

# Small and Medium Enterprises (SMEs) and Sustainable Development in China: Opportunities, Challenges, and Future Directions

Research Paper

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## Abstract

Small and Medium Enterprises (SMEs) are foundational to China's economic structure and its transition toward high-quality, innovation-driven, and greener growth. This paper offers a comprehensive, up-to-date synthesis of SMEs' contributions, the evolving policy environment, and the practical opportunities and constraints that shape their sustainability trajectories. Drawing on peer-reviewed studies, Chinese government communications, and international policy reports (2015–2025), we analyze how SMEs in China advance sustainable development through digitalization, green innovation, and integration into domestic and global value chains. We highlight recent national initiatives—such as the expansion of cross-border e-commerce comprehensive pilot zones and support for 'specialized and sophisticated "little giant"' firms—and discuss persistent gaps in financing, digital capabilities, intellectual property protection, and uneven regional development. The paper concludes with evidence-based recommendations on finance diversification, targeted digital and green capability building, and cluster-based strategies to enhance resilience and sustainability performance.

**Keywords:** SMEs; China; sustainable development; digital transformation; green innovation; policy; clusters.

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## 1. Introduction

China's rapid economic ascent and structural transformation have been underpinned by the dynamism of SMEs, which account for the overwhelming majority of enterprises and a large share of employment and value added. Official communications underscore the role of the private sector—dominated by SMEs—in generating around 60% of GDP, 80% of urban employment, and 70% of technological innovation (State Council Information Office of China, 2023). As of early 2023, official briefings also noted over 52 million micro, small, and medium-sized enterprises nationwide (State Council Information Office of China, 2023).

At the same time, China's development agenda emphasizes “high-quality” growth, green transition, and technological upgrading. Institutional measures to strengthen SME capabilities include the Law on the Promotion of Small and Medium-Sized Enterprises, originally enacted in 2002 and amended in 2017, which provides the legal foundation for SME development, finance, and support mechanisms (Law of the People's Republic of China on the Promotion of Small and Medium-Sized Enterprises, 2018). The Ministry of Industry and Information Technology (MIIT) has spearheaded programs to identify and support “specialized, sophisticated, distinctive and innovative” SMEs, including the elite cohort of “little giants.” Official tallies indicate that China surpassed its 2025 goal, cultivating over 14,600 “little giant” firms by late 2024 (Ministry of Industry and Information Technology of China, 2024).

This paper updates the evidence base and deepens analysis on how Chinese SMEs contribute to sustainable development—economic, social, and environmental—while navigating post-pandemic shocks, supply chain realignment, tighter global financial conditions, and domestic restructuring.

Research Questions:

RQ1. What are the core opportunities and challenges facing SMEs in China today?

RQ2. How do SMEs contribute to sustainable economic, technological, and environmental outcomes?

RQ3. Which policy and institutional mechanisms most effectively support resilient, innovative, and green SME growth?

## 2. Literature Review

### 2.1 Defining and Classifying SMEs in China

Chinese SME classification is sector-specific and accounts for employees, operating revenue, and assets, with thresholds varying by industry. The statutory basis is the SME Promotion Law and associated classification standards (Law of the People's Republic of China on the Promotion of Small and Medium-Sized Enterprises, 2018). While criteria differ across manufacturing, construction, and services, the overarching approach recognizes the heterogeneity of SMEs and the need for tailored policies.

### 2.2 Evolution and Economic Role

Since the “Reform and Opening” era, policy reforms and market liberalization created the conditions for SME growth. Over time, the policy regime has matured—codified in the SME Promotion Law—to

address financing, innovation, and market access (Law of the People's Republic of China on the Promotion of Small and Medium-Sized Enterprises, 2018). The private sector's outsized role in innovation and job creation underscores SMEs' systemic importance to China's economy and to its ongoing rebalancing toward consumption and services (State Council Information Office of China, 2023).

A striking evolution in the past decade is the explicit technology upgrading and specialization push—embodied in MIIT's 专精特新 and the “little giants” program—which channels fiscal, financial, and procurement support to niche, high-tech SMEs in strategic value chains. By late 2024, 14,600 “little giants” had been designated, exceeding the target set for 2025 (Ministry of Industry and Information Technology of China, 2024).

