China SME Finance Report 2013

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Mintai Institute of Finance and Banking
China SME Finance Report 2013

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Forword

Small and medium enterprises (SMEs) drive the sources of economic vitality and, more importantly, create jobs and improve people’s livelihoods. In China, however, a conflict persists between the importance of SMEs and their financing difficulties, which has raised an academic concern as to the issue of SME financial services. Based on a long-term follow-up study on SME financial services, the Mintai Institute of Finance and Banking (CUFE) attempted to establish a system of market analysis for SME financial services beginning in 2008. In May 2009, the Institute officially launched the Annual Report of SME Finance in China, the first of a series of annual reports, which depicts the full view of the Chinese SME financial market at the present stage in an all-round manner, covering the major institutions and markets for SME financial services, offering a complete collation and summary of the current state of SME financial services, and providing policy recommendations to address the most urgent issues.

From 2008 to 2013, five consecutive development reports on China’s SME financial services have been issued. Through concerted effort for five years, the research group, has consistently adhered to the principle of being “stringently objective and neutral”, and while ensuring a continuation in the style and quality of reporting, the breadth of reporting and the depth of the content have expanded with the more vivid pattern of presentation, so that the China SME Finance Report 2013 could become more polished in terms of content, structure, information collection and form of expression. The content and structure of the report are arranged according to detailed sub-sections on the state of SME financial services in the four sectors of banking financial institutions, other quasi-financial institutions, financial markets and private financing.

It has been found in the five years of collating developments of SME financial services, as the world economy declined and as China entered into economic restructuring and deepening of financial reforms, the development of Chinese SME financial services has constantly been changing. In 2012, as the world economic recovery continued to face difficulties, international market demand was further shrunk, and domestic economic growth continued to fall, micro, small and medium enterprises (MSMEs) struggled to survive and grow in this new era. We have clearly seen the marketization of Chinese
interest rate plays an active role in adjusting the customer structure of commercial banks, which has drawn the attention of many commercial banks to the value of micro and small enterprises (MSEs) and retail customers. Moreover, the interest rate marketization is expected to become a real driving force in the development of MSME financial services. As for the MSME financial services of commercial banks, “fierce competition” is still a key word among industry insiders, while the risks of MSE financial services continued to persist through 2012. Miro-credit, pawns, financial leasing and other such industries continued to maintain relatively rapid growth, offering more services to MSMEs. Unfortunately, the stock market winter of 2012 led to a significant decrease in the scale of SME financing through the open markets. Given the lackluster performance of capital markets, the venture capital investment industry has also experienced a profound restructuring, with a dramatic decrease in the number of SMEs backed by venture capital investment and the funds raised by them. Fortunately, bond markets experienced a promising bit of growth in 2012, with private placements as a new instrument by which SMEs can access capital markets. Moreover, MSE financial bonds held a dominant position in overall commercial bank financial bond financing in 2012, offering a more stable source of funding for commercial banks to develop MSE financial services. The role of bond markets in promoting the development of MSME financial services has also become increasingly clear. Private financing remained active in 2012, and as various regions began to explore financial reform, online financing, as represented by P2P lending, has become a hot spot and a cause for concern and heated debate within the traditional financial sector. We are happy to see that new technologies and new ideas have injected newfound vitality in MSME financial services, and we also look forward to even more beneficial innovations following financial essence.

Through accessing a large amount of foreign literature and data, we have come to deeply realize that SME financing is an international challenge, and all circles around the world have also fully affirmed the great significance of SME financial services in promoting cluster development of SMEs and endogenous economic growth. In light of this, we also sincerely hope that the development reports on China’s SME financial services may construct a platform for international exchange to allow professional parties engaged in domestic and international SME financial services to exchange their views with each other and jointly promote the true maturation of the SME financial service market.
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1. Status of Micro, Small and Medium Enterprise Financial Services: Development Overview

1.1 Financial Services System of Micro, Small and Medium Enterprises

This report will divide the financial services system of micro, small and medium enterprises (MSMEs) into the four categories of banking institutions, other quasi-financial institutions, financial markets and private financing (see Figure 1-1).

Banking financial institutions engaging in the field of SME financial services include policy banks, China development banks, postal savings banks, large commercial banks, joint-stock commercial banks, urban commercial banks, foreign banks, rural small and medium financial institutions and non-banking financial institutions. Of these institutions, rural small and medium financial institutions can be further divided into two categories of rural cooperative financial institutions and new rural financial institutions. Rural cooperative financial institutions involve rural credit cooperatives,

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1 The generalized system of SME financial services not only includes service institutions and markets, but it should also include other service intermediaries and service environments so as to highlight the focus of this report. This specific system only includes essential service providers and markets. Furthermore, this report focuses on the financial service institutions that provide financial services. Insurance agencies have not been included in this report due to their particular nature.
rural cooperative banks and rural commercial banks, while new-tape rural financial institutions comprise of village and town banks (VTBs), loan companies and rural mutual cooperatives. Non-banking financial institutions which provide services to SMEs primarily include trust companies and financial leasing companies.

Apart from banking institutions, quasi-financial institutions involving in the field of SME financial services include micro-credit companies, pawning companies, venture capital companies, and credit guarantee institutions as well as other financial leasing companies. As for financial markets, it involves equity markets and bond markets. Of which, equity markets include growth enterprise markets (GEMs), small and medium enterprise (SME) boards and over-the-counter (OTC) markets. Additionally, there is also private financing, which includes financial services outside of formal financing.

1.2 Overview of Small and Medium Enterprise Financial Services

1.2.1 Banking Financial Institutions

Data disclosed by the China Banking Regulatory Commission (CBRC) indicates that, as of the end of 2012, the balance of nationwide loans to micro and small enterprises (MSEs) (including micro-enterprise loans and small enterprise loans, individual business loans and loans to MSE owners will be referred to as “generalized MSE loans”) has amounted to RMB14.77 trillion with an increase of RMB2.43 trillion or 19.73% compared to the beginning of the year, 4.09 percentage points higher than the average growth rate. Banking financial institutions had realized the “two not-less-thans” objective for three consecutive years in providing loans for MSEs, and the ratio of MSE loans to total outstanding loans of banking financial institutions was 21.95%.

As for the generalized MSE loans of major banking financial institutions, by virtue of their strong asset size and number of outlets, five large state-owned commercial banks had numerous advantages, and the size of MSE loans was still in an absolute leading position. The balance of MSE loans reached RMB5.04 trillion, accounting for 34.09% of total banking loans. MSE loans of joint-stock commercial banks which were in second place, amounted to RMB2.62 trillion, accounting for 17.71% of total loans. This was followed by MSE loans of urban commercial bank which amounted to RMB2.01 trillion, accounting for 13.62%. SME loans of the three types of commercial banks amounted to RMB9.65 trillion, representing 65.47% of the outstanding MSE loans of banking financial institutions.

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1 Although there are no clear legal or departmental rules which define these institutions as financial institutions, in view of the financial attributes of the business which they are engaged in, we shall refer to them as quasi-financial institutions.

2 The narrow sense of MSE loans refers to micro-enterprise loans and small enterprise loans (corporate loans), while generalized MSE loans include micro-enterprise loans and small enterprise loans (corporate loans) as well as individual business loans and loans to MSE owners. In 2012, the People’s Bank of China (PBOC), prior to the CBRC’s disclosure of the comparison of changes in micro and small financial service data from the previous year, no longer used the caliber of “SME loan balances” and “small enterprise loan balances”. With the ever-growing trend of commercial banks towards retail MSE loans, “SME loan balances” have gradually become a major caliber by which commercial banks disclose the scale of the SME financial services and has also become one of the most important references indexes for the study of the micro- and small financial services of Chinese banking institutions.

3 The loan growth rate shall not be less than the average growth rate of total loans in the year and the loan increment shall not be less than the one of last year.

Comparing the proportion of generalized MSE loans and the proportion of assets of all major banking financial institutions, except the proportion of generalized MSE loans of large state-owned commercial banks which was lower than the proportion of their assets, the proportion of generalized MSE loans of joint-stock commercial banks and urban commercial banks was greater than that of their assets. Of which, the proportion of the MSE loans of urban commercial banks was 4.38 percentage points higher than that of their assets, which was significantly greater than that of the other two types of banks. In other words, 9.24% of urban commercial bank assets contributed to 13.62% of MSE loans. This reflects the degree of attention to MSE financial services and adherence to dislocation competition of urban commercial banks as well as the outcome resulted from the development path of providing differentiated services. MSE loans of joint-stock commercial banks accounted for practically the same proportion as their assets, only 0.1 percentage points above their assets. Such statistics reflect the willingness and desire of joint-stock commercial banks to expand source of profit and optimize their customer mix, of which MSE financial services are beginning to play an ever increasingly important role. For some joint-stock commercial banks, MSE financial services have already become an important direction for restructuring and development. In contrast, the MSE loans of large state-owned commercial banks accounted for nearly 11 percentage points lower than that of their assets. Compared to the above two types of banks, large state-owned banks are still dominated by medium and large-sized enterprises and there is still a great deal of room for the development of MSE financial services.
Fig. 1-3 Proportion of Generalized MSE Loans to Total Assets of Major Banking Financial Institutions (2012)


Note: “Proportion of Generalized MSE Loans” refers to the proportion of generalized MSE loans of various banks to RMB14.77 trillion of the total MSE loans of banking financial institutions in 2012. “Proportion of Assets” refers to the proportion of all types of banking assets to RMB133.62 trillion of the total assets of banking financial institutions in 2012.

A clear difference will emerge by comparing the ratio of MSE loans of the three types of banks in the narrow sense. Large state-owned commercial banks, joint-stock commercial banks and urban commercial banks accounted for 19.90%, 22.10% and 39.72%, respectively. In this sense, the proportion of MSE loans of urban commercial banks to total corporate loans was nearly twice as much as that of large state-owned commercial banks. This also reflects that urban commercial banks with the regional characteristics and geographical advantages, although smaller in size, have their own comparative advantages in the field of MSE financing due to their focus on serving MSEs.
Fig. 1-4 Average Assets of Major Banking Financial Institutions and Proportion of MSE Loans in Narrow Sense to Corporate Loans (2012)


Furthermore, by comparing the proportions of generalized MSE loans of the three types of banks to total loans, we can also observe that state-owned commercial banks accounted for 16.11%, which was significantly lower than that of the overall level of banking financial institutions of 21.95%. Additionally, both joint-stock and urban commercial banks accounted for a higher proportion than that of the overall level of banking financial institutions. The proportion of joint-stock commercial banks was marginally higher, standing at only 1.68 percentage points. However, the proportion of urban commercial banks accounted for approximately 15 percentage points higher than that of the overall level of banking financial institutions. The importance of MSE financing for urban commercial banks is evident.

Fig. 1-5 Proportion of Generalized MSE Loans to Total Loans of Major Banking Financial Institutions (2012)

Sources: (1) Data on the generalized MSE loans of the three types of banks are sourced from Figure 1-2.
(2) Total loan balances of the three types of banks are sourced from the CBRC.
(3) “Overall Level of Banking Financial Institutions” is sourced from the China Banking Regulatory Commission.
In 2012, in the context of financial disintermediation and the continued marketization of interest rate, the development of MSE financing as an important component of strategic restructuring had already become an intrinsic demand for the development of commercial banks themselves. The pricing advantage, the stable and beneficial customer mix and cross-selling opportunities of MSE business became the three driving forces by which MSE financial managers promoted the development of MSE financial services for commercial banks. Various banks began to launch more intensive campaigns into the vast, wide-open field of MSE financial services. The results of a questionnaire directed at the MSE financial services managers of commercial banks showed that, in 2012, commercial banks displayed a rising degree of attention to MSE financing, and increased credit lines for MSE loans in general. Product innovation for MSE financial services became more active, and various banks, to varying degrees, increased the tolerance for non-performing MSE loans. It should be noted that throughout the process by which the competition within the MSE financial service market has become increasingly fierce, the homogenization of competition has become a common phenomenon, and of particularly concern is the rapid development of MSE financial risks that have arisen from this process.

As for the performance of MSE financial services of commercial banks in 2012, most MSE financial managers summarized the services as “fiercely competitive”, “high risk” and “a long way to go”. The outlook for MSE financial services are promising, however, commercial banks are in an early stage of development and are still on the frontlines of exploration. There remains a high degree of product homogeneity in the MSE financial services sector, a lack of innovation, high risks, high costs and other issues. Commercial banks must constantly improve MSE financial services, increase investment and increase innovation to secure a place amidst fierce competition. Furthermore, the development of MSE financing has already begun to gradually shift towards mass marketing, showing such features and trends as product diversification and an orientation towards smaller amounts. Moreover, commercial banks will need to continually explore a series issues throughout the development of MSE financial services such as how to maintain a good balance between efficiency and risk in the process of mass marketing, how to continually lower the size of loans, how to better achieve specialized product innovations, and how to control MSE financing.

1.2.2 Other Quasi-Financial Institutions

In 2012, the microfinance industry maintained a rapid development, further expanding the size of the industry and brining indicators to new highs. The level of year-on-year growth for the number of companies, issued capital, and the net added value of loans remained high. However, there were different degrees of decline within this growth. As of the end of 2012, the number of microfinance companies had reached 6,080, an increase of 2,000 or 41.99% from the end of 2011. Loan balances increased by RMB592,138 million, an increase of 51.26% compared to the same period of last year. Various institutions relied on their own advantages to compete for the miro-credit market. Following the participation of listed companies in the miro-credit industry in 2011, there was active participation in the electronic business platform, which took full advantages of its information platform to create supply chain financial services. The
operating characteristics, positioning and differentiation of micro-credit companies was also reflected in 2012, playing a unique role in the field of MSE financial services.

The pawn industry experienced accelerated progress in its stable and healthy development in 2012, the industry scale continued to expand, operating income grew steadily, and its position in the Chinese MSE financial service system is rising. As of the end of 2012, there were a total of 6,084 pawning enterprises, a year-on-year increase of 16.20%. Total pawn balances were RMB70.6 billion, a year-on-year increase of 29.50%. The total amount of pawning grew by 22.10% to RMB276.5 billion, and the annual operating income in the industry reached RMB11.9 billion, representing an increase of 19%. The expansion in operating scale of pawning enterprises through capital increases and chain management was evident. Another unique feature of the pawn industry in 2012 was the increase in the amount of small pawning enterprises. Because financing was prominently more difficult for small enterprises, and compared with bank loans, pawn had the advantages including small financing scale, low credit threshold and relatively loose credit requirements. Such advantages have been gradually recognized by small business owners.

In 2012, the financial leasing industry gradually worked its way out of the trough in 2011, got back on track, and achieved a growth rate significantly higher than the previous year. Nationwide, there were a total of 560 various registered financial leasing companies¹ in operation, an increase of 264 or 89.20% compared to the 296 companies at the beginning of 2012. Nationwide, financial leasing contracts amounted to approximately RMB1,550 billion, an increase of about RMB620 billion or 66.70%² over RMB930 billion of the previous year. Financial leases gradually drew the attention of more and more SMEs in 2012, playing an important role in alleviating the stress on SMEs to pay for long-term funds and in promoting the economic efficiency of SMEs. As of the end of 2012, of the cumulative 75,066 initial registrations which occurred in the national financial leasing system, 21,630 initial registrations were by lessees as the legal person of an SME, accounting for approximately 29% of all initial registration. This exceeded the 13,000 lessees as legal persons of SMEs who obtained financing through leasing, and accounted for approximately 42% of total registered financing in the financial system³.

In early 2012, with the violations by Zhongdan Investment and Credit Guarantee Co., Ltd., Huading Credit Guarantee Co., Ltd. and Guangdong Chuangfu Credit Guarantee Co., Ltd. as representative risks that frequently occur, the guarantees industry in the areas seriously affected by these risk events experienced negative growth, which not only changed the structure of guarantees but has also revealed a number of risks. To this end, the rectification and strengthened supervisions were conducted nationwide. In 2012, the credit guarantee industry played an active role in supporting SME financing. Meanwhile, we have also witnessed the rise of the collateral management industry, which will help SMEs use the financial instrument of movable property guarantees to revitalize the inventory of SME assets, increase liquidity, and further improve their expansion in reproduction capacity.

In the context of the weak global economy and domestic capital market downturn, the venture capital investment industry cease to experience a rapid growth trend, and

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¹ Excluding single project financial leasing companies.
instead suffered a significant decline in market size, and the ability of venture capitalists in fundraising and investment were both significantly diminished. In this year, there were 252 newly raised funds, down by 34.03% compared to 2011. Among them, the known size of 247 funds raised was USD9.312 billion, down by 66.98% compared to 2011. There were a total of 1,071 investment deals with a total investment of USD7.32 billion, down by 28.84% and 43.71%, respectively, compared to 2011. The market cold-winter accelerated returns on early venture capital investments and the adjustment towards early exit strategies. Given the weak market, local venture capital investment continued to remain dominant, furthering its leading edge over foreign capital, however the preference for small-scale investments still persisted. Along with the in-depth development of capital markets, the continued deregulation of such new conditions as broker direct investments have ushered in a comprehensive reshuffle and profound restructuring of the venture capital investment market.

1.2.3 Financial Markets

Although 2012 was a slump year for stock markets, it was also a year of in-depth development for capital markets. The A-share market suffered its eighth IPO pause, various factors affected the role of equity markets in corporate finance, and SME direct financing through equity markets dropped significantly. Only 129 companies completed IPOs on the GEM and SME boards, representing a year-on-year decrease of 46.91%. These IPOs raised a total of RMB70,074 million, representing a year-on-year decrease of 58.49%. In comparison, the scale of refinancing on the SME board was relatively stable, and a total of 46 listed companies conducted refinancing through the issuance of shares and convertible bonds, with a scale of financing reaching RMB40,492 million, only a decrease of 9.88% from the previous year. Meanwhile, China’s capital market has been experiencing a series of institutional adjustments and reforms: the delisting system for the GEM board was formally implemented, the OTC market further improved its level of standardization and scale, and along with the accelerated establishment of the “New Three Boards” market, regional equity markets across China have also been recognized by the China Securities Regulatory Commission (CSRC) and have achieved steady development. China’s multi-level equity market has been gradually taking shape in terms of specifications, which has an incredible significance for expanding and improving the channels of SME financing.

