

China MSME Finance Report 2015

(Compact Edition)

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Mintai Institute of Finance and Banking

ChinaMSME Finance Report 2015

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Preface

In 2014, with its prominent characteristics of new normal, the under downward pressure of Chinese economy kept emerging. With dual pressure of shrinking market demand and rising operation cost, the survival and development of enterprises encountered widespread difficulties. In particular, with the remarkably rising credit risk of MSMEs, institutions providing debt financing to MSMEs generally slowed down the steps of scale expansion, and “credit grudging” reappeared. How to achieve a balance between risk control and innovative development became the biggest challenge for MSME financial service institutions.

However, just in the same year we felt the gradually rising heat of MSE financial market. “MSE finance”, “inclusive finance” had never become a flag held highly by many financial institutions like this at present. “Long tail customers” also had never become the favorable target of many business institutions like this at present, including private banks under BAT.

What had brought this change?

We could see clearly in the process of tracking the policy trend that the policies of regulators to encourage the development of MSE financial service had been gradually put into practice, especially the differentiated regulation and finance and taxation incentive policies for the biggest supplier—commercial banks’ MSE financial service. The marginal utility of encouragement policies had diminished.

What really brought change was the force of market-oriented reform. Although it did not directly aim at MSE finance, market-oriented reform, such as the further advance of interest rate liberalization reform, the lower access threshold in banking sector, the introduction of deposit insurance system, the accelerated building of credit information system and the opening of credit information market to private enterprises, the accelerated building of multi-level capital market that promotes the development of direct financing, etc., was a fundamental reform that respected the objective operation law of financial market and let the market play a decisive role in the allocation of resources. It focused on changing the financial repression resulted by price distortion and insufficient competition, thus bringing profound and everlasting influences for the market.

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Meanwhile, economic and social change was another force that could not be ignored. Industry economy transformed into information economy, the internet accelerated its infiltration into traditional industries and data became the new production factor; with the enormous change of production and consumption brought by generation replacement, the need and habit of financial service had changed accordingly. The advantage of internet in servicing “long tail consumer” had been widely acknowledged, which in turn extended into the area of internet finance. The most outstanding manifestation was that the application of big data technology in MSE financial service triggered the wide attention of various institutions including commercial banks.

When the technological and institutional change made the MSE financial service more profitable and competition of financial market was more sufficient, instead of passive implementation as a response to the regulation requirements, the development of MSE financial service would become a strategic option taken proactively by more and more financial institutions to carry out differentiated competition. This would produce important impact on the change of development pattern of MSE financial service market.

We were lucky to have witnessed this unprecedented change in the seven years of tracking and recording. Although the change was just at its beginning, it was enough to make us happy and with expectations.

Based on continuously upholding the principle of “objective, neutral and precise”, this year the research group raised higher requirements on the study depth. In addition to have more in-depth work in professional sections, the group also strove to break through the horizontal connections among various sections and to gain insight into the objective law of the development of MSME financial service market. The investigation and survey into the market frontline provided strong support for the deepening of the study. The group carried out the third Questionnaire Survey of MSE Financial Managers in Commercial Banks; cooperated with Financial News in the survey of financial new pattern in rural areas; cooperated with China Microfinance

Institution Association in carrying out the sample survey of microfinance companies across the country; cooperated with 01caijing.com in carrying out the data survey of P2P MSE financial service and the investigation and survey of MSMEs of financial leasing. The group members also visited and interviewed various typical institutions and carried out field investigation and survey of their MSE financial service. Moreover, we started the exploration of establishing industry expert reviewer mechanism and received selfless help from old and new friends. Taking this opportunity, we would like to extend our deep appreciation to the practitioners at the frontline and experts and scholars of the industry! To be precise, this report is the common fruit of all participants' wisdom.

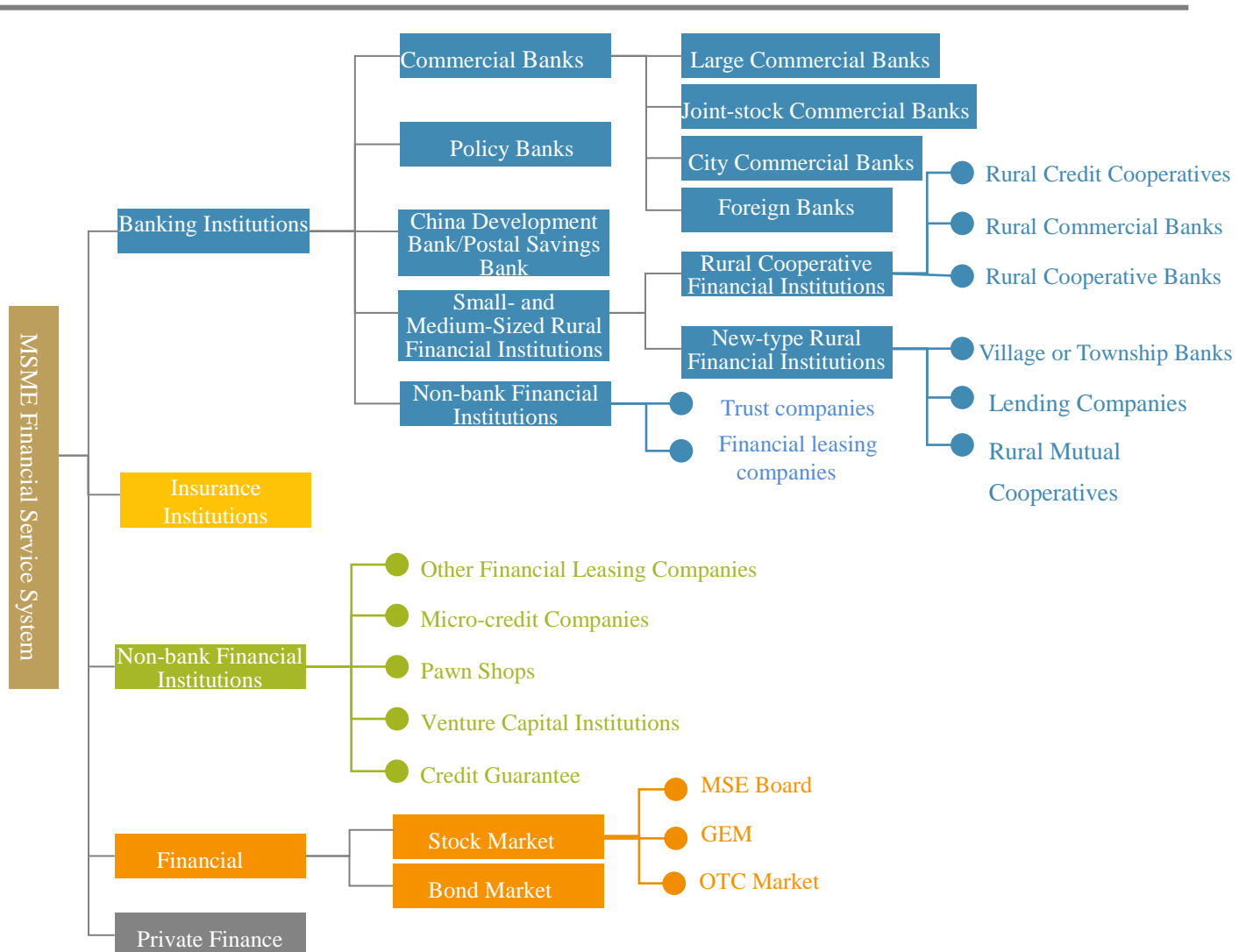
In particular, this year the research group received strong support from China Banking Regulatory Commission (CBRC) and the People's Bank of China (PBoC) in obtaining the detailed data of MSE loans. It was the first social disclosure by way of this year's report of the types and structure of MSE loans in banking institutions and the characteristics and contributions of MSE loans of the major institutions. Moreover, from this year CBRC started to make quarterly and formal external disclosure of the loan data used by banking institutions in MSE, which was of great benefit in promoting the whole society to understand financial institutions' service to MSE and in carrying out competition between financial institutions. We also expected that the government regulating departments would make more open access to data.

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

In this report, MSME financial service system¹ is divided into five categories: banking institutions, insurance institutions, other quasi-financial institutions, financial market and private financing (See fig. 1-1).

¹ Generalized MSE 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.

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 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 cooperative 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

MSE financial services mainly include trust companies and financial leasing companies.

Apart from banking institutions, other quasi-financial institutions¹ investing in MSE 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 Micro, Small and Medium Enterprise (MSME) board, growth enterprise market (GEM) and over-the-counter (OTC) market. In addition, private financing constitutes another type of finance, including financial service forms other than formal finance.

From this year, in addition to the attention of financial service institutions providing financing service, the report also adds financial institutions such as insurance institutions which do not provide financing directly but provide risk management service.

