

# Analysis of the Impact of Optimizing Business Environment on Small and Medium-sized Enterprises Taking Shanghai Pilot Free Trade Zone as an Example

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## ABSTRACT

Since its establishment, Shanghai pilot free trade zone has formulated and implemented a series of effective policies for the business environment of small and medium-sized enterprises, and continuously launched institutional innovation to form a series of construction experience with reference significance. This paper analyzes the problems faced by the business environment of small and medium-sized enterprises in Shanghai pilot Free Trade Zone, studies the content and formulation and implementation process of relevant policies, summarizes the optimization effect of the business environment in Shanghai pilot Free Trade Zone, looks forward to the future development of Shanghai pilot Free Trade Zone, and puts forward suggestions. After the analysis and summary of the article, the several results have obtained. The relevant policies put forward by the Shanghai pilot free trade zone have made some constructive achievements and provided a good foundation for the future development. However, these policies also contain some problems, which may reduce the advantages of the Shanghai pilot Free Trade Zone in the domestic and international trade environment and may also have a negative impact. Combing the new characteristics of the policies carried out by the government in Shanghai free trade zone is conducive to the reference and promotion of the experience of the free trade zones in China.

**Keywords:** *Small and medium-sized enterprises, Business environment, Shanghai pilot free trade zone*

## 1. INTRODUCTION

Small and medium-sized enterprises play a vital role in China's economic development. Ministry of Industry and Information Technology statistics, by 2020, the number of Enterprises in China has reached or exceeded 40 million, of which more than 95 percent are small and medium-sized enterprises. According to research by IDC China, small and medium-sized enterprises (SMEs) in China will contribute more than 60 percent of GDP and 80 percent of urban employment in 2021. Therefore, accelerating the development of small and medium-sized enterprises has become the top priority of China's economic development. Since 2013, the government has approved 21 pilot free trade zones covering 70 cities and regions in order to stimulate the development of small and medium-sized enterprises in China. The move is intended to stimulate the development and expansion of local enterprises by improving the business environment

in some regions. Research literature in related fields mainly includes the following two aspects: research on the promotion effect of business environment optimization on SMEs development and research on institutional innovation of business environment optimization in Shanghai pilot Free Trade Zone.

A large number of domestic and foreign researchers have pointed out that optimizing the business environment has a significant promoting effect on SMEs' innovation ability and profitability. Some scholars study the impact of business environment on SMEs from the perspective of the whole business environment. A 2021 study based on panel data modeling analysis of 30 Provinces in China from 2008 to 2017 found that optimized business environment has a significant role in promoting the innovation and development of SMEs [1]. In addition, based on panel data modeling and analysis of 30 provinces in China from 2008 to 2016, some scholars found that in today's Internet era, the development of the

Internet and the optimization of the business environment of small and medium-sized enterprises have a two-way promoting effect [2]. The business environment can be divided into market, policy service, socialized service, financing, law and other aspects. Starting from a certain aspect of the business environment, there are abundant research results to analyze the effect of this aspect on SMEs. Some scholars took 7,069 loan events of 539 SMEs in China from 2005 to 2017 as research samples to construct an analytical framework of relationship financing and enterprise technological innovation, and found that overall optimization of the business environment could facilitate SME financing [3]. Some scholars believe that the coordination and cooperation of all parties and the improvement of laws and regulations system can provide a legal guarantee for the business environment of SMEs [4]. In terms of market research, studies have shown that the construction of a unified open market system in the Yangtze River Delta is conducive to the optimization of the market environment for regional SMEs and the development of SMEs [4]. In addition, empirical studies have found that the cultural and social environment is also one of the very important business environments and has a certain impact on the development of SMEs [5]. Since the establishment of China (Shanghai) Pilot Free Trade Zone in 2013, a series of institutional innovation measures have been taken to optimize the business environment for small and medium-sized enterprises in the zone, which has played a very important role in economic growth. Based on the monthly data of industrial added value growth rate and total import and export growth rate of 31 provinces and cities in China, the economic growth effect of the establishment of Shanghai Pilot Free Trade Zone is evaluated. The results show that the establishment of Shanghai pilot Free Trade Zone has a significant positive effect on the economic growth of Shanghai. This economic growth effect is inseparable from the optimization of the business environment for SMEs brought about by institutional innovation [6]. Other studies show that the Shanghai pilot Free Trade Zone has a very good business environment and location in terms of investment liberalization and trade facilitation, financial openness and innovation, government regulation and service, and infrastructure, which plays a significant role in promoting the development of SMEs [7]. As one of the first pilot free trade zones in China, the Shanghai Pilot Free Trade Zone plays a very important role in promoting the optimization of the domestic business environment through institutional innovation and the formation of pilot experience to be extended to other pilot free trade zones and even to the whole country. Many Chinese scholars have also conducted relevant studies on this. A study shows that Shanghai pilot Free Trade Zone has achieved remarkable institutional innovation in terms of trade convenience, which can provide experience and reference for Heilongjiang pilot Free Trade Zone in institutional innovation [8]. Some