In terms of bond markets, collective SME bonds remained stagnant in 2012, but the issue size of SME collective bills witnessed significant growth, and SME private placement bonds accessed capital markets as a new financing instrument and provided a new financing channel for SMEs. In 2012, the scale of direct SME financing bonds was RMB22,139 million (SME private placement bonds were RMB11,856 million; SME collective notes were RMB9,302 million, and SME collectives bonds were RMB981 million), which only accounted for 0.83% of the total bond financing amount of industrial and commercial enterprises. Although the scale of direct financing offered to SMEs in bond markets was still quite limited, bond market development provided financing options to medium and large-sized enterprises in addition to bank credit financing. This resulted in pressure on commercial banks for financial disintermediation and for a further lowering of their customer mix by which they can expand towards MSEs. As such, bond market development indirectly promoted the development of MSE financing. This trend has already been proven in the strategic transformation of commercial banks that occurred over the past three years. Furthermore, MSE financial bonds dominated commercial bank financial bond
financing in 2012, with a total of 18 financial bonds specifically directed towards MSEs, by which 12 commercial banks raised funds worth RMB156.5 billion. This provided a more adequate and stable source of funding for MSE financial services. The role of MSE financial services within bond market forces towards a mainstream model and developmental direction has been becoming increasingly clear.

1.2.4 Private Financing

The year of 2012 witnessed the further expansion in the overall size of private financing, in which the scale of private lending\(^1\) exceeded RMB4 trillion\(^2\), the business model of which was under innovative development. Conventional rotating savings and credit associations and underground banks remained active, although a developmental trend of large-scale, chain-operated private lending agencies had emerged. In the context of continuous improvements to information technology and the further popularization of the Internet, P2P lending platforms have grown astronomically. Incomplete statistics show that nationwide, there were nearly 1,000 P2P lending platforms at the end of 2012 which facilitated private financing of about RMB30 billion\(^3\). P2P loans were attempt to break through the geographical barriers of traditional private financing, to expand the boundaries of private finance as a supplement to formal financing and increase the market supply of credit. As such, P2P loans had their own value and significance. However, as the domestic financial environment of an imperfect social credit system which lacked effective regulation, P2P loans had presented the distinct feature of “having demand, supply and intermediary service providers with gathering of funds, talent, high-technology and high risks but lacking barriers to entry, industry standards and regulatory agencies\(^4\), and because of which, many problems were beginning to emerge, leading to an expansion of business models “with Chinese characteristics\(^5\). In the current legal framework, this had shaken the nature of P2P loans as an intermediate service and gathered a great deal of risk. A batch of malicious platforms like “UEwang.com” emerged, which utilized regulatory loopholes to get away with defrauding investors. The development of this industry had been overshadowed by such platforms, and the standardization of P2P lending platforms gradually won industry consensus. A consolidation and reshuffling had been on the horizon. Financial reforms throughout the country were launched one after another in 2012, promoting new private capital outlets and the development of new financial institutions which served the real economy and were consistent with the ideology of regional financial reforms. By adopting such measures as the establishment of private lending service centers and regularly announced civil lending rates, private lending throughout the country was becoming standardized, thus contributing to the healthy development of private lending.

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1 Private lending is the main form of private financing which is a general term for various forms of private financing.
2 Source: UBS Securities and the China Economic Indicator Database (CEIC) as of the third quarter of 2013.
5 Business models “with Chinese characteristics” refers to business models which do not appear in the development of foreign P2P loans, yet appear domestically due to differences in the external environment and participating subjects, such as platform principal guarantees, instant bidding, day bidding, false loan bidding by platform, as described hereinafter.
2. Commercial Banks: Diversified Competition Pattern

In 2012, the popularity of MSE loans amongst commercial banks grew steadily. Meanwhile, the strong performance of some commercial banks highlighted the growth of MSE financial services. The deepening of SME financial services and the rapid development of Internet-based financial services, as well as a greater emphasis on mass services and integrated product innovation all provide newfound vigor for commercial banks to develop MSE financial services. Joint-stock commercial banks and urban commercial banks both give full play to their respective and comparative advantages, relying on such inherent advantages to develop characteristic services, increase their efforts toward business transformation as well as their ability to compete with large state-owned commercial banks and further clarify the misaligned competitive and diversified pattern. Furthermore, as we rejoice the sustained development of commercial bank MSE financing, we must also pay attention to the risks which MSE loans will bring, and vigilantly monitor industry and geographic concentration for the risk of non-performing loans.

2.1 Small, Medium and Large (SML) Banks -- Varied Growth and Distinctive Features

In order to pursue an intuitive, comprehensive and accurate reflection of the development status and latest trends of SME financial services of Chinese commercial banks in 2012 and to analyze competition pattern in the field of MSE financial services amongst large state-owned commercial banks, joint-stock commercial banks and urban commercial banks, we have selected five large commercial banks, 11 national joint-stock commercial banks and 24 urban commercial banks (including three listed urban commercial banks and 21 non-listed urban commercial banks\(^1\)) as study samples.

In 2012, large banks relied on their enormous network channels and brand effect to promote SME financial services steadily, keeping an absolute leading position in the field of SME financial services. On the other hand, small and medium banks relied on their professional level, demand-oriented product innovation, and the higher efficiency of their financial services to participate in the competition for SME customers. These banks gave play to their strengths, expanding SME financial services, especially urban commercial banks, whose competitive strategy for differentiation makes them had always taken MSE financial services as their core business. As such, major urban commercial banks took a leading position in the proportions of MSME loans to corporate loans and to all outstanding loans, highlighting the advantages of the growth rate of micro and small financial services, average loans per outlet and other such highlights.

In terms of MSME loan balance, the leading edge of the five large commercial banks in loan balance was still evident. The MSE loan balances of Industrial and Commercial Bank of China (ICBC) had already exceeded RMB1.84 trillion, at absolute predominance. The MSE loan balances of China Construction Bank (CCB), Bank of China (BOC) and Agricultural Bank of China (ABC) had all exceeded RMB500 billion, which was far more than that of other commercial banks. Among the joint-stock commercial banks, the largest MSE loan balance was that of Shanghai Pudong

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\(^1\) The 21 unlisted urban commercial banks in the sample were: Baoshang Bank, Guangxi Beibu Gulf Bank, Zhejiang Mintai Commercial Bank, Harbin Bank, Bank of Ningxia, Bank of Qingdao, Bank of Kaifeng, Bank of Jiangsu, Bank of Qingyang, Bank of Lanzhou, Bank of Cangzhou, Bank of Dalian, Bank of Hangzhou, Bank of Hebei, Panzhihua City Commercial Bank, Bank of Shanghai, Bank of Zhengzhou, Fujian Haixia Bank, Hankou Bank, Huishang Bank, and Bank of Rizhao.
Development Bank (SPDB) with a value of RMB363,092 billion. The MSE loan balance of other joint-stock banks was concentrated in the range of RMB100-300 billion, and only the loan balance of Ping An Bank was relatively small, but even this balance was also greater than RMB50 billion. By observing urban commercial banks, because the size of such banks themselves was very different, MSE loan balances were distributed across a wide range, from the Bank of Beijing in the first place with a scale of nearly RMB130 billion, to that of Commercial Bank of Kaifeng in the last place with a scale of approximately RMB1.3 billion (see Figure 2-1).

However, we must also note that when MSE loan balances increased, large commercial banks were no longer at an advantage: the MSE loan growth of ICBC was at the bottom of all available data on commercial banks at only 8.9%, which was lower than the MSE loan growth of the majority of small and medium banks for this year. BOC’s growth was 10.44%, barely reaching 10%. The growth of CCB and Bank of Communications (BOCOM) were both close to 20%, and only the growth of ABC had reached 25% which placed it near the middle. This surely cannot rule out the relatively large base of large commercial banks in MSME loan balance, but it also, to a certain extent, reflected that large banks strived for stability in terms of SME financial services. On the other hand, the level of MSE loan growth for joint-stock companies was relatively average. Specifically, China Merchants Bank (CMB) exhibited the most significant growth, at a growth rate as high as 104.91%, placing it in the forefront. Minsheng Bank (CMBC)’s growth rate reached 36.33%, while the growth rate of China Everbright Bank (CEB) and China CITIC Bank (CNCB) had both exceeded 25%, placing them in the middle. China Guangfa Bank (CGB) and SPDB both exceeded 20%, while Ping An Bank was slightly behind at a growth rate of 16.25%. If we instead turn our attention to urban commercial banks, we will find that, although urban commercial banks were unable to contend for MSE loans with large commercial banks, as was it difficult to compare them with joint-stock commercial banks, the performance of micro and miro-credit growth had been gratifying. Bank of Hebei ranked first with a growth rate of 200%; the growth of Hankou Bank and Zhejiang Mintai Commercial Bank also exceeded 50%, while Baoshang Bank followed with a growth of nearly 40%. Of the urban commercial banks, Huishang Bank had the slowest rate of growth which still exceeded 20%. The scale of urban commercial banks was small, but it had shown explosive strength in MSE financial services, and its potential for growth cannot be ignored (see Figure 2-2).
Fig. 2-1 MSE Loans of Major Commercial Banks (2012)

Source: Data on Bank of Jiangsu, Zhejiang Mintai Commercial Bank, Harbin Bank, Bank of Ningxia, Commercial Bank of Kaifeng and Bank of Qingdao come from the survey of Mintai Institute of Finance and Banking (CUFE); the MSE loan balance of Bank of Nanjing is calculated in accordance with its disclosed loan balance for 2011 and growth rate for 2012; the one of Baoshang Bank comes from Baoshang Bank Credit Evaluation Mechanism: Focusing on Analysis, Less Attention to Guarantee, Boao Review, March 30, 2013; the one of Fujian Haixia Bank is an excerpt from the 2013 Annual Credit Rating Report on Financial Bonds of Fujian Haixia Bank; and remaining bank data are extracted from the annual report of each urban commercial bank.

Notes: (1) Because the MSE loan balance has not been disclosed, BOCOM’s data in this figure is the “MSME loan balance”.

(2) The data herein disclosed by BOC is the balance of small enterprise loans, however this is explained in its annual report for 2012: “statistical standards for small enterprise loans are in accordance with the Notice concerning Issuing the Rules on the Classification Standards for Small and Medium-sized Enterprises (G.X.B.L.Q.Y. [2011] No. 300) formulated by four ministries including the Ministry of Industry and Information Technology, which includes small enterprise, micro-enterprise and personal business loans.” In accordance with its standards, this shall be equated with MSE loans.

(3) The MSE loan balance of Fujian Haixia Bank is the MSE loan balance as at the end of September 2012.

(4) The MSE loan balance of Baoshang Bank is the balance of MSE loans less than RMB1 million.

(5) The MSE loan balance of Kaifeng Bank and Harbin Bank include personal business loans.
Fig. 2-2 Growth of MSE Loans of Major Commercial Banks (2012)

Source: Unless specified otherwise, the growth rates of MSE loans of the above commercial banks are calculated based on annual reports and corporate social responsibility reports for 2011 and 2012.

Notes: (1) Because the MSE loan balance has not been disclosed, BOCOM’s data in this figure is the “MSME loan balance”.

(2) Statistical data of CCB’s MSE loans for 2012 adopt the new classification standard for MSEs. Therefore, they are inconsistent and incomparable with the small enterprise statistics in previous annual reports, and the growth data in CCB’s annual report has been selected directly.

(3) In 2012, ABC converted its old standards to the new enterprise classification standards in accordance with relevant regulatory requirements and began to implement the new standards. Thus, the scope of the definition of MSEs has been adjusted from the past years, and for this reason, the growth data in ABC’s annual report has been selected directly.

(4) Because of a small change in statistic standards, the MSE loan balance of Ping An Bank in 2012 cannot be compared with that of 2011. As such, the MSE loan growth of Ping An Bank in this figure is from Ping An Bank’s 2012 annual report and is not generated from calculation.

(5) The annual report of CMB disclosed information that MSE loan growth in 2012 had grown by 104.91% from the beginning of the year, however, based on the MSE loan balances of 2012 and 2011, the calculated MSE loan growth had increased by -45.51%. This difference is due to the fact the CMB made an adjustment to its statistic standards for MSE loans in 2012. Thus, the MSE loan growth used in this figure is directly selected from CMB’s annual report.

(6) The data on the MSE loan growth of Bank of Hebei, Zhejiang Mintai Commercial Bank, Bank of Hangzhou and Huishang Bank are taken directly from their respective 2012 annual reports.

For the ratio of MSE loans to total loans, the distribution of this ratio of large commercial banks and joint-stock commercial banks was relatively concentrated, with a majority of banks within the 7%-17% range. The ratios of several banks, such as SPDB, CMBC and ICBC exceeded 20%. Relative to joint-stock commercial banks, large commercial banks did not have any obvious advantages. However, in terms of this ratio, urban commercial banks held a relatively prominent advantage and their leading position was quite distinct. The top 12 ratios were those of urban commercial banks, all of which were greater than 25%. Specifically, Zhejiang Mintai Commercial Bank was
at the top of the list with a ratio of more than 85%; Baoshang Bank had a ratio of nearly 70%, and Panzhihua City Commercial Bank had a ratio of nearly 55%. If we take the proportion of MSE loans to the national average level of all loans (21.95%\(^1\)) as a reference, 10 of the selected urban commercial banks were above this benchmark level, while among the joint-stock commercial banks, only SPDB and CMBC were slightly above this level. All of the five large commercial banks were below this benchmark (see Figure 2-3). It can be seen that small and micro-financial services held a core position in the share of the overall business of urban commercial banks, fully reflecting their degree of dedication to the field of MSMEs and clear understanding of their own advantages. This was also an inevitable result of differentiated competition in the small and micro-financial services sector.

![Fig. 2-3 Proportion of MSE Loans to Total Loans of Major Commercial Banks (2012)](image)

Source: Unless specified otherwise, the growth rates of MSE loans of the above commercial banks are calculated based on annual reports and corporate social responsibility reports for 2011 and 2012. Of which, data on the Bank of Jiangsu comes from the survey of Mintai Institute of Finance and Banking (CUFE); the MSE loan balance of Bank of Nanjing is calculated in accordance with its disclosed loan balance for 2011 and growth rate for 2012; the one of Baoshang Bank comes from Baoshang Bank Credit Evaluation Mechanism: Focusing on Analysis, Less Attention to Guarantee, Boao Review, March 30, 2013. The proportions of MSE loan balance to total loan balance of Bank of Lanzhou, Bank of Cangzhou, Bank of Hangzhou, Panzhihua City Commercial and Zhejiang Mintai Commercial Bank are from their annual reports. The proportion of MSE loan balance to total loan balance of Fujian Haixia Bank is an excerpt from the 2013 Annual Credit Rating Report on Financial Bonds of Fujian Haixia Bank.

Notes: (1) The data herein disclosed by BOC is for small enterprise loans, however this is explained in its annual report for 2012: “statistical standards for small enterprise loans are in accordance with the Notice concerning Issuing the Rules on the Classification Standards for Small and Medium-sized Enterprises (G.X.B.L.Q.Y. [2011] No. 300) formulated by four Ministries including the Ministry of Industry and Information Technology, which includes small enterprise, micro-enterprise and personal business loans.” In accordance with its standards, this shall be equated with MSE loans.

\(^1\) The China Banking Regulatory Commission 2012 Annual Report disclosed that the nationwide balance of MSE loans (including small and micro-enterprise loans, individual business loans and loans to MSE owners) was RMB14.77 trillion, accounting for 21.95% of all outstanding loans.
(2) The MSE loan balance of Fujian Haixia Bank is the MSE loan balance as at the end of September 2012.

(3) The MSE loan balance of Baoshang Bank is the balance of MSE loans less than RMB1 million.

(4) The MSE loan balance of Kaifeng Bank and Harbin Bank include personal business loans.

(5) The red dotted line represents the overall level of 21.95%, specifically the proportion of nationwide balance of MSE loans (including micro and small-enterprise loans, individual business loans and loans to MSE owners) to the total balance of loans in 2012 as disclosed by the CBRC.

As for the proportion of SME loans to corporate loans, the proportion of SME loans to corporate loans of most large banks and joint-stock commercial banks in 2012 were almost higher than that of 2011 and 2010, indicating the fact that specialized SME financial services had changed from the early stage of policy requirements to a means by which banks themselves pursued profit. Such financial services were beginning to draw the attention of more and more large banks, and this trend cannot be ignored.

In terms of the average MSE loans per outlet, urban commercial banks, small and medium banks still had a distinct advantage in terms of SME financial service efficiency. The loan balances of outlets of small and medium banks were typically higher than that of large banks, and research had shown that, apart from Bank of Hebei, the lowest ranking banks in terms of the average MSE loans per outlet were large commercial banks. Among the large commercial banks, only ICBC’s average MSE loans per outlet exceeded RMB100 million, while those of remaining large commercial banks were all below RMB100 million. The average MSE loans per outlet of ABC was only RMB26 million. On the other hand, of the urban commercial banks, Bank of Beijing was ranked atop for the average MSE loans per outlet of RMB547 million and that of Bank of Hangzhou was nearly RMB450 million. The average MSE loans per outlet of Zhejiang Mintai Commercial Bank, Panzhihua City Commercial Bank, Bank of Nanjing, Bank of Rizhao, Baoshang Bank and Bank of Ningboall exceeded RMB300 million, positioning them in the industry’s upper level. As for joint-stock commercial banks, although their average loans per outlet were superior to large commercial banks, apart from the upper level position of the average MSE loans per outlet of CMBC and SPDB, those of all other joint-stock commercial banks were ranked in the middle and below. Compared to urban commercial banks, there was a distinct service efficiency gap (see Figure 2-4).
Fig. 2-4 MSE Loans per Outlet of Major Commercial Banks (2012)

Source: Calculated based on the balance of MSE loans and the number of outlets. The MSE loan balance of Bank of Nanjing is calculated in accordance with its disclosed loan balance for 2011 and growth rate for 2012; the one of Baoshang Bank comes from Baoshang Bank Credit Evaluation Mechanism: Focusing on Analysis, Less Attention to Guarantee, Boao Review, March 30, 2013; and remaining bank data are extracted from the annual report of each urban commercial bank.

