange rate really come to be market-oriented and flexible.

On August 24th, CFETS firstly published reference rate, five times a day. This event could drive RMB into SDR, owing to reference rate can take as SDR standard of price making.

On Sept. 22nd, PBOC approved HSBC and BOC released one billion and ten billion financial bond in China bank’s bond market, which means that international commercial banks firstly were approved to released RMB bonds in the banks’ market.

On Oct. 8th, PBOC announced to adopt SDDS, which gained IMF’s recognition. On the second day, ministry of finance published to rolling release three-month book-entry national debts from the fourth quarter.

On Nov. 27th, three foreign sovereign funds came into china’s bank foreign exchange market. Allowing foreign finance institutions to step into our bond market, deeply contributes to finance market reform and increases market mobility.

As this meaning, included into SDR would force china’s finance reform. RMB into the SDR basket is an irreversible process, which can promote Chinese government releasing finance regulation. So the finance system gradually evolved to a more transaction instrument and multi-layered finance market.

Conclusion

Facing our condition of financing constraints, RMB included into SDR is opportunity and challenge. We should size up the situation and take full advantage of international environment, to solve the financing constraints bottleneck furthest.

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