2. An Overview of MSME Financial Service

In 2014, the development of MSME financial service market encountered risk and “cold current”. Under economic slowdown, MSME suffered badly. The ratio of non-performing loans grew apparently. The institutions providing MSME debt financing supply generally felt the coldness. Among them, the biggest main body of supply—banking institutions slowed down their expansion of scale, even with negative growth in certain institutions. The “credit grudging” of banks reappeared. It was even more difficult for institutions engaged in such as small credit, pawn, financial leasing, etc. to have a narrow escape, particularly those institutions which had engaged in “quasi-bank” business for a long time in good economic situation were more obviously hit. Affected by the frequent outbreak of risk events, the trust relationship in private credit also experienced disintegration. It was increasingly difficult for MSME to have financing through private channels. While the debt financing market was in stagnancy, MSME equity financing suddenly rose in 2014. The venture capital investment market and equity transaction market all experienced rapid growth, opening up more diversified financing channels for innovative MSMEs with high growth.

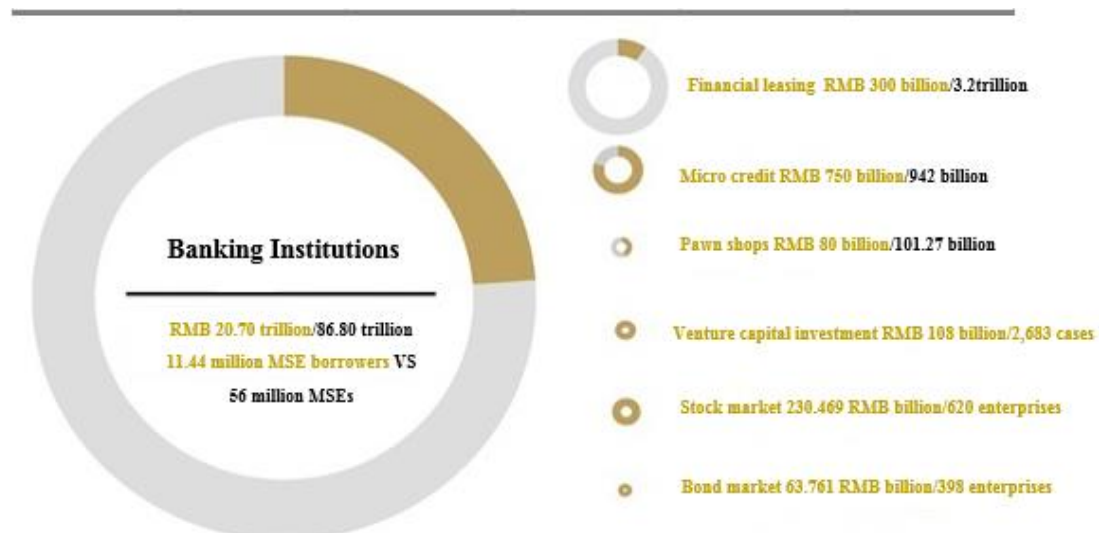
“Competition” was another key word for the development of MSME financial service in 2014. The competition brought by internet finance which was led by forces outside banking industry encouraged commercial banks to start paying attention to the role of data in MSE financial service. Private banks with their advantages in data, channels and technology were regarded as the strongest competitors by existing commercial banks in MSE finance. The continuous sinking of customer structure by banking institutions formed direct competition with institutions such as micro credit, pawn, etc. How to play the unique advantage of the industry and to form differentiated competition with mainstream institutions became issues faced by these institutions.

¹ 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.

What was clear was that more MSME would benefit from the wrestles among various institutions.

Fig. 1-2 shows the scale of MSME financial service provided by major supply bodies in the MSME financial service system. We can see that banking institutions were still the biggest finance suppliers of MSME, providing financing at the scale of trillion for tens of millions of MSEs; those providing financing at the scale of one hundred billion include micro credit, financial leasing, stock market and venture capital investment, among which stock market and venture capital investment entered the one hundred billion financing list for the first time, thanks to the heat of capital market rebound and start-ups; in comparison, the balance of MSME pawn still had not reached one hundred billion and rested at the level of only ten billion, though in 2014 the financing scale provided to MSME by the bond market substantially increased than that of 2013.

Fig. 2-1An Overview of MSME Financial Service (2014)



Note: ①Circles above refers to financing scales of various kinds of institutions in banking, financial leasing, micro credit and pawn industry in 2014 (gray numbers within the circle 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 statistics/estimation covers generalized 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); of the coverage of financial leasing and pawning is the MSME business balances; for venture capital, stock market and bond market, the yellow circle represents the financing increment of MSMEs in 2014, among which the venture capital part is the investment amount and number of investments already disclosed, and the actual scale will be larger than the disclosed data.

②By the end of 2014, banking institutions had provided MSE loan services to 11.446 million MSEs, accounting approximately for 20.44% of the total 56 million MSEs nation-widely.

2.1 Banking Institutions

In 2014 banking industry entered into “new normal” development stage where there were high risk, low return, more diversified competitors, more complicated financial risks and more rigorous monitor. Interest rate liberalization, technological change and opening up of the industry to private capital would promote the internal competition and differentiated development in banking industry. The continuous slowdown and shift of the economy resulted in the slowed profit increase and accelerated rise of risk in banking industry. The rapid development of direct financing market also brought more challenges to the traditional banking industry.

The results of the annual Questionnaire Survey of MSE Financial Managers in Commercial Banks¹ showed that, the most outstanding characteristic of the year 2014 was the increase of MSE credit risk and “increase of risk” became the key word mentioned the most frequently in MSE financial managers’ description of 2014. The rise of MSE credit risk had been reflected in the general increase of non-performing loans in banks in 2014.

In the past several years, commercial banks’ triumphant advance in MSE financial service encountered disappointment in the bitter reality. Most commercial banks took a defensive strategy which was comparatively conservative, and they generally slowed the steps of scale expansion in MSE credit, allocating more energy into the non-performing loan clearance and the risk control of existing loans. “Progress while maintaining stability”, “enhance risk control” and “prudent development” became the widespread choice for most commercial banks against the background of increasing MSE credit risk in 2014. The interviewee in some banks even mentioned key words such as “development stagnancy” and “lack of achievements to be mentioned”.

Data showed that the increase of MSE credit scale in banking institutions continued to slow down. Some model banks for MSE finance even encountered negative growth of MSE credit in 2014, such as China Minsheng Bank and Industrial and Commercial Bank of China. Meanwhile, we also noticed that the banking industry faced greater competition pressure driven by interest rate liberalization, financial disintermediation and rapid development of internet finance. While enhancing the risk control, the banking industry continued to deepen organizational and structural change, kept exploration and innovation in MSE service pattern, and stated to try information technology in MSE service.

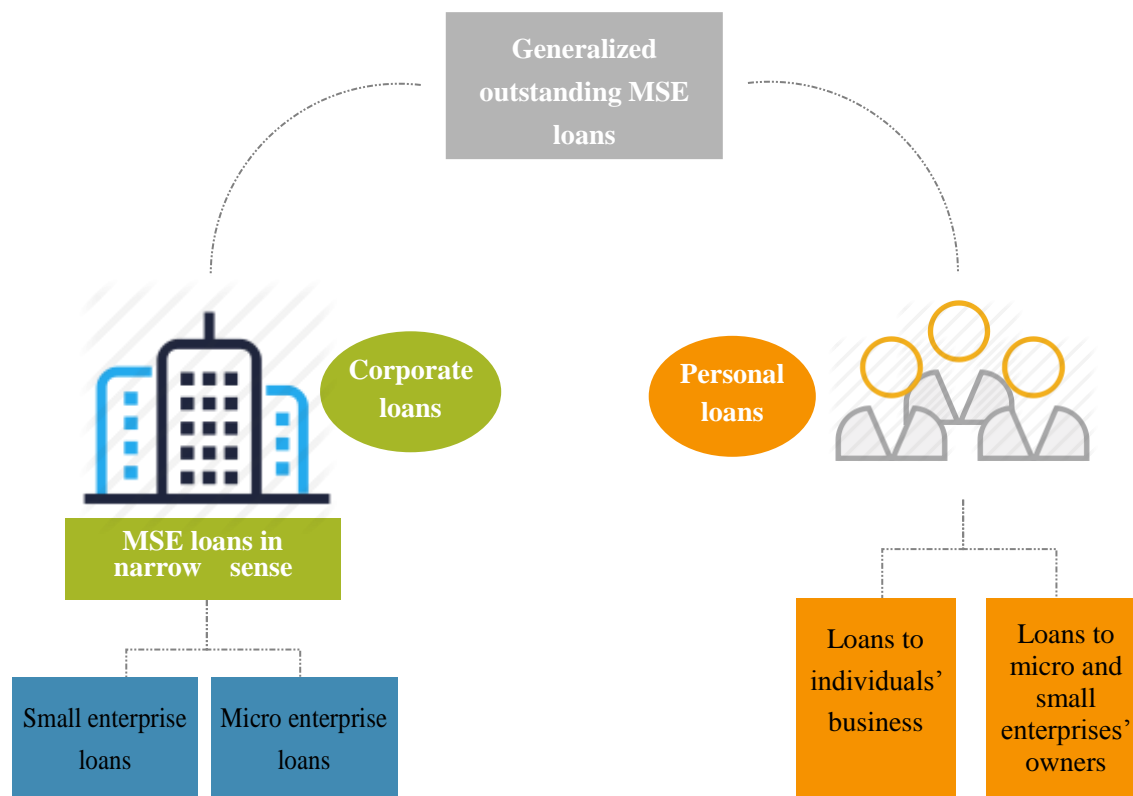
■ The Category Composition of Banking Institutions’ MSE Loans