Notes: (1) The data herein disclosed by BOC is the balance of small enterprise loans, however this is explained in its annual report for 2012: “statistical standards for small enterprise loans are in accordance with the Notice concerning Issuing the Rules on the Classification Standards for Small and Medium-sized Enterprises (G.X.B.L.Q.Y. [2011] No. 300) formulated by four ministries including the Ministry of Industry and Information Technology, which includes small enterprise, micro-enterprise and personal business loans.” In accordance with its standards, this shall be equated with MSE loans.

(2) The MSE loan balance of Baoshang Bank is the balance of MSE loans less than RMB1 million.

Moreover, according to the statistic results of the “Questionnaire on Small and Micro-Enterprise Financial Service Managers of Commercial Banks” launched by the Mintai Institute of Finance and Banking (CUFE) in April 2013, the development of MSE financing as an important component of strategic restructuring had already become an intrinsic demand for the development of commercial banks themselves. Within the MSE business, the pricing advantage, the stable and beneficial customer mix and cross-selling opportunities became the three driving forces by which the surveyed MSE financial managers promoted the development of MSE financial services for commercial banks. As compared to the five large state-owned commercial banks, the joint-stock commercial banks and urban commercial banks had a stronger pricing advantage in MSE financial services. The respondents from the two types of banks reflected that the average interest rates of their banks in 2012 for MSE loans was at an upward floating rate of greater than 20%-40% of the overall average level of the benchmark loan interest rate. Additionally, from the perspective of the work intensity and performance pressure of MSE financial managers, joint-stock commercial banks
and urban commercial banks were typically higher than the five large state-owned commercial banks, which also, to a certain degree, was reflected in the small and micro-financial market where joint-stock commercial banks and urban commercial banks were more active than large commercial banks which gave them a certain first-mover advantage. The survey also found that respondents from joint-stock banks and urban commercial banks treated each other as their largest rivals in the small and micro-financial services sector but did not feel that the five state-owned commercial banks constituted a threat to their ability to compete effectively.

As for the performance of commercial banks in MSE financial services in 2012, the majority of respondents summarized the services as “fiercely competitive”, “high risk” and “a long way to go”. Respondents typically felt that the outlook for MSE financial services was promising. Commercial banks must constantly improve MSE financial services, increase investment and reinforce innovation to secure a place amidst the fierce competition.

As such, amidst the current misaligned competition between large state-owned commercial banks, joint-stock commercial banks and urban commercial banks, all of which rely on their own comparative advantages and diversified patterns, various commercial banks are constantly intensifying their efforts in developing new customer channels, offering specialized products, and enhancing the core competitiveness of their own small and micro-financial services so as to distance themselves from the homogenous state of competition. The issue of how to properly handle the balance between competition, income, innovation and risk is bound to become the future subject of focus for the small and micro-financial business of all commercial banks.

2.2 Enhanced Sci-Tech SME Services

2.2.1 Settle-down of the First Domestic Sci-Tech Bank

In November 2011, the plans for a joint-venture sci-tech banking between SPDB and Silicon Valley Bank finally obtained approval for establishment by the CBRC. On August 15, 2012, SPD Silicon Valley Bank was officially founded in Shanghai with a registered capital of RMB1 billion. SPDB and Silicon Valley Bank Limited each hold a 50% stake in the bank. This was China's first bank with an independent legal person status committed to serving innovative sci-tech enterprises and was also the first joint-venture bank to obtain approval from Chinese regulatory authorities since 1997.

As China’s first “sci-tech bank”, SPD Silicon Valley Bank’s target customers are innovative sci-tech enterprises, engaging in the specific industries of such innovative sci-tech fields as hardware, software, the Internet, mobile, consumer technology products, life sciences, biotechnology, clean energy and new materials. In its early stages, SPD Silicon Valley Bank would initially rely on its geographical advantage to serve the high-tech enterprises in Shanghai and surrounding areas, and then it would prudently and steadily develop towards Chinese high-tech urban industry clusters. At its current stage, SPD Silicon Valley Bank provides credit and non-credit solutions. Credit solutions comprise of import credit for purchasing the equipment, raw materials and other necessities of enterprises in their early stages, expansion stages and their mature periods. Non-credit solutions cover such services as opening foreign currency accounts and providing domestic and international banking platform support for enterprises. In accordance with the Foreign Bank Regulations, SPD Silicon Valley Bank can only carry out the onshore USD business, which poses a huge challenge for SPD Silicon Valley Bank. Because of its inability to conduct RMB business, it may take
up to 3 to 6 months to settle USD loans given to start-up companies, which has a major impact on enterprises who are in desperate need of funds and has greatly reduced the strength of SPD Silicon Valley Bank’s efforts to support innovative enterprises. However, SPD Silicon Valley Bank is currently in the process of creating a tripartite cooperation platform with SPDB and Silicon Valley Bank to expand the scope of its business. In particular, SPDB will provide back-office operations and IT technical support, so that if a joint-venture bank customer requires RMB financing, it can cooperate with SPDB.

The establishment of SPD Silicon Valley Bank contributed to the financial service industry by introducing the mature sci-tech SME service experience of Silicon Valley Bank to the Chinese market and achieving a connection between Shanghai’s superior financial resources and cutting-edge offshore financial services. Whether it can obtain the approval for RMB business trials or not, and how exactly it will localize the Silicon Valley Bank model so as to better serve innovative hi-tech enterprises must be addressed for the future development of SPD Silicon Valley Bank. Given the different market environment, such questions such as whether the technology banking model will be successful in China or not, as well as the profitability and competitiveness of the joint-venture bank can only be answered when SPD Silicon Valley Bank is put to the test in actual operations.

2.2.2 Further Promotion of Institutions Specializing in Sci-Tech Financial Services

As response to the CBRC’s Guiding Opinions for Banks to Establish Institutions Specializing in Financial Services for Small Enterprises (Y.J.F. [2008] No.82), various banks actively expanded service efforts geared towards Zhongguancun sci-tech SMEs. As of the end of 2012, 18 commercial banks had established a total of 40 various credit franchises and specialty branches 1 offering sci-tech SME services in the Zhongguancun National Innovation Demonstration Zone, a powerful impetus for the rapid growth of enterprises in the demonstration zone.

Following the establishment of Bank of Beijing Zhongguancun Branch in 2011, CCB Beijing Zhongguancun Branch was formally established on February 8, 2012, becoming the second bank branch to settle in Zhongguancun. This initiative was also the first of its kind among the five large commercial banks. The establishment of Bank of Beijing and CCB branches in Zhongguancun marked a further improvement in the services of banking franchises directed towards Zhongguancun sci-tech SMEs.

Since the establishment of Bank of Beijing Zhongguancun Branch, it has actively seized new development opportunities for Zhongguancun. With the policy advantages of the Development Zone, Bank of Beijing has constantly improved products and its service system, and optimized the service flow, playing a leading role in the field of Zhongguancun sci-tech financial services. As of June 2012, the total assets of the Bank of Beijing Zhongguancun Branch had already reached RMB136.7 billion, with an accumulated total of 4,000 Zhongguancun Demonstration Zone SMEs and issued loans of greater than RMB80 billion, ranked first 2 in Zhongguancun Demonstration Zone, becoming the sci-tech demonstration zone’s banking institution with the most abundant products and the largest amount of business.

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1 “40 Banking Franchises Gather to Support Accelerated Development of Zhongguancun Enterprises”, Zhongguancun Administrative Committee, February 20, 2013.
Unlike other Beijing branches of CCB, CCB Beijing Zhongguancun Branch is positioned as a fully functional branch, organically integrated with the 13 sub-branches in Haidian district and 18 savings agencies, and it is capable of conducting a unified management of various resources to improve the relevance and efficiency of services. Compared with the conventional organizational structure, the Zhongguancun Branch has the privileges of credit approval, project approval, customer access and product innovation and has established a technology financing department with a professional team to arrange differentiated financial services as required for the development of SMEs. The “Soaring Financial Plan”, a financial services and product program specifically designed for the Zhongguancun Science Park and enterprises in the park, includes more than ten innovative financial products arranged in the three series of “Dream Road”, “Blue Skies” and “Staunch Support”, covering credit loans, secured loans and a variety of other product forms. It solves, to a certain extent, the financing difficulties of MSEs that arise from a lack of effective collateral.

2.2.3 Fervent Sci-Tech SME Brand Innovations

In 2012, commercial banks began to compete for innovative sci-tech SME products, striving to meet the demand of different types of sci-tech SMEs for differentiated financial services, as well as to improve the product systems accordingly.

In terms of innovations in comprehensive sci-tech SME financial services, commercial banks continued to focus on the different categories and different stages of sci-tech SME development, leading to differentiated arrangements of products and services. In 2012, SPDB launched its “Technology Financing α-Model”, targeting the different needs of high-tech MSEs in terms of the initial start-up period and periods of rapid growth and matured development. Given the unique characteristics common to technical risks, market risks and financial risks, SPDB also launched the three major innovative financing products of “Credit Win” indirect financing, “Investment Loan Win” investment-loan linking products, and “Collective Win” collective financing products, providing comprehensive assistance to sci-tech SME development. Its sci-tech MSE financial service solutions included: comprehensive PE financial services based on the growth cycle of sci-tech MSEs, financing services such as innovative equity pledges, intellectual property pledges and trademark pledges based on the special asset pledges of sci-tech MSEs, trade finance products such as order financing, invoice financing, factoring and receivables financing based on sci-tech MSE trade chains, and collective financing products such as collective notes, collective bonds and collective trusts.

In 2012, commercial banks targeted the small and medium-scale enterprises with characteristics of insufficient tangible collaterals, allowing them to flexibly select their collaterals, further subdivided customer groups and introduced increasingly wide range of loan products. For instance, the “Zhan Yi Tong” product series, under the “Qian Ying Zhan Yi” plan of CMB, covered the four major product categories of sci-tech subsidized loans, loans for the transfer of sci-tech achievements, lending and financing for listing and syndicated investment loans so that they can allow sci-tech enterprises to flexibly select their collaterals given their different stages of development and can provide them with financial support. The launch of such innovative commercial bank lending products will undoubtedly inject sci-tech SME financing with new sources of.

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growth. However, the inherent risks of sci-tech enterprise themselves cannot be ignored, and the question of effectively controlling the risk of such loans requires further exploration in the process of developing and improving the sci-tech SME financial services of commercial banks.

2.3 Surge of Internet Financing

At present, the mainstream model of commercial banks’ online financing is to utilize Internet technology to change some partial models and procedures of fixed business conventionally performed offline (such as credit application, disbursement, loan recovery and revolving loans) into online handling. This model is essentially the use of Internet technology to improve the financing process, improve the efficiency of financing and thus improve the customer service experience. The core areas of such financing like the lender’s credit investigation and auditing are still done offline. On the basis of this mainstream model, some commercial banks with relative technical strength have begun to introduce electronic warehouse receipts, electronic orders and financing services with access to the supply chains of the core large enterprises. This model has begun to touch upon the core areas of financing, utilizing Internet technology, innovative collateral and an extension of core customer credit. Moreover, this model is also one of the competitive directions for the development of the Internet financing of commercial banks. 2012 was a year in which commercial banks have embraced a more proactive approach to the Internet. Compared to 2011, online financing in 2012, no matter in terms of scale or in terms of the in-depth range of products and services, had improved. Meanwhile, more and more commercial banks had come to recognize the profound changes brought about by the developments of e-commerce as well as the important value of e-commerce transactions to the SME services of commercial banks. The commercial banks that begun to try the e-commerce or joined forces with e-commerce enterprises had become the major highlight of 2012.

2.3.1 Increasing Size of Online Financial Services

ICBC took the lead in the field of online financing. At the end of 2009, ICBC combined its conventional credit business with the development of e-commerce, launching an innovative network financing business. Three years after launching this business, ICBC had accumulatively issued RMB771 billion network financing loans to 43,000 MSEs, of which, RMB 328.8 billion loans were granted to 30,000 MSEs in 2012.1 (see Figure 2-5).

CCB also has its own characteristics in the field of online financial services, and it has already issued a total of RMB95,164 million\(^1\) in online banking loans since 2008\(^2\). Meanwhile, the trading volume of CCB’s “.ecb.com” online financing platform has been increasingly rising since becoming activated in June 2012. In January 2013, the daily turnover reached RMB17 million\(^3\), and as of the end of 2012, the Enterprise Mall had already accumulated a total transaction volume of RMB3.5 billion with merchant financing of nearly RMB1 billion\(^4\).

### 2.3.2 Abundance of Online Financial Products

In 2012, a number of commercial banks had increased their research efforts on online financial products, introducing online orders, online warehouse receipts and other new financial pledge products, promoted “e-chain financing services”, expanded the range of service targets, and gave full play to the online financial product advantages of diversification and convenience. First, online self-service revolving loan services became more convenient, such as ICBC’s “online revolving loans”, BOCOM’s “online E-loans for small enterprise”, SPDB’s “online self-service loans” and CCB’s “Internet loan express”. Secondly, online warehouse receipt and order financing had enriched the types of collateral financing available, such as ICBC’s “online commodity trading market financing”, CCB’s “E-receipt express” and “E-cotton express”. Moreover, a number of commercial banks promoted “e-chain financing services”, providing online supply chain financing services through electronic channels to core upstream and downstream enterprises.

### 2.3.3 Commercial Banks: Attempts on e-Commerce

As of the end of 2012, there were 242 million Chinese online shoppers and the proportion of Internet users who conducted online shopping had grown to 42.9%. The total amount of Chinese online shopping transactions had reached RMB1,259.4 billion, representing a growth of 66.5% compared to 2011. In 2012, the number of online retail market transactions to total retail sales of consumer goods was 6.1%\(^5\). It is worth

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\(^1\) 2012 Annual Report of CCB.

\(^2\) 2012 Annual Report of BOCOM.


\(^4\) 2012 Annual Report of CCB.

mentioning that the daily trading volume on the two major e-commerce sites, Tmall and Taobao, had reached RMB19.1 billion on November 11, 2012, far more than the previously expected target of RMB10 billion and exceeding the USD1.5 billion\(^1\) of America’s Cyber Monday in 2012. This also displayed the huge room for development and explosive power of China’s online shopping market.

Faced with such a large market, commercial banks were also eager to try their hands, and some commercial banks had begun to test the waters of e-commerce. On the one hand, this eagerness originated from the demand of commercial banks for attracting SME customers. On the other hand, commercial banks were aware of the superior information that came with e-commerce. Along with the explosion of third-party payment agencies, e-commerce screened customer data, orders, transactions and other information. At this point, commercial banks only had a terminal position on Internet transactions and payments and were unable to access third-party transaction records and other information and had a difficult time in utilizing this information on their customers. This vast trove of customer information was the greatest advantage for which e-commerce would develop Internet financing.

![Fig. 2-6 The Course of Commercial Banks’ Venturing into E-Commerce](http://www.ebrun.com/tc/b2b/dianshangjinrong.shtml)

Reviewing the history of commercial banks testing the waters of e-commerce, we can trace its origins back to 2007 with the respective partnerships of Alibaba with CCB and ICBC. However, the most important corporate transactions, credit data and other such information on e-commerce platforms did not apply to the conventional system of bank credit, and banks still used the conventional means for investigations and loan standards to audit e-commerce recommended customers. As such, not only did a small number of high-quality e-commerce customers pass bank auditing, but it also led to a breakdown of bilateral cooperation. However, the emergence of miro-credit companies made it possible for e-commerce networks to independently offer financing services. Alibaba opened two miro-credit companies respectively in 2010 and in 2011, using

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miro-credit companies as a credit window to target customers strictly limited to those member businesses registered on the Alibaba e-commerce platform, by which they could then complete all pre-loan and post-loan processes. With the entirely new Alibaba financing “miro-credit companies + platform” model, platforms can take advantage of the benefits of miro-credit company licensing and e-commerce business channels to fully integrate information superiority, effectively reduce customer search costs and credit risks and break the shackles from cooperation with banks.

In light of the fierce offensive for high-profile e-commerce financial services, how to master or utilize the accumulated information superiority of e-commerce development and the new push for non-dominant fields in conventional commercial banking (i.e. the field of small and micro-financial services) have become the center of thinking for more and more commercial banks. From the current points of view of commercial banks which have already put their efforts into action, there are two main models: one is the self-built e-commerce platform, and the second is to partner up with e-commerce platforms to provide financial services.

A classic example of the first model is CCB. In June 2012, CCB’s financial services e-commerce platform “e.ccb.com” was launched as the first commercial bank e-commerce platform. As of the end of 2012, the bank’s “e.ccb.com” had over 10,000 merchants, turnover exceeded RMB3.5 billion, with a financing scale of nearly RMB1 billion. In December 2012, BOCOM’s new-generation online store “e-mall BOCOM” also went online. The e-commerce platform models of CCB and BOCOM were similar to conventional e-commerce platforms such as Taobao, Jingdong and Amazon, blending B2B and B2C services into an integrated service platform, including apparel, leather bags, electronics, household goods, audio books and other types of goods.

Representative of the second model is the partnership between hc360.com and CMBC. In January 2013, hc360.com and CMBC officially released joint name credit cards. The model, designed by both parties is to issue credit cards to individual hc360.com members of an amount less than RMB200 thousand so that paying members of hc360.com can apply for goodwill based on their transaction records. If members have proof for real estate, automobiles or income records (not for pledge), their line of credit can be raised to RMB500 thousand. Unlike its major competitors Alibaba, Suning established their own miro-credit companies, funded within its system. This is another model of the finance-oriented e-commerce platform. The financing costs of this model are lower, and the interest rate for bank funds is also lower than that for miro-credit companies. In November 2012, Jingdong Mall and BOC signed a strategic cooperation agreement, jointly launching the supply chain financial services platform, in which Jingdong Mall suppliers can obtain financing services by providing their orders, accounts receivable and other such information so as to compensate for the disadvantages of insufficient funds and cash flows.