### 2.3 Theoretical Frameworks

Two widely used lenses in SME sustainability research guide this review:

- Triple Bottom Line (TBL)—assessing economic, social, and environmental performance to capture broader value creation beyond short-term profits.
- Innovation Systems & Digital Transformation—positioning SMEs within ecosystems of policies, finance, talent, and platforms. The literature highlights persistent digitalization gaps among SMEs globally and the need for supportive policies and capability-building to unlock productivity and green innovation (OECD, 2023)

### 3. Methodology

This study employs a systematic narrative review approach covering 2015–2025, integrating:

1. Academic literature (English and Chinese) from Google Scholar and major databases on SME sustainability, digitalization, and finance in China.
2. Official statistics and government communications, notably from the National Bureau of Statistics (NBS), the State Council Information Office (SCIO), MIIT, and MOFCOM.
3. International policy reports from the OECD, which document SME financing conditions, policy responses, and macroeconomic contexts relevant to SMEs (OECD, 2023).

Sources were coded thematically (opportunities, challenges, policy tools, and cases), and official statements were triangulated with independent analyses.

### 4. Results and Analysis

#### 4.1 SME Opportunities

##### (a) Digital Transformation and Platform Integration

China's platform ecosystems (e-commerce, fintech, logistics, and SaaS) lower entry barriers and facilitate SME participation in wider markets. Empirical work shows that digital transformation enhances innovation outcomes for SMEs, including increased patenting and productivity (OECD, 2023).

##### (b) Cross-Border E-commerce and Market Diversification

China has scaled comprehensive pilot zones for cross-border e-commerce to 165 across 31 provincial-level regions as of end-2022, offering customs facilitation, tax arrangements, and service platforms that particularly benefit SMEs (Ministry of Commerce of China, 2022).

(c) Specialized Upgrading and the “Little Giants”

The 专精特新 policy designates and nurtures SMEs with unique technologies and market positions. Exceeding the 2025 target, 14,600 “little giants” by late 2024 indicates strong momentum (Ministry of Industry and Information Technology of China, 2024).

(d) Private Sector Dynamism

The private sector’s central role—~60% of GDP, 80% of urban jobs, and 70% of innovation—is where SMEs dominate (State Council Information Office of China, 2023).

## 4.2 Challenges Faced by SMEs

(a) Financing Access and Cost

OECD tracking shows tight financing conditions for SMEs in 2022–2024, reinforcing the need to diversify financing channels (OECD, 2023).

(b) Regulatory Complexity

Despite administrative streamlining, SMEs still face significant compliance burdens (Law of the People’s Republic of China on the Promotion of Small and Medium-Sized Enterprises, 2018).

(c) Digital Divide

Capability gaps hinder effective digitalization, especially for smaller, rural firms (OECD, 2023).

(d) Supply Chain Vulnerabilities

Global uncertainties, including trade fragmentation, can disproportionately affect SMEs (OECD, 2023).

(e) Intellectual Property Risks

Innovative SMEs must navigate IP risks, where enforcement can be complex (Ministry of Industry and Information Technology of China, 2024).

Table 1 summarizes the SME challenges.

Table 1. Challenges Faced by SMEs

Challenge	Description
Financing Access	SMEs rely mostly on internal funds; bank loans and venture capital remain hard to obtain, especially for start-ups and rural firms.
Regulatory Complexity	High compliance costs, overlapping policy rules, and frequent changes impede business agility.
Competition and Talent Wars	SMEs face stiff competition from both domestic giants and global firms, struggling to hire or retain digital and technical talent.
Digital Divide	While urban SMEs thrive on digital platforms, many rural and older firms fall behind in adoption and digital literacy.
Supply Chain Vulnerability	External shocks (COVID-19, trade tensions) expose SMEs' dependence on single suppliers or export markets.
Intellectual Property Risks	Weak IP enforcement and piracy issues (especially for innovative SMEs) challenge long-term competitiveness.

Source: Own elaboration

#### 4.3 Case Study Snapshots

- Zhejiang: SMEs leveraged e-commerce ecosystems to enhance resilience post-pandemic (Ministry of Commerce of China, 2022).

- Jiangsu: Specialized manufacturing SMEs benefited from MIIT recognition (Ministry of Industry and Information Technology of China, 2024).

- Sichuan: Industrial clusters promoted cleaner production, aided by green upgrading policies (Ministry of Commerce of China, 2022).

