

# China MSME Finance Report 2014

## ( Compact Edition )

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SHI JIAN PING



**Mintai Institute of Finance and Banking**

# China MSME Finance Report 2014

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# China MSME Finance Report 2014

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## *Preface*

This is the sixth successive year of China MSME Finance Report. In the past six years, the report had investigated main financial institutions and financial markets, helping the public fully understand the overall situation of MSME financial services in China, and therefore perceive the pulse of private economy with MSMEs as the principal. In 2013, ups and downs of financial sector and regional economy could be seen from the change of MSME financial services. The transformation of huge economy, though not very fast, had exactly occurred in MSMEs, the “nerve ending” of economy.

The global economic recovery was slow while growth in China continued to slowdown in 2013. Under the overlaying effect of “three period” simultaneously, China’s economic development was facing great challenges. Unbalanced regional and industrial developments, as well as potential risk accumulation in financial sector have attracted broad attention. Especially in real estate, steel trading and other sectors that had excess capacity, risk had been reflected in non-performing loan surge in commercial banks and frequent private lending cases. During economic restructuring, enterprises that were not able to overcome “transition threshold” would face the risk of being eliminated. Under such circumstance, credit risk of MSMEs had aroused wide concern among financial institutions once again.

Just as predicted in the report last year, force from the market had been playing an increasingly important role in boosting MSME financial services. Because of the full liberalization of loan rate regulation, commercial banks, initiated by Yu’eobao, competed to launch various “Bao products” to capture the engulfed current deposit market share and promote deposit rate to be further marketized. Though the effect of financial disintermediation was indistinctive in 2013 due to IPO suspension in stock market and bear bond market, the trend of developing direct financing was irreversible.

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Commercial banks that had sensed crisis had accelerated implementing response strategies. Retail bank strategies, including MSE finance, had attracted unprecedented attention. Commercial banks as principal financial service providers with the largest scale at present, had also led to a series of chain reaction as they designed to do MSE finance. In 2013, we had visited many institutions including micro-credit companies, pawn shops and credit guarantee institutions etc. All of them had felt competition pressures from commercial banks. In this case, many institutions adopted a more differentiated strategy. Influenced by unproductive IPO market, SMEs' financed amount through OTC was down by half compared with last year. Nevertheless, SMEs saw a glimmer of hope from the deep development of capital market, which was arisen from the official expansion of NEEQ (National Equities Exchange and Quotations). Due to sluggish withdrawal channel of IPO in domestic market, venture capital institutions were suffering from continuous declining fundraising and investment. But in the meantime, investment in emerging areas like TMT (Technology, Media and Telecom) was hyperactive. The rising of new generation of entrepreneurs and investors as well as the participation of industrial capital would have a far-reaching impact on the situation, in which venture capital investment committed to provide service for MSMEs. In terms of bond market, SME private placement bonds had maintained its development from 2012 and became the only one growing among SMEs' bond financing approaches. Moreover, specialized MSE financial bonds, issued by commercial banks, continued to progress and became an important channel by which medium and small commercial banks broadened their businesses. Under the influence of economy slowing and economic structural transformation, informal finance maintained its development scale but risks were constantly accumulated and exposed. Informal financing which relied on P2P internet technology, crowdfunding and etc. experienced an explosive growth and the news of their "close down" and "run away" can be heard without an end. With deepening understanding of internet technology and the intervention of regulation, boom in financial activities, where informal finance met internet finance, was expected to gradually return to a reasonable level under the test of market. We had seen that in the matter of MSE financial service, P2P lending with standardized operation had formed a diversified market positioning with traditional financial institutions, partly filled the market gap of MSE financial services.

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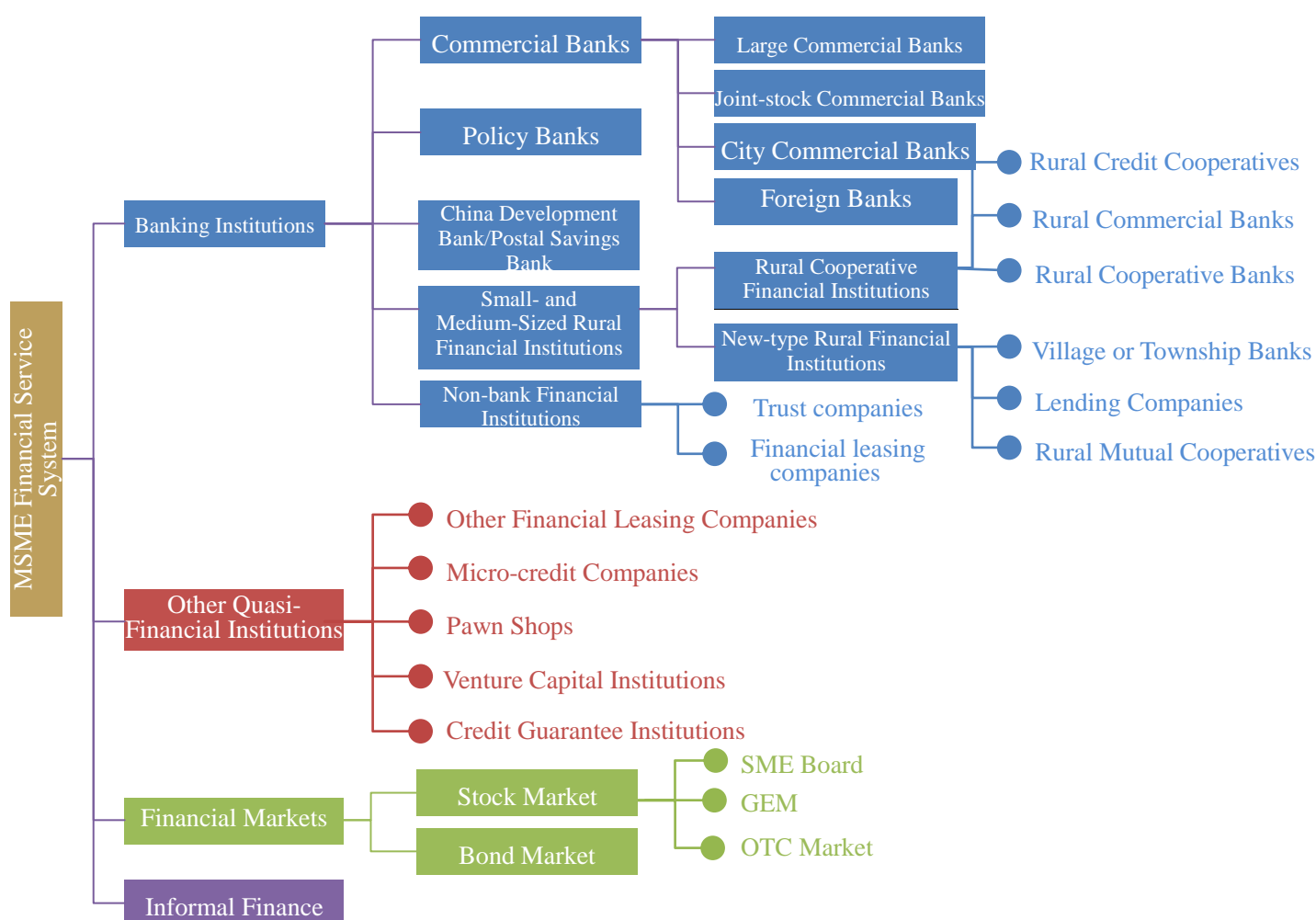
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In 2013, we noticed in particular that all levels of the economic society had been going through a generational turnover, which was more influential than ever before. The generation after 80s and 90s gradually became the main body of social labor power as well as consumption. As a result, principal and object of financial service would experience great substitutions. Furthermore, the content, form, channel and etc. of financial services would be changed accordingly. Especially in MSE finance field, such change had begun to take shape in 2013. The prosperity of “grass root” internet finance, the rise of newborn funds in venture capital and the innovation of retail banks’ channel as well as marketing all announced the coming of a new age. China’s financial industry would greet unprecedented revolutions and challenges.

## 1. Micro, Small and Medium Enterprise(MSME) Financial Service System

In this report, MSME financial service system<sup>1</sup> is divided into four categories: banking institutions, other quasi-financial institutions, financial market and informal finance (See fig. 1-1).

**Fig. 1-1 MSME Financial Service System**



Among banking institutions, those involved in MSME financial services include policy banks and China Development Bank, Postal Savings Bank, large commercial banks, joint-stock commercial banks, city commercial banks, foreign banks, small and

<sup>1</sup> Generalized SME financial service system includes not only service institutions and market, but also other service intermediaries and service environment. In order to highlight the important points of the report, here the system only covers major service institutions and service market. Besides, since this report focused on financial service institutions that provides financing services, insurance institutions were not included in this report due to the special nature of their business.

