

# Financing Problems of the Arts and Crafts Industry and Suggestions

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**Abstract:** China's arts and crafts industry is mostly composed of small and medium-sized private enterprises with weak capital, and financing has been its one major problem in development. This paper will focus on small and medium-sized enterprises in the arts and crafts industry, analyze their financing situation and problems in development and propose countermeasures and suggestions to optimize the financing of the industry.

**Keywords:** Arts and Crafts Industry; Small and Medium-Sized Enterprises; Financing

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## Introduction

The Chinese government has always been attaching importance to the arts and crafts industry which has established a relatively complete industrial system after developing over years. In recent years, the industry has presented bright prospects with supporting policies in the cultural prosperity. However, small and medium-sized enterprises in the industry face a certain development issues, among which financing difficulties such as the lack of financing channels are the prominent factors restricting its development. This paper analyzes financing problems of the arts and crafts industry and puts forward corresponding countermeasures and suggestions.

## 1. Analysis on financing needs of arts and crafts enterprises

There are 11 categories<sup>1</sup> including 65 types and 83 sub-types of arts and crafts in China. Currently, the arts and crafts industry mainly consist of large arts and crafts enterprises, small and medium-sized ones and master studios. Large-scale arts and crafts enterprises, such as Yangzhou Arts and Crafts Group Co.,Ltd. and China National Arts & Crafts (Group) Corp. which are state-owned enterprises with large production scale and high-level modernization. They rely on labor-intensive production and large-scale mechanized production, demanding relatively large long-term and stable funds which will be mainly used for purchasing raw materials, expanding production scale and maintaining the regular operation. With abundant assets, good credit and solvency, such enterprises can gain access to loans from banks and other financial institutions.

Apparently, master studios and small & medium-sized enterprises comprise the main body of the arts and crafts industry in China. They have small scale and relatively low-level modernization, featuring individual-owned or family-owned business with low capital needs. By making production with their own capital, such enterprises maintain the traditional operation of mom and pop businesses. According to the field survey, master studios and small & medium-sized enterprises have certain capital needs which are small and short-term. For occasional financing, they often chose to turn to friends, relatives or private financing for loans to deal with short-term fund shortage and normal operation like covering workers' wages before funds are withdrawn. There are three reasons for such financing model. Firstly, such enterprises operate with a

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<sup>1</sup> According to the national arts and crafts industry census, there are 11 categories of arts and crafts in China, including: sculpture crafts, metal crafts, lacquer crafts, painting crafts, natural plant fiber weaving crafts, faggoting embroidery crafts, carpet tapestry, jewelry, ethnic crafts, ceramic crafts and fireworks.

small scale and have low demand for capital; secondly, influenced by the traditional thinking and business philosophy of operators, master studios and small & medium-sized enterprises mostly adopt the traditional family-style business model. Their owners do not have modern operation and management thinking or understanding of modern finance and management, fear to take risks in financing; thirdly, large arts and crafts enterprises can use factories, large buildings of product exhibition and other inherent assets as collateral, while master studios and small & medium-sized enterprises are unable to obtain loans from formal institutions or banks for a long time due to the lack of assets used as collateral and low credit level. They can only choose folk financing, private lending or no financing as far as possible.

## **2. Analysis on financing problems of the arts and crafts industry**

### **2.1 The VAT (value-added tax) is difficult to deduct**

The industrial chain of arts and crafts specifically contains three parts of raw material production, production & processing and sales. According to supply-and-demand situation and price, raw materials can be divided into precious raw materials and common raw materials. Precious raw materials are expensive with scarcity and poor pourability, such as precious metals (jewelry, jade, crystal, gold, silver and others), and precious wood (mahogany, African rose wood and others). Currently, China's arts and crafts industry needs a large number of precious raw materials including jewelry, jade and precious wood from abroad. While it is easy to obtain common raw materials, which are cheap such as natural stones, shells, bamboo, silk, common tree roots etc.

With diminishing of domestic resources such as jade, jewelry and wood, some arts and crafts are getting to rely on imported raw materials increasingly. For example, domestic jadeite are practically exhausted, and need lots of imports from Myanmar; as Xinjiang Hetian jade are in decline gradually, the import of white jade from Russia and Canada is increasing year by year; mahogany, small-leaf rosewood, scented rosewood, wenge and other rosewood are mainly imported from Southeast Asia and Africa. With the increase of import, price of raw materials rise and the tax get higher, thus the smuggling seems to get severe. Meanwhile, most of the raw materials that can be locally obtained are purchased from the folk or directly from farmers, so it is difficult to obtain VAT invoices, resulting in the difficulty of VAT deduction. According to prevailing policy, China collects consumption tax on ordinary jewelry and other arts and crafts. As a large number of arts and crafts enterprises have few channels for tax burden shift, they have to pay for the final consumption tax eroding profits, which definitely restricts their development.

### **2.2 Product value is difficult to appraise**

Arts and crafts products' economic value represents from two aspects, the material value and the artistic value, which makes them non-standard and precious. Due to the lack of authoritative institutions of assessment and valuation, a lot of arts and crafts cannot be reasonably valued especially when it comes to the works of masters. Those works with inflation proofing and possible appreciation possess financial attributes.