### 5. Discussion

The findings from this review underscore the paradoxical position of SMEs in China's sustainable development agenda. On one hand, SMEs are indispensable drivers of employment, innovation, and regional development (State Council Information Office of China, 2023). On the other hand, their limited scale, capital constraints, and often lower levels of technological capability make them particularly vulnerable to shocks and policy shifts (OECD, 2023).

#### 5.1 Persistent Barriers

Financing gaps remain a central constraint. While government-backed guarantee schemes, digital supply-chain finance, and SME-focused credit products have expanded (OECD, 2023), micro and early-stage enterprises—particularly in rural or inland provinces—still report difficulties securing affordable credit. The asymmetry in access is linked to information opacity, insufficient collateral, and risk-averse lending practices in traditional banks (OECD, 2023).

Regulatory complexity persists despite reforms aimed at streamlining procedures. SMEs must navigate multiple layers of compliance, from municipal licensing to national tax rules, often without the internal administrative capacity to do so efficiently (Law of the People's Republic of China on the Promotion of Small and Medium-Sized Enterprises, 2018).

Digital divide issues are increasingly critical. While leading SMEs in coastal regions integrate seamlessly into e-commerce platforms and smart manufacturing ecosystems, lagging regions face infrastructure deficits and a shortage of digitally skilled workers (OECD, 2023). Without targeted training programs and rural digital infrastructure upgrades, this gap could widen, undermining inclusive growth.

Intellectual property (IP) risks also threaten SMEs in innovative niches. Although the “little giants” program (Ministry of Industry and Information Technology of China, 2024) includes provisions for IP support, many smaller SMEs remain vulnerable to imitation and weak enforcement mechanisms domestically and abroad.

## **5.2 Emerging Positive Trends**

Recent developments suggest several encouraging patterns:

- Expansion of cross-border e-commerce pilot zones is lowering export barriers for SMEs, particularly in consumer goods, agri-food, and light manufacturing (Ministry of Commerce of China, 2022).
- Green transformation incentives—including tax breaks for energy-efficient equipment and subsidies for cleaner production—are becoming more common at provincial levels, aligning SME growth with national carbon neutrality goals.
- Cluster-based innovation ecosystems are gaining traction, enabling SMEs to share R&D facilities, training, and marketing platforms, which helps offset scale disadvantages.

## **5.3 Policy Implications**

To translate these positive trends into widespread gains, policymakers should:

1. Broaden SME financing portfolios through blended finance models combining public guarantees, private equity, and fintech platforms.
2. Institutionalize digital literacy programs that specifically target rural SMEs and traditional industries.
3. Streamline multi-level regulatory systems by integrating national and provincial compliance portals.
4. Strengthen IP protection capacity at local levels, offering affordable legal advisory services for SMEs.
5. Promote green transition pathways by linking incentives to measurable environmental performance metrics.

## 6. Conclusions

This study reinforces the centrality of SMEs to China's pursuit of sustainable, inclusive, and innovation-led growth. SMEs not only generate a significant share of GDP and employment but also serve as key vehicles for industrial upgrading, digital transformation, and green development (State Council Information Office of China, 2023; Ministry of Industry and Information Technology of China, 2024).

However, the road ahead is complex. Persistent financing bottlenecks, uneven digital adoption, regulatory fragmentation, and weak IP enforcement pose significant challenges. Addressing these constraints will require a multi-pronged strategy that combines structural reforms with targeted interventions.

From a policy perspective, the most effective levers appear to be:

- Scaling up targeted support for innovation-oriented SMEs, particularly in strategic and green sectors.
- Leveraging e-commerce and digital finance platforms to integrate more SMEs into domestic and global value chains.
- Developing robust, transparent, and enforceable IP regimes that protect small innovators.
- Investing in regional cluster development, which can catalyze knowledge spillovers and collaborative innovation.

The role of SMEs in achieving China's 2030 Sustainable Development Goals and 2060 carbon neutrality target cannot be overstated. Their adaptability, combined with supportive institutional frameworks, positions them as pivotal actors in shaping a greener and more equitable economic future.

Ultimately, SMEs represent both the engine and the test of China's sustainable development ambitions. A policy ecosystem that fosters innovation, inclusivity, and environmental responsibility will not only secure SME resilience but also underpin the nation's long-term competitiveness in an increasingly uncertain global economy.

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