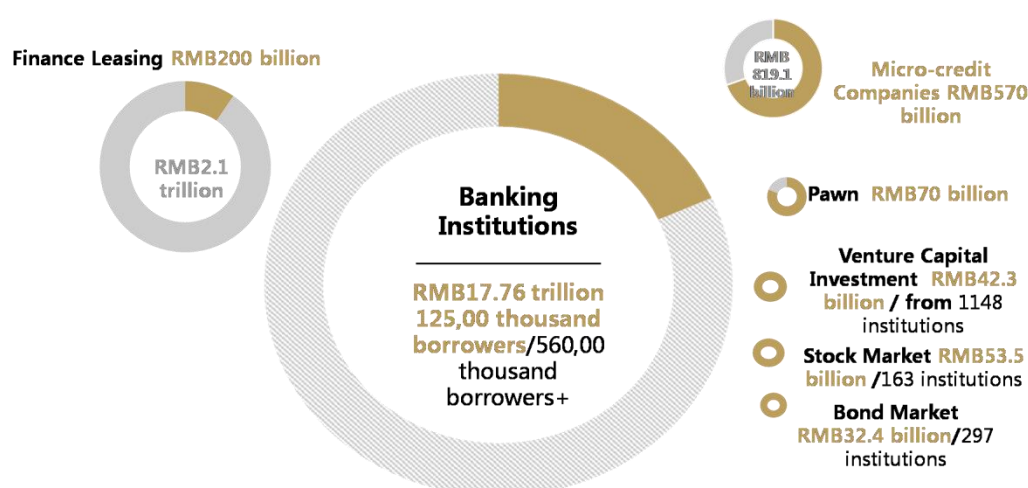
medium-sized rural financial institutions as well as non-bank financial institutions. Thereinto, small and medium-sized rural financial institutions can be further divided into rural cooperative financial institutions and new-type rural financial institutions. Rural cooperative financial institutions include rural credit cooperatives, rural corporative banks and rural commercial banks; new-type rural financial institutions are comprised of village or township banks (VTBs), lending companies and rural mutual cooperatives. In non-bank financial institutions, organizations involved in SME financial services mainly include trust companies and financial leasing companies.

Apart from banking institutions, other quasi-financial institutions<sup>1</sup> investing in SME financial services include micro-credit companies, pawn shops, venture capital institutions, credit guarantee institutions and other financial leasing companies. Financial market consists of stock market and bond market, in which stock market comprised small and medium enterprise(SME) board, growth enterprise market(GEM) and over-the-counter (OTC) market. In addition, informal finance constitutes another type of finance, including financial service forms other than formal finance.

## 2. An Overview of MSME Financial Service

In China, banking institutions remain to be the largest funds supplier to MSMEs, providing billions in fund-raising scale whereas only micro-credit companies and financial leasing companies could provide trillions in fund-raising scale. Simultaneously, pawn balance of MSMEs was not in excess of RMB100 billion. Venture capital, stock market and bond market, by contrast, financed only tens of billions Yuan for MSMEs in 2013.

Fig. 2-1 An Overview of MSME Financial Services (2013)



Notes: ① Circles above refers to financing scales of various kinds of institutions in banking, financial leasing, micro-credit and pawn industry in 2013. (Gray numbers represent specific financing scales) The yellow parts represent financing scale of MSMEs (Yellow numbers refer to specific financing scales). Detailed statistical coverage is as follows: for banking institutions and micro-credit companies, the estimation covers generalized

<sup>1</sup> Though haven't been defined as financial institutions by laws or regulations, these organizations are called as quasi-financial institutions due to the financial features of their businesses.



MSE loan balances(including small-sized enterprises loans, micro-sized enterprises loans, loans to individuals' business and personal business loans of micro and small enterprises' owners). The coverage of financial leasing and pawning is MSME business balances, including venture capital, stock market and bond market. Yellow circle represents the growth of MSME financing in 2013.

② By the end of 2013, banking institutions had provided loan services for 12.5million micro and small enterprises (MSEs), accounting approximately for 22% of total 56million MSEs nation-wide.

## 2.1 Banking Institutions

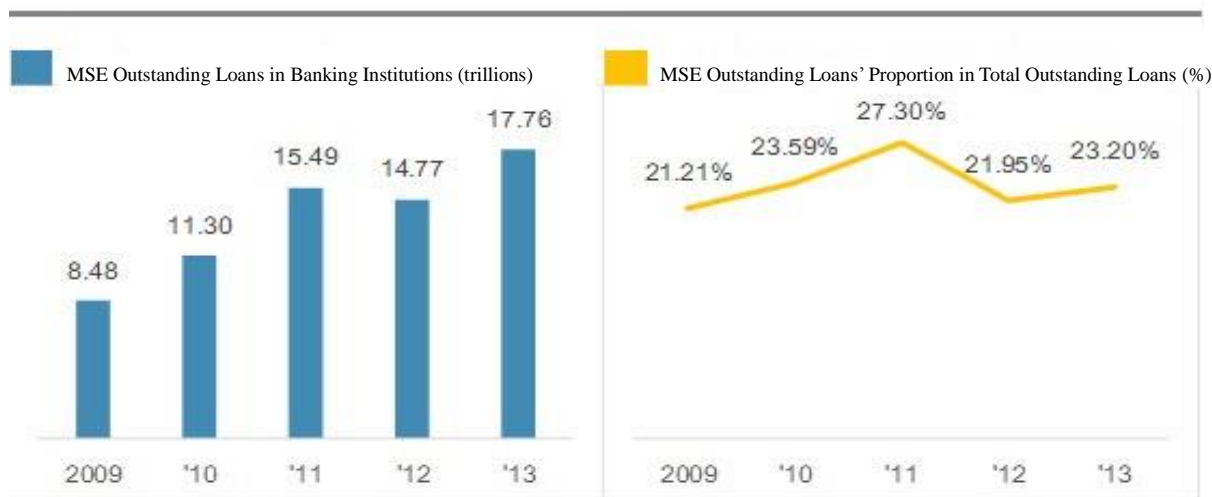
In 2013, micro and small enterprises (MSEs) fund-raising scale through banking had new changes in overall MSE loan balances and growth as well as in distribution features of MSE loans in main banking institutions.

### ■ Proportion of MSE Loan in Banking Institutions

According to data revealed by China Banking Regulatory Commission(CBRC), by the end of 2012, nationwide generalized MSE outstanding loans<sup>1</sup> amounted to RMB17.76 trillion, which had increased RMB2.99 trillion from last year's RMB14.77 trillion with a growth of 20.24%---5.6 percent higher than the growth of total outstanding loans in banking institutions. MSE borrowers reached 12.4977 million across the country, accounting for 22.29% in total 56.06 million MSEs (including 1170 MSEs and 44.36 million individual businesses).

Driven by external regulatory policy and intensified interest rate liberalization, banking institutions further accelerated the speed of turning to MSE businesses. Growth of MSE outstanding loans was 5.6 percent higher than growth of total outstanding loans, restoring the proportion of MSE outstanding loans in total outstanding loans to 23.20%, which was higher than 2012's 21.59%.

**Fig. 2-2 MSE Outstanding Loans' Proportion in Total Outstanding Loans in Banking Institutions (2009~2013)**



Source: Annual report of CBRC (2009-2013).

Notes: ① As CBRC didn't publicize MSE outstanding loans in 2009 and 2010, values were calculated by adding publicized small-sized enterprises outstanding loans and individual business outstanding loans. Proportions of MSE outstanding loans in total outstanding loans were also obtained by calculation.

<sup>1</sup>MSE loans of narrow sense refer to small and micro-size enterprises loans (corporate enterprises loans). Generalized MSE loans include small and micro-size enterprises loans (corporate enterprises loans), individual business loans and MSE main loans. In the retail trend of MSE loans, the coverage of "generalized MSE loan balances", disclosed in MSE financial service scopes was further strengthened in official information disclosure in 2013.

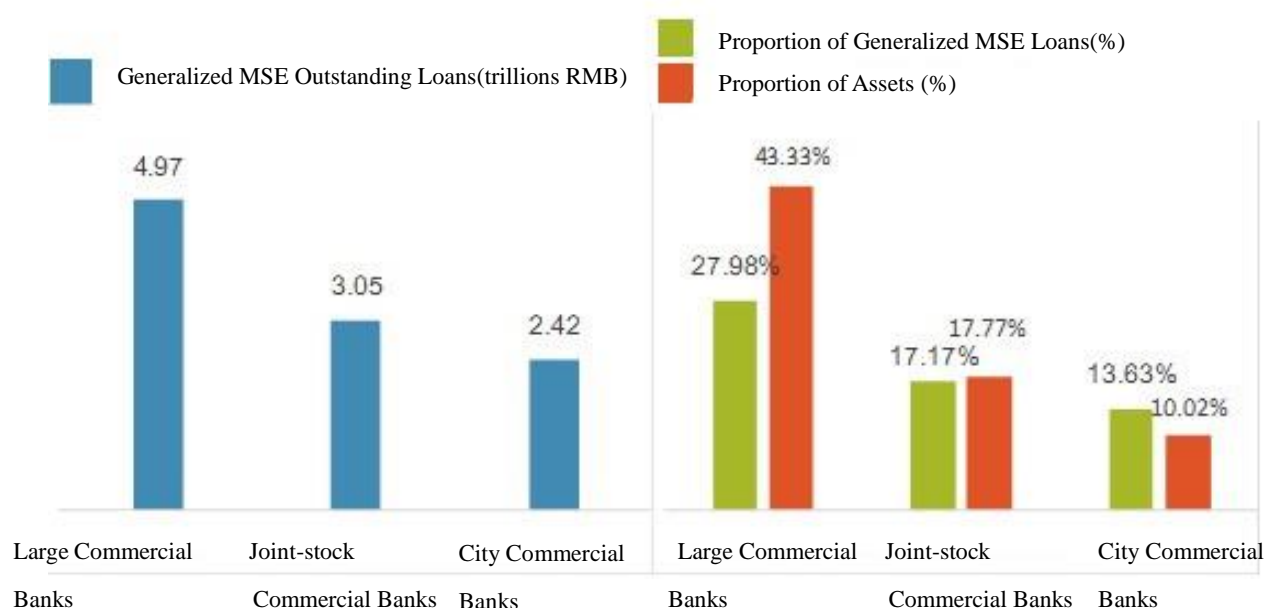
②MSE outstanding loans and their proportion in total outstanding loans in 2011, 2012, 2013 were from publicized annual reports of CBRC.