According to the definition of the research group of *China MSME Finance Report (2015)* of the Central University of Finance and Economics, generalized MSE loans can be divided into two categories in terms of forms: one is MSE loans provided in the form of corporate loans, i.e. small enterprise loans and micro enterprise loans (collectively referred to as MSE loans in narrow sense); and the other is loans to individuals’ business and loans to micro and small enterprises’ owners in the form of

¹ For details of the survey, please refer to the annex of the Chinese version: Questionnaire Survey of MSE Financial Managers in Commercial Banks (2015)

personal loans.

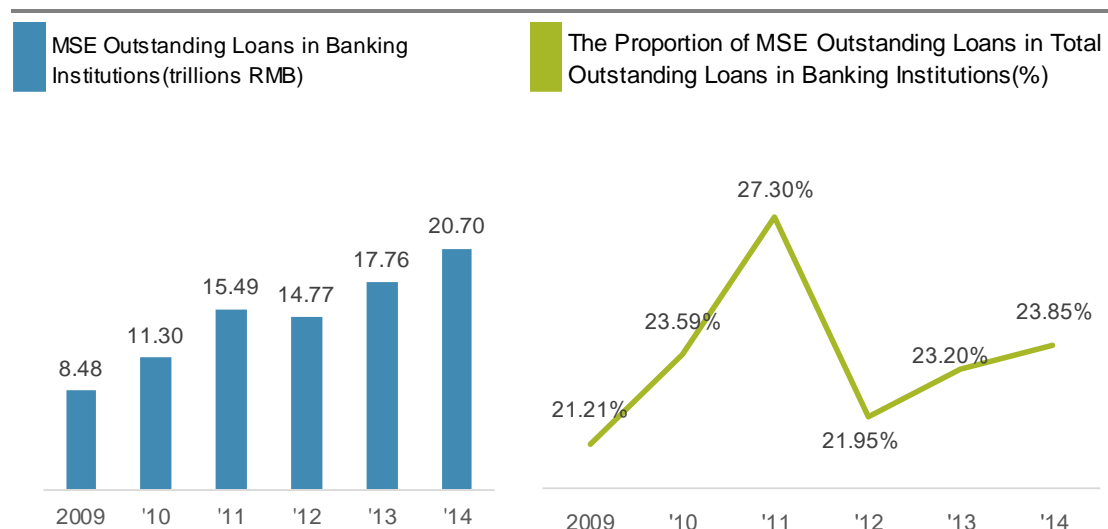
Fig. 2-2 Category of Banking Institutions' MSE Loans



■ The Scale and Structure of Banking Institutions' MSE Loans

According to CBRC data, by the end of 2014, banking institutions' generalized outstanding MSE loans was RMB20.70 trillion (including small enterprise loans, micro enterprise loans, loans to individuals' business and loans to micro and small enterprises' owners; unless specifically noted as MSE loans in narrow sense, the loans mentioned in the following all refer to generalized MSE loans), which was an increase of 16.55% compared with that of 2013, higher than the increase rate of each loans by 4.2 percentage point, reaching the target of "double not lower than" for six consecutive years, but the increase rate dropped. The nationwide number of MSEs enjoying loan services reached 11.446 million, which was a 9.0% year-on-year growth, accounting approximately for 20.44% of the total 56.06 million MSEs (including 1,170 MSE and 44.36 million individuals' business). In 2014, outstanding MSE loans in banking institutions accounted for 23.85% of the total outstanding loans, an increase of 0.65 percentage point compared with 23.20% in 2013.

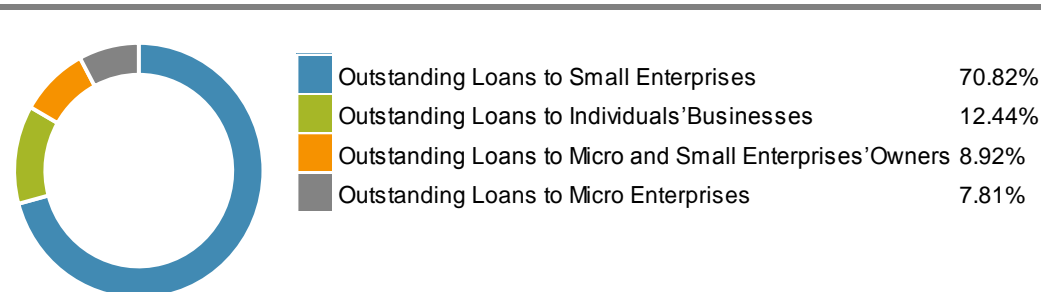
Fig. 2-3 MSE Outstanding Loans and their Proportion in Total Outstanding Loans in Banking Institutions (2009~2014)



Note: MSE loans data of 2014 come from relevant CBRC data; data of total outstanding loans come from the RMB outstanding loans data provided by PBoC; the data of 2009-2013 come from *China MSME Finance Report (2014)*.

In the above generalized MSE loans, those in the form of enterprise loans, i.e. MSE loans in narrow sense, accounted for approximately 80% and those in the form of individual loans accounted for approximately 20%. To make further detailed analysis, most of the loans were small enterprise loans, taking a proportion as high as 70.82%; while micro enterprise loans occupied the lowest proportion of only 7.81%; the loans to individuals' business and to micro and small enterprises' owners accounted for 12.44% and 8.92% respectively.

Fig. 2-4 MSE Loan Structure of Banking Institutions (2014)



Note: Obtained through summarizing CBRC data by the research group of *China MSME Finance Report (2015)* of the Central University of Finance and Economics.

■ MSE Loan Contribution of Various Banking Institutions

The outstanding MSE loans of the five large commercial banks reached RMB5.45 trillion, ranking the first with a proportion of 26.34% of the total outstanding MSE loans of the banking institutions. Besides, the outstanding MSE loans of joint-stock commercial banks, city commercial banks and rural commercial banks all exceeded 3 trillion.

Fig. 2-5 Outstanding Generalized MSE Loans and their Proportion in Various Banking Institutions (2014)

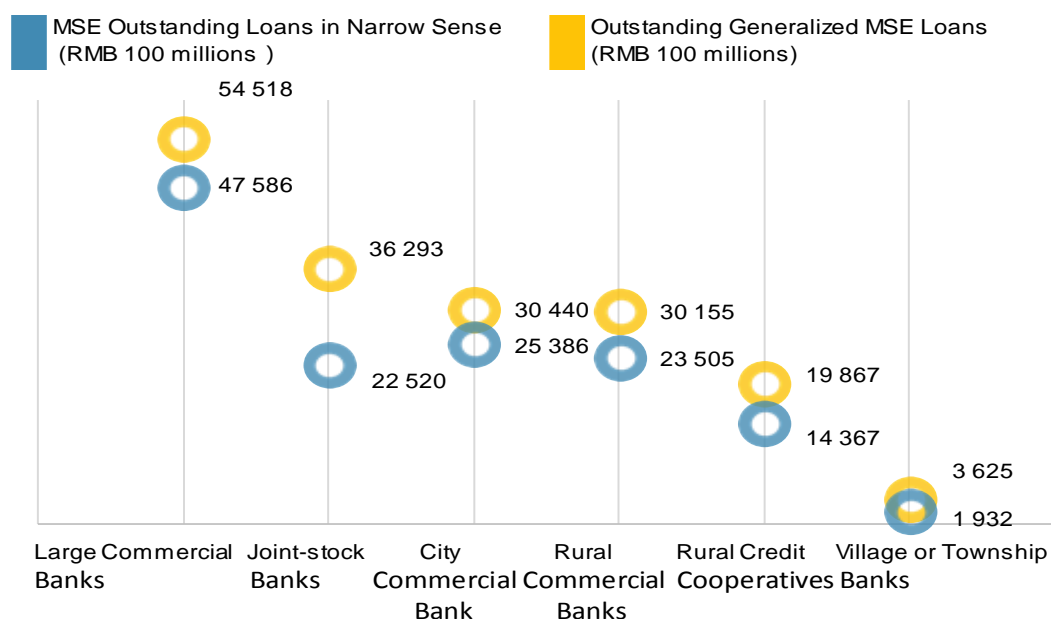


Note: ①Obtained through summarizing CBRC data by the research group of *China MSME Finance Report (2015)* of the Central University of Finance and Economics.