scholars also studied a certain policy of Shanghai pilot Free Trade Zone. For example, some studies showed that the reform of "one industry, one certificate" in Shanghai pilot Free Trade Zone was highly practical and could effectively serve SMEs in terms of policy services [9]. Financial reform and innovation in Shanghai pilot Free Trade Zone is conducive to alleviating the difficulty and high cost of financing for small enterprises in China, and these experiences can be copied and promoted, providing reference for other regions to alleviate the financing problems of small and medium-sized enterprises [10].

In this paper, based on the literature analysis, from small businesses facing the business environment of the various aspects of problems, in China (Shanghai) free trade area, for example, from the market, policy, social services, financing and legal Angle of five Shanghai free trade area to improve business environment policy and its role in promoting the development of small and medium-sized enterprises. The main analysis methods used in this paper are SWOT analysis and specific case analysis. When analyzing the development status of small and medium-sized enterprises, we used SWOT analysis method. When introducing the reform measures of Shanghai Pilot Free Trade Zone, we selected representative policy cases for detailed analysis. Finally, we come to the conclusion that the reform and innovation of Shanghai Pilot Free Trade Zone in recent years has greatly improved the business environment of small and medium-sized enterprises, but there are still deficiencies in some aspects, such as financing convenience and legalization.

## **2. THE ANALYSIS OF SMALL AND MEDIUM-SIZED ENTERPRISES**

In recent years, SMEs have maintained steady growth on the whole and become an important force for national economic and social development. SMEs contribute more than 50% of tax revenue, 60% of GDP, 70% of technological innovation, 80% of urban employment and 90% of the number of enterprises. They are the main force for national economic and social development and an important support for expanding employment and improving people's livelihood. By the end of November 2021, the balance of loans to small and micro enterprises nationwide was 49.45 trillion RMB, among which the balance of inclusive loans to small and micro enterprises with single family credit of 10 million RMB or less was 18.73 trillion RMB, with a year-on-year growth rate of 24.13%, 12.79% age points higher than the growth rate of all loans.

China's SMEs Economic Development Index (SMEDI) is the first evaluation index related to SMEs' development in China. Based on the questionnaire survey of the economic development of SMEs in some provinces and cities across the country, the index makes a comprehensive and systematic evaluation of the

economic development of SMEs in China from the four dimensions of institutional environment, corporate governance, market organization and financial strength. It is an authoritative index to evaluate the development of SMEs at present. China's SMEs were hit hard by the first wave of the epidemic in late 2019 and early 2020, and gradually recovered with the epidemic. As shown in the figure below, China's SMEs development index gradually stabilized at 86~87 after the epidemic, and SMEs recovered to a stable and positive development. Figure 1 is from CASME and shows SMEDI from November 2019 to December 2021, as shown in Figure 1.