## ■ Distribution of MSE Loans in Major Banking Institutions

In this report, we take commercial banks, which played a dominant role in banking institutions, as observation objects, and have analyzed the distribution features of MSE loans in different types of commercial banks. In aspect of generalized MSE outstanding loans, 5 large commercial banks held their advantages with an absolute volume of RMB4.97 trillion in 2013, relying on capital scale and branch predominance. However, generalized MSE outstanding loans in above 5 banks comprised a declining share of that in all banking institutions, falling to 27.98% in 2013 from 34.09% in 2012. In 2013, MSE outstanding loans in joint-stock commercial banks increased to RMB3.05 trillion, still ranking the 2<sup>nd</sup> in banking industry while its percentage in the whole industry slightly decreased to 17.17%. City commercial banks, though limited by business scale, took the 3<sup>rd</sup> place in the whole sector in absolute volume of MSE outstanding loans and its share in banking industry, having realized double growths in both indicators. MSE outstanding loans climbed to RMB2.42 trillion, accompanied with a small increase of its proportion in banking institutions. This fully embodied city commercial banks' potential on the growth of MSE financial services. Besides, generalized MSE outstanding loans of 3 types of commercial banks totaled RMB10.44 trillion in 2013, which was RMB0.77 trillion higher than previous year. By contrast, the portion in banking institutions fell from 65.47% in 2012 to 58.78% in 2013.

In general, 3 types of commercial banks provided 60% of MSE loans in banking sector with 70% of assets of the whole industry. Specifically, MSE outstanding loans still held less percentage than assets did in state-owned commercial banks. MSEs were less important to large commercial banks compared with other two types of small-and-medium sized commercial banks. Moreover, large commercial banks contributed less to MSE financial service than small-and-medium sized commercial banks did. Meanwhile, MSE loans took slightly lower proportion than assets did in joint-stock commercial banks in 2013. But overall, these two ratios were basically flat. Compared to the former two types of banks, city commercial banks became the only type of commercial bank, whose MSE outstanding loans' portion exceeded assets' in 2013. Relying on traditional advantages of MSE services, they contributed larger percentage of MSE financial services with relatively smaller portion of assets.

Fig. 2-3 Generalized MSE Loans in Major Banking Institutions (2013)



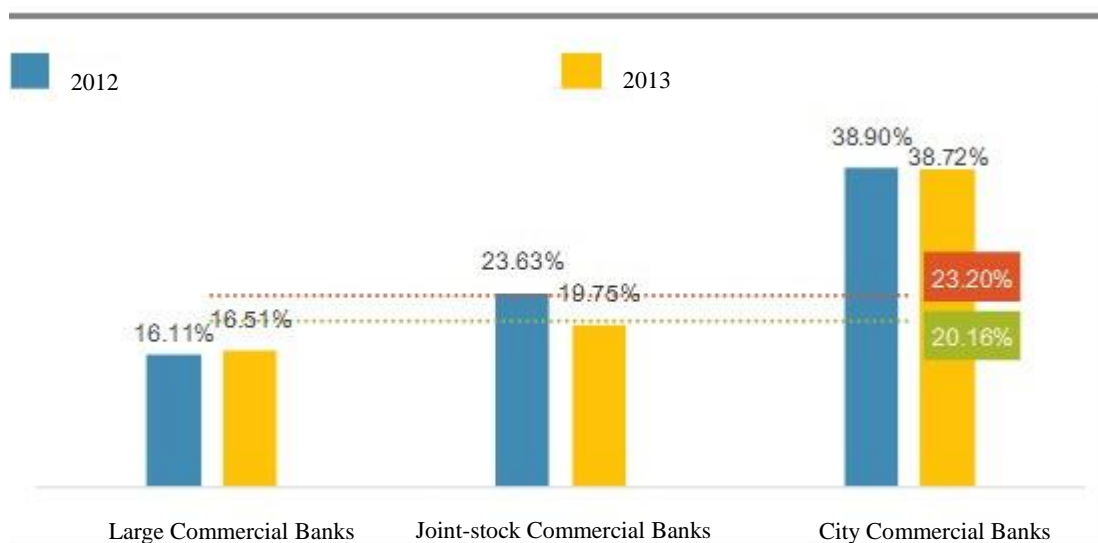
Source: 2013's data are from CBRC.

Notes: "Proportion of generalized MSE loans" refers to the proportion of generalized MSE outstanding loans in various banks took in the total MSE outstanding loans of banking industry (RMB 17.76 trillion) in 2013.

"Proportion of assets" refers to the proportion of asset sizes of various kinds of banks took in the total asset size (RMB151.40 trillion) of banking institutions in 2013.

Above we discussed the proportion of MSE outstanding loans in different types of commercial banks in comparison with that in the whole banking industry. Following we would further make a longitudinal observation of the proportion of generalized MSE loans occupied in total loans among 3 types of commercial banks respectively. In 2013, MSE outstanding loans devoted a percentage of 23.20% in total loans in banking industry on average. Taking this number as reference, in large commercial banks and joint-stock commercial banks, proportions of MSE outstanding loans in their total loans were 16.51% and 19.75% respectively, which were below the average. By contrast, city commercial banks maintained their advantages in this respect with a proportion of 38.72%, which was 15 percent higher than the average. Compared to 2012, credit growth in large commercial banks shrank moderately thus slightly increased the proportion of MSE outstanding loans in their total loans this year. But in joint-stock commercial banks and city commercial banks, such proportion reduced to some different degree. Especially in joint-stock commercial banks, the rate of decline had reached 3.88%.

**Fig. 2-4 Proportion of Generalized MSE Loans in Total Loans of Major Banking Institutions (2012~2013)**

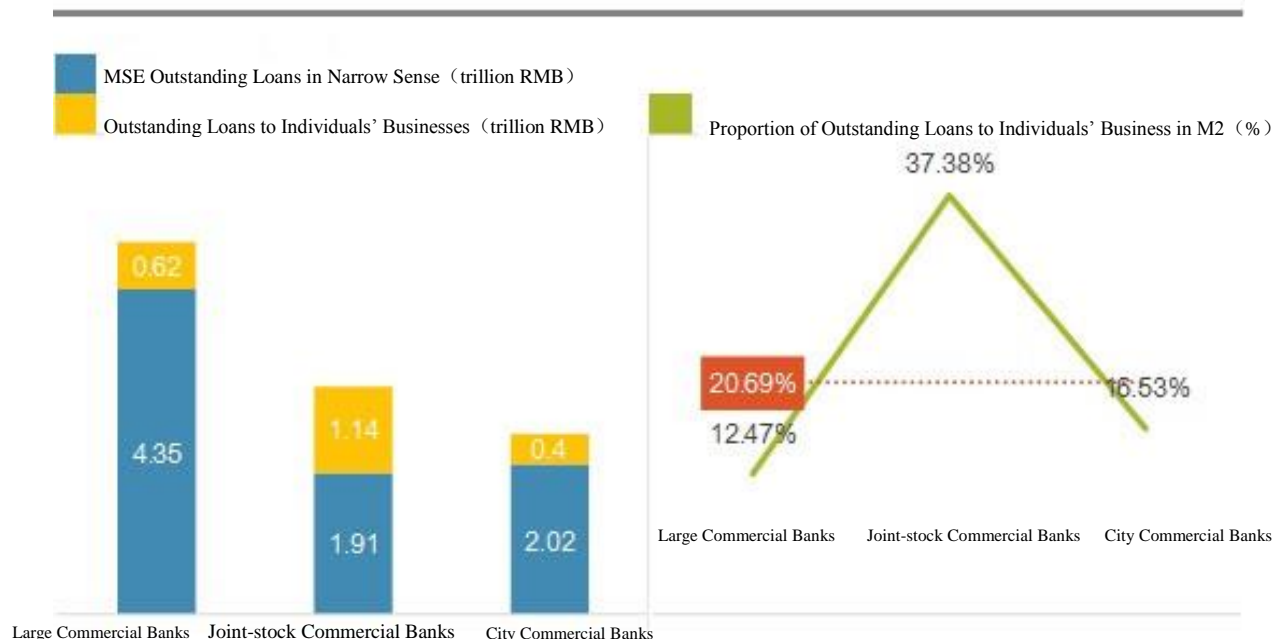


Source: For allocation of three types of generalized MSE loans source from data in Fig. 2-3. Data of total loans of 3type commercial banks are from CBRC.

Notes: Red dotted line means in 2013, MSE outstanding loans accounted for 23.20% in total outstanding loans in banking industry; green dotted line means in 2013, MSE loan balances accounted for 20.16% in total outstanding loans in all three types of banks.

After investigating generalized MSE outstanding loans in banking institutions, we turned to two components of generalized MSE outstanding loans: MSE outstanding loans in narrow sense (legal person enterprise loan) and outstanding loans to individuals' businesses. In 2013, large commercial banks were still dominant in MSE outstanding loans in narrow sense. Joint-stock commercial banks, which had the second largest amount of generalized MSE outstanding loans, were far below city commercial banks in MSE outstanding loans in narrow sense. To take a different angle, joint-stock commercial banks had an outstanding performance in outstanding loans to individuals' businesses with the amount well above that of the other two types of banks. In respect of proportions, loans to individuals' businesses accounted for 37.38% of generalized MSE loans in joint-stock commercial banks while in the other two types of commercial banks, it made up lower than 20.69%, the average of three kinds of commercial banks. Represented by China Merchants Bank (CMB) and China Minsheng Bank (CMBC), the trend of retailing was clearer and further reinforced in MSE financial services of joint-stock commercial banks. Therefore, joint-stock commercial banks' input in loans to individuals' businesses became a crucial breakthrough of expanding MSE businesses.