②According to the CBRC's explanation of scope, others include policy banks, China Development Bank, Postal Savings Bank, foreign banks and non-bank financial institutions.

No matter judging from generalized outstanding MSE loans or from outstanding MSE loans in narrow sense, the five large commercial banks' contribution in terms of "volume" were the biggest, with joint-stock banks ranking the second. Meanwhile it could be found out that the joint-stock banks had the largest margin in the absolute values between generalized outstanding MSE loans and the outstanding MSE loans in narrow sense, which also meant that large amount of MSE loans were issued in the form of individual loans in joint-stock banks.

Fig. 2-6 Outstanding Generalized MSE Loans and MSE Loans in Narrow Sense of Various Banking Institutions (2014)

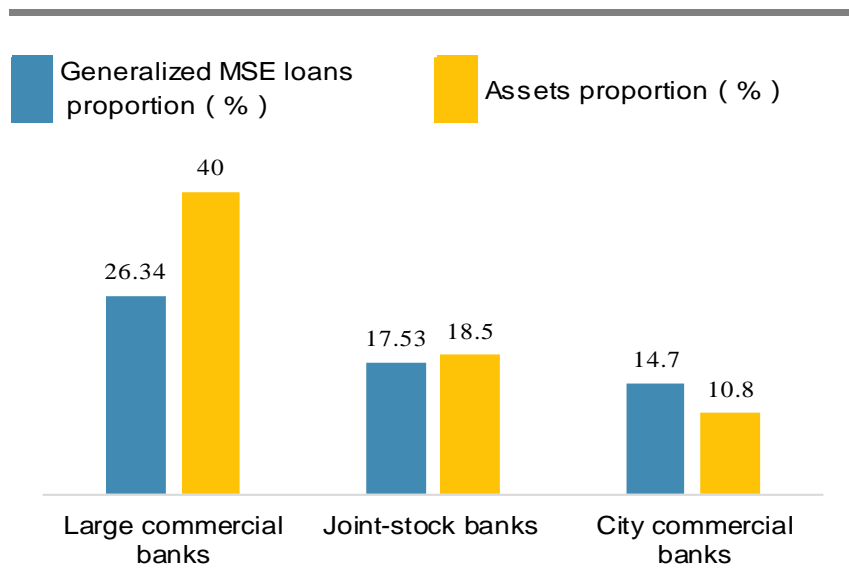


Note: ①Obtained through summarizing CBRC data by the research group of *China MSME Finance Report (2015)* of the Central University of Finance and Economics.

②MSE loans in narrow sense = small enterprise loans + micro enterprise loans; generalized MSE loans = MSE loans in narrow sense + loans to individuals' business + loans to micro and small enterprises' owners

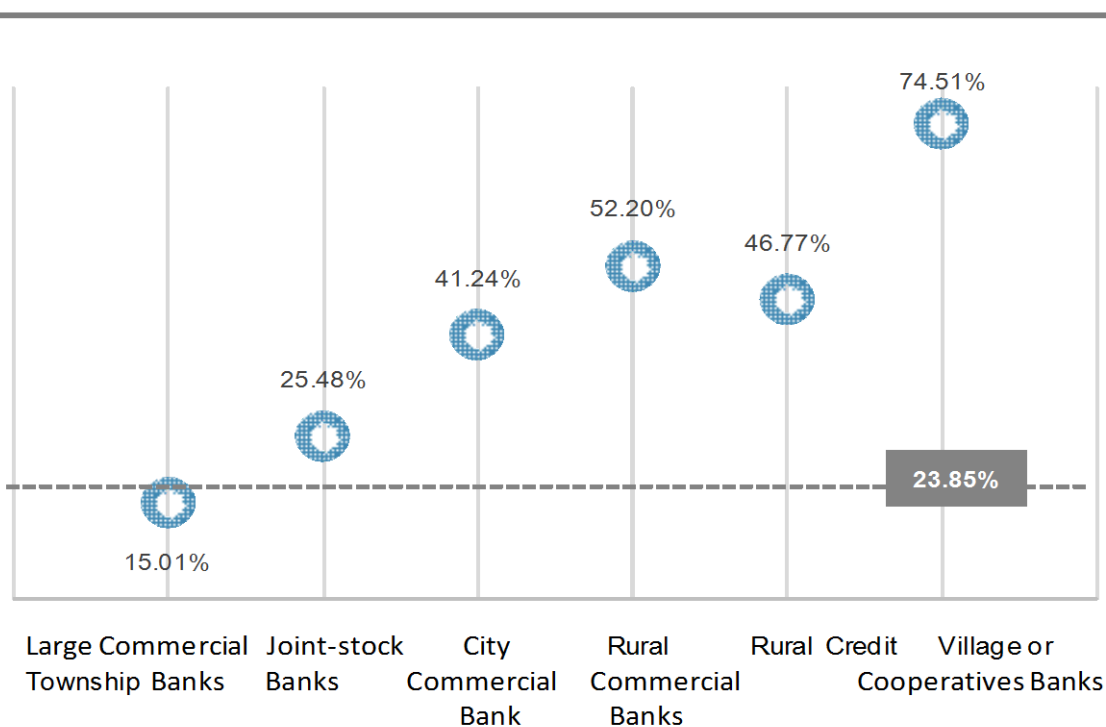
We made a further observation of the matching degree between MSE financial service contributions of the three major types of commercial banks and their assets' proportion. Large commercial banks, joint-stock commercial banks and city commercial banks provided around 60% of MSE loans with an asset scale of approximately 70% of the total banking industry, among which the proportions of large commercial banks' outstanding MSE loans were still smaller than their assets proportions, joint-stock commercial banks had basically equal proportions of outstanding MSE loans and assets, and the proportion of city commercial banks' outstanding MSE loans was higher than their assets proportions by nearly 4 percentage point.

Fig. 2-7 Proportion Comparison of Three Major Types of Commercial Banks' MSE Loans Contributions and Assets (2014)



Besides, we might observe the contributions of various institutions by examining the proportions of their outstanding MSE loans in the total outstanding loans. As mentioned above, the proportion of outstanding MSE loans in the total outstanding loans of banking institutions was 23.85% in the end of 2014. Large commercial banks did not reach the overall level of the banking industry in terms of this ratio, while other types of financial institutions all exceeded the overall level of the banking industry. Village or township banks had the best performance in the proportion of outstanding MSE loans, which was as high as 74.51%.

Fig. 2-8 Proportion of Generalized Outstanding MSE Loans in the Total Outstanding Loans of Various Banking Institutions (2014)



Note: ①Obtained through summarizing

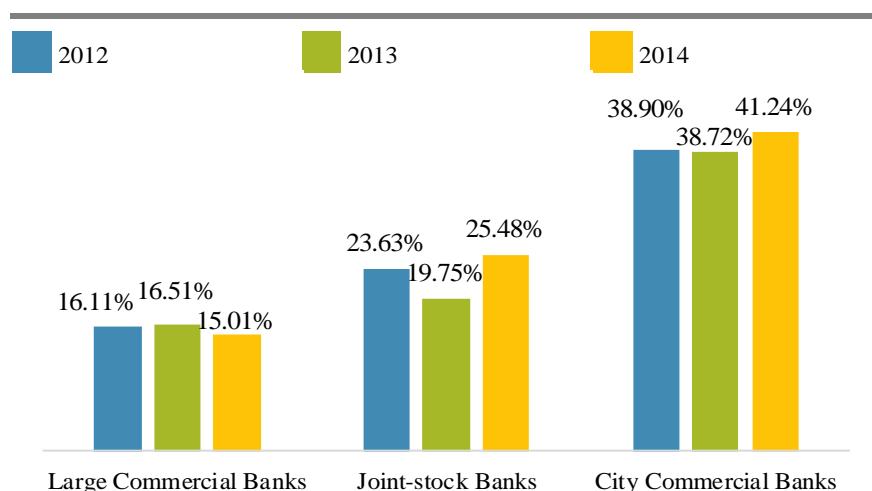
CBRC data and PBoC data by the research group of *China MSME Finance Report (2015)* of the Central University of Finance and Economics.

②The purple dotted line is the average proportion—23.85%—of outstanding MSE loans in the total outstanding loans of banking institutions.