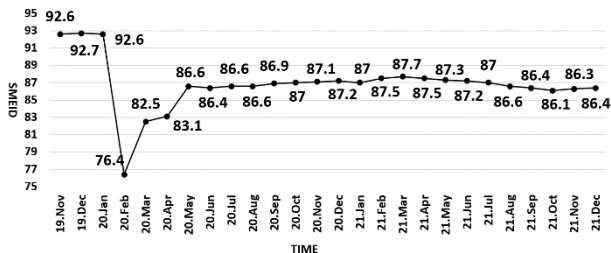


Figure 1 SMEDI [11]

Next, the article will use SWOT analysis introduced by Marcin [12], to analyze the business environment of SMEs from four aspects.

Firstly, compare to the big enterprises, SMEs are relatively slim so more flexible. Could easily change the targeted industry and would be easier to adapt to the technology revolution. Besides, the natural, lands and labors resources are abundant in Chinese market. Thus, the price of the products could be very cheap. At the same time, SMEs could react to the change of the preference of the people, thus provide satisfactory products for the customers. And, this would improve the market diversification.

SMEs also have got some weaknesses compare to the big enterprises. Firstly, the registered capital of SMEs is much less compared that of the big enterprises. Concurrently, SMEs are simply with underdeveloped management and financial system. All these disadvantages would make these SMEs hard to get financing. Simultaneously, with less political support imposed for them and less incentive from the government, the SMEs would have no resource to do the research and development. Thus, they are relatively less competitive in the market.

The opportunities for the further development of the SMEs in China are becoming more and more optimistic during these decades. With the stable economic growth in China, there are more domestic opportunities for the SMEs. Meanwhile, with the rapidly development of the globalization, there are more opportunities for the SMEs in the international market. For the present, the government of China has been improving the financial and political support for the SMEs during these years.

With more opportunities from the global market, the SMEs in China would also face the challenge from the foreign enterprises. The global economic situation is not optimistic recently. to the Chinese enterprise. With the trade war and the public health emergencies, both economic activity and international trade are facing a recession.

### 3. PROBLEMS CONFRONTED BY THE BUSINESS ENVIRONMENT OF SMALL AND MEDIUM-SIZED ENTERPRISES IN SHANGHAI PILOT FREE TRADE ZONE

#### 3.1. Difficult financing access for the SMEs in Shanghai

There are two main channels for the corporate to get financing, direct and indirect finance. Direct finance means the bond or stock issued by the economic existence such as government, corporate or individual. Compare to the large enterprise, SMEs are always slimmer and easier to be changed. Because of the low requirement of capital and relatively underdeveloped technology, it is difficult for them to be listed, that's why it is difficult for the SMEs to raise funds through direct finance. Compared with direct finance, indirect finance is more likely for the SMEs to obtain financing. Indirect financial channels include banks, financial institutions and credit institutions. However, indirect finance generally has thresholds, such as credit rating and guarantee system. Compared with large enterprises, the operation and management of SMEs is not good enough, which means that the repayment ability of SMEs could rarely meet the requirement of financial institutions. Therefore, it is difficult for SMEs to gain financing through indirect finance.

#### 3.2. Some administrative examination and approval procedures are complicated

After years of reform of the administrative examination and approval system, China has achieved certain results in the reform of the establishment of enterprises and other aspects, greatly improving the administrative efficiency. But there is still a gap compared with the world's advanced level. For example, in terms of procedures for starting a business, New Zealand has the best performance in the world, with only 1 item, while China (Shanghai) has 4 items. It takes only 0.5 days to start a business in New Zealand, but 9 days in China (Shanghai). For construction permits, OECD high-income economies require 12.7 procedures, while China (Shanghai) requires 19 procedures. The average processing time for construction permits in high-income economies is 153.1 days, while in China (Shanghai) it is 169.5 days. In addition, problems such as unequal delegation of power, multiple examination and approval

procedures and difficulty in obtaining licenses still exist to varying degrees, which affect the investment progress of market entities and the process of entrepreneurs.