**Fig.2-5 MSE Outstanding Loans in Narrow Sense and Outstanding Loans to Individuals' Businesses in Major Banking Institutions (2012~2013)**



Source: Data of 2013 are published by CBRC.

Notes: Red dotted line represents that in 2013, the total outstanding loans to individuals' businesses in three types of commercial banks took 20.69% proportion of their total generalized MSE outstanding loans.

Based on above analysis, viewed from the overall increase of MSE outstanding loans in banking institutions, no matter in terms of the absolute amount of generalized MSE outstanding loans or the proportion of MSE outstanding loans in total outstanding loans, the overall size of MSE financial service in banking industry had been further expanded in 2013 than previous year. In terms of the distribution of MSE loans in 3 representative types of commercial banks in major banking institutions, the 3 types of banks maintained their comparative advantages. In the absolute amount of generalized MSE outstanding loans, large commercial banks, though still had an absolute advantage in quantity, MSE outstanding loans accounted for significantly higher proportion to their total outstanding loans in joint-stock commercial banks and city commercial banks than in their larger counterparts. This phenomenon was still particularly remarkable in city commercial banks. The ratio was far above the average level of banking industry though slightly lower than last year's. However, compared with 2012, the ratio in joint-stock commercial banks sharply fell under industry average. Furthermore, growth of outstanding loans to individuals' businesses in joint-stock commercial banks was more noticeable than in the other 2 types of commercial banks, thus further demonstrated the retail trend of MSE financial services in joint-stock commercial banks.

According to the Questionnaire Survey of MSE Financial Managers in Commercial Banks<sup>1</sup>, commercial banks continued to pay more attention to MSE finance in 2013,

<sup>1</sup> See details in appendix: "Survey of MSE Financial Managers in Commercial Banks 2014".

thus intensified the competition in MSE financial service market. Most respondents summarized commercial banks' performance on MSE financial services in 2013 as "highly competitive", "steadily growing" and "have some improvement". Respondents generally believed that MSE financial service was booming with frequent innovations, presenting the characteristic of blossoming. But meanwhile, homogeneous competition was increased while some banks were lack of progress. Such problems still existed.

Meanwhile, what deserved particular attention were risks accompanied with the rapid development of MSE financial services. In some areas, rise in non-performing loans of many banks in 2013 had indicated the growing MSE credit risk. Over 80 percent of respondents thought that MSE credit risks in 2013 was higher than that in 2012; more than half considered the non-performing loan ratio of MSEs in their industries had risen. Findings showed that MSE credit risks clearly differed from regions. Thereinto respondents in Yangtze River Delta area held the most pessimistic view to the issue. All of them deemed that MSE loan risks had increased.

In 2013, interest rate liberalization was substantially promoted while competition of MSE financial market was intensified. Moreover, internet finance had realized full development. Facing such situation, MSE financial service in commercial banks turned to the comprehensive upgrade of scope and quality of services from previous high-speed growth of credit scale. Through organizational reform, process improvement, and enhancing information technology and etc, commercial banks tried to adapt to the diversified competition of MSE financial market in all-round. More and more banks pursued growth in both "amount" and "number of borrowers" instead of "outstanding loans" only. Besides, continued construction of specialized institutions faced new changes in organization pattern. China Minsheng Bank and China Merchants Bank had established independent institutions specialized in MSE business and opened a new chapter of "Big Retail" in MSE finance's development. Hence, sinking of customer structure center in commercial banks would be further accelerated. "Business circle + industry chain" model continuously escalated through more efficient and convenient "platform" thanks to information technologies. In 2013, reform of internet and information technologies had had a critical influence on the promotion of MSE financial services in commercial banks. In view of such situation, commercial banks significantly increased input to information technology and improved customer experience through optimizing service content channels therefore to meet the rise of internet finance.

## **2.2 Other Quasi-financial Institutions**

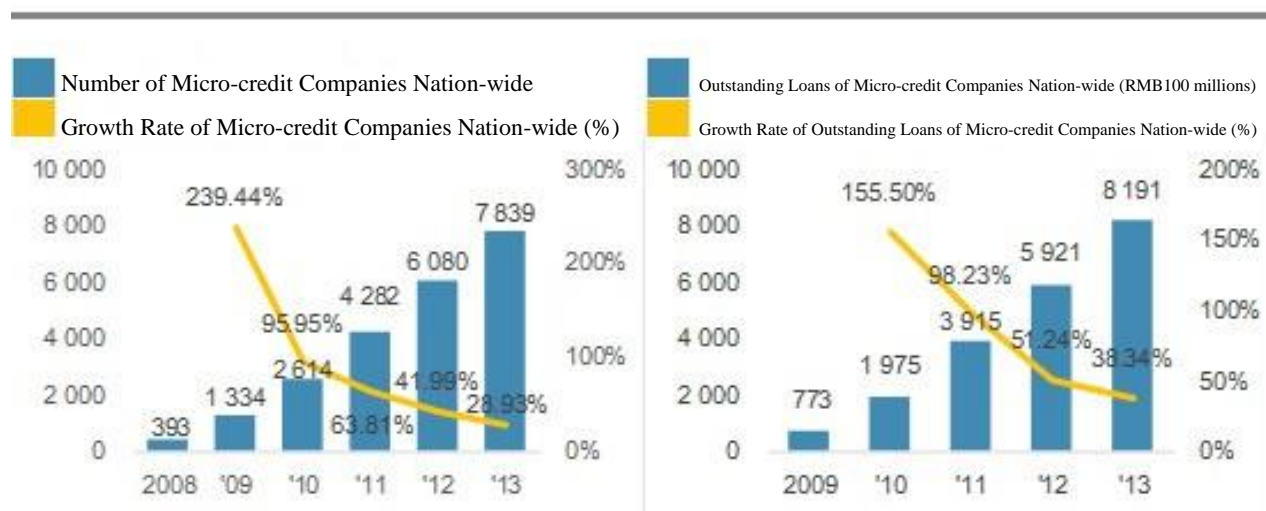
### **2.2.1 Micro-credit Companies : Development and Differentiation in Slowed Growth**

Micro-credit industry kept inclusive growing in number of institutions, employees, paid-up capitals and outstanding loans in 2013. However, growth of major scale indexes dropped year-on-year. By the end of 2013, there were 7839 micro-credit companies and outstanding loans of RMB819.1 billion nation-wide, with year-on-year growths of 28.93% and 38.33% respectively. Both growth rates had dropped by 13 percentage points. Given that seven in ten of micro-credit companies' loans had



flowed to MSEs<sup>1</sup>, approximately RMB570 billion of outstanding loans were MSE loans. In the context of economic slowing, operation risks of micro-credit companies became increasingly obvious while the industry growth had revealed weakness. But in general, the industry development was gradually towards on track. Rating and the accessing to central bank's credit system of micro-credit companies were on progressing steadily. Generally speaking, micro-credit companies presented different features with traditional financial institutions like commercial banks in loan industry, prospective borrowers and loan interest rate. By contrast, differences in length of maturity, loan limit and guarantee type were not quite apparent. As customer structure center kept sinking in traditional financial institutions, micro-credit companies were universally facing direct competition from them. Differentiation had already occurred in this group after a few years rapid development. Some provident micro-credit companies began to stand out from the competition. They truly insisted on the "small and scattered" principle, paying highly attention to the growth of client numbers rather than loan amount solely. Through diversified competition from traditional financial institutions, they opened the market and formed core competences. Besides, with the explosive development of e-commerce, micro-credit companies became the "standard configuration" of mainstream e-businesses. Owing to trading platform and massive amount of customer transaction data, e-businesses had exceptional advantages in improving efficiency of risk management and reducing management costs.

**Fig. 2-6 Micro-credit Companies and Their Outstanding Loans (2008~2013)**



Source: ①People's Bank of China (PBoC), "Survey of the distribution of micro-credit companies" of each year.2010-2013.

②2008, 2009 data source: Xinhua Online, "micro-credit companies had over numbered 1300 in China", 2010-03-25.

Notes: Line charts were selected from PBoC and calculated, "Survey of the distribution of micro-credit companies 2013", "Survey of the distribution of micro-credit companies 2012", "Survey of the distribution of micro-credit companies 2011", "Survey of the distribution of micro-credit companies 2010".

<sup>1</sup> Estimation relies on "Sample survey of 100 micro-credit companies nation-wide", please refer to the 8<sup>th</sup> chapter of this report.

### 2.2.2 Pawn: Seeking Development during Recovery

Due to market liquidity squeeze in 2013, pawn as an industry providing short-term working capital loans became popular among MSMEs and the public. Enthusiasm of entering to pawn industry continued in private sector. The whole industry kept growing, though in some areas presented business shrink due to slowdown in macro-economy. Up to the end of 2013, there were 6833 pawn shops in total nation-wide with an increase of 12.3 percent. Pawn balances reached RMB86.6 billion, with year-on year growth of 22.7 percent. Main purposes of pawn shop loans included SMEs' liquidizing remnant assets, emergency loans and establishing businesses and bridge financing of enterprises and financial institutions. Bridge financing businesses surged in 2013 owing to depression of real estate market and low gold price. It fell into two types: one was paying bank loans using pawn shop loans to get new loans or pay the cash deposit; the other was the business of bank acceptance bills, which means enterprises obtain working cash through discounting undue bank acceptance bills in pawn shops. Approximately RMB70 billion of pawn balances had flowed to MSMEs if estimated that eighty percent of pawn businesses were MSMEs' pawn<sup>1</sup>. In 2013, traditional civilian products pawn received attention due to downturn of real estate industry. What worth noting was that traditional advantages of pawn were gradually weakened because of lacking sound laws and regulations in pawn industry, resulting to homogeneous development as banks and micro-credit companies in MSME financial services. Therefore, it was emergent to improve the development environment of pawn industry, enabling pawn shops to regain traditional business strength therefore enrich alternatives of MSME financial services through differentiated services.