③The total outstanding loans in calculation of rural credit cooperatives and village or township banks come from the outstanding RMB loans data of banking institutions in the end of 2014 provided by PBoC. The total outstanding loans in calculation of other types of financial institutions are the data of local and foreign currency outstanding loans.

By making further observation of the proportion change of the generalized outstanding MSE loans in the total outstanding loans of three major types of commercial banks, we noticed that after a slight rise in 2013, the proportion of large commercial banks' outstanding MSE loans in the total outstanding loans dropped obviously in 2014; while the same proportions of the joint-stock commercial banks and city commercial banks all increased remarkably, especially for joint-stock commercial banks, the percentage climbed from 19.75% in 2013 to 25.48% in 2014.

Fig.2-9 Proportions of Generalized MSE Loans in Total Loans of Three Major Types of Commercial Banks (2012~2014)



Data source: Generalized outstanding MSE loans of three types of banks and the total outstanding loans come from CBRC.

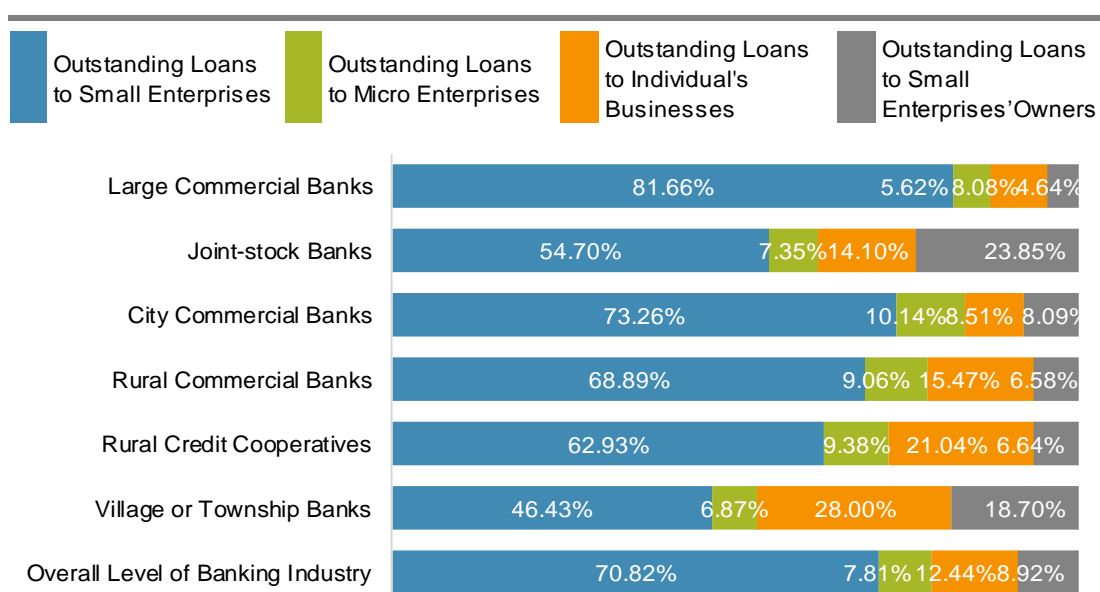
■ MSE Loan Structure of Various Types of Banking Institutions

The MSE loans of the five large commercial banks mainly took the form of small enterprise loans, the proportion of which was as high as 81.66%, exceeding the overall level of banking industry (70.82%). It is worth noting that for the outstanding MSE loans in narrow sense (i.e. small and micro enterprise loans) of the joint-stock commercial banks, the proportions were much lower than the five large banks (merely

higher than village or township banks), while the proportion of outstanding loans to micro and small enterprises' owners was far higher than that in other types of banking institutions. Along with the clearer and further reinforced trend of retailing in MSE financial services, input in loans to individuals' businesses became a crucial breakthrough of joint-stock commercial banks' expansion of MSE businesses.

For city commercial banks, rural commercial banks and rural credit cooperatives, their proportions of MSE loans in narrow sense took a descending order respectively, and their proportions of MSE loans issued in the form of individual loans (i.e. loans to individuals' business and to micro and small enterprises' owners) took an ascending order respectively. Among various institutions, the proportion of MSE loans in narrow sense of village or township banks was the lowest, slightly over 50%, and accordingly, its proportion of MSE loans issued in the form of individual loans was the highest among the several types of institutions.

Fig. 2-10 MSE Loan Structure of Various Financial Institutions (2014)



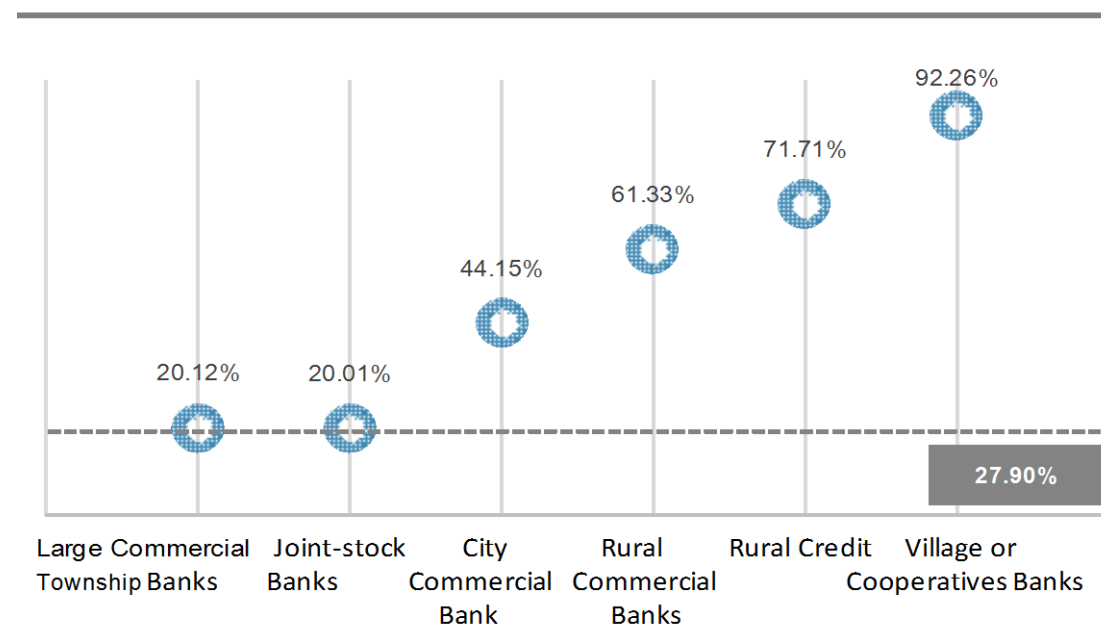
Note: Obtained through summarizing CBRC data by the research group of *China MSME Finance Report (2015)* of the Central University of Finance and Economics.

We further divided the afore-mentioned MSE loans into two types: small enterprise loans and micro enterprise loans issued in the form of enterprise loans, and loans to individuals' business and to micro and small enterprises' owners issued in the form of individual loans. Then we analyzed the proportions of these two types of MSE loans in their enterprise loans and individual loans respectively for various financial institutions.

In terms of enterprise loans, the sum of small enterprise loans and micro enterprise

loans in banking institutions accounted for 27.90% of the total non-financial enterprises and other department loans, with only large commercial banks and joint-stock commercial banks not reaching the overall level of banking industry. Village or township banks had the highest proportion, which was over 90%.

Fig. 2-11 Proportions of Small Enterprise Loans and Micro Enterprise Loans in Total Non-financial Enterprises and Other Department Loans of Various Financial Institutions (2014)

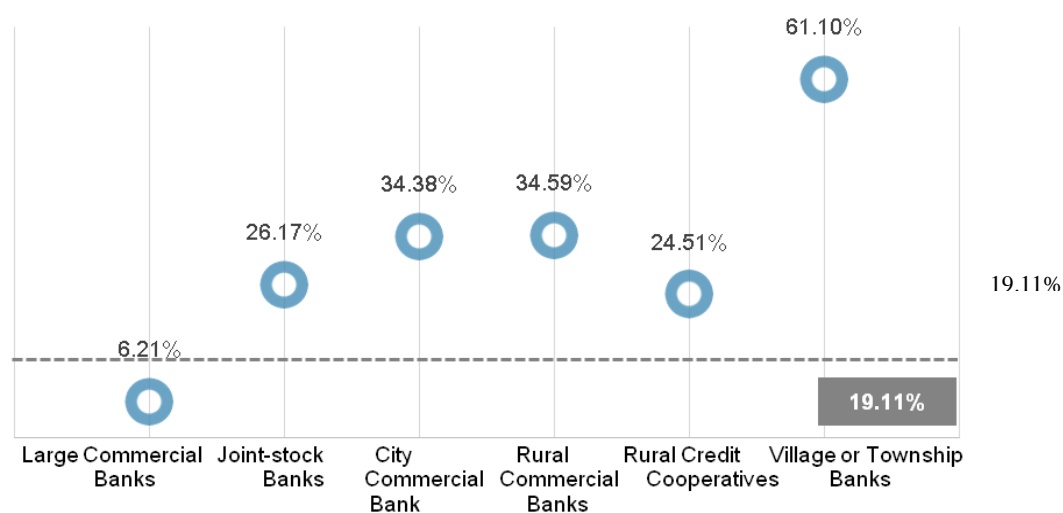


Note: ①Obtained through summarizing CBRC data and PBoC data by the research group of China MSME Finance Report (2015) of the Central University of Finance and Economics.