### **3.3. Imperfect legal system**

At present, there are some imperfections in the process of legalization. Some laws and regulations are not practical. In the process of safeguarding their rights, some enterprises are in a weak position. In the actual law enforcement process, the implementation of the rule of law is not smooth, such as food, medicine, environmental protection and other fields related to public security and ecological protection. The law enforcement boundary between punishment and exemption is not clear enough. The following is a case of Shanghai Free Trade Zone in 2019. During the operation of the software developed and operated by a company, the website navigation home page of other companies set in the user browser was hijacked as the content of the software without authorization. The Pudong New Area court held that the company's malicious tampering with the user's browser home page and hijacking traffic not only violated the principle of good faith and recognized business ethics, but also violated the principle of equal competition, and ordered it to stop this behavior.

## **4. POLICIES RELATED TO OPTIMIZING BUSINESS ENVIRONMENT IN SHANGHAI PILOT FREE TRADE ZONE**

### **4.1. Lowering the financial threshold for the SMEs**

It was strait for the SMEs in Shanghai to gain debt because the channels that could lend them money are rare several years ago. The high thresholds from the financial institutions and credit agencies made the SMEs hard to get financing. Meanwhile the individual financing channel is not mature in China, thus this way to gain debt are rarely chosen because of the high risk. To solve the financial problem of the SMEs, the Chinese central bank and relative government institutions have issued series of policies in recent years. In one hand, the financial institutions and credit agencies are required to lower their threshold of lending, meanwhile, these institutions are asked to delay some of the debt and interest payment from the SMEs. Besides the SMES of manufacture, agriculture, import and export, Individual business such as truck driver, Taxi drive and the owner of online store are also targeted by the policy.

### **4.2. Policy and government reform**

In recent years, the Shanghai Pilot Free Trade Zone has made a number of institutional innovations in government services, significantly improving the capacity of government service enterprises. This part

takes the reform of "one business one certificate" and the reform of single window export tax rebate as an example for a brief analysis.

The reform of "one industry and one license" refers to the optimization of industry access business process and the integration of multiple licenses involved in an industry access into an industry comprehensive license. Shanghai Pilot Free Trade Zone has set up an online management service platform of "One Business, one License", which includes both web version and mobile terminal. Applicants of small and medium enterprises can complete the application process online, and the comprehensive window will collect materials and issue comprehensive licenses online. This will significantly reduce the number of procedures and time limits for approval, simplify approval procedures, effectively improve administrative efficiency and efficiency, and further stimulate the development of market entities. The first batch of 31 pilot industries includes Internet e-commerce, Internet hospitals, supermarkets and convenience stores, most of which are closely related to people's daily life. Small and medium-sized enterprises (SMEs) play a leading role in these industries.

Rebates to previous cases, the enterprise must hold and authorization of the ministry of foreign trade and economic cooperation approved the export approval documents of the management, industrial and commercial business license, tax registration certificate and the customs code certificate file to the local competent tax rebate business tax authorities to fill in the tax registration form "export enterprises, the whole process is relatively complicated, time-consuming, It will produce relative labor cost and time cost for small and medium-sized enterprises.

The Shanghai Pilot Free Trade Zone innovatively proposed the reform of "single window" export tax refund, integrating customs filing, customs declaration data query and download, tax refund declaration and other businesses into one platform through system connectivity and data sharing. Tax refund enterprises only need to log in once and apply once to achieve one-stop export tax refund. In this way, small and medium-sized enterprises that need export tax rebates do not need to entrust relevant institutions to help with the procedures, but only the financial personnel of the company can operate on the online tax refund platform.