**Fig.2-7 Development of Pawn Shops' Scales Nation-wide (2011~2013)**



Source: Ministry of Commerce, "Development report of China pawn industry 2012", "Development report of China pawn industry 2013".

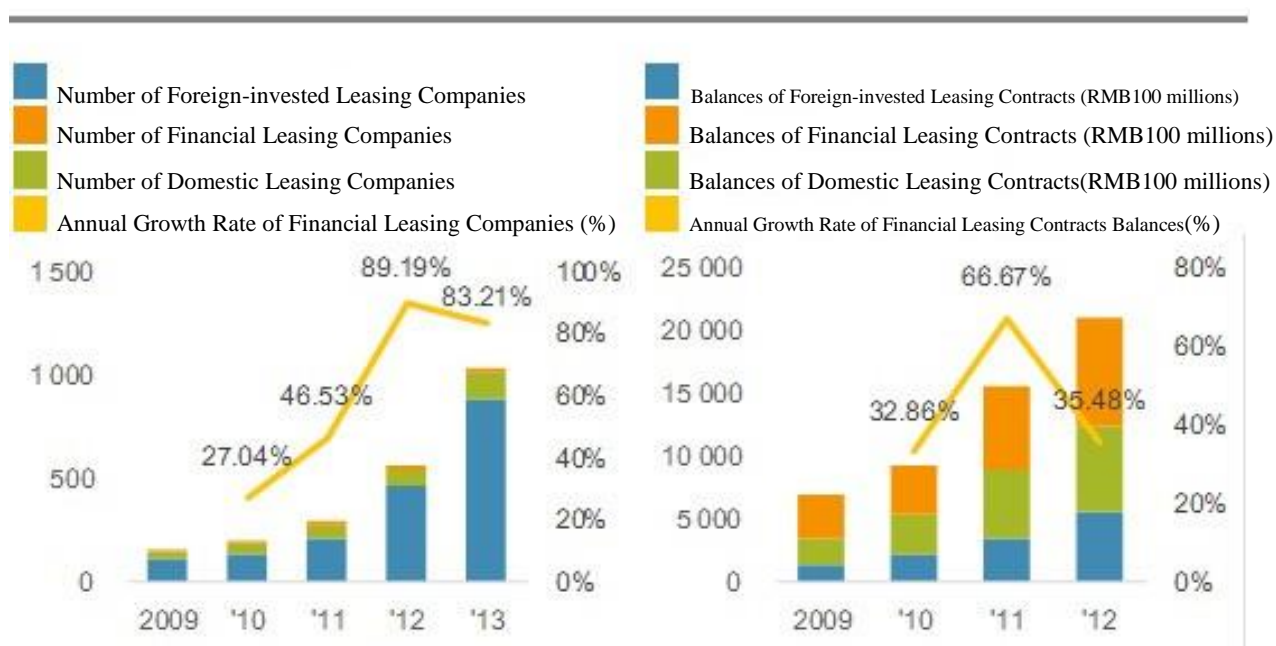
<sup>1</sup> Our rough estimation was based on the fact that China's pawn industry mainly served for productive uses. Besides, we also took customer structures of several pawn shops, which were obtained through actual investigations, as references. Unlike estimating MSE loans, pawning estimation focused on MSMEs' pawn.



### 2.2.3 Financial Leasing Companies: Persistent Overheating

As one of the best links between industries and finance, financial leasing continued its good momentum in 2012, performed extremely well in 2013 and maintained rapid growth. By the end of 2013, financial leasing companies over numbered 1000, achieving 1026 with an increase of 83.2 percent points. Annual balances of financial leasing contracts reached RMB2.1 trillion, with year-on year growth of 35.5 percents. Though the overall scale of financial leasing was expanding rapidly, limited business scale of SME financial leasing was not apparently improved. According to estimates, balances of SME financial leasing contracts were less than RMB200 billion in 2013. As financial leasing had an increasingly higher social recognition, financial leasing companies devoted to expand SME financial leasing services in succession and played a critical role in SMEs' updating equipment, adapting technology as well as alleviating financial pressures and etc. Manufacturer-dependent financial leasing companies remained the major supplier of SME financial leasing at present. Meanwhile, independent financial leasing companies also carried out active exploration in SME financial leasing field. As for financial institution-dependent financial leasing companies, they began to step into SME financial leasing businesses discreetly. Nevertheless, they couldn't become the main financial leasing channel of SMEs in the short term as a result of its large capital and immobilization of leased assets.

**Fig. 2-8 Number of Three Types of Financial Leasing Companies and Their Contract Balances (2009~2013)**



Source: ①2011-2013 data source: "Development report of China financial leasing industry" (2009-2013), China Financial Leasing Alliance(<http://www.zgzllm.com>).

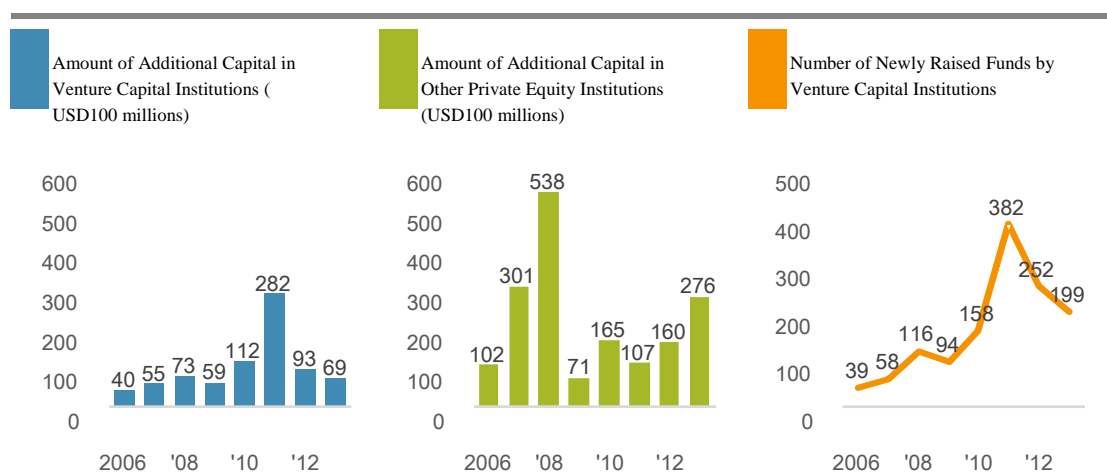
②2010 data source: "Annual report of China Banking Regulatory Commission 2010", "2010 Annual meeting of China financial leasing was held in Beijing", CLBA:[www.clba.org.cn](http://www.clba.org.cn), 2010-12-03.

③2009 data source: "Annual report of China Banking Regulatory Commission 2009", "2009 Annual meeting of China financial leasing was held in Beijing", UniTrust International Leasing Corporation: [www.utfinancing.com](http://www.utfinancing.com), 2009-12-09.

### 2.2.4 Venture Capital: New Features Supported the Development of Emerging Industries

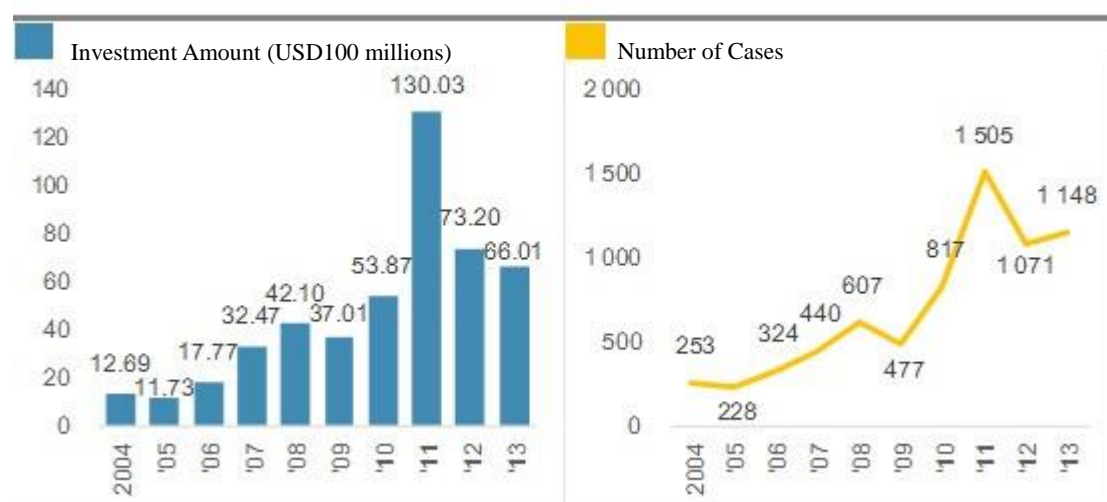
Venture capital industry was buoyant in 2013 with rational development. Fundraising and investment in venture capital institutions occurred to increase and decrease respectively. Newly raised funds reduced to 199, down 21.03% compared with 2012. Growth of additional capital amount was negative for two consecutive years, from USD9.311 billion in 2012 to USD6.919 billion in 2013 with a decline of 25.69%. Total amount of venture capital investment had fell from USD7.320 billion in 2012 to USD6.601 billion. In contrast with the continuous slide of investment amount, number of investment cases had increased by 77, reaching 1148 in 2013.