However, the art market is not completely competitive, the value of arts has not been recognized among the mass, and there are few credible institutions of assessment and valuation. Products' artistic value is difficult to assess with a objective unified standard. It is common that people take the material value as the product value in valuation, ignoring the important artistic value. As a result, many products get low worth, and their art value are difficult to be recognized by formal financial institutions such as banks. Against this background, it is impossible for enterprises to finance with the expected value of products as collateral. Enterprises of arts and crafts are generally small in scale and have limited fixed assets such as factories and equipment. Most of the assets are product inventories, which need to be sold for cash. Therefore, those products are not likely to be used as collateral, seriously restricting the financing of enterprises.

### **2.3 Mismatch between supply and demand of funds**

On the one hand, though enterprises of jade carving and wood carving have big short-term and uncertain financing needs, they find it is cumbersome to apply for loans from formal financial institutions like banks. Moreover, there is no

specific targeted financial products in banks who have no sustainable financing mode for arts and crafts enterprises, driving them to turn to folk financing. In more mature market operation, on the other hand, enterprises have to seek private bridge loan, because of long duration of occupancy of funds, production links and period, while many loans from banks having time limit for only one year, or rather eight to nine months excluding the time for submitting application formalities and repaying the loan in advance.<sup>[1]</sup>

## **2.4 Asymmetric information between capital demanders and suppliers**

Commonly, banks are lack of recognition of arts and crafts industry development, masters, their social status, values of their works and the industry prospects. Artworks are different from movable and immovable property when they are taken as collateral. Restricted by the risk and standardization of the art market, many financial institutions still have not tapped into this field, lack of corresponding financial innovation products for art financing. On the other hand, enterprises, especially small and medium-sized ones and master studios, have little basic understanding of the application process and operation mode of financing, and are conservative to the modern financial system. They would rather choose private loans or high-risk folk financing than borrow from banks and other financial institutions.

## **3. Suggestions on the financing for development of the arts and crafts industry**

### **3.1 Provide more support with tax policy**

In recent years, China made a series of policies about tax cuts. Although the new tax law is an adjustment and improvement to the original one, it cannot cover all special situations in the arts and crafts industry as it is different from other manufacturing sections. Arts and crafts enterprises should get policy support from three aspects. Firstly, the arts and crafts industry should have the same tax rate of 6% with the whole cultural and creative industry. Considering that the value-added rate of the arts and crafts industry is relatively higher than that of other industries and the fact that small and micro enterprises make up a large part of the industry, the VAT rate should be appropriately lowered or the threshold of VAT should be raised; Secondly, VAT deduction method should be improved. The raw materials mainly come from agriculture, forestry, minerals which are not likely to get the actual VAT invoice. We suggest a direct deduction in a certain proportion with reference to the Pilot Implementation Measures for Verification and Deduction of Input Tax of VAT on Agricultural Products, and deduction procedures be simplified; Thirdly, it is necessary to expand the scope of VAT deduction. For arts and crafts enterprises of minorities should get taxed refereeing to the deduction policy applying to those of high-tech industry on terms of technical transformation and fixed assets purchase. As for those production of endangered arts, we suggest that they have a certain years of tax holidays to promote their conservation and development.

### **3.2 Establish and improve the credit system of enterprises and masters**

It is suggested to build a credit service platform of the arts and crafts industry, establish credit record of enterprise owners, credit consultation system and standards for individuals and enterprises in the industry, improve their credit awareness, and provide information inquiry channels for financial institutions. For example, a master credit evaluation and credit system should be built to conduct unsecured loan business for arts and crafts masters. Those with national or provincial honor and having certain assets or high reputation can obtain unsecured loans through the system.

### **3.3 Promote the construction of financing and service platforms**

It is necessary to strengthen the cooperation between banks and enterprises, and gradually establish the financing and guarantee system for the industry to meet the financing needs in it. Meanwhile, we suggest to improve the system of productive services covering finance, information and commerce to provide a service platform. A cooperation agreement on the credit construction should be signed between the government and the bank to set guarantee companies for small and

medium-sized enterprises and assessment & auction mechanism of arts and crafts products, establish and perfect a series of systems including democratic appraisal of loans, enterprise credit rating, assessment and pricing standards of arts and crafts products, loans evaluation standard, and social evaluation of enterprises, forming a four-in-one financing system of government, bank, social intermediary and enterprise; establish the repurchase system of arts and crafts to introduce collectors, potential buyers or institutions in the process of valuation and evaluation of collateral who will repurchase the collateral to minimize the risk when the lender is unable to repay; <sup>[2]</sup>finally, we suggest auction agencies and other institutions cooperate to better understand the market and realize product appreciation through mortgage auction.

### **3.4 Expand direct financing channels for small and medium-sized enterprises**

Guide and support qualified small and medium-sized enterprises to issue corporate bonds, short-term financing bonds and bills for financing, and encourage them to get being listed on the GEM (Growth Enterprise Market) and SME board (Small and Medium Enterprise Board), in order to expand financing channels and improve financing capacity. Furthermore, moderately increase the interest subsidy for and medium-sized arts and crafts enterprises, especially for those inheriting intangible cultural and traditional handicrafts, to reduce their financing costs. In addition, innovate mutual guarantee methods to reduce credit risks. For example, high-quality small and medium-sized enterprises can obtain credit by being endorsed by the local core enterprises in the industry.

## **Conclusion**

As the arts and crafts industry become an important part of the cultural creative industries, its financing issue is drawing more and more attention. In order to resolve financing difficulties restricting the development and break new ground, more fiscal and financial support should be provided to the arts and crafts industry by perfecting relevant supporting measures, setting up the integrity trading mechanism, and innovating the mode of financing.

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