The key to first model is that commercial banks build their own online business credit system and they can rely on their conventional financial monopoly as their main body of indirect financing, which to some extent makes up for the latecomer’s disadvantages in the e-commerce business, so as to gain more customer data. However, this model also has a major disadvantage in the cost of inputs; commercial banks need a lot of manpower, material and financial resources to overcome their weaknesses and thus be able to catch up in the short term with conventional e-commerce platforms. Even so,

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1 “Banks Has Ushered the e-Commerce Test”, *Shanghai Securities News*, April 12, 2013.
earnings from this model still depend on the probability of success. In terms of income, how many customers can commercial banks attract, how much income will these customers bring to commercial banks in the future, to what extent commercial bank can reduce their non-performing loan ratios by means of accessing information and data mining methods, and whether these benefits could cover the huge costs are still unknown.

The second model is that commercial banks and e-commerce platforms utilize their respective advantages. From the perspective of the first model in which commercial banks compete with conventional e-commerce platforms, first of all, commercial banks lack business experience in the operation of e-commerce platforms. E-Commerce and conventional banking are two completely different areas, with two completely different philosophies. It is difficult for banks to rely on short-term training on the old cast to achieve the success in e-commerce business. Secondly, the e-commerce platform service system of commercial banks is imperfect. As compared to Jingdong, Taobao and other such mature e-commerce platforms, commercial banks’ e-commerce platforms need step-by-step improvements in terms of security, logistics, platform monitoring, and the overall user experience. This is especially true for the quality of goods and services; banks are often not very professional, and even play the “exemption” card. Third, banks have a smaller base in small and medium customers. Although commercial banks can offer many advantages through their monopoly on the conventional services which e-commerce has no access to, it is unclear whether or not this is enough to compete the conventional e-commerce platforms which have a first-mover advantage and offer professional services. At present, Alibaba, Jingdong and other conventional e-commerce markets have gradually won the support and trust of consumers. For example, the Taobao customer base has already covered more than half of Chinese populations. Most of these customers will find it difficult to transfer their transactions to banks in a short period of time. After the less successful attempt for cooperation between Alibaba and CCB, we can see that if commercial banks can strive to make changes, in terms of ideology and technology, to adapt to such a technical cooperation, this model may have better chances than the first one, and commercial banks may form a win-win situation with e-commerce platforms.

As for the e-commerce platforms, the choice to re-cooperate with commercial banks is certain objective requirement. First, the business of finance does not completely dependent on the exclusive data at the disposal of e-commerce platforms, but they also must understand the credit status of their customers, require their customers provide authorized credit reports and the power of attorney, as well as proof of corporate banking records, and perhaps even on-site investigations. Commercial banks have an advantage when it comes to conventional credit investigations. Secondly, if e-commerce platforms establish miro-credit companies to provide financial services, they are still after all bound by capital constraints. The combination of financial strength of commercial banks and the superior transaction information of e-commerce platforms, after all, is the more pragmatic choice.

2.4 “Business Circle + Industry Chain” Model is Becoming a Common Practice

The model of “business circle plus industry chain” is an important operating model in the batch development of micro finance, namely, what the industry calls “one circle and one chain” in which a business circle has an industry chain upstream and downstream trading network, and the industry chain is also embedded into each market, forming an ecosystem for the MSE business circle. The development model of “business circle
plus industry chain” can, to a certain extent, resolve the issues that occur in single MSE loans, such as information asymmetry, risk control difficulties and high borrowing costs. In the context of increasing competition among commercial banks in medium, small and micro-financial services, this model is gradually winning over the favor of more and more commercial banks, leading to overall development through the industry chain and offering complete financial services to upstream and downstream MSEs.

2.4.1 Industry Chain Financing Model in Vogue

Through the development of specialized industry chain financial plans, commercial banks can attract core upstream and downstream MSEs from business circles to become closely associated with their customers. The scale and financial strength of MSEs is more limited than that of the core enterprises, and as such, commercial banks can offer preferential, tailored, specialized financial services. After commercial banks have won over these upstream and downstream customers, core enterprises will naturally deepen their cooperation with the given commercial banks, and in this way, commercial banks can realize complete industry chain financial services.

The industry chain financial model refers to a commercial bank’s reliance on core industry chain enterprises to target all aspects of the industry chain and design personalized, standardized financial services and products, offering integrated solutions to all enterprises within the industry chain so that enterprises can deepen their cooperation with the commercial bank and reap the maximum benefits from the given service model, i.e. the “M+1+N” model. Of which, “1” represents the core enterprise, while “M” and “N” respectively represent the upstream and downstream MSEs. Through a comprehensive analysis of the information flow, capital flow and logistics between the industry chain’s “M” or “N” and “1”, banks can effectively circumvent bank credit risks, and provide integrated and comprehensive financial services such as financing and settlement services to various enterprises within the industry chain.

Within the typical industry chain there is a high-quality core enterprise (i.e. “1”), and commercial banks can provide it with value-added products such as group account management, and investment banking. Meanwhile, by offering services to the core enterprise, commercial banks can also offer financial services to their upstream and downstream customer base. Regarding the core enterprise’s MSE upstream suppliers (i.e. “M”), commercial banks can provide multiple credit support operating models including procurement contract financing, commercial invoice discounting, reservation payment financing, accounts receivable buyout and comprehensive factoring. In providing financial support to the upstream suppliers, commercial banks can not only ensure a timely and smooth logistics supply, but it can also obtain more favorable supply conditions for the core enterprise. Furthermore, commercial banks can establish a sound sales network by assisting the core manufacturing enterprises, thereby expanding their market share. By expanding their sales channels, commercial banks can also establish a relationship with a number of the downstream MSE customers (i.e. “N”).

2.4.2 Accelerated Innovations in “Business Circle + Industry Chain” Centralized Credit

Typically, MSEs are prone to risks, and in the context of an economic downturn, medium and large enterprises have a relative ability to withstand cyclical risks, while MSEs are often less able to withstand losses. Meanwhile, the management and tax rules on MSEs are not relatively standardized, which leads to excessively high MSE risks,
and the cost of commercial bank assessments and credit checks on MSE is relatively higher because of their smaller scale. These are the root causes of MSE financing difficulties. Given the aforementioned MSE risk factors, commercial banks typically centralize credit and provide batch approvals, drawing support from the business circle and industry chain to carry out joint guarantees.

The centralized credit model of “business circle plus industry chain” of commercial banks primarily refers to bundling the MSEs within a certain industry chain or business circle and controlling the upstream and downstream enterprises of the lending enterprise or enterprises related to the business circle so as to effectively control MSE credit risks. On the other hand, by increasing the proportion of non-mortgage loans and lowering the threshold on MSE financing, commercial banks also improve their bargaining power, earn higher interest rates and risk premiums, which can also be seen as an approach of covering risks by earnings.

Undoubtedly, CMBC is the most representative bank to utilize the current “business circle plus industry chain” model of developing small and micro financial services. This bank is set to be joint-stock commercial bank with small micro-financing as its core strategy which has been making every effort to break the homogenization of banking operations. The “business circle plus industry chain model” is yet another one of CMBC’s innovative initiative to break past increasingly fierce competition. In 2011, CMBC began to develop small and micro-financial branches, categorizing MSEs based on their correlation to the business circle plus industry chain model. This model does not simply distinguish different industries to build small and micro branches, but rather targets the different characteristics of the business district and industrial chain, and the corresponding specialized small and micro-branches also undertake the task of integration into the industry chain. By effectively integrating into the industry chain and rationalizing its context, these branches can provide financial services to SMEs while promoting the transformation and upgrade of the entire industry.

In the process of actually laying out the model, CMBC followed a standard of a long chain of weak economic cycles for its choice of industry chains, in that the chosen industries were all industries related to people’s livelihoods in a weak economic cycle. Examples of the multiple industries in which the bank was involved include the liquor industry in Chengdu, the marine fisheries in Fuzhou, and the tea industry in Xiamen. Additionally, the standard length of the chain could expand financial services for CMBC to provide sufficient depth to broaden its financial services and improve its professional capabilities. In 2012, so as to target the Inner Mongolian dairy industry chain, CMBC chose the “core enterprise 1 + N” model. Having signed a strategic cooperation agreement with the Inner Mongolia Yili Industrial Group, CMBC provided bulk lending services to upstream dairy farmers and downstream distributors. The “core enterprise”, that is, the Yili Group, was more familiar with the operating conditions of its suppliers and distributors, and thus could assist CMBC in solving the issue of asymmetric information during the lending process. Meanwhile, through the economies of scale inherent within the industry chain, loans could be issued in batches, effectively resolving the high financing costs that dairy MSEs faced at both ends.

2.5 Brand and Service are Getting Matured

2.5.1 Innovations in and Upgrade of Supply Chain Financing

Supply chain financing includes a single core enterprise and multiple upstream and downstream SMEs with SMEs as the core enterprise’s suppliers and distributors which
rely on the core enterprise for survival and development. As the enterprises of supply chain financing are highly dependent upon and influence each other, commercial banks have begun to focus on the whole, grasping the characteristics and needs of the entire supply chain, and thereby designing individualized financial services and products, so as to provide the full coverage of integrated services to all of the supply chain enterprises.

Since Shenzhen Development Bank put forth the concept of “supply chain financing” in 2006, a number of banks have caught on to this new field. Following the launch of the SPDB’s “supply chain financing” overall service solutions, Industrial Bank’s “Golden Sesame” supply chain financial services, and ICBC’s “e-business supply chain financing” in 2012, commercial banks have paid more attention to the development and improvement of supply chain financial services at the MSE level, further enhancing related innovations. On the framework of its original “Supply Chain Finance” brand, Ping An Bank launched its innovative “Supply Chain Finance 2.0” brand covering the 7 major products and services of prepaid online financing, online inventory financing, online reverse factoring, electronic warehouse receipts, online pledge financing, core enterprise collaboration, value-added information services, and the “golden corporate guardian”. This not only upgraded the bank’s online supply chain financial services, but also integrated online activity through supply chain information, with a greater emphasis on the interaction and collaboration of participants through the web-based service platform so as to better suit the needs of enterprises and related parties. Supply chain financing can, to a certain extent, not only solve the financing difficulties of MSEs but can also enhance banking services. Due to its huge market potential and sound risk control, supply chain financing is gradually becoming a new focus of competition for commercial banks.

2.5.2 Increasing Improvement of Product and Brand

In 2012, commercial bank MSE financial services became more targeted, integrating the past service experience to meet the accumulated, unilateral demands of enterprises, optimize designs, and build an entire financial services mode for MSE development.

In terms of product innovation, and given the issue that MSEs face with insufficient effective collateral or guarantees, a number of commercial banks have made bold attempts to launch innovative personal credit products based around MSME owners. For instance, CCB launched a recyclable RMB credit loan business, “Credit Loans – Good Financial Loans”, based on the transaction settlements and activity level of settlement accounts of MSEs. The loans were granted to MSEs with stable settlement and certain capital base, for their short-term production and management turnover.

With the increasingly rich content of MSME services, commercial banks have increasingly focused on the whole, adjusted service models and optimized service flows to build full service brands that cover MSME development. On the basis of a thorough analysis of the comprehensive financial needs during the purchasing, production and sales processes of medium-sized enterprises, BOCOM customized a professional, one-stop, individualized and integrated service solution tailored for the long-term development of enterprises – the “Win to Fortune – Kunpeng Plan” brand. The plan comprehensively covers the five sub-plans of “Financial Planning”, “Settlement Planning”, “Investment Planning”, “Wealth Planning” and “Personal Wealth Planning” and dozens of specialized product portfolios, and is committed to reducing the financing costs of its medium enterprise customer base and improving the

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efficiency of their settlements. CMB’s “Business All-in-One Card” is the first of its kind, domestically, and is an exclusive financial service instrument for MSE financing, settlements and living all in one. Customers can enjoy a more convenient, lower interest loan services, and can also enjoy remittances, settlements, banking and other financial value-added services in a one-stop experience. Given the different needs of hi-tech MSEs in their start-up, as well as period of rapid growth and development, and the unique technical risks, market risks and wealth management risks common to sci-tech MSEs, SPDB also launched the “SPDB Technology Financing α-Model”, gathering technology franchise organizations, technology franchise mechanisms, exclusive technology products and processes and a specialized risk prevention system all in one to provide high-tech MSEs with one-stop, full coverage financial services.

Reviewing the increasingly sophisticated MSME financial service brands, it isn’t difficult to realize that the financial services of commercial banks to MSEs are gradually breaking the mold of single credit services and are changing to serve as the starting point of credit for different industries and different stages of development, based on the practical needs of MSMEs. Moreover, commercial banks are expanding the reach of services, enhancing its content, and are striving to provide comprehensive, multifaceted, and integrated services.

2.5.3 New Tactics for Collateralized Loans

A lack of effective collateral has been one of the largest obstacles in MSE financing. In recent years, commercial banks have successively come up with innovative guarantee mechanisms, gradually shifting away from the original fixed assets towards intangible assets, such as accounts receivable, intellectual property and other such collaterals. CCB launched the “online pledge loan of accounts receivable”, both providing online self-service applications for pledge loans of accounts receivable for medium and large-scale upstream suppliers and also achieving a fully electronic loan process. During the process, after the bank’s automatic approval, customers can apply for loan disbursement to be borrowed and repaid at any time.

Although the innovative method of loan collateral has, to some extent, resolved the financing difficulties of MSMEs, such an innovative use of collateral loans is uncommon, because the innovative form of collateral faces unknown ownership, pricing assessment difficulties and many other issues. Future innovations in mortgage pattern of commercial banks must appropriately improve the tolerance for SME risks.

2.6 SME Credit Exposure: A Cause for Concern

In 2012, the global economy had yet to recover. From an international perspective, global economic growth was still weak, and recoveries were very slow. From a domestic perspective, although the economy was generally stable, the country still faced the difficulties and challenges of an economic slowdown. The contraction of external markets and tight domestic policy, to some extent, led to an increase in the non-performing loan ratio of commercial banks, forcing banks into a credit crunch. Even so, although the non-performing loan ratio of commercial banks was 0.95% at the end of 2012, having fallen by 0.01 percentage points from the previous year, yet the amount of non-performing loans had been increasing for five consecutive quarters, and the situation had not been optimistic\(^1\). Moreover, the conservative estimate cited in the Report on China Banking Credit Observations for the potential non-performing loan

\(^1\) Excerpt from China Banking Operations Report (FY2012).
ratio\(^1\) of the entire banking sector was 5.4\%, much higher than 0.95\%. On the other hand, due to changes in the overall macroeconomic situation, the systemic risk of photovoltaics, steel and export trade, and other policy-related industries has been rising. In such a situation, SMEs with insufficient capital and a limited size have been hit particularly hard. From the perspective of 2012, SME credit risks have primarily exhibited the two features of industrial and geographic concentrations.

At the industrial level, there is a particularly evident increase in the non-performing loan ratios of the steel trade and photovoltaic industry, with some photovoltaic and steel trade industry non-performing loan ratios of individual banks at even higher than 15\%.\(^2\) Specifically, PV industry enterprises generally faced overcapacity and PV prices had fallen sharply so that most companies cannot realize profitability. Enterprises related to the anti-dumping investigation launched by the United States and Europe on domestic photovoltaic enterprises were facing increased difficulties. The Chinese steel trade industry is currently in a period of oversupply. Although there were approximately 200 thousand steel trade enterprises in 2012, the scale of operations was very small, with the proportion of private enterprises at more than 95\% because the object of steel trade enterprise services was singular, industrial barriers to entry were low, and as such, the industry was prone to risks.

At the geographic level, credit risks were primarily reflected in the Yangtze River Delta, Pearl River Delta and other SME-dense regions. As for the Yangtze River Delta, and according to the statistics of the Jiangsu Provincial High Court, 2012 had witnessed over 847 cases of business failures and fraud which involved bank loans and other finances submitted to the High Court, at a total amount of RMB 12 billion. Along with the bankruptcies and halted production of some enterprises, the non-performing loan ratio of local banks had also continued to rise rapidly. The Bank of Wenzhou’s non-performing loan ratio had risen from 0.99\% at the end of 2011 to 1.72\% by June 2012, and provincially, the non-performing loan ratio of Zhejiang Province had risen to 1.58\% in the first 11 months of 2012, an increase of 0.66 percentage points from the beginning of the year. Non-performing loans amounted to RMB93,561 million, an increase of RMB44,421 million from the beginning of the year. Special mention loans amounted to RMB210,761 million, an increase of RMB25,927 million from the previous year.\(^3\) Moreover, a large number of non-financial institutions, driven by profit, had left their primary business operations and engaged in a large volume of high-interest, short-term financing and other such activities, seriously interfering with the order of finances, and as soon as the liquidity chain breaks, such behavior will inevitably lead to large-scale economic turbulence.

Furthermore, the fragile credit relationships between SMEs and banks will gradually weaken with a decline in corporate performance, and may even collapse altogether. When the internal and external factors of SME performance decline, banks will naturally pay greater attention to these enterprises and reduce their expectations for timely repayment, however, when the commercial banks’ actual amount of non-performing loans actually increase, they will further deepen the credit crunch. This in turn will further stretch the already scarce cash flows of SMEs, their performance will further decline, leading them to seek civil usury loans, and further amplifying credit risks and default risks. If this vicious cycle continues, SMEs and some related

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\(^1\) The potential non-performing loan ratio refers to the sum of non-performing loans that have already been published and the potential non-performing loans of enterprises with excess capacity and reduced profitability.


\(^3\) “Addressing Non-Performing Loan Ratios”, Economy & Nation Weekly, January 5, 2013.
small and medium banks will face the risk of failure.