**Fig. 2-9 Fundraising Status of Venture Capital and Other Private Equity Investment Institutions (2006~2013)**



Source: Zero2IPO Group: "Annul research report of China venture capital 2013", "Annul research report of China private equity investment 2013".

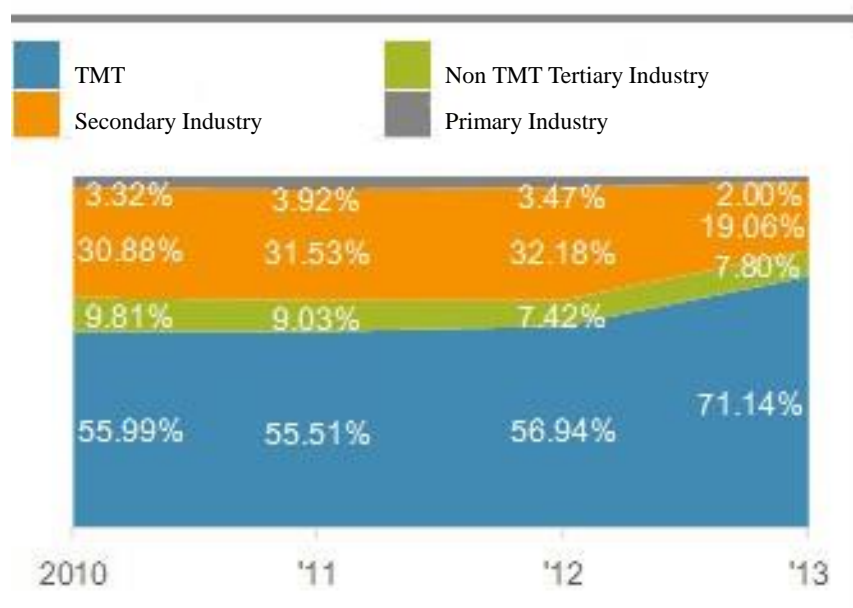
**Fig. 2-10 Status of Venture Capital Industry (2004-2013)**



Source: Zero2IPO Group: "Annul research report of China venture capital investment 2013".

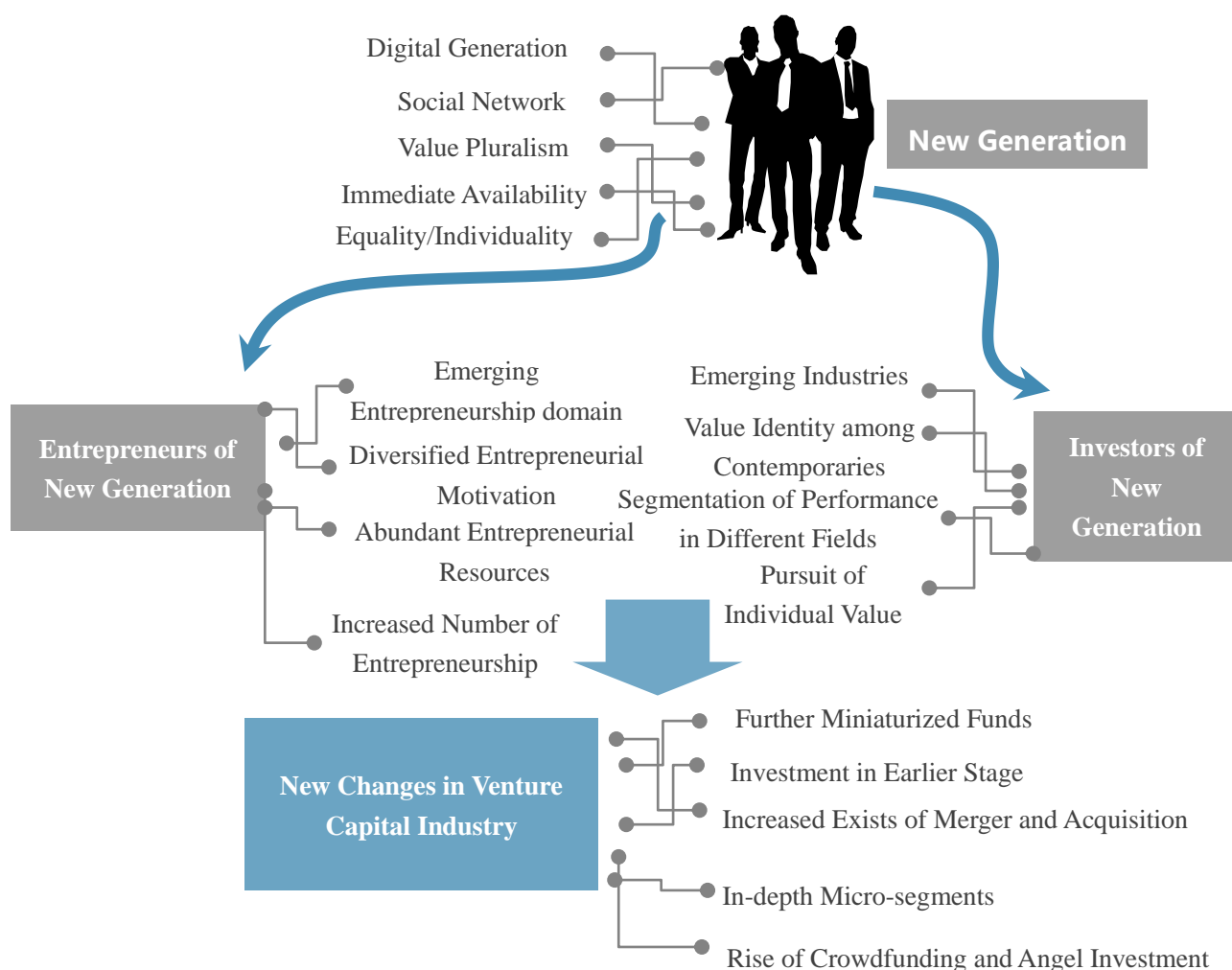
New features of venture capital were concentrated in 2013. Investment orientations focused on new economy industries while secondary market of private equity (PE) got initial development. It was worth noting that young investors became active in venture capital field since the generation of 1970s, 1980s even 1990s had become the mainstay of entrepreneurship. Participation of emerging industrial capital not only increased available amounts of funds to invest from supply side, but also improved the entrepreneurial ecosystem from demand side. The trend of gradually rational returning to the essence of venture capital investment was increasingly apparent among venture capital institutions.

**Fig.2-11 Proportions of Different Investment Orientations (2010~2013)**



Source: Zero2IPO Group: “Annul research report of China venture capital 2010”, “Annul research report of China venture capital 2011”, “Annul research report of China venture capital 2012”, “Annul research report of China venture capital 2013”.

Fig.2-12 Generational Turnover's Impact on Venture Capital Industry



Source: The research group.

### 2.2.5 Credit Guarantee Industry: Risks and Opportunities Coexisted

After retrenchment and sorting out by the government, credit guarantee industry gradually stepped out from cases like “Zhongdan” and restored growth in 2013. By the end of the year, there were 8185 financing guarantee institutions nation-wide in total. The business scope was growing rapidly while multiplication had increased compared with previous three years. With regard to outstandings of MSME financing guaranteed loans nation-wide, the number had reached RMB1.28 trillion, increased by 13.9% from the end of 2012, accounting for 75.8% in outstandings of financing guaranteed loans.

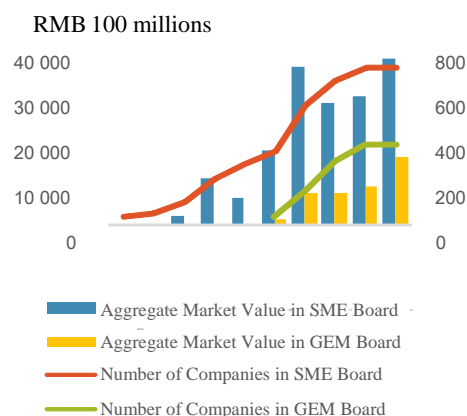
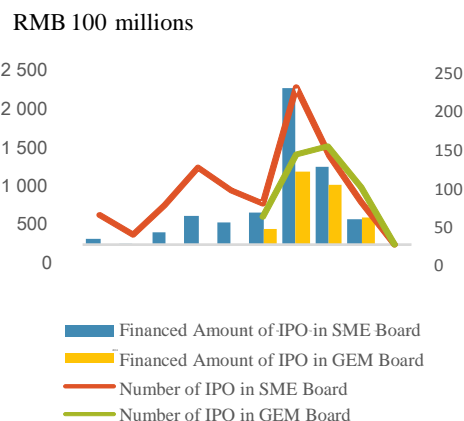
Influenced by domestic economic slowdown and risk exposure of some industries, compensatory cases frequently occurred. As a result, some private guarantee institutions fell into difficulties. Many of them began to seek new growth through multi-perspective innovation. Banking industry enhanced MSME financial services with the deepening of interest rate marketization and pressures from financial

disintermediation. Moreover, customer structure center in guarantee institutions began to sink. Since banks had accumulated certain experiences in and improved capacity of MSME credit-risk management, guarantee industry needed to further enhance risk management capacity and actively explore new lines of business to obtain living space. Simultaneously, expansion of re-guarantee businesses and rise of collateral management provided important support to SMEs under financing difficulty. Besides, SMEs had a strong demand of chattel mortgage loans. Financial institutions lacking independent collateral management capacity were longing for developing customers' movable assets finance as well. Consequently, financial warehouse was growing rapidly in the past year and resulted in the mutual development of traditional logistics storage companies and specialized financial warehouse companies. At the end of 2013, "Warehouse receipt fundamental elements and form" was approved and officially released. It was expected to promote the normalized and healthy development of stock secured industry and bring new opportunities to financial warehousing by the standardization of industry.