### **4.3. Tax reduction for SMEs**

Because of the public health emergencies, the price of the raw material raised rapidly. As the number of economic activities have decreased greatly during this period of time, the number of the orders also decreased for the SMEs in Shanghai. Most of the SMEs are facing dilemma of bankrupt because their lower revenue could not match the increment of the cost. To solve this problem,

Chinese government have delayed the tax lodgment (personal income tax, corporate income tax and good and service tax etc.) for the manufacture SMEs. Small business could delay 50% of amount of several taxes' lodgment, whereas the median business could delay 100% of amount of several taxes' lodgment. Meanwhile the government raised the tax lodgment threshold and reduced the tax rate of several taxes for the SMEs. The threshold of value-added tax for the SMEs' taxpayers has been raised from 100,000 RMB to 150,000 RMB, total tax reduction has reached 66.7 billion RMB and benefited 4.05 million taxpayers; The tax rate of the value-added tax for the SMEs' taxpayers has been decreased from 3% to 1% which reached 185.3 billion RMB, 8.95 million taxpayers were benefited; The income tax for SMEs and individual business was also decreased the reduction of 43.1 billion RMB has benefited 10.6 million taxpayers. According to the National Bureau of Statistics of China, the tax payment reduction of SMEs reached 295.1 billion RMB and benefited ten million of taxpayers in Shanghai.

## **5. THE EFFECT OF BUSINESS ENVIRONMENT IN SHANGHAI PILOT FREE TRADE ZONE**

### ***5.1 The improvement of financing system***

According to the "Doing Business Report 2020" released by the World Bank, the second-level index of "credit information Depth Index" under the first-level index of access to credit in Shanghai reached the maximum 8, indicating that enterprises in Shanghai can obtain sufficient credit information when making financing decisions. However, at the same time, the "strength of legal rights" under the first-level index of obtaining credit in Shanghai only scored 4 points (the highest score is 12), indicating that the legal guarantee of corporate financing in Shanghai still needs to be improved.

### ***5.2. The outcome of the financial policy***

Since the government has reduced the financial threshold of the credit agencies and financial institutions, the number of debts has raised moderately. During the pandemic, the economy of China faced the first economic recession after PRC had been built. As SMEs is the most important component of Chinese economy, to help the SMEs to gain rapid recovery, the government and central bank of China keeps improving the financing policy for the SMEs. The data from National Bureau of Statistics of China indicated that until the end of the April 2021, the number of debts for the SMEs has gained a yearly increment of 13.6% and reached 118.4 trillion RMB, and of which 10.2 trillion and the interest payment were allowed to be delayed [13].

Although various financial policies were issued for

solving the financing difficulties of SME, the outcome was not as good as expected. According to the data from the World Bank in July 2020, Shanghai's ranking of financing access has dropped from 68th to 80th, the ranking showed a huge gap between Shanghai and the economies that are excellent in this area. SMEs in Shanghai still facing the financing problem such as high threshold and high borrowing costs etc.

Get financing is becoming one of the most crucial factors for the survive of the SMEs. The increasing price of the raw material has increased the cost of production in SMEs. Tremendous amount of the SMEs announced bankrupt during this period of time because their revenue could not fulfill their cost. Chinese government and relative has issued policies, whereas, lowering the financial threshold could only solve the urgent needs, strong follow-up support is as same as important for the development of SMEs.

### ***5.3. The effect of policy service construction***

Shanghai pilot free trade zone has achieved remarkable construction results in policy services. First, cross-border trade has been accelerated and fees reduced. Implement the policy of reducing fees and standardizing fees at ports, and connect the "one-stop" platform for fee inquiry with the "single window". Improve the quality and efficiency of port logistics operations, create a paperless delivery form logistics platform, promote the "two-step declaration" and "early declaration" mechanisms, and carry out the pilot of "direct loading at port" and "direct delivery at the ship's side" for goods export. The second is the optimization of bankruptcy procedures. In order to facilitate the settlement of bankruptcy problems, the priority of credit after commencement shall be stipulated, and the participation of creditors in bankruptcy proceedings shall be improved. Optimize the bankruptcy procedure and speed up the trial of reorganization identification and pre reorganization. The bankruptcy court, the bankruptcy court and the bankruptcy administrator should be trained. Strengthen the integration mechanism of "government and court", reduce the degree of information asymmetry between administrative departments and courts, jointly promote the marketization of debt restructuring, and coordinate the handling of bankruptcy and other businesses. With the deepening of the reform of the business environment, the market vitality of enterprises in Shanghai is increasing.