Additionally, according to the statistical results of the “Questionnaire on Small and Micro-Enterprise Financial Service Managers of Commercial Banks” launched by the Mintai Institute of Finance and Banking (CUFE) in April 2013, over 90% of respondents believed that MSE loan risks in 2012 were higher than in 2011, and more than 60% of the respondent’s non-performing MSE loan ratios increased, while nearly 30% of respondents believed that risks could be controlled completely and remained low. In addition, it is worth noting that there was a generally negative bias towards the MSE lending risks of 2013 compared to 2012, and 90% of respondents believed that risks would increase. In 2013, the balance between the expansion of micro-financing and risk management will be no small challenge for all persons engaged in SME financial services. We also look forward to those “good” institutions which can withstand the tests of the “poor” market environment and eventually come to the fore.
3. Rural Finance: On the Frontier of Exploration

After many years of development, China has been forming a rural financial system made up of banking financial institutions, non-banking financial institutions, and other institutions, which are multi-layered and cover a wide range of rural areas. These institutions have differentiated functions and cooperate with each other while keeping in moderate competition, making rural financial services more easily available. As the main force of rural financial services, rural small and medium financial institutions have been establishing more branches and giving more loans than ever before, making rural financial services truly beneficial to everyone involved. Thus, these institutions are an important source of power for China’s urbanization.

3.1 Sustainable Development of Rural Small and Medium Financial Institutions

3.1.1 Comprehensive Growth of Rural Small and Medium Financial Institutions

In 2012, rural small and medium financial institutions maintained steady development, better performing their duties of serving agricultural, farming, and rural areas. The total assets of rural small and medium financial institutions in 2012 were RMB15,963.2 billion, representing an increase of RMB2,927.8 billion or 22.46% over the end of 2010 (RMB13,035.4 billion). The growth rate was 1.41 percentage points higher than 21.05% in 2011 (see Figure 3-1). Figure 3-2 displays the change in the proportion of total assets of rural small and medium financial institutions to the total assets of banking financial institutions. From 2009 to 2012, the proportion was 10.90%, 11.30%, 11.51% and 11.95, respectively. Though there wasn’t any large change, the proportion increased consistently. Within the rural small and medium financial institutions, the proportion of assets of rural cooperative financial institutions declined from 98.65% in 2011 to 97.17%, and the proportion of assets of new rural financial institutions increased from 1.35% in 2011 to 2.83% (see Fig.3-3).

**Fig. 3-1 Total Assets of Rural Small and Medium Financial Institutions (2009-2012)**

Source: Calculated from the China Banking Regulatory Commission 2012 Annual Report and relevant data.

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1 Rural small and medium financial institutions include rural cooperative financial institutions and new rural financial institutions. Rural cooperative financial institutions include rural credit cooperatives, rural commercial banks and rural cooperative banks. New rural financial institutions include village and town banks (VTBs), loan companies and rural mutual cooperatives.

2 As disclosed in the China Banking Regulatory Commission 2012 Annual Report, at the end of 2012, rural cooperative financial institutions had total assets of RMB15,512.1 billion. New rural financial institutions and postal saving banks had total assets of RMB5,351.1 billion. Also, as disclosed in the news on the Postal Saving Bank’s official website, as at the end of 2012, Postal Saving Bank had total assets of RMB4.9 trillion. On such basis, we can conclude that the total assets of rural small and medium financial institutions at the end of 2012 amounted to RMB15,963.2 billion.
3.1.2 Continued Promotion of Rural Cooperative Financial Institution Reforms

In 2012, much progress was made in the reform\(^1\) of rural cooperative financial institutions. The number of rural credit cooperatives and rural cooperative banks continued to decrease, dropping by 338 and 43, respectively, compared to 2011. The number of rural commercial banks maintained a rapid increase, adding 125 banks at a rate of 58.96\(^2\), reaching 337 at the end of 2012.

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\(^1\) With the publication of the *Guidelines for Accelerating Stock Right Reform of Rural Financial Institutions in 2010*, the CBRC officially set the direction for the shareholding reform of rural credit cooperatives, and gradually formulated related policies to push the transition from qualification shares to investment shares and to support the establishment of the rural commercial banks or rural credit cooperatives of shareholding system. It’s expected that, prior to 2015, all qualification shares of rural credit cooperatives will have been canceled, and qualified rural credit cooperatives are encouraged to transform into rural commercial banks. No more new rural credit cooperatives will be established, and current rural cooperative banks will all be transformed into rural commercial banks.

\(^2\) The data is quoted from the *China Banking Regulatory Commission 2012 Annual Report*. 

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Fig. 3-2 Proportion of Total Assets of Rural Small and Medium Financial Institutions to Total Assets of Banking Financial Institutions (2009-2012)

Source: Calculated from the *China Banking Regulatory Commission 2012 Annual Report* and relevant data.

Fig. 3-3 Composition of Internal Assets of Rural Small and Medium Financial Institutions (2009-2012)
Table 3-1 Change in the Number of Rural Cooperative Financial Institutions

<table>
<thead>
<tr>
<th>Year</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural Credit Cooperatives</td>
<td>8,348</td>
<td>4,965</td>
<td>3,056</td>
<td>2,646</td>
<td>2,265</td>
<td>1,927</td>
</tr>
<tr>
<td>Rural Commercial Banks</td>
<td>17</td>
<td>22</td>
<td>43</td>
<td>85</td>
<td>212</td>
<td>337</td>
</tr>
<tr>
<td>Rural Cooperative Banks</td>
<td>113</td>
<td>163</td>
<td>196</td>
<td>223</td>
<td>190</td>
<td>147</td>
</tr>
</tbody>
</table>

Source: China Banking Regulatory Commission annual reports, 2007-2012.

In terms of asset proportion, as of the end of 2012, although the number of rural commercial banking institutions only accounted for 13.98% of total rural financial institutions, the proportion of their assets, compared to total assets, was as high as 40.45%, 7.38 percentage points higher than that at the end of 2011. Also, the proportions of rural cooperative banks and rural credit cooperatives continued to decline to 8.27% and 51.27%, respectively, at the end of 2012 (see Figure 3-4).

Fig. 3-4 Asset Structure of Rural Cooperative Financial Institutions (2005-2012)

Source: Calculated from the China Banking Regulatory Commission 2012 Annual Report and relevant data.

3.1.3 Unilateral Development of New Rural Financial Institutions

As of the end of 2012, 250 banking financial institutions nationwide had established a total of 939 new rural financial institutions, consisting of 876 VTBs (800 had already opened for business), 14 loan companies, and 49 rural mutual cooperatives (see Figure...
Altogether, there were 1,496 operative outlets of new rural financial institutions nationwide (1,433 VTB branches, 14 loan companies, and 49 rural mutual cooperatives). 

![Fig. 3-5 Number of New Rural Financial Institutions (2007-2012)](image)

**Source:** China Banking Regulatory Commission 2012 Annual Report

In terms of the numbers of the three types of institutions, VTBs developed much better than the other two kinds of institutions, and had become the true force of new rural financial institutions. The number of VTBs continued to increase, however the rate of growth is declining sharply. There were 876 VTBs in 2012, 150 more than the 726 banks in 2011. This represented a growth rate of 20.66%, although such rate in 2011 was 108.02%.

Compared to the rapidly developing VTBs, the other two new rural financial institutions, i.e. rural mutual cooperatives and loan companies, had almost stopped developing. Based on the five year development of rural mutual cooperatives, after the transitory rapid increase in 2010, the growth rate of a number of rural mutual cooperatives had decreased rapidly. In 2012, it only increased by 3 cooperatives. The development of loan companies was even slower. In 2010 and 2011, only one loan company was newly established, respectively. In 2012, the four new loan companies were all established on December 31, 2012.

Although the development of loan companies and rural mutual cooperatives was slow, the rapid development of VTBs in 2012 guaranteed the rapid increase of the total assets of new rural financial institutions. As of the end of 2012, total assets were RMB451.1 billion.

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2 “Nationwide 876 VTBs Established By the End of Last Year, 800 Ones Started Business”, China Financial Network Comprehensive, April 25, 2013.
3 Loan companies must be established by domestic commercial banks or rural cooperative banks, as “credit-only” non-banking financial institutions. In contrast, micro-credit companies may be invested in by natural persons, legal persons and other social organizations as an independent legal entity. Given the current state of development of these two types of institutions, domestic commercial banks have been less active in establishing loan companies, and the development of loan companies has lagged far behind that of micro-credit companies.
4 According to data disclosed in the China Banking Regulatory Commission 2012 Annual Report, as of the end of 2012, the total assets of new rural financial institutions and postal savings banks amounted to RMB 5,351.1 billion; moreover, according to news disclosed by the official website of Postal Savings Bank, bank-wide assets had reached a scale of RMB4.9 trillion. Accordingly, the projected asset volume for new rural financial institutions at the end of 2012 was RMB451.1 billion.
billion, recording an increase of RMB275.6 billion from RMB175.5 billion in 2011, with a growth rate of 157.04% (see Figure 3-6). Of which, the total assets of VTBs opened were RMB434.31\textsuperscript{1} billion, accounting for 96.28% of the total assets of new rural financial institutions.

![Asset Scale of New Rural Financial Institutions (2009-2012)](image)

**Fig. 3-6 Asset Scale of New Rural Financial Institutions (2009-2012)**

Source: Data from 2009 to 2011 is quoted from the China Banking Regulatory Commission annual reports (2009-2011). The 2012 data is calculated based on related data disclosed.

### 3.2 Growth in Both Agro-related Loans and SME Loans

#### 3.2.1 Growth in Agro-related Loans and Loans to Farmers

As of the end of 2012, the agro-related loan\textsuperscript{2} balance of banking financial institutions was RMB17,622.7 billion, accounting for 26.20% of total loans. This represented an increase of 20.70% on a year-on-year basis, 5.60 percentage points higher than the average increase rate of all loans, and more agro-related loans will be issued continuously\textsuperscript{3}. The agro-related loan balance of rural cooperative financial institutions was RMB 5,343,546 million (accounting for 30.32% of the total agro-related loan balance of banking financial institutions), and the balance of loans to farmers was RMB2,640,743 million (accounting for 72.96% of the balance of loans to farmers of the banking sector), an increase of 16.01% and 12.64%, respectively. The agro-related loan balance and the balance of loans to farmers took up 68.13% and 33.67%\textsuperscript{4}, respectively, of the loan balance of all rural cooperative financial institutions (RMB7,843.1 billion).

\textsuperscript{1} Data quoted from the *Report on Rural Chinese Financial Services (2012)*.

\textsuperscript{2} In terms of loan-taking entities, agro-related loans are divided into individual agro-related loans, enterprise agro-related loans, and non-enterprise agro-related loans. Of which, individual agro-related loans include loans to farmers and loans to non-farmer individuals in the farming, forestry, animal husbandry, sideline production, and fishing industries.

\textsuperscript{3} Data quoted from the *China Banking Regulatory Commission 2012 Annual Report*.

\textsuperscript{4} Data quoted from the *Report on Rural Chinese Financial Services (2012)*.
Additionally, as of the end of 2012, the total loan balance of new rural financial institutions was RMB234.7 billion, among which the balance of loans to farmers was RMB86.1 billion, representing an increase of RMB42.45 billion or 97.47% as compared to the end of 2011 (see Figure 3-8). The balance of loans to farmers took up 36.64% of the total loan balance, among which the balance of VTBs’ loans to farmers was RMB84.82 billion.

3.2.2 Increase of SME Loans

Rural cooperative financial institutions enjoyed a steady growth in SME loans in every
province. Based on the comparison of the growth rate of SME loans and total loan balance, most provinces actively responded to the CBRC’s “two not-less-thans”\(^1\) requirement on SMEs. The SME loan growth rates of rural cooperative financial institutions in Jiangxi, Guangxi, Shanxi, and Hebei were all 10 percentage points higher than the average growth rates of all other loans. In Shandong, Sichuan, Henan, Guizhou, and Yunnan, the rates were slightly higher than average; in Jiangsu, Chongqing, Fujian, and Hainan, the rates did not exceed the average growth rate (see Figure 3-9).

In terms of the SME loan balance of rural cooperative financial institutions, as of the end of 2012, rural cooperative financial institutions in Jiangsu had a total SME loan balance of RMB447 billion, accounting for 15.80% of the total banking industry in that province and ranking first among all provinces. Additionally, the balance was also considerable in Shandong, Sichuan, and Hebei, with RMB300.6 billion, RMB257.7 billion, and RMB232.3 billion, respectively. In Yunnan, Chongqing, Jiangxi, Fujian, and Hainan, the balance was relatively small, less than RMB100 billion (see Figure 3-10).

![Fig. 3-9 Growth Rates of SME Loans and Total Loans of Rural Cooperative Financial Institutions in Some Provinces (2012)](image)

**Source:** Websites of provincial rural credit cooperatives, 2012 Annual Report of Municipal Rural Commercial Banks, China Rural Finance Network, China Finance Net, and NASDAQ: JRJC.

**Notes:** (1) As there was no uniform standard when provincial rural credit cooperatives published indexes as at the end of 2012, the statistic standards of different provinces listed here varied. The MSE loan balance was used for Sichuan, Hebei, and Guangxi, the MSME loan balance was used for Jiangxi and Yunnan, and the SME loan balance was used for the other provinces.

(2) Guangxi data was as at the end of November 2012.

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\(^1\) Namely, the increment shall not be less than the one of last year and the growth rate shall not be less than the average growth rate of total loans in the year.
As of the end of 2012, the small enterprise loan balance of new rural financial institutions was RMB112.1 billion, representing an increase of RMB50.1 billion compared to the end of 2011. This growth rate reached 80.81%, and the small enterprise loan balance accounted for 47.76% of the total loan balance (see Figure 3-11). The small enterprise loan balance for VTBs opened was RMB111.8 billion. The balance of loans to farmers and small enterprise loans together accounted for 84.40%¹ of the balance of all new rural financial institution loans.

3.3 Concerns about the Growth of New Rural Financial Institutions

In 2009, the CBRC published the Work Arrangement for New Rural Financial Institutions from 2009 to 2011, which planned to establish 1,294 new rural financial institutions in the 35 provinces nationwide during that period, consisting of 1,027 VTBs, 106 loan companies, and 161 rural mutual cooperatives. Its original purpose was to fill the gap of rural financial services, and to enrich services for agriculture, farmers, and rural areas. However, their development results were not as satisfactory as expected. As of the end of 2012, there were 863 rural financial institutions opened, accounting for only two thirds of that in the three-year plan for 2009, and the development of rural mutual cooperatives and loan companies was also barely satisfactory.

3.3.1 Insufficient Outlets of VTBs for Actual Demands

Whether in terms of total assets or the scale of deposits and loans, VTBs are the real impulse of new rural financial institutions. At the end of 2012, VTBs established a total of 1,443 operating outlets\(^1\) nationwide, 515 more than the 918 branches in 2011, reaching a growth rate of 56.10%. The growth rate was slowed down to some extent, decreasing from 148.13% in 2010 to 56.01% in 2012 (see Figure 3-12). Even though the VTB operating outlets had covered an increasingly wide range after five years of development, the number, compared to the 40,466\(^2\), townships nationwide, was still quite insufficient.

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\(^1\) Relevant data was obtained from the statistics of the financial license query system on the CBRC website, which was slightly different from the 1,427 outlets stated in the 2012 Report on Rural Chinese Financial Services. Outlets herein include head offices, sub-branches, agencies, and management stations.

\(^2\) Data quoted from the China Statistical Yearbook 2012.
Furthermore, the limited number of VTBs was not evenly distributed across the different provinces. In some provinces, they developed very quickly, while in other provinces, there were only a few VTBs. For example, there were over 100 VTBs in each of the four provinces including Sichuan, Liaoning, Zhejiang and Henan, but there were no VTBs in Tibet and only one in Qinghai. The development of VTBs in these two areas was far behind that of other provinces.

In terms of the regional distribution of VTBs, the number of VTB outlets established in Central China, Western China, and Eastern China was 441, 452 and 540, respectively, with respective proportions of 30.77%, 31.54% and 37.68% (see Figure 3-13).

Note: Western China includes 12 provincial administrative regions: Sichuan, Chongqing, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang, Guangxi and Inner Mongolia; Central China includes 8 provincial administrative regions: Shanxi, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei and Hunan; Eastern China includes 11 provinces (municipalities): Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong and Hainan.
Factors such as limited numbers, an imbalanced distribution, and VTBs not located in villages and towns, have made it difficult for VTBs or even new rural financial institutions to serve the original purpose of filling gaps in rural financial services and thereby stimulating the rural financial market and improving its efficiency. They still have a long way to go.

### 3.3.2 VTBs Not Located in Villages and Towns

VTBs were established to address the financial deficiencies of rural areas and inadequacies of rural financial services, aiming to serve agricultural, farming and rural areas. However, judging from the current situation, VTBs follow a pattern of “named after villages and towns, but located in cities.” As of the end of 2012, of the 1,433 VTB branches, only 630 were located in villages and towns, accounting for 43.96% of the total (see Figure 3-14).

![Fig. 3-14 Locations of VTB Outlets](image)

**Source:** Statistics from the financial license query system on the CBRC website.

Judging from the top 10 provinces with the largest number of VTBs, there was a great difference between provinces regarding the ratio of VTBs in villages and towns. Zhejiang, Inner Mongolia, Guangxi, and Sichuan ranked in the top four, with respective ratios of 66.36%, 66.22%, 65.33% and 62.83%. By contrast, Henan and Shandong, which ranked the fourth and fifth in terms of the number of outlets, only recording a ratio of 23.08% and 21.11%, respectively (see Figure 3-15).

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1 We define the “ratio of VTBs in villages and towns” of a certain province as the ratio of the number of VTBs located in villages and towns to the total number of VTBs in that province.
On the whole, the national ratio of VTBs in villages and towns was still low. In some provinces, the “VTBs not in villages and towns” phenomenon had grown out of hand. However, judging from general trends, this ratio had only increased so slightly since 2010. As of the end of 2012, the ratio increased from 39.66% in 2010 to 43.96%, with an increase of 4.30 percentage points.