## **2.3 Financial Market**

### **2.3.1 Stock Market: Innovative Development under Structuralization**

China's stock market had suffered significant volatility in 2013. A new pattern had been formed: main board, SME board and GEM board greatly differed in market quotation rather than moved together. Differentiations among various industry parts were intensified with apparent policy shock. No new stocks were issued in 2013. Though there were constant rumors about IPO reopen, it hadn't been implemented until the end of the year.

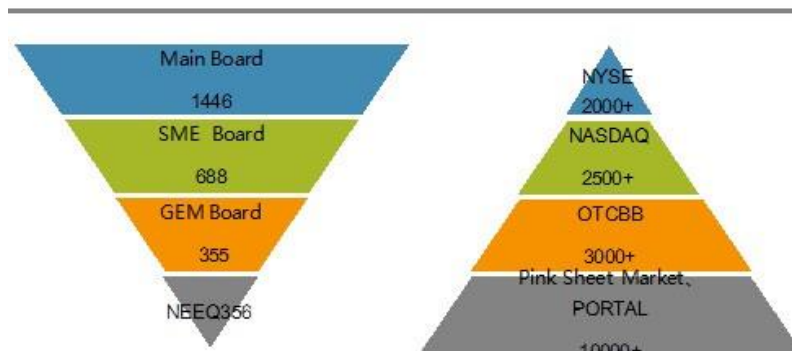
**Fig. 2-13 Number of Companies and Total Market Value in SME Board and GEM Board (2004~2013)****Fig. 2-14 Number of IPOs and Financing Amount in SME Board and GEM Board (2004~2013)**

Source: Number of companies and total market value in SME board and GEM board (2004-2013): website of Shenzhen Stock Exchange. Number of IPOs and financing amount in SME Board and GEM Board (2004~2013) : Wind information.

Under the special circumstance in 2013, SMEs shifted their major financing methods in stock market from previous IPO finance to issuing additional stocks and right offering. 163 companies had refinanced RMB53.458 billion through issuing additional stocks in SME board, GEM board and NEEQ. Though the refinancing scale had increased by 35.15%, SMEs' financed amount from stock exchange market had sharply dropped by 51.65% due to failure in IPO finance.

Multi-level capital market had developed in depth and scope in 2013 with the NEEQ as one of the few highlights. With favorable policies, NEEQ formally expanded its capacity and welcomed leapfrog development. Structure of capital market in China, compared to its more mature and developed US counterpart, was shown as an inverted pyramid. At the present stage, main board came to the largest market, followed by SME board and GEM board markets. NEEQ markets were small in scale. Meanwhile, lack of lower levels of trading market led to direct financing difficulties of SMEs. Hence, accelerating the construction of NEEQ and supporting innovative MSMEs had great potential in China.

Fig. 2-15 “Inverted Pyramid” of OTC in China VS “Pyramid” of OTC in US (2013)

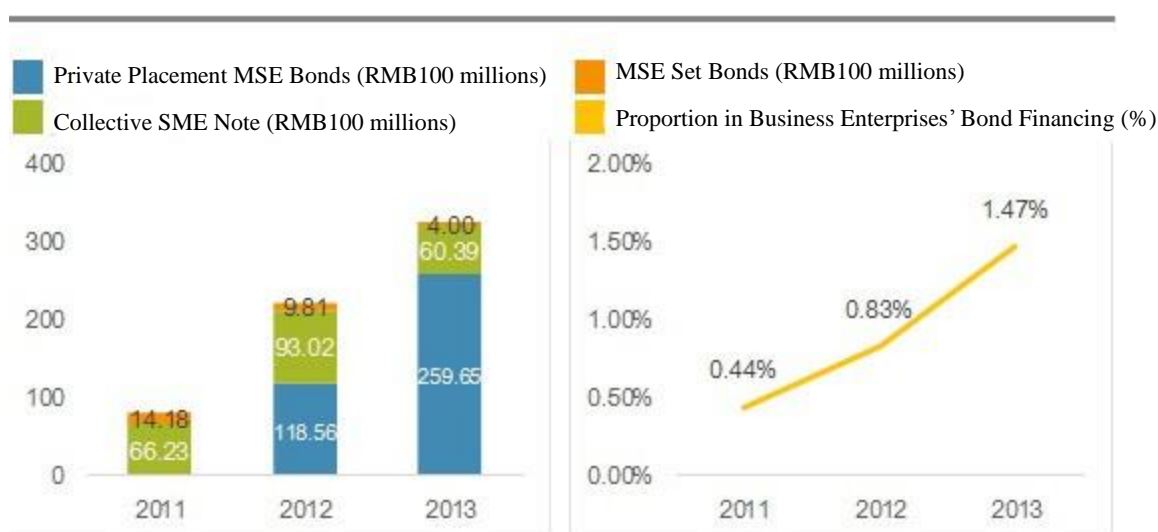


Source: Wind, CITIC Securities' research report: "The capacity expansion of NEEQ has a moderate impact on stock market in short and medium term". (Data up to the end of 2013)

### 2.3.2 Bond Market: Simmered below the Surface

Bond market was fluctuated in 2013, accompanied with constant innovation and reforms. Debt financing of MSMEs was still being explored. In terms of direct financing of MSMEs, private placement SME bonds continued to evolve rapidly and became the most active as well as the only growing part. Collective SME notes failed to continue developing from 2012 with the issuance fall dramatically. Meanwhile, collective SME bonds issuance continued shrinking. As a direct financing tool of MSMEs, it existed almost in name only. Benefited from fast growing private placement SME bonds, MSMEs had directly financed RMB32.404 billion from the bond market (including RMB25.965 billion of private raised bonds, RMB6.039 billion of collective notes and RMB400 millions of SME set bonds) and increased by 46.33%, accounting for 1.47% to the total amount of bond financing up from 2012's 0.83% .

Fig. 2-16 SMEs' Scale of Direct Financing in Bond Market (2011~2013)



Source: Wind

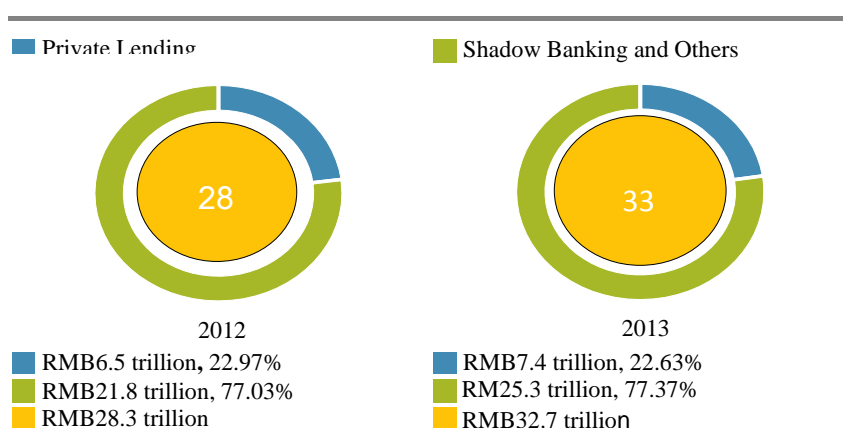


Providing bond financing channels came to an approach to expand MSMEs' financial supply. In this respect, specialized MSE financial bonds maintained stable development in commercial banks, playing a chief role in financial bonds sector of commercial banks in 2013. 33 specialized MSE financial bonds were issued and raised RMB111.5 billion for 22 commercial banks. Number of commercial banks acting as issuers increased from 12 to 22 in spite of the downsizing of fundraising scale. Moreover, number of issuers and fundraising scales in medium and small regional commercial banks were remarkably increased and expanded. Besides, bond financing of business enterprises was challenged by high financing cost in 2013, especially the second half of year. Social fundraising scale was encumbered as well. However, we assumed that the proportion decline of enterprises' bond financing would not be a trend. This was because the development of bond market had effectively promoted commercial banks' financial disintermediation and driven the downward shift of their customer structure center. The trend was irresistible.

## 2.4 Informal Finance: Normalized Evolvement

Informal financing was in the road of standardizing development. The scale of informal finance was continuously expanding in 2013 because of economic slowdown, bank credit crunch and direction limitation of loan investment as well as the development of internet finance. By the end of 2013, the amount of informal finance nation-wide had reached RMB7.4 trillion, accounting for 22.6% in the total amount of shadow banking (RMB32.7 trillion). Traditional private lending approaches like united societies and underground private banks were active in “uneconomic” field of formal financial system. The united society had been clearly defined by local laws as a type of private lending in mainland China for the first time since the reform and opening up. Similarly, the standardization of underground private banks relies on breakthrough polices in the future.

Fig. 2-17 Scale and Proportion of Private Lending (2012~2013)



Source: China Merchants Securities.

Notes: ① Data of 2012 were up to the 3<sup>rd</sup> quarter of that year.