②The purple dotted line is the average proportion—27.9%—of outstanding loans to small enterprises and to micro enterprises in the total non-financial enterprises and other department loans of banking institutions.

In terms of individual loans, the average proportion of outstanding loans to individuals' business and to micro and small enterprises' owners in the total household loans of banking institutions was 19.11%. Except large commercial banks, other types of banking institutions all exceeded average level of the industry in this proportion. Village or township banks had the highest proportion, which was 61.10%.

Fig. 2-12 Proportion of Outstanding Loans to Individuals' Business and to Micro and Small Enterprises' Owners in the Total Household Loans of Various Banking Institutions (2014)



Note: ①Obtained through summarizing CBRC data and PBoC data by the research group of China MSME Finance Report (2015) of the Central University of Finance and Economics.

②The purple dotted line is the average proportion—19.11%—of outstanding loans to individuals' business and to micro and small enterprises' owners in the total household loans of banking institutions.

2.2 Other Quasi-financial Institutions

2.2.1 Micro Credit: Exploring and Advancing in Plight

The scale of micro credit industry continued its growth in 2014, but the growth rate slowed down sharply year by year. The operational risks were apparent and the overall industry growth revealed weakness. By the end of 2014, there were 8,791 micro credit companies nationwide in total, with outstanding loans of RMB942.038 billion as well as 12.14% and 15.01% growth rate respectively compared to the same period last year. The growth rate obviously dropped. Given that eight in ten of the micro credit companies' loans flowed to MSEs, approximately RMB750 billion of the outstanding loans were MSE loans. *The Sample Survey of Micro Credit Companies Nationwide*¹ showed that micro credit companies presented obviously different features compared with traditional financial institutions such as commercial banks in loan industry, prospective borrowers, loan interest rate and guarantee type. But differences in length of maturity and loan limit were not quite apparent. In the context of continued economic slowdown, traditional financial institutions had their service

1 For estimation basis, please refer to "The Sample Survey of Micro Credit Companies Nationwide" in the 8th chapter of Chinese Report.

sunk; e-businesses and internet companies crossed the border into retail finance. Micro credit companies were facing double squeeze from top and bottom, with continuously growing competitive pressures.

2.2.2 Pawn: Competition Urges Returning to Exploration

Although the pawn industry still maintained a growth trend in 2014, its growth rate slowed down. Up to the end of 2014, there were 7,574 pawn shops in total nationwide with an increase of 10.8 percent. For the first time pawn balances exceeded hundred billion RMB, reaching RMB101.27 billion, with a growth of 16.9%. The growth rate declined. Approximately RMB80 billion of pawn balances flowed to MSMEs if estimated that eighty percent of pawn businesses were MSMEs' pawn¹. The pawn industry was made to face an unprecedented development challenge by the increasingly greater competitive pressure from inside and outside the industry and the business risks brought by the economic slowdown. Along with the industry's deepening awareness of the risks brought by the highly concentrated large-scale real estate pawn businesses, the proportion of movable property pawn was gradually and slightly increasing. The traditional business as the origin of pawn received more attention. Utilizing internet technology to accelerate the innovation of pawn business also became an option for the pawn industry in their seeking of breakthrough. Relevant policies were also further encouraging the pawn shops to highlight their operational characteristics of "short-term, small scale, quick and flexible", fully playing the "relieving and supplementary" role in MSME financing field. In the increasingly fierce market competition, the pawn industry needed to actively respond to the issue of how to actively make innovation on the basis of returning to origin businesses, to reinforce the differentiated competition advantages and to fully play a unique role in MSME financing field.

2.2.3 Financial Leasing: still Waiting for Deep Plough

What formed sharp contrast to the gradual drop of Chinese economic growth rate under the "new normal" was the explosive growth of financial leasing industry in 2014, driven by the mushrooming growth of foreign financial leasing companies. By the end of 2014, there were 2,202 financial leasing companies nationwide, with an increase as high as 114.62%; the total registered capital was RMB661.1 billion, with an increase as high as 116.05%; balances of financial leasing contracts reached RMB3.2 trillion, with a growth of 52.4%. However, the large number of "empty shell" leasing companies behind the rapid growth triggered concerns. Although financial leasing had unique advantages in MSME service, as a business with "hard-earned" money, it had limited attraction to most of the financial leasing companies. There was

¹ The research group made rough estimation according to the feature of production-based use of our country's pawn industry and the customer structure data obtained during the actual investigation and survey of some pawn shops. Due to the lack of breakdown of customer structure data, slightly different from estimation of MSE loans in micro credit, the estimation in pawn is MSME pawn.

no apparent change in the pattern of MSME financial leasing market. We estimated that the proportion of MSME leasing scale in total financial leasing industry was still very low, not higher than 10%, i.e. balances of SME financial leasing contracts were approximately within RMB300 billion. It deserves credit that some financial leasing companies which paid attention to market segmentation and building of core competitiveness insisted in the exploration of this field, succeeding especially in MSME-concentrated business areas such as the leasing of agricultural machinery, heavy trucks, work clothes, etc. It needs to be paid attention to that the economic slowdown and rise of MSME operation risks caused financial leasing companies to shrink MSME leasing businesses or treat them with caution.

2.2.4 Credit Guarantee Industry : Standardization of Industry Development

The credit guarantee industry struggled to develop in economic downturn in 2014 and deep integration continued within the industry. Financing guarantee companies in many locations were experiencing great shocks in the industry. Many private financing guarantee institutions were eliminated and withdrew during the industry reshuffle. The financing guarantee amount in some regions dropped and the compensate rate increased. Various regions one after another carried out cleaning and standardization of non- financing guarantee companies, with unceasingly enhanced supervision. The chaos in guarantee companies resulted in increasingly more difficult cooperation between banks and guarantee companies. Some banks greatly compressed the scope of cooperation between banks and guarantee companies and raised the threshold of credit extension, even stopped business cooperation with private guarantee institutions. Various local governments actively supported the steady development of credit guarantee industry, taking measures to push policy-based guarantee back to the leading position again. Meanwhile, it was just the right time for the development of collateral management industry. With the introduction of *Management Standard for Third Party of Guarantee Inventory* and the decision of implementing the national standard of *Warehouse Receipt Elements and Form Specifications*, the industry gradually moved towards standardization.

2.2.5 Venture Capital: Promotion of Universal Entrepreneurship and Social Innovation

The environment for venture capital investment changed dramatically in 2014. Represented by “grass-root entrepreneurs” and “private innovation force”, “the Chinese style entrepreneurs” received attention of the whole society from top to bottom. The opening of “mass entrepreneurship and innovation by millions of people” era made venture capital industry embrace a new stage of rapid development. The venture capital market in 2014 got rid of the downturn in previous years and shifted into a trend of rise and development, with different extent of growth in each segment

of “collection, investment and withdrawal”. The investors’ interest was stimulated by the restarted IPO of A-share, the accelerated building of multi-level capital market and diversified exit channels of the project, all of which also simultaneously enhanced the confidence of LP investment. Newly raised funds reached 258 with a year-on-year increase of 29.6%, among which the fund raising scale of 253 funds were already known. Additional capital amount was USD19.022 billion, a growth of 174.9% over the previous year, which was the first positive growth of fund raising scale since 2011. In 2014 the total number of investment cases was 1917, an increase of 67.0%, among which the number of investment transactions with disclosed amount was 1,712, with total investment of USD16.883 billion, a year-on-year growth of 155.8%. Under the background of innovation and entrepreneurship, domestic and foreign venture capital institutions entered a “fever period” of investment. At the same time, the joining of emerging industrial capital and equity-based crowd-funding lowered the investment threshold and intensified the competition in venture capital industry simultaneously. The great increase of angel investment and the further moving to earlier investment stage made more young entrepreneurs have more resource choices at the initial stage of entrepreneurship and realized rapid development. Meanwhile, we also noticed that some areas were overvalued due to the in burst of excessive fund.