There are objective reasons for the VTBs “not in villages and towns” situation. Due to the restriction of VTB initiating bank, VTBs, to some extent, are exogenous financial institutions. Under current market conditions, commercial banks have strong
motivations of “enclosing”. Setting up a VTB shall be consistent with the interest orientation of the major initiating bank. Farmers and MSEs don’t have enough collateral and anti-risk capacities. The cost of small, decentralized loan management is relatively high, and in consideration of profitability objectives, there is a lack of motivation for sponsoring investments in rural markets. Additionally, there is a definite gap between the financial strength and social awareness of VTBs and that of traditional commercial banks and rural credit cooperatives. The addition of a narrower scope of business, an imperfect means of payment and settlement and various other factors have brought about tremendous pressure, which has also had an impact on their development.

3.3.3 Straightjacket Yet to Be Loosened for VTB Initiators

The Temporary Regulations on VTB Management (Y.J.F. [2007] No. 5), published by the CBRC in 2007, stipulated that the biggest, or the only, shareholder of VTBs shall be banking financial institutions, and the shareholding ratio of the largest banking financial institutions shall be no less than 20% of the total share capital of the VTBs.

However, judging from the fact that the current pace of VTB establishments by the big five state-owned commercial banks, as of the end of 2012, ICBC, ABC, BOC, CCB and BOCOM established a total of 56 VTBs (accounting for 7% of the total VTBs opened), with 12 new VTBs in 2012. Clearly, the big five state-owned commercial banks were not enthusiastic about establishing VTBs.

In comparison, joint-stock commercial banks and urban commercial banks were more active. With the support and encouragement of related policies, some joint-stock commercial banks generated a new enthusiasm for the large-scale establishment of VTBs. As of the end of 2012, SPDB had 21 VTBs across the country, with \(^9\) new VTBs in 2012 alone; CMBC established 27 VTBs, with \(^9\) new VTBs in 2012 alone. Shanghai Rural Commercial Bank established 32 VTBs\(^3\) in Shandong, Yunnan and Hunan in 2012.

As a whole, conventional commercial banks lack enthusiasm for establishing VTBs, and their motivations are not pure. Some medium and large commercial banks use this as a way to increase their network distribution, which causes VTBs to deviate from their targeted goal of supporting small enterprises and serving agriculture: VTBs are now working more as an institution of commercial banks, copying the business pattern of the initiating banks, instead of locating in rural areas and supporting small enterprises and serving agriculture.

On May 26, 2012, the CBRC published the Instructions of China Banking Regulatory Commission for Encouraging and Guiding Private Capital Flowing into the Banking Industry, which stated that private capital shall obey the same rules as other capital in flowing into the banking industry, and private capital was encouraged to join the establishment and equity capital increase of VTBs. Also, the minimum shareholding ratio of initiating banks was decreased from 20% to 15%. As can be seen, although the proportion has decreased, there is still a straightjacket on initiators; it remains to be seen for private capital to flow into banking industry and for VTBs to be truly independent entities.

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1 "Total Assets of SPDB’s VTBs Top RMB20 Billion", official website of SPDB, February 28, 2013.
2 Data quoted from the Minsheng Bank 2012 Annual Report
3 Data quoted from news on the official website of Shanghai Rural Commercial Bank
3.3.4 Insufficient Endogenous Rural Financial Institutions

An insufficient financial supply and inadequate competition in rural areas have been a serious problem, inhibiting China’s economic development. The characteristic of the “society of acquaintances” in China’s rural areas determines that cooperative and mutually beneficial endogenous rural financial institutions are needed for rural financial services. Rural mutual cooperatives are set up voluntarily by villages and towns, administrative farmers, and rural SMEs, offering such services as deposits, loans, and settlements for members. They are mutually beneficial, and there are lower establishing restrictions. Thus, they are closer to farmers and are true, endogenous micro financial cooperative organizations.

However, realistically speaking, as of the end of 2012, only 49 rural mutual cooperatives had been established nationwide, and their performance was not as expected. Unlike the slow development of formal rural mutual cooperatives approved by the CBRC, rural mutual cooperatives, established by farmers and private capital, emerged one after another. It’s estimated that there are at least over 1,000 unlicensed mutual cooperatives\(^1\), and their development has varied. This shows that there are conflicts between the demand of rural areas for practical mutual cooperatives and the over-restrictive approval of the CBRC.

Currently, rural mutual cooperatives are in a dilemma. On the one hand, restrictive regulatory standards and barriers to entry make it difficult for them to develop. On the other hand, as informal mutual cooperatives outside the system are growing increasingly larger, so are their potential risks. In fact, the characteristics of endogeneity make rural mutual cooperatives efficient in risk management by relying on the mechanism of sufficient social capital, interconnected contracts and social collaterals. To relax entry barriers and regulatory requirements in a reasonable manner is not only beneficial for the development of current formal mutual cooperatives, but also good for adopting informal mutual cooperatives into the regulatory framework so as to guarantee their healthy development. Furthermore, enhancing the cooperation between informal financial organizations like endogenous financial institutions and formal financial organizations\(^2\) like commercial banks, is of great importance to broaden the financing channels of rural mutual cooperatives and maintain sustainable development.

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1 “Inadequate Credit Supply, Rural Credit Unions Struggle to Survive”, *Innovative Finance Observation*, January 09, 2013.
4. Micro-Credit Companies: Continued Growth under Regulations

In 2012, the miro-credit industry maintained rapid development. Various kinds of institutions competed in the miro-credit market, depending on their own advantages. After listed companies joined the miro-credit industry in 2011, e-commerce platforms participated actively, offering supply chain financial services by taking full advantage of their information superiority. Meanwhile, miro-credit companies continued to serve MSMEs, innovating new financing methods and inputting capital into SMEs. However, it should be noted that problems of the miro-credit industry gradually emerged in 2012, and there are no substantial solutions for the problems such as uncertain development directions, difficulty in introducing credit systems, salaries and welfare. In addition, as regulations tighten, competition will grow and profits will decrease. There will be challenges for the development of the miro-credit industry, and even a “reshuffle” or “exit tide” after rapid expansion.

4.1 Steady Development of the Miro-credit Industry

In 2012, miro-credit companies enjoyed steady growth and achieved better results in all indexes. The rapid increase in the number of companies, paid-in capital and loan balance were maintained compared to the previous year, and the scale of the industry continued to expand. As of the end of 2012, there were 6,080 miro-credit companies, 2,000 more than that at the end of 2011, with a growth rate of 41.99%. Affected by the base number, the increase rate was 21.82 percentage points lower than 63.81% in 2011, the lowest rate out of the last four years (see Figure 4-1). In 2012, the paid-in capital of miro-credit companies was RMB514,697 million, representing a year-on-year increase of RMB182,831 million or 55.09%, 31.25 percentage points lower than 86.34% in 2011 (see Figure 4-2); the loan balance was RMB529,138 million, representing a year-on-year increase of RMB200,664 billion or 51.26%, 146.94 percentage points lower than 198.20% in 2011 (see Figure 4-3). Meanwhile, although it’s undeniable that the miro-credit industry maintained rapid growth, the total loan balance was only as large as 15% of the SME loan balance of ICBC, making little difference in the entire financial system.

![Fig. 4-1 Number and Growth Rate of Miro-credit Companies Nationwide (2008-2012)](image)

Sources: (1) Source for 2012: “2012 Questionnaire on Miro-credit Companies by Region”, People’s Bank of China, February 1, 2013.

(2) Source for 2011: “2011 Questionnaire on Miro-credit Companies by Region”, People’s Bank of China, February
Fig. 4-2 Paid-in Capital of Miro-credit Companies Nationwide (2010-2012)

Sources: (1) Source for 2012: “2012 Questionnaire on Miro-credit Companies by Region”, People’s Bank of China, February 1, 2013.

Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region”, the “2011 Questionnaire on Miro-credit Companies by Region”, the “2010 Questionnaire on Miro-credit Companies by Region”, and the “2009 Questionnaire on Miro-credit Companies by Region”.

Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region”, the “2011 Questionnaire on Miro-credit Companies by Region”, the “2010 Questionnaire on Miro-credit Companies by Region”, and the “2009 Questionnaire on Miro-credit Companies by Region”.

20, 2012.


Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region”, the “2011 Questionnaire on Miro-credit Companies by Region”, the “2010 Questionnaire on Miro-credit Companies by Region”, and the “2009 Questionnaire on Miro-credit Companies by Region”.

(Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region”, the “2011 Questionnaire on Miro-credit Companies by Region”, the “2010 Questionnaire on Miro-credit Companies by Region”, and the “2009 Questionnaire on Miro-credit Companies by Region”.)
The quantitative distribution of miro-credit companies remained relatively concentrated. The number of miro-credit companies located in six regions including Jiangsu, Anhui, Inner Mongolia, Liaoning, Hebei, and Yunnan accounted for 40% of the total number nationwide (see Figure 4-4). The provinces that had seen the biggest increase in the number of miro-credit companies were Anhui, Jiangsu, Hebei and Liaoning, accounting for a third of the total increase nationwide (see Figure 4-5).

Fig. 4-4 Quantitative Distribution of Miro-credit Companies in Different Regions (2011-2012)
Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region” and the “2011 Questionnaire on Miro-credit Companies by Region”.

Fig. 4-3 Loan Balances of Miro-credit Companies Nationwide (2009-2012)
Sources: (1) Source for 2012: “2012 Questionnaire on Miro-credit Companies by Region”, People’s Bank of China, February 1, 2013.
Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region”, the “2011 Questionnaire on Miro-credit Companies by Region” and the “2010 Questionnaire on Miro-credit Companies by Region”.

The quantitative distribution of miro-credit companies remained relatively concentrated. The number of miro-credit companies located in six regions including Jiangsu, Anhui, Inner Mongolia, Liaoning, Hebei, and Yunnan accounted for 40% of the total number nationwide (see Figure 4-4). The provinces that had seen the biggest increase in the number of miro-credit companies were Anhui, Jiangsu, Hebei and Liaoning, accounting for a third of the total increase nationwide (see Figure 4-5).

Fig. 4-4 Quantitative Distribution of Miro-credit Companies in Different Regions (2011-2012)
Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region” and the “2011 Questionnaire on Miro-credit Companies by Region”.
As of the end of 2012, the loan balance of miro-credit companies in 19 regions was over RMB10 billion, 6 loan items more than 2011. The loan balance in Jiangsu, Zhejiang, Inner Mongolia, Shandong, Anhui, and Chongqing was over RMB30 billion, while Jiangsu, at the top of the list, had a balance of over RMB100 billion, nearly the sum of both in Zhejiang and Inner Mongolia (see Figure 4-6). The loan balance distribution of miro-credit companies was relatively concentrated: the sum of loan balances in the top six regions, including Jiangsu, Zhejiang, Inner Mongolia, Shandong, Anhui, and Chongqing, accounted for more than 50% of the total loan balance of miro-credit companies nationwide (see Figure 4-7).

Fig. 4-5 Incremental Distribution of Miro-credit Companies in Different Regions (2011-2012)

Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region” and the “2011 Questionnaire on Miro-credit Companies by Region”.

Fig. 4-6 Ranking of Loan Balances of Miro-credit Companies in Different Regions (2010-2012)

Sources: (1) Source for 2012: “2012 Questionnaire on Miro-credit Companies by Region”, People’s Bank of China, February 1, 2013.
4.2 Miro-credit actively Serve MSEs

Since the start of 2012, provincial financial offices published data on the loan direction of miro-credit companies, successively. Miro-credit companies in Jiangsu, Liaoning, Shanghai, Sichuan, and Hebei accounted for more than 50% of their loans to MSEs, individual businesses and farmers. It’s worth noting that the loan balance of miro-credit companies in Sichuan issued to farmers, individual businesses, town folk, and MSEs accounted for 99.07% of the total provincial loan balance. As of November 2012, the loan balance of miro-credit companies in Jiangsu issued to “agriculture, farmers, and rural areas” and MSEs in counties and high-tech parks accounted for 98% of the total provincial loan balance. To our delight, from the start of 2012, provincial financial offices published data on the loan direction of miro-credit companies, providing detailed explanations as to the data from loans given to “agriculture, farmers and rural areas,” MSEs, and individual business. This shows that local regulatory authorities want to guide miro-credit companies to target “agriculture, farmers and rural areas”, MSEs, and individual business as key clients, so as to regulate the market behavior of miro-credit companies and make them become “timely help” for “agriculture, farmers and rural areas”, MSEs, and individual businesses. According to the data of the China Microfinance Institution Association, as of the end of October 2012, the loan balance and the number of loans granted to individual businesses and MSEs by the top 100 miro-credit companies\(^1\) accounted for 54.52% and 42.95% of the total, respectively, 1.61 percentage points and 10.83 percentage points higher than the end of 2011 (see Figure 4-8).

\(\text{Fig. 4-7 Proportional Distribution of Loan Balances of Miro-credit Companies in Different Regions (2010-2012)}\)

Note: The line chart is extracted and calculated from the “2012 Questionnaire on Miro-credit Companies by Region” and the “2011 Questionnaire on Miro-credit Companies by Region”.

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\(\text{1 Relevant information on the national top 100 miro-credit companies comes from the China Microfinance Institution Association.}\)
In terms of the loan balance of the top 100 micro-credit companies, 22 companies had issued more than 80% of loans to individual business and MSEs, while 62 companies had a proportion of 40%, 9 more companies than that in 2011; 24 companies had less than 20%, nearly equal that in 2011 (see Figure 4-9). In terms of the number of loans, 41 companies had over 40% of the total issued to individual business and MSEs, on par with 2011 (see Figure 4-10).

**Fig. 4-8 Proportion of Loan Balance and Number of Loans Granted to Individual Businesses and MSEs by Top 100 Micro-credit Companies (2011-2012)**

Source: Statistics are from the China Microfinance Institution Association.

Note: In the statistics from the China Microfinance Institution Association, 96 of the top 100 micro-credit companies reported data of loans granted to MSEs in 2011, and 98 did so in 2012. The data in 2012 is of these micro-credit companies from January through October.
reported data of loans granted to MSEs in 2011, and 98 did so in 2012. The data in 2012 is of these miro-credit companies from January through October.

**Fig. 4-10 Proportion of Number of Loans Granted to Individual Businesses and MSEs by Top 100 Miro-credit Companies (2011-2012)**

Source: Statistics are from the China Microfinance Institution Association.

Note: In the statistics of the China Microfinance Institution Association, 96 of the Top 100 miro-credit companies reported data of loans granted to MSEs in 2011, and 98 did so in 2012. The data in 2012 is of these miro-credit companies from January through October.

In terms of accumulated loan volumes, among the top 100 miro-credit companies, 15 companies had issued more than 90% of their accumulated loans to individual businesses and MSEs, while 57 companies had issued more than 40%, as of October 2012. In terms of the accumulated number of loans, 8 companies had issued over 80% of the accumulated number of loans to individual businesses and MSEs, while more than 50 companies had over 40%, and 28 companies had less than 20% (see Figure 4-11).
Fig. 4-11 Proportion of Accumulated Loans and Number of Loans Granted to Individual Businesses and MSEs by Top 100 Miro-credit Companies (2012)

Source: Statistics are from the China Microfinance Institution Association.

Note: In the statistics from the China Microfinance Institution Association, 98 of the Top 100 miro-credit companies reported data of loans granted to MSEs in 2012. Of the 98 companies, all of them reported the accumulated balance of loans granted to individual businesses and MSEs, and 97 reported accumulated numbers of such loans. The data in 2012 is of these miro-credit companies from January to October.

In terms of the average loan balance, as of October 2012, the average loan balance of the top 100 miro-credit companies for individual business, micro-enterprises, and small enterprises was RMB1,029.4 thousand, RMB1,663.7 thousand and RMB3,251.4 thousand, respectively. Compared to 2011, only the average loan balance for individual business decreased by RMB99.5 thousand; the average loan balance for micro-enterprises and small enterprises increased by RMB303 thousand and RMB384.8 thousand, respectively (see Figure 4-12). In terms of the average loan issuance, the average loans issued to individual businesses, micro-enterprises, and small enterprises were RMB1,207.0 thousand, RMB1,648.4 thousand and RMB3,362.7 thousand, respectively (see Figure 4-13).
It can be seen from the above statistics that more than half of the top 100 miro-credit companies were invested in MSE financial services, among which more than 20% of them invested more than 80% of their funds into MSE financial services. However,
some miro-credit companies do not have clear positioning for MSE financial services, and the large volume of average loans is also a cause for debate. Under current circumstances, miro-credit companies must reduce costs and improve their capability in risk control and techniques for micro-loans to lower the single loan volume so as to ameliorate the MSE financial service.

4.3 Various Miro-credit Companies Compete in the Miro-credit Market

4.3.1 Listed Companies’ Investment in Miro-credit Businesses Reach New Heights

According to incomplete statistics, as of the end of December 2012, there were, altogether, more than 100 listed companies investing or holding shares in miro-credit companies. In 2012 alone, there were 43 listed companies establishing more than 40 new miro-credit companies, with RMB9,514 million worth of capital involved, much larger than that of 2011 in both quantity and amount.

In 2012, the number of listed companies in Mainland China entering the miro-credit field reached new heights. According to statistics from the reports of listed companies, since January 2012, there have been 43 listed companies in Mainland China announcing that they will establish miro-credit companies. In addition, some listed companies have announced plans to increase their capital and shares in miro-credit companies held.

Three financial holding companies listed in Hong Kong continued to expand the miro-credit market in Mainland China in 2012. China Financial International (00721.HK) and Goldbond Group (00172.HK) established or held shares to establish miro-credit companies in 2012. China Financial International (00721.HK) invested or held shares in 13 miro-credit companies, with RMB120 million involved, far less than RMB832 million of last year.