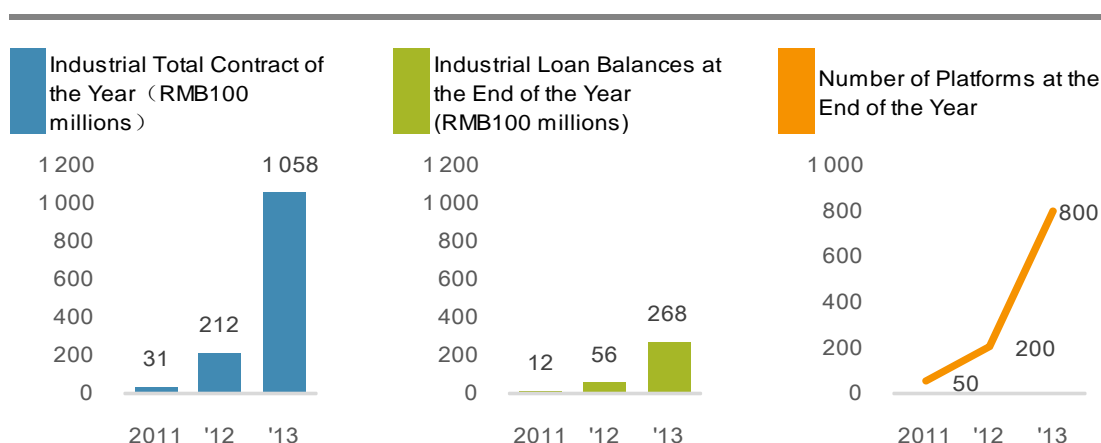
② Area of yellow circle represented scales of shadow banking; Numbers in the circles represented scales of shadow banking, measured by RMB trillion.

③ “RMB6.5 trillion, 22.97%” means that the amount of private lending in 2012 is RMB6.5 trillion, accounting for 22.97% in total amount. “RMB28.3 trillion” means in 2012, the amount of shadow banking is RMB28.3 trillion and so on.



Based on internet technology, informal finance had experienced explosive development in the past year. P2P and crowdfunding had become the main financial activities in the crossing field of informal finance and internet finance. In 2013, P2P lending industry had suffered series of fluctuations, including “bankruptcy trend” and “runaway trend” etc. caused by industrial liquidation and consolidation. However, it maintained boom, which was boosted by the awakening of public awareness to internet finance. Total turnover of P2P lending industry in 2013 had achieved RMB105.8 billion; year-end outstanding loans reached RMB26.8 billion with an almost fourfold increase in scale compared with 2012. Moreover, the number of platforms had risen to 800 too. Simultaneously, various market participants had had deeper understanding of P2P; regulators had concerned more about it as well. Hence, the upsurge of P2P was gradually returning to a sensible level under the test of market. In the matter of MSE financial service, P2P lending platform with proper operation had formed a differentiated market positioning with traditional commercial banks and micro-credit companies, partially filling the gap of MSE financial service market. Meanwhile, crowdfunding got started, providing MSMEs a brand-new channel of direct financing. We had noticed that not only information technology, represented by internet, drove the innovation and development of informal finance forms, what’s more important was the power of generation turnover.

**Fig. 2-18 Growth Trend of P2P Debit and Credit in China (2011~2013)**



Source: WangDaiZhiJia(Portal site of P2P lending: <http://www.wangdaizhijia.com/>) .

Furthermore, regional financial reform started from Wenzhou and spread to major cities of the country. Infrastructure construction of regional informal finance had achieved unprecedented progress. The first local law defining private lending was published in 2013 as well. In accordance with historical law regarding the appearance of various financial institutions, products and markets, civilian wisdom was constantly exploring more effective solutions for information asymmetry in financing activities in different fields. New forms of financial activities would appear when certain results involving risk, cost and efficiency management had been achieved. Through the test of time, new forms of financial activity would keep growing or become extinct.

### **3. A Prospect of Development in MSMEs Financial Service**

At the end of 2013, the Third Plenary Session of 18<sup>th</sup> CPC Central Committee was solemnly convened, deliberated and passed the “The Decision of the CPC Central Committee on Major Issues Concerning Comprehensively Deepening Reform”, which had explicitly presented that deepening the reform of economic system should be tightly focused on allowing the market to play a more “decisive” role in allocating resources. Opening a new chapter of China’s economy through further unleashing reform dividends was widely expected by all sectors of the society. However, in this special period of economic development, deep-seated reforms require greater courage and wisdom. In 2014, the triple-effect of economic growth shifting, structural adjustment throes and earlier stimulus digestion is expected to be further exposed. Developments situation will be greatly different in regions and industries. Credit risks in Yangtze River Delta continue releasing and spreading out to other areas. Meanwhile in economic transition, industrial structure transfer and regional industrial transfer lead to the differentiation development of MSEs and their financial services. Fortunately, retuning to entity economy has become a shared understanding of more and more people after high drops.

In the guidance of “allowing the market to play a more decisive role in allocating resource”, more market-oriented reforms are expected to be introduced in 2014. In financial sector, interest rate marketization will be carried forward. Besides, admittance and exit system of financial market will be further improved as well. Regulators are likely to raise tolerance of “catfish effect” brought by new financing activities like internet finance while strengthening supervision. No matter in direct or indirect financing field, downward shift of customer structure center becomes increasingly obvious. Thus a MSE financial industrial condition with multi-levels and growing diversity is expected, offering more diversified and personalized financial services for MSEs.

Downward shift of customer structure center is still an irresistible trend in 2014. Driven by market demand and directed by information technology, commercial banks will accelerate the exploration and the innovation in internet finance, mobile finance, community finance, direct banking and other fields. Development in such fields closely related to MSE finance is undoubtedly benefits to the vitality and connotation of MSE financial services. Meanwhile, both subjects and objectives of MSE financial services in commercial banks are steadily transiting to new generations under the influence of generational turnover, resulting to changes in contents, forms and channels of services. Such changes are likely to raise attention from commercial banks in 2014. Growth of micro-credit industry will continue to decline and become more sensible with more voluntary or passive exits. Simultaneously, micro-credit institutions should attach great attention to internet finance by taking full use of advantages brought by it, including platforms, costs, data and etc. In pawn industry, the probability of structural differentiation will be greatly increased. Outstanding pawn shops have adopted branding and chain operation as strategic objectives. In 2014, private guarantee companies will still face a tough situation with the industrial reshuffle continuing. Even though compensation cases in policy security companies will rise, credit guarantee industry is more certain to return to policy guarantee, given fiscal risk compensation and endorsed letter of credit, which have expanded its market

share. Venture capital will further warm up with fund raising, investment and exit going dynamic. During economic transformation, the decline of traditional manufacturing industry is accompanied with the rise of tertiary industry and the increasing briskness of emerging industries like TMT. This will bring more investment opportunities. Sensitive venture capitalists will increase their allocation to emerging industries, therefore providing more financing opportunities and resulting value-added services to MSMEs in these fields. In terms of trust companies, downward shift of customer structure center in trust financing enterprises will be maintained, along with the spreading of finance region—from large central cities to the outside. As fiduciary business become broader and deeper, trust companies will have a vast potential prospect in broadening and deepening SMEs' financing channels. Revitalizing credit resources inventory in financial institutions through SMEs' credit assets securitization is expected to become a new business direction of trust companies. In the matter of stock exchange market, the construction of multi-level capital market has entered a fast development period with favorable terms in the “new nine suggestions”. NEEQ is rapidly growing and such trend is likely to continue in the coming year. The number of listed companies will certainly exceed one thousand at the end of 2014. Stock financing channels of SMEs will be further opened. Under a relatively loose monetary policy environment, enterprise bond financing is likely to take a larger proportion in total social financing. Thereinto, MSE special financial bonds are expected to become an important channel of small and medium commercial banks to expand their liability businesses. Informal finance will experience crucial tests from the market. The trend of follow suit in private investment will be contained to some degree and the informal finance interest rate is expected to fall back, which is in favor of MSME financing. Emerging informal financing activities, born with the integration of informal finance and internet finance, will have a large scale of optimizing and recombining after spotty and savage development with dual function of market elimination mechanism and strengthened supervision.

Finally, it still needs to be emphasized that a healthy and stable real economy is the foundation of financial services' sound development. While constantly promoting the development of MSME financial services, improving business environment of MSMEs, stimulating entrepreneurship and innovation and releasing economic development potentialities are still a critical task that requires long-term persistence. In 2014, tax incentives cover greater range of MSEs, but it still needs time to reduce MSMEs' heavy tax burdens. Besides, fair development opportunities and more market-oriented competitive environment are imperious demands of private economy development with MSMEs as principals. We look forward to more pragmatic reform measures that can really benefit MSMEs, therefore stimulate the sustainable development of MSME financial service.

## Abbreviations

Table of Abbreviations

Abbreviation	Full Name
CBRC	China Banking Regulatory Commission
CPC	Communist Party of China
CCCPC	Central Committee of Communist Party of China
CMB	China Merchants Bank

<b>CMBC</b>	China Minsheng Bank
<b>CSRC</b>	China Securities Regulatory Commission
<b>CUFE</b>	Central University of Finance and Economics
<b>GEM/GEMs</b>	Growth Enterprise Market(s)
<b>IFC</b>	International Finance Corporation
<b>IPO</b>	Initial Public Offering
<b>MSE/MSEs</b>	Micro and Small Enterprise(s)
<b>MSME/MSMEs</b>	Micro, Small and Medium Enterprise(s)
<b>NASDAQ</b>	National Association of Securities Dealers Automated Quotation
<b>NSFC</b>	National Natural Science Foundation of China
<b>OTC</b>	Over-the-Counter
<b>P2P</b>	Peer-to-Peer
<b>PBoC</b>	People's Bank of China
<b>PE</b>	Private Equity
<b>PE ratio</b>	Price Earning ratio
<b>SEC</b>	Securities and Exchange Commission
<b>SME/SMEs</b>	Small and Medium Enterprise(s)
<b>SML</b>	Small, Medium and Large
<b>TMT</b>	Technology, Media and Telecom
<b>VTB/VTBs</b>	Village and Town Bank(s)