2.3 Financial Market

2.3.1 Stock Market: Innovative Development under Bull Market

The stock markets in Shanghai and Shenzhen surged with across-the-board gains in 2014. With favorable bull market, the multi-level stock market further deepened the development. China Securities Regulatory Commission announced the restart of IPO, GEM board published new regulations for first issue and additional issue, NEEQ formally entered the national market. Both of the number of enterprises which conducted financing through stock market and the financing amount had substantial growth. A total of 620 companies obtained financing in SME board, GEM board and NEEQ, an increase of 313.33% compared with 2013; total fund-raising amount was RMB230.469 billion, an increase of 257.65% compared with 2013. Among the above, the total fund-raising amount of 161 companies in SME board was RMB163.106 billion; that of 114 companies in GEM board was RMB54.364 billion; and that of the 345 listed enterprises in NEEQ was RMB15.021 billion. In the building of multi-level capital market, the weakened differences between GEM board, SME board and main board were not seen to be reversed. However, the rapid development of NEEQ in 2014 attracted people’s attention. It was substantially improved in terms of listings, market deals, financing capacity, etc., providing a channel with lower threshold for

MSME entering capital market and becoming the “test field” for the “de-administration” reform in capital market. Along with the issue of “new nine suggestions”, the process of building a stock market that is multi-level, widely covered, tightly supervised and highly efficient would further accelerate.

2.3.2 Bond Market: Trend, Danger and Opportunity

The bond market saw a bull market in 2014. The overall yield decrease of the secondary bond market brought along the drop of coupon rate of the new bonds, hence reducing the cost of enterprises’ bond financing and promoting the expansion of the scope of enterprises’ bond financing. Examined from the absolute scale, the scale of financing through bond market by the economic entity drastically increased. The enterprises’ bond financing scale reached RMB2.43 trillion, the proportion of which in the social financing scale increased to 14.76%, both being the highest since 2002. The bond market’s role in financial disintermediation was further enhanced. In terms of providing direct financing for MSMEs, both the absolute scale of direct financing through issuing bonds by MSMEs and its proportion in total financing scale of the enterprises increased in 2014. As the major tool for MSMEs’ financing through bond market, the issuance quantity and financing scale of SME private raised bonds kept their momentum of rapid development, driving the direct financing scale of MSME bonds up to RMB63.761 billion. This was an increase of 55% compared to 2013, which included RMB62.883 billion of SME private raised bonds, RMB430 million of SME collective notes and RMB448 million of SME set bonds. The issuance of SME collective notes was not popular and SME set bonds were still at the edge of existence in name only. Although SME private raised bonds outshined the others, as the repayment peak arrived, the credit risks of SME private raised bonds gradually exposed and the problem of underwriters and guarantors to fulfill their responsibilities became apparent, the subsequent development could arouse concern. In terms of providing bond financing channels for small and medium-sized financial institutions so as to help them in improving their MSME financing service capabilities, financial institutions financed through bond market had an obvious trend of diversification. In 2014 a total of 25 commercial banks issued RMB55.3 billion of the specialized MSE financial bonds, with regional commercial banks as the main force of the issuance. Besides, the re-rise of asset-backed securities provided objectively a road for financial institutions such as micro credit companies, commercial banks, etc. to revitalize MSME loan stocks, enabling us to see more possibilities in the bond financing channels provided for small and medium-sized financial institutions by the bond market.

2.4 Insurance: Making the First Step in a Long Way

Insurance industry had rapid development in 2014, which was the year of the best development in the history of insurance industry in China. Various indexes, such as premium income, compensation expense, application of funds, total assets, service economy, etc., all created the best historical standard. Compared with the quick development of insurance industry, the insurance market of MSME was not optimistic. The problems of weak insurance awareness, single insurance product and uneconomical insurance still existed. MSME did not understand insurance and insurance companies failed to pay enough attention to MSME either. Fortunately, the success of back freight insurance of sellers in Taobao.com showed the development direction of MSME internet insurance product. The new model which was developed according to needs, calculated by price, insured on the internet and imbedded in product solved the problem of uneconomical insurance service for MSME. It would be the development direction of MSME internet insurance product innovation in the future. With the shock from internet finance and the popularization of insurance knowledge, the MSME insurance market may meet a new development opportunity.

2.5 Private Finance: Bravely Advancing in Torrent and the Waves Washing away the Sand

In 2014 the private finance bravely advanced in torrent and the sand was washing away by the great waves. In the large environment of continued deepening of national economic restructure, investment in fixed assets suffered a big downturn. The formal financial system was in structural fiscal tightening. Private finance ran into more submerged reef while meeting with greater demand. The private lending in some regions experienced unprecedented crisis of confidence. In 2014 P2P lending industry in China continued to stride forward, with the number of platforms reaching 1,575, which was a growth of nearly 100 percent; total turnover within the year amounted to RMB252.8 billion and year-end outstanding loans reached RMB103.6 billion, which were 2.4 times and 3.9 times of those of 2013 respectively. It was worth noting that after an explosive development, the P2P lending platforms which started from providing service to individuals and MSEs were actually no longer limited to that service. Attracted by the bright future of on-line wealth management, they evolved into platforms where various assets linked with capitals, increasing rapidly while creating a new highest number of problematic platforms. Though budding in the first year of development, crowd-funding also met with quality test of its model. Influenced by both overall economic downturn and confidence crisis in private finance, it became even more difficult for MSMEs to finance through private channels. The old private financial activities seemed not to escape from this “ebb” again. However, no matter the development of private financial activities, or the popularization of public awareness to investment risk, they all required mechanism and system with an overall outlook to promote the formation of private financial

environment that could develop sustainably. In the new context of economy, private financial activities which truly integrated with the strength of new technology would hopefully bring higher service efficiency and more abundant options to MSME financial service. And to realize the new form of private finance against the background of new technology, the environment for private finance in China was at a crossing where changes had to be made.

3. A Prospect of Development in MSME Financial Service

2015 is the last year of the 12th five-year plan, and will be destined to be an unsmooth year. With still grim economic growth, the difficulties met by each reform when entering into the deep water area will probably be far greater than expected. Against the background of “guarantee growth, adjust structure, promote reform and benefit the people”, as the main carrier of entrepreneurship and innovation and the indicator of economy’s vitality, the development of MSE as a whole will still attract great attention.

In terms of debt financing supply, the trend of customer structure sinking in mainstream financial institutions driven by the marketization force will still continue. The competitive pressure brought thereof will promote returning to maintaining of their original advantages of business models by the quasi-financial institutions with special industry attributions such as pawn, financial leasing, etc., and realizing more apparent differentiation in MSME service. This will be conducive to the formation of a MSE financial service system with more diversified business models, clearer levels and more abundant products. As regards equity financing supply, the huge market fluctuation has casted a shadow over the development of MSME equity financing in 2015. However what can be sure is that the “catfish effect” brought by private banks will hopefully appear in 2015, hence triggering more innovation bright spots in MSE financial service. Data-driven risk management, scenarized financial service and capabilities of wide link and contact with customers will become new issues faced by the main body of MSME financial service.

In 2015, how to make a balance between risk management and business development will remain to be the biggest challenge of MSE financial service of the commercial banks. Under pressure of the growth of borrower number, the trend of retailing in MSE finance of commercial banks will still continue. The function of internet finance in promoting MSE finance innovation has already appeared. Credit management innovation based on big data will hopefully become a focus direction of commercial banks’ MSE financial service innovation in 2015. Meanwhile, under the new situation of scenarized financial development, the comparative advantages of big, small and medium-sized banks in MSE financial service market for a long time will perhaps experience subtle changes. The possibility greatly increases that big banks gain late-mover advantages in MSE financial service market by utilizing transaction-based credit technology. Yet more and more banks probably will need to rely on the

cooperation with internet institutions which have data, channels and technology resources or cooperation with new banks in order to keep a place in the increasingly fierce market competition. In 2015 we will hopefully continue to see innovations of commercial banks in service model, service channels, risk management, etc. The day at which MSE financial service market pattern changes obviously is in the near future.

After many years of silence, hopefully rural finance will become one of the bright spots in 2015 financial area, driven by the massive entry of new finance suppliers such as “ant financial” and so on. In the new rural development pattern of continuously enriched production and operation business models and the consumption upgrading promoted by the e-business going to the countryside, both the connotation and denotation of rural finance are changing enormously. The layout of new finance suppliers with internet genes will have more focus on the cultivation of behavioral habit and extension of service channels based on mobile internet technology. They will also try their hand at financial products. Particularly, inspiring products will appear in financial management and consumption credit. In the short term the dominant position of traditional rural financial institutions in rural areas cannot be shaken. However institutions with awareness to crisis will grasp this time window to follow up with the step of industry transitions. To carry out complimentary cooperation with new financial suppliers will become the practical choice of more and more institutions. A diversified rural finance supply system of co-existing competition and cooperation and mutual integration is in the process of formation.