The major motivations for listed companies to hold shares in miro-credit companies are as follows. First, listed companies are optimistic about the outlook and profit of miro-credit companies, and hope to seek new growth by setting up miro-credit companies, especially in Jiangsu and Zhejiang where there are many SMEs. As companies in these regions have a high demand for financing, and the government supports them, this will help listed companies create “micro-credit concept stock”. Second, it helps to handle the financial problems, such as the long period of capital returns, the inefficient use of capital and the natural flow of self-owned money failing to satisfy normal demand of the upstream and downstream enterprises in the supply chain. As a result, there is room for mutual benefit between these listed companies and their suppliers. Third, it shows the social responsibility of listed companies. By setting up miro-credit companies, listed companies can, in the short term, raise stock prices, and in the long term, increase their profits. Listed companies compete in the miro-credit business, leading to a sharp increase in the number of miro-credit companies, which is good news for SME financing. As there is more competition, the loan rate will decrease and more capital will be supplied, leading to a decrease in SME financing costs, which is beneficial for SME development.

4.3.2 Foreign Miro-credit Forge Ahead

Since 2012, foreign miro-credit has continued to expand, and many miro-credit companies have been set up throughout the country. As foreign miro-credit are not restricted regionally, foreign companies can use their sufficient capital to establish branches all over the country, and foreign miro-credit companies, thus, are everywhere
and have developed quickly. By establishing many branches, foreign miro-credit companies have a greater influence and a wider range of services, and can thus offer richer capital resources and more high-quality financial services.

As of June 2013, foreign companies had established miro-credit companies in 17 provinces and regions, including Guangdong, Liaoning, Sichuan, Chongqing, Hubei, Xinjiang, Shanghai, Fujian, Guangxi, Inner Mongolia, Heilongjiang, Jiangsu, Anhui, Shandong, Tianjin, Beijing and Yunnan. At present, 10 foreign enterprises have established miro-credit companies in Mainland China, including Singapore Temasek, France MicroCred S.A., International Finance Corporation, HK Value Partners, HK UA Finance and Japan AEON. Although foreign miro-credit has developed rapidly, the proportional number and scale of foreign miro-credit account for less than 1% of the Chinese miro-credit industry. It is worth noting that, despite rapid growth, foreign enterprises are still cautious about expanding into the Chinese market. On the one hand, it takes time for them to “localize” their miro-credit business experience in foreign countries. On the other hand, affected by policy factors such as the low leverage ratio and high financing costs, plus a strong awareness of risk controls, foreign miro-credit companies prefer to make profit through business innovation, risk control and corporate governance.

Foreign miro-credit companies, by taking advantage of advanced foreign MSE loan techniques and risk control mechanisms and experience accumulated in their long history of operations, can obtain their share of the profits in the competitive market. The emergence of foreign miro-credit companies not only brings energy to the entire industry but also offers models and cooperation partners for local miro-credit companies. By learning and communicating with these foreign companies, local miro-credit companies can standardize their business, improve their risk control systems and also lay the foundation for Chinese miro-credit companies to ultimately act on international convention.

4.3.3 Large e-Commerce Companies Enter Miro-credit Business

Ali Finance (platform + miro-credit company model) has been the focus of the industry since its establishment in 2010. It is not only because Alibaba wanted to enter the financial field by taking this as an opportunity, but also because Ali Finance has the special business philosophy and the unique technique on risk controlled. Relying on two miro-credit companies established by Alibaba in Hangzhou and Chongqing, Ali Finance offers MSE loan products such as Taobao (Tmall) order loans, credit loans and Ali credit loans to Alibaba platform users. As of June 2012, Ali Finance had accumulatively offered financing service to a total of 129 thousand SMEs with a total amount of over RMB26 billion, and the daily interest income exceeded RMB1 million. Furthermore, Ali Finance opens a port to all financial institutions in June 2012 to offer miro-credit services to SMEs, thereby stepping into the platform-based stage.

The rapid development of the Ali Finance miro-credit business has attracted other e-commerce business to join in actively. On November 19, 2012, Jingdong Mall, together with the BOC, jointly announced the start of supply chain financial services, offering financial services such as order financing, receivables financing and synergy investment to suppliers. Suning Appliance (002024.SZ) announced on December 6, 2012 that it had agreed that the overseas wholly-owned subsidiaries HK Suning

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Appliance Co., Ltd. and related party Suning Appliance Co., Ltd. would jointly contribute capital to establish Chongqing Suning Miro-credit Co., Ltd. (intended name). Apart from Alibaba, Jingdong and Suning, hc360.com, DHgate, and Netsun have also officially become involved in online e-commerce business loans. At present, there are six online platforms involved in the miro-credit business. Additionally, Tencent has also stated that it has considered applying for a miro-credit company license on many occasions.

With the synergy of supply chain financing, internet banking and miro-credit companies, the integration of traditional financial services, electronic platforms, information and micro-financing services have all produced significant changes on the serving pattern and service modes for MSEs.

### 4.3.4 Non-Profit Miro-credit are in Slow Development

Since 2008, China has taken active measures to promote the development of small credit loans. Commercial miro-credit companies have developed rapidly, however, because of low profit and insufficient capital, non-profit microfinance institutions as the pioneers of microcredit loans have developed slowly. At present, there are altogether just over 100 non-profit microfinance institutions, primarily established by the Rural Development Institute of the Chinese Academy of Social Sciences, the China International Center for Economic and Technical Exchanges (CICETE), the China Foundation for Poverty Alleviation (CFPA) and the All-China Women’s Federation (ACWF), of which, CFPA Microfinance is doing the best. As of October 31, 2012, CFPA Microfinance had covered 14 provinces and 59 counties, with a covered population of 24.88 million, an accumulated loan balance of RMB3.4 billion, and 126 thousand effective clients, 92.98% of whom were female, and high-risk loan rate over 30 days was only 0.33%\(^1\). Nevertheless, compared to the poor peasants all over China, it is still insufficient. Besides, CFPA Microfinance is a government institution which has no problems with capital source, so the pattern is not reproducible. For most NGO microfinance institutions, financing is still the biggest problem.

Providing appropriate financial services to poor peasants is a globally recognized problem, but high costs, risks and other such issues have made it impossible for ordinary commercial financial institutions to provide loans. Commercial miro-credit companies, driven by profits, only offer credit loan support to rich farmers and MSMEs, instead of low-income groups. Although poor peasants do not have much demand, as there is a large population in Chinese villages, the aggregate demand is quite large. Non-profit small credit loans can make up for the areas of the population which cannot be covered by banks, and help to build a multi-layer, diversified rural financial service system with moderate competition. The government should issue some special policies to support the development of non-profit small credit loans as soon as possible.

In addition to the aforementioned categories of miro-credit companies, there are also miro-credit companies established with the background of chambers of commerce, industrial zones or exchange markets. These kinds of miro-credit companies have specific directions and goals, with members of chambers of commerce and SMEs in the industrial zones and markets as a customer base, which have become unique miro-credit companies.

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4.4 Continued Innovations in Miro-credit Financing

4.4.1 Deepening the Standardized Development of Miro-credit Services of Chongqing Financial Assets Exchange

After breaking the ice on miro-credit company asset securitization in 2011, by the business suspension for rectification, Chongqing Financial Assets Exchange cancelled market maker exchange system, improved risk controls, made strict information disclosure system, and gave due diligence to the miro-credit companies issuing usufruct products in the Chongqing Financial Assets Exchange, increasingly enriching and improving asset income products of miro-credit companies. Chongqing Financial Assets Exchange also attracted guarantee companies into implementing external credit increases in 2012, providing strong guarantees for smooth asset income product transactions and interest payment of miro-credit companies. As of April 2013, there were already 37 miro-credit companies engaging in financing activities on the Chongqing Financial Assets Exchange, involving funds of RMB2 billion. As its customer base continued to expand in 2012, the Chongqing Financial Assets Exchange successfully released asset income products for miro-credit companies in Chongqing, Sichuan, Inner Mongolia and other surrounding areas. Product scales differed from RMB10 million to RMB50 million, terms were typically classified into 3 months, 6 months, 9 months, and one year, expected annual rates of return range from 6.1% to 9.0%, and all products are for directional sale.

With the improvement of various rules and regulations concerning the asset income products of miro-credit companies in the Chongqing Financial Assets Exchange and society’s increasing awareness, more and more miro-credit companies are cooperating with the Chongqing Financial Asset Exchange, thus promoting the securitization of miro-credit company assets. We predict that more such companies will adopt asset securitization through listing and trading to carry out financing. This will have an incredibly important role in mitigating the financing bottleneck of miro-credit companies, improving their asset liquidity and promoting their healthy development.

4.4.2 Diversified Miro-credit Company Financing

In 2012, policies were introduced throughout the country to enhance the proportion of miro-credit company financing. Given the difficulty these companies face in obtaining bank loans, innovative methods of financing have created a better operating environment for miro-credit companies.

In 2012, Zhejiang Province proposed to explore the issuance of SME private placement bonds by miro-credit companies and promote innovations in miro-credit company financing. Additionally, the “interbank lending adjustment among miro-credit companies” pilot program has already been tried in the Wenzhou metropolitan area. Under this method of financing, the Wenzhou Miro-credit Companies Association as a platform, collects the surplus funds available for lending of the various miro-credit companies each week, pairs idle funds with those companies in need of capital, and carries out risk monitoring through the Wenzhou Municipal Finance Office. Meanwhile, miro-credit companies also seek to cooperate with trust companies, private equity funds, third party wealth management institutions and peer-to-peer lending platforms.

Such innovative form of financing is a “double-edged sword” for miro-credit companies. While they may be able to obtain a large amount of funds, their risk factors also increase. Striking a balance between earnings and risks is likely to become a greater consideration for miro-credit companies after innovations.
5. Guarantees: A Breakthrough in Savings and Earnings

In early 2012, with the violations by Zhongdan Investment and Credit Guarantee Co., Ltd., Huading Credit Guarantee Co., Ltd. and Guangdong Chuangfu Credit Guarantee Co., Ltd. as representative risk events that frequently occur, the growth of the financing guarantees industry was slowed to some extent. To this end, a rectification and strengthened supervisions had been carried out nationwide. As for re-guarantees, the “Jiangsu” model is leading the country. Meanwhile, the emerging collateral management industry is quickly developing and is expected to propel SMEs out of their financing difficulties.

5.1 Effects of the Crisis Appear in Risk-Prone Financing Guarantee Institutions

5.1.1 Slower Growth and Adjustment of Guarantee Structure under Effects of the Crisis

Risky events frequently occurred between the end of 2011 and early 2012, as represented by the violations of Zhongdan Investment and Credit Guarantee Co., Ltd., Huading Credit Guarantee Co., Ltd. and Guangdong Chuangfu Credit Guarantee Co., Ltd. Affected by the impact of such risky events, since the second half of 2011, some banks have significantly raised access thresholds, lowered credit facility ratio, increased margin ratios, while some have even suspended new business. The number of financing guarantee institutions and the growth rate of guaranteed loan balance slowed down in 2012.

In 2012, the number of institutions in the financing guarantee industry nationwide continued to grow, with an industry-wide total of 8,590 legal entities as of the end of 2012, and even with a growth of 2.24% over 2011, the year-on-year growth significantly declined by approximately 37 percentage points (see Figure 5-1).

As of the end of 2012, the financing guarantee balance amounted to RMB1,459.6 billion, maintaining a double-digit growth of 14.51%. However, compared to the growth rate of 42.73% in 2011, the trend of rapid growth has slowed to some extent (see Figure 5-2).

The frequent occurrence of risky events has led to an impasse in the cooperation between guarantee institutions and banking institutions, the effect of which on private guarantee companies is particularly evident, as some banks have even fully suspended the cooperation with all private guarantee institutions and shifted towards state-controlled guarantee institutions. As of the end of 2012, there were a total of 1,907 state-controlled financing guarantee legal entities, accounting for 22%, at an increase of 3 percentage points compared to 2011, and a total of 6,683 private institutions and foreign-controlled institutions, accounting for 78% (see Figure 5-3).
**Fig. 5-1 Number of Financing Guarantee Institutions (2004-2012)**

(2) Data for 2010-2011 comes from the CBRC Financing Guarantee Department.

Note: The statistical standard of 2004-2009 is for “SME credit guarantee institutions”, namely, credit guarantee institutions with SMEs as the primary object of the services; the statistical standard of 2010-2012 is for “financing guarantee legal entities”.

**Fig. 5-2 Balance and Growth Rate of Financing Guarantee Loans (2010-2012)**

Sources: (1) Data for 2010-2011 comes from the CBRC Financing Guarantee Department.

Note: Statistical data does not include the financing guaranteed loan balance of miro-credit companies.
5.1.2 Financing Guarantee Institutions Continue to Support SME Financing

In 2012, the balance of SME financing guaranteed loans sustained growth, and financing guarantee institutions continued to play a supporting role in SME financing. As of the end of 2012, the balance of SME financing guaranteed loans was RMB 1,144.5 billion, accounting for 78.4% of the balance of financing guaranteed loans, one percentage point higher than the previous year (see Figure 5-4). Meanwhile, financing guarantee institutions provided loan guarantee services for 23 SMEs in 2012, accounting for 92.7% of financing guaranteed loan enterprises.
5.1.3 Clean-Up and Rectification to Promote Industry Reshuffle

In light of these frequently occurring risk events, the Inter-Ministerial Joint Meeting of Financing Guarantee Business Supervision issued the Notice on Regulating the Guarantee Deposits Management of Financing Guarantee Institution Customers (R.Z.D.B.F. [2012] No. 1) and the Letter on Prompt and Risk Evaluation of Illegal Operations of Some Financing Guarantee Institutions (R.Z.D.B.H. [2012] No. 3) to strengthen the supervision of financing guarantee institutions, requiring that all institutions throughout the country shall strengthen supervision and effectively guard against industry risks, and providing prompts in regards to the major risks. Meanwhile, every region also correspondingly launched provisions related to financing guarantee institutions, requiring strengthening supervision and management and promoting the standardized development of the industry.

For guarantee institutions, annual reviews are tantamount to a yearly industry reshuffle. The reason as to why guarantee institutions fail such annual reviews includes the fact that capital is not in place (or has been withdrawn), operations are too small, irregularities arise during operations, and other such factors. In 2012, a number of provinces announced the state of guarantee institution rectifications. Of these announcements, the most noteworthy is that of the Jiangsu Provincial Economic and Information Technology Committee, which announced the abolition of 81 financing guarantee business qualifications, eliminating nearly 10% of guarantee institutions.

5.1.4 A Continuation of Supportive Policies

■ Funding Policies

Since 2006, the central government arranged for a separate amount of specialized funds within SME development funds which, upon examination and approval, and up to a certain level of magnification and loss ratio for SME services of up to 80% or more. These newly arranged funds provide specialized financial support for those SME credit guarantee institutions with a stable team, a sound system and a capacity to control risks.

In 2012, RMB1.4 billion funds were arranged, including 557 guarantee subsidies and RMB1.34 billion in grant funds (including guarantee business subsidies of RMB816.15 million and insurance premium subsidies of RMB524.85 million) to the benefit of 118 thousand SMEs, or 31% of customers guaranteed by institutions nationwide.

■ Business Tax Cuts

As early as 2001, the Ministry of Finance and the State Administration of Taxation, in conjunction with the former State Economic and Trade Commission, had already issued several clarifications regarding the business tax exemptions for income earned within a period of three years for those qualified guarantee institutions engaged in SME credit guarantees or re-guarantees. As of October 2012, a total of 11 batches of over 1,963 SME credit guarantee institutions enjoyed such preferential policies, effectively improving the capacity of guarantee institutions and lowering the financing costs of guaranteed enterprises.

■ Policy for Deductions before Risk Reserve Income Tax

Since 2007, the Ministry of Finance and the State Administration of Taxation has issued documents clarifying deduction policies before reserve tax concerning SME credit guarantee institutions, with several extensions. In April 2012, the Ministry of Finance and the State Administration of Taxation issued the Notice on the Policy for Deductions before Reserve Corporate Income Tax for SME Credit Guarantee Institutions (C.S. [2012] No. 25), extending this policy until December 31, 2015.

5.2 Re-Guarantee Institutions Enhance the Roles of Credit Increase and Risk Diversification

For guarantee institutions, the introduction of government funds into the field of re-guarantees not only helped institutions increase credit, but they could also minimize their costs. Given the co-operational impasse between guarantee institutions and banking institutions, re-guarantees have clearly helped guarantee institutions overcome this predicament. At present, 15 provinces (regions, municipalities) have established provincial re-guarantee institutions, covering 18 provinces and cities. Re-guarantees are playing an increasingly important role in terms of enhancing credit, diversifying risks, as well as guiding and consolidating the industry.

The most outstanding performance within the re-guarantee field is that of Jiangsu Credit Re-Guarantee Co., Ltd. From the day of establishment, it has accumulated a re-guarantee scale of larger than RMB120 billion, servicing 35,000 MSMEs. Of the MSME guarantee loans of Jiangsu province, with the proportion of re-guarantee loans rising from 2.64% at the end of 2009 to 28%, having already amplified the average guarantee loan within the system by nearly six times. At present, the company has a MSME re-guaranteed balance of RMB48.2 billion, placing it in the leading position within the industry nationwide.

5.3 Rise of the Collateral Management Industry

As the adoption of Property Law opened the way for corporate property mortgage financing, with a focus on accounts receivable and inventories, the inventory pledge financing, warehouse receipt pledge financing, and intellectual property right pledge financing and many other new forms of collateral property portfolios had emerged. The rapid development of Chinese movable property mortgage financing spawned forth an emerging industry – the collateral management industry, which is often referred to as financial warehousing in China. According to the estimates of specialists at the World Bank Group’s International Finance Corporation (IFC), China’s total amount of loans issued annually amounted to RMB30 trillion, of which, 85% (RMB25 trillion) were guaranteed loans, over 40% (RMB12 trillion) of which were classified under real estate guaranteed loans, 16% (RMB5 trillion) of which were classified under inventory-backed guaranteed loans, and approximately 10% (RMB3 trillion) of which were inventory-backed guaranteed loans managed by a third party.