### ***5.4. The improvement of legal system***

According to the 2020 global business environment report, the quality and efficiency of contracts implemented in Shanghai pilot free trade zone have been improved. Specify the maximum number of extensions allowed, and limit the extension of unforeseen and special circumstances. Optimizing execution links,

reducing costs, and encouraging online judicial auctions. Building and promoting the national court inquiry and evaluation system, and improve the supervision of the practice norms of appraisal institutions. Standardize the bidding and post bidding process of government procurement, establish the information disclosure mechanism of government procurement and bidding, and publicize the procurement intention measures within 60 days after the budget approval.

## **6. PROSPECTS AND SUGGESTIONS FOR SMALL AND MEDIUM-SIZED ENTERPRISES IN SHANGHAI PILOT FREE TRADE ZONE**

Based on the relevant articles from Contemporary Economic Management and The Whole World, this paper summarizes and puts forward the following three suggestions at the end of this paper [14].

### ***6.1. Prudently promote financial openness and implement risk control***

Based on China's current development status, Shanghai pilot free trade zone should carefully promote financial opening. Excessive financial opening will easily lead to arbitrage of international capital through the platform of Shanghai pilot Free Trade Zone, which may have a serious impact on the capital market and the real economy. Therefore, in the process of promoting the financial opening of Shanghai pilot Free Trade Zone, it is necessary to gradually open it step by step, so as to not only ensure the smooth operation of various business activities in the pilot Free Trade Zone, but also effectively achieve risk control.

### ***6.2. Internal implementation of relevant policies***

Other cities in China except Shanghai do not need to follow the current policies of the Shanghai pilot free trade zone at this stage. Shanghai has a great advantage in the development foundation, so the relevant policies of the pilot free trade zone are matched with Shanghai's own development level. Relatively speaking, other important cities in China do not have the existing development foundation of Shanghai. Therefore, at present, it is not appropriate to rapidly promote all the policies of the Shanghai pilot free trade zone to the whole country. Cities with different development levels and in different regions should clarify their respective positioning and formulate policies according to local conditions.

### ***6.3. Establish a system of cross-border investment and trade rule***

Adhere to the development strategy of free trade and establish a system of cross-border investment and trade rules in line with international norms and the rule of law.

The most prominent feature of Shanghai pilot free trade zone is to integrate the domestic trade and investment system with international rules, which reflects the guidance of the Chinese government to further implement the development strategy of free trade. In line with international standards, the trade and investment policies of Shanghai pilot free trade zone are the inevitable requirements for the development of a real market economy and the driving force for China's wider and deeper integration into the world economy.

## **7. CONCLUSION**

All in all, the pandemic of the COVID-19 has slowed down the global economic growth during recent years, therefore, to reviving the economic growth becomes the most crucial task for the affected countries. China, with the most rapid economic growth during recent decades, is also one of the most affected countries. During the period of the COVID-19, huge number of SMEs in China are facing bankrupt because of the reduction of the orders. As the most important component of the Chinese economy, how to solve the problem faced by SMEs could be the most vital task for the Chinese government whom want to gain economic growth again.

This paper tried to use SWOT analysis to explore whether the strengthen of the business environment could improve the growth of the SMEs in Shanghai or not, and consequently find out that the SMEs in Shanghai became better after the government had imposed supported polices. Whereas, some of the policies are not as efficient as expected. As one of the most important factors for the survive of the SMEs, the ranking of the SMEs financial access section even dropped in the announcement by the world bank in 2020. Meanwhile, the accuracy of the implication of the government policies is also a big issue in China. Therefore, how to improve the financial access of the SMEs should be one of the main points for the researchers who would like to investigate the effects from the business environment optimization. At the same time, the estimation of how to improve low enforcement could also be focused by the further studies.

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