Micro credit industry will continue its trend of a declining development. Industry risks still stay at a high level. Micro credit license is not popular. The voluntary withdraw or passive clearing of micro credit companies will still accelerate. Along with the continuous sinking of commercial banks’ customer structure, mainstream micro credit companies mainly engaged in million RMB loans are facing direct competition. Against the background of internet finance development and opening of personal credit information market, those micro credit companies that are really engaged in small loans and have realized differentiated competition with traditional financial institutions will also face new market competition of small loans based on the drive of data.

In the context of economic slowdown and trend of caution in banking institutions’ loans to MSMEs, it will become a rational choice of most leasing companies to treat MSME leasing customer with the same caution. However as a differentiated way of financing with bank loans, financial leasing companies face the following opportunities: to control risk by professional capacity and business advantage of financial leasing; to innovate in new models of MSE financial leasing by fully utilizing technologies such as internet, internet of things, etc.; to carry out differentiated competition aiming at different industries and customer bases; and to attract and provide good service to the MSMEs which try hard to continue and proactively innovate in economic transition and upgrading. When the assets bubble fades, financial leasing industry will hopefully return to normal pathway of growth and play a more significant role in transformation and upgrading of industrial structure, promoting effective social demand, etc. as an innovative financial institutional arrangement.

The pawn industry is facing increasingly fierce external competition, which is

reflected in the double converging attacks suffered by “large amount” mortgage loan business and “small amount” credit loan business from banks and internet finance respectively. In the increasingly fierce market competition, the individual differentiation in pawn industry will further increase. Hopefully, we will see that more and more pawn shops begin to change from extensive development into being professional, perfect and strong; proactively carry out business transition; pay attention to developing movable property and property right pawn businesses; base upon traditional operation advantages; enhance differentiated competition; and practically play a good “complementary” role.

Credit guarantee industry will continue the overall trend of adjustment. Risk events of credit guarantee will continue to appear. It is definite that the industry will comprehensively return to policy-based guarantee. The threshold of cooperation between banks and guarantee companies will not lower, and guarantee events in bond market will also cast a shadow over the credit of guarantee industry itself. Along with the accelerated building of credit information system, the development space of guarantee companies which are positioned as an intermediary to enhance the mutual trust between banks and MSMEs will be further squeezed. As the demand potential of MSME movable property financing are unceasingly inspired by the financial innovation of supply chain, the unified platform of movable property financing of PBoC keeps a good momentum of development. It gradually becomes an industry consensus to build a unified registration system of security interest. In 2015 hopefully we will see that collateral management industry attracts more new entrants, the industry development can be expected, and in turn promote the development of MSME movable property financing.

Benefited from the opportunity of multi-level capital market’s development, wave of acquisition and reorganization as well as economic restructure, the development of venture capital industry will meet new chances and collection, investment and withdraw will become more dynamic. Investment heat will continue in technology-intensive industries such as information technology, bio medicine, new energies, mobile internet, etc. The deep integration between internet and traditional industries will bring more investment opportunities with bigger scales. Inspired by the theme of “mass entrepreneurship and innovation by millions of people”, new generation of investors will grow rapidly in the process of continuous trial and error. The trend of moving to earlier investment stage will not be reversed. More and more investors begin trying to use crowd-funding platform to explore and lock MSE investment target with potentials. The competition in this industry will further increase.

The transition of credit guarantee industry will still continue. In the context of unclear economic situation, the motivation of credit guarantee industry to voluntarily develop private enterprises, particularly the MSME financing demand, will weaken apparently. Compared to direct MSME services, indirect MSME services by way of such as small amount loan trust, credit assets securitization trust, etc. are the more practical choices for credit guarantee industry. Along with the deepening liberalization of finance and interest rate, financial repression is gradually lessened. Only when the credit guarantee industry makes full use of its flexible institutional advantages and strong innovation capacity as well as provides differentiated service can it obtain greater development.

The reform of stock market is attached with great expectations and the reform towards registration-based issuing system is surely in the offing; the pilot project of transfer-board system is on the agenda; the Shanghai Stock Market is preparing strategic emerging industry board to attract the returning of high and new technology enterprises listed overseas; the transaction system and hierarchical system of NEEQ will hopefully be improved. The speed of IPO examination and approval apparently accelerates in the first half of 2015. The vitality of NEEQ is obviously improved and becomes the choice of more and more MSMEs when they enter the capital market. However, the “fast bull” market which is generally regarded as lacking the support of real performance stops abruptly at half of the year, triggering government bailout and reflections on the building of capital market system and financial regulations simultaneously. It is probably difficult for the various reforms as in the plan to be introduced by the scheduled time. The growth expectation of MSME financing through stock market will greatly reduce in 2015.

Against the overall background of interest rate liberalization and financial “disintermediation”, large and medium-sized enterprises with good qualifications increasingly obtain debt financing through bond market, which will empty more space of bank credit resources for MSMEs. Besides, the year 2015 will witness more types of small and medium-sized financial institutions engage in larger scale of financing through bond market and improve the capacity of SME financing service. However, the aura of specialized MSE financial bonds will disappear as the preferential policies being inclusive. The highlights in the financing provided to small and medium-sized financial institutions by the bond market will come from asset securitization. It is expected that in 2015 the scale and quantity of asset securitization products will continue to expand and the products will become more diversified. Comparatively speaking, SME private raised bonds will gradually enter in to the peak of repayment. In the context of frequently occurred events of default and the tightening of regulation, the pace of issuing SME private raised bonds will slow down, while it is hard to see improvement in other varieties. Therefore, it is highly probable that the growth of SME direct financing scale through bond market will slow down. We insist that instead of the direct pathway, the realization of the bond market’s function in promoting MSME financing mainly relies on the above two indirect pathways.

It will still be difficult for the situation in which MSME customer bases are ignored for a long time by traditional insurance companies to have obvious changes in 2015. However we think that in the future this deadlock will be gradually broken by internet insurance product innovation. Internet insurance products developed based on internet transaction data are sold through internet channels, which will greatly reduce the insurance cost, making it profitable to provide service to long tail customers. It is hopeful that the small amount internet insurance products centered on MSME operational activities will be more diversified.

Private finance will continue to sustain the test of risk. It requires a long period of time to restore the trust relationship after its collapse. With the implementation of

regulatory rules, it is expected that the P2P lending industry will see the development inflection point. Capital will still stride into the market. The trend of industry professionalized development will become even more apparent. It is possible that driven by mobile internet, more new business growth points and new business models will emerge. Against the overall background of the country's vigorous encouragement of innovation and entrepreneurship and the development of inclusive finance, it is hopeful that equity-based crowd-funding will achieve substantial progress. Rewards-based crowd-funding will form its business model with Chinese characteristics in the test of practice. From a long term point of view, more and more MSMEs will become the service target of emerging private financial activities with internet as the platforms. However, in the context of the macro economy which fails to be materially better, the pains of private finance in the transformation between old and new will still turn up from time to time.

After experiencing the pains of economic slowdown and structural transformation, the whole society will have a deeper understanding of the saying that "the real economy is the basis of financial development". Finance without the support of real economy will become water without source and woods without roots. Regarding the problems of MSMEs' "difficult financing" and "expensive financing", it will not only be difficult to obtain satisfactory answers if solutions are simply sought from finance supply side, but also will cover the root of the problem. In 2015, at the same time of continuous deepening of financial reforms, reducing financial repression, promoting the development of MSME financial service, it will be the priority among priorities to deepen the reform of economic system, solve the prominent problems in the operation of macro economy and promote the healthy development of real economy. It is still the important work requiring long-term persistence to improve the operational environment and operational expectations of MSMEs, inspire the vitality of entrepreneurship and innovation and unleash the potential of economic growth.

Abbreviations

Table of Abbreviations

| Abbreviation | Full Name |
|---------------------|--|
| BAT | Baidu, Alibaba, Tencent |
| CBRC | China Banking Regulatory Commission |
| CUFE | Central University of Finance and Economics |
| GEM/GEMs | Growth Enterprise Market(s) |
| IPO | Initial Public Offering |
| MSE/MSEs | Micro and Small Enterprise(s) |
| MSME/MSMEs | Micro, Small and Medium Enterprise(s) |
| NEEQ | National Equities Exchange and Quotations |
| NSFC | National Natural Science Foundation of China |
| OTC | Over-the-Counter |
| P2P | Peer-to-Peer |
| PBoC | People's Bank of China |
| SME/SMEs | Small and Medium Enterprise(s) |
| VTB/VTBs | Village or Township Bank(s) |