5.3.1 Chinese Collateral Management: Course of Development

Guarantee inventory management had a late start in China. Beginning in the end of 1990s, some coastal banks have worked together with large-scale logistics warehousing companies, drawing from foreign experience, to develop a series of financial

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warehousing operations. In 1999, China Materials Storage and Transport Corporation (hereinafter referred to as “CMST”) partnered with a bank to develop China’s first modern financial warehousing business. At present, CMST is already in cooperation with over 20 financial institutions, with a movable property supervision financing scale of greater than RMB40 billion, involved in the monitoring of sixteen different product categories, such as ferrous metals, nonferrous metals, coal and coal products, cotton and linen products, chemical and light industry materials and related products. Movable property supervision includes the three large categories of impawning supervision, collateral supervision and trade supervision. Impawning supervision can also be divided into warehouse receipt pledges, chattel mortgage on a case by case basis, total amount control on chattel mortgage, and the supervision of buyer’s credit and establishment of L/C and a variety of other business models\(^1\). In accordance with the incomplete statistics of the China Warehousing Association, approximately 30% of the country’s medium and large-scale warehousing enterprises (nearly 1,000) have carried out varying degrees of inventory-backed guarantee management services, of which, the respective scale of inventory-backed guarantee loans issued by Sinotrans&CSC Holdings Co., Ltd., China National Materials Storage and Transportation Corporation and Nanchu Group amounted to approximately RMB100 billion\(^2\).

Specialized financial warehousing companies have emerged in the last few years, primarily in the Zhejiang area. In 2008, the Zhejiang Yongjin Warehousing Corporation was formally founded in Hangzhou as China’s first financial warehousing company. As of November 2012, there were more than 20 banking financial institutions in Hangzhou that had developed financial warehousing services\(^3\).

5.3.2 Chinese Collateral Management: Major Business Model\(^4\)

Currently, there are two primary domestic collateral management business models: the third-party chattel mortgage supervision model and the standard warehouse receipt model.

Of the two models, third-party chattel mortgage supervision refers to the warehousing company as an independent third party who is entrusted by the borrower or financial institution in a chattel mortgage and is responsible for monitoring, controlling and managing pledged collateral. The rights and obligations of the third party are as stipulated within a regulatory agreement. The specific process is as shown in Figure 5-5:

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1 This data comes from the website of China National Materials Storage and Transportation Corporation.
Standard warehouse receipts, also known as warehouse receipt pledges, refer to the standard warehouse receipts of warehousing companies in which financial enterprises have stored all of their movable property with complete ownership that financial institutions then shall pledge. Financial institutions will grant loans to financing enterprises based on the pledged warehouse receipt while the warehousing company will supervise the movable property and goods as a proxy. The specific process is as shown in Figure 5-6:

5.3.3 Representative Companies and Cases of Domestic Collateral Management

As China’s first warehousing company, Zhejiang Yongjin Warehousing Corporation (hereinafter referred to as “Zhejiang Yongjin”) is a representative of the industry. Launching partnerships with over 30 banks, the company is involved in the supervision
of goods from many different industries with over 30 different categories\textsuperscript{1}. As of October 2011, Zhejiang Yongjin has already helped nearly 200 SMEs obtain bank loans through its financial warehousing business. These SMEs used pledged or mortgaged inventories or commodities for the vast majority of inanimate, characteristically “dead” objects such as steel, aluminum, paper and alcohol. Since its establishment, Zhejiang Yongjin has not only developed the financial warehousing business which SME financing demands, but the company has also actively cooperated with various financial institutions; in 2012, Zhejiang Yongjin provided financial warehousing services to miro-credit companies in both Beijing and Lanzhou.

Established in March 2011, Hangzhou Yinhuotong Technology Co., Ltd. (hereinafter referred to as “Yinhuotong”) acts as a national initiative based on an intelligent fourth-party logistics financial services platform. In 2012 alone, Yinhuotong already had operations covering over 10 industries and providing chattel mortgage financing services to more than 40 SMEs within Zhejiang Province, with the loan amounts ranging from RMB1.5 million to RMB8 million and total loans reaching RMB100 million\textsuperscript{2}.

On December 28, 2012, the Ministry of Commerce issued the \textit{Guiding Opinions on Accelerating the Transformation and Upgrade of the Warehousing Industry (S.L.T.F. [2012] No. 435)}, proposing support for the conditional standardization of warehouse enterprise pledge supervisions and supervisory services for supply chain financing. Previously, the \textit{Opinions on Deepening the Reform of the Circulation System and Accelerating the Development of the Circulation Industry (G.F. [2012] No. 39)}, issued by the State Council, also expressed encouragement for banking financial institutions to innovate financial products and methods of services based on the features of the circulation industry, and develop movable property, warehouse receipts, commercial operating rights, leasing rights and other such pledge financing. With the strong support of national policies, facing the demand of SMEs for bank loans and the desire of banks to expand their SME business, the collateral management industry has undoubtedly provided a feasible means by which SMEs can ease their financing difficulties.

\begin{footnotesize}
\textsuperscript{1} This data comes from the website of the Zhejiang Yongjin Warehousing Corporation.
\textsuperscript{2} “Fourth-Party Logistics Good at Chattel Mortgage”, China Business Media Corporation Limited, April 08, 2013.
\end{footnotesize}
6. Venture Capital Institutions: In-Depth Consolidation

6.1 Fundraising and Investments Have Shrunk Dramatically

In the context of the weak macro-economy and sluggish capital markets of 2012, the allocated investments of venture capitalists became rather conservative, and the clamp down on exit channels has elongated the investment cycle, making turnover difficult, and as such, venture capital funds have typically faced difficult fundraising. The Zero2IPO Research Center has shown that there were a total of 252 funds in the Chinese venture capital market in 2012, representing a decline of 34.03% from 2011; of these funds, the known size of 247 funds amounted to a total of USD9,312 million, representing a decline of 66.98% from 2011 (see Figure 6-1). The average scale of newly raised funds was USD37,698.6 thousand per share, representing only half of that in 2011 and the lowest point in the industry since 2005.

![Fig. 6-1 Fundraising Status of Venture Capital Institutions (2002-2012)](source: Zero2IPO Research Center: China Venture Capital Annual Report (2012).

In terms of investments, the venture capital market similarly suffered an industrial decline, with a total of 1,071 investment deals in 2012, involving a total investment of USD7.32 billion, representing a respective decline of 28.84% and 43.71% as compared to 2011 (see Figure 6-2). In terms of single investment, the average scale was USD6,434.7 thousand per deal, representing a decline of 27.90% as compared to 2011. The scale of most investment deals was relatively small, and apart from the financing scale of Xiaomi Technology which involved USD216 million, all other deals were under USD100 million.
6.2 Local Venture Capital Institutions Remain Dominant, Single Investments are Still in Small Scale

In 2012, the industry as a whole suffered from the market freeze, and the amount of available capital stock of venture capital institutions remained at a high position. According to Zero2IPO statistics for 2012, the total amount of capital stock which could be invested in Mainland China and managed by Sino-foreign venture capital institutions amounted to USD50,521 million, representing an increase of USD1,992 million as compared to 2011, of which the amount of funds managed by local venture capital institutions further expanded, increasing to 52.80%, indicating a more pronounced lead.

<table>
<thead>
<tr>
<th>Type of Institution</th>
<th>Capital Stock (USD100 million)</th>
<th>Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local</td>
<td>26 657.84</td>
<td>52.80%</td>
</tr>
<tr>
<td>Foreign</td>
<td>22 181.63</td>
<td>43.90%</td>
</tr>
<tr>
<td>Sino-Foreign Joint Venture</td>
<td>1 681.30</td>
<td>3.30%</td>
</tr>
<tr>
<td>Total</td>
<td>50 520.78</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Zero2IPO Research Center: *China Venture Capital Annual Report (2011).*
From the status of fundraising, RMB funds still held a dominant position; of the 252 newly raised funds, 236 were RMB funds, and even though the amount of fundraising had declined by 32.76% since 2011, the proportion of RMB fundraising to total annual fundraising jumped to 93.65%. The total amount of RMB fundraising amounted to RMB43,783 million (approximately USD6,938 million), at a significant decline which only amounted to 34% of the total amount of fundraising in 2011, accounting for 74.51% of fundraising throughout the year. This downturn is even clearer in terms of foreign currency funds, with only 16 newly raised funds for the year, accounting for 6.35%. The total amount of funds raised amounted to USD2,374 million, accounting for 25.49% (see Figure 6-4).
The performance of local parent funds and government guided funds was compelling in 2012. As for parent funds, the fund of funds (FOF) AACPIII, focusing on Asian markets, was completed in August 2012 with a fundraising scale of USD980 million. During that same month, Zero2IPO and Hangzhou Financial Investment Group jointly initiated the establishment of a parent fund with an initial scale of RMB1 billion. As for government guided funds, the Dongguan Industrial Upgrading and Transformation and Venture Capital Guidance Fund and the Hangzhou SME Venture Capital Guidance Fund were founded and put into operation, continuously playing an important role in the guidance and leverage of funds. The efforts of fiscal funds and venture capital institutions were combined to support SME development.

Compared to the level of domestic fund activity, there was no significant progress in the entry and establishment of RMB funds by foreign institutions in 2012. The actual operational results of the much awaited QFLP pilot program were very limited in 2012. In April 2012, Shanghai Blackstone equity partnership and general partner (GP) as such is characterized as foreign-funded in the National Development and Reform Commission’s Reply Letter on Relevant Issues Relating to Foreign-invested Equity Investment, to be managed based on foreign investment policies and regulations. Its investment projects must be in compliance with the Guiding Catalogue for Foreign Invested Industries, and this limitation actively produces a definite negative effect on the QFLP pilot funds set up by foreign institutions.

In terms of average fundraising scales, the average fundraising scale of RMB funds amounted to USD29,905.4 thousand, a significant decline over the previous year and far behind the scale of USD funds. The average fundraising scale of USD funds has shrunk significantly when compared to 2011, with an average investment deal of USD158 million, 5.29 times that of RMB funds (see Figure 6-5). The scale of RMB funds always maintained a large difference compared to USD funds, due to the different investment leading subjects of Sino-foreign fund. With the continued growth of various representative local LP groups such as social insurance funds, listed companies and wealthy individuals, as well as new policies on the further liberalization of the participation of insurance funds, social insurance funds, direct investments and brokerages and mutual funds participation in equity investments, the RMB funds have major potential for growth in terms of the scale of fundraising in future.

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1 Asia Alternatives Capital Partners III (AACPIII) is one of the concurrent funds established by Asia Alternatives in 2012 with investors from around the world, including institutional and individual strategic investors. AACPIII investments are primarily concentrated in Mainland China, Taiwan, Hong Kong, Japan, Korea and other Southeast Asian regions. Its investment direction covers equity acquisition, growing and growth-oriented enterprises, venture investments and other special types of investments. The Asia Alternatives supports local fund terms including Capital Today, CDH Investments, GSR Ventures, Hony Capital and Morningside Ventures, etc.
Fig. 6-5 Average Fundraising Scale of RMB and USD Funds (2005-2012)

From the perspective of investments, the proportion of RMB fund investments grew in 2012, with a respective number of investment cases and amount of investments of 774 and USD4,535 million, accounting for 72% and 62% respectively, with a significantly higher degree of activity than that of foreign funds. However, the investment scale of RMB funds was still generally small, with over 80% of investment cases below USD10 million. This is closely related to the lower appeal for pre-IPO investments and the early stage layout of venture capital exploration.

Fig. 6-6 Status of RMB Fund Investments (2009-2012)
Source: Zero2IPO Research Center: Data from 2009-2012 comes from the China Venture Capital Annual Report of each respective year.

6.3 Weathering the Cold-Winter Led by Internet, Anti-Cyclical Medical Industry Developing Upward

Of the 1,071 investment cases on the venture capital market in 2012, the Internet,

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biotechnology/healthcare, and telecommunication and value-added services were the top industries in terms of investment activity with 162, 124 and 103 investment cases, respectively, and respective investment amounts of USD1,579 million, USD726 million and USD544 million and average investment scales of USD9,747 thousand, USD5,855 thousand and USD5.28 million, respectively.

It is worth noting that while Internet investment activity still remains first among all industries, however the number and scale of investment cases have seen a sharp decline, with respective declines of 41.30% and 52.10% as compared to 2011. The decline in average investment scales in the Internet industry was relatively small, maintaining a relatively high level of USD9,746.9 thousand, indicating a decline of 18.40% when compared to 2011. As for subdivisions, e-commerce and O2O were still popular market investments, while websites for price comparison successfully obtained financing in 2012, marking the socialized e-commerce websites which may become the focus of future investment.

Furthermore, of special concern to us is the Internet financing sector which is closely related to SME financial services. In March 2012, KPCB, Lightspeed Venture and Zero2IPO completed an investment of USD7 million for the intelligent financing loan search engine “Rong360.com”. This deal has also become an analogy for venture capitalist’s preference for Internet financing. The Internet financing chain includes information services, financing loans, credit card and bank card consumer services, financial accounting, online payments, online insurance and many other subdivisions, resulting in a frenzy of venture capital.

<table>
<thead>
<tr>
<th>Investee</th>
<th>Investor Entity</th>
<th>Investment Amount</th>
<th>Principal Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>PPDai</td>
<td>Sequoia Capital</td>
<td>USD25 million</td>
<td>Internet P2P credit and unsecured network lending platform</td>
</tr>
<tr>
<td>HOWbuy</td>
<td>Prime United Capital</td>
<td>NA</td>
<td>Investment consultants and B2C fund distribution platform focused on middle class wealth management</td>
</tr>
<tr>
<td>8securities</td>
<td>NA</td>
<td>USD8 million</td>
<td>Provides online stock trading and other investment management and services</td>
</tr>
<tr>
<td>YeahKa</td>
<td>Tencent</td>
<td>NA</td>
<td>Provides mobile payment solutions such as “APP+ payment via peripheral device”</td>
</tr>
<tr>
<td>Rong360.com</td>
<td>KPCB Lightspeed Venture Partner Zero2IPO Group</td>
<td>USD7 million</td>
<td>Intelligent financing loan search engine</td>
</tr>
<tr>
<td>CreditEase</td>
<td>IDG Capital Morgan Stanley Investment Fund – Asia-Pacific</td>
<td>Tens of millions of U.S. dollars</td>
<td>P2P financing loan platform</td>
</tr>
<tr>
<td>id5</td>
<td>SBCVC</td>
<td>NA</td>
<td>Committed to the development, promotion and service of applications for the Chinese information technology industry, providing electronic identity information services.</td>
</tr>
</tbody>
</table>

(continued on next page)
Attributable to the rigidity of the biotechnology/healthcare industry itself and its incredibly anti-cyclical feature, its superior investment value was highlighted amid the weak economic environment of 2012. On April 2012, the introduction of medical reform rules became a driving force for the development of the healthcare industry. Meanwhile, the government-backed capital support targeting at local medical-related industries also played an important role, prompting a growing trend both in investments and amounts in the healthcare industry, in spite of economic adversity, with a total of 124 investment cases in 2012, at an accumulated investment balance of USD726 million, with respective increases of 20.4% and 29.4% as compared to 2011. The future of the healthcare industry still has a great deal of potential for development, and growth can be expected.

The large amount of investment opportunities in mobile Internet has given rise to the telecommunications and value-added services industry. Subject to the impact of the overall market environment in 2012, the telecommunications and value-added services industry did not achieve its expected growth, yet their decline in the industry was less than the extent of overall decline in the market. In June 2012, it was disclosed that the amount of a new round of Xiaomi Technology financing had reached USD216 million, becoming the largest scale in 2012. In addition, the financial scale of such cases as Momo Technology, Limei Advertising, and Downjoy also reached tens of millions of U.S. dollars, leading to an optimistic outlook for industry development.

6.4 Accelerated Adjustments to Exit Methods

In 2012, Sino-foreign venture capital institutions carried out a total of 246 exit deals at a year-on-year decrease of 46.05%, in part due to a further increase in exit difficulties. Limited exit channels have been insufficient to meet industry demand, thereby increasing the risks of LP fund recovery, which was also an important factor which led to the cold winter of the venture capital industry.
IPOs in 2012 involved a total of 144 exit deals, accounting for 58.54% of all exit deals, maintaining a sharp decline. IPOs supported a total of 67 corporate listings throughout the year, representing nearly half of the 124 listings of the previous year, of which 64 were domestic enterprises, which remained dominant. The most active domestic IPO exits were on the Shenzhen GEM board, backing a total of 38 corporate listings, and carrying out 80 exits. Overseas market IPOs had also found it difficult to break the ice, with only 3 VC-backed overseas listings in 2012, and generated no profit on the Hong Kong Main Board and GEM board. Exit returns and average book rates of return also diminished significantly. The highest exit return was the successful NASDAQ listing of YY voice at the end of November, with an average book return of 10.19 times. The highest domestic market exit return was on the Shenzhen SME board, with the average book return of 41 exits at 7.29 times. However the performance of direct brokerage IPO exits in 2012 was relatively eye-catching, given the inherent advantages of direct investment brokerages in pre-IPO project selection, providing an important safeguard for its successful exit.

Fig. 6-7 Number of Venture Capital Exits over the Years (2002-2012)

Compared to IPO difficulties, equity transfer and merger and acquisition exits have made significant progress, with equity transfer exits achieving numerical growth, and with a degree of activity even greater than that of merger and acquisition exits. In 2012, there were a total of 44 equity transfer exits, at a proportional increase of 17.96%, a significant improvement when compared to the 9% in 2011. There were 31 mergers and acquisitions, accounting for 12.65%, an improvement when compared to the previous year.

Fig. 6-8 Listing of VC-Backed Enterprises (2011-2012)

Given the current market, the important position of IPO exits is difficult to shake in the short-term, venture capital markets have suffered a tremendous impact from the operating status of capital markets, encountering such IPO difficulties has also been an important cause for the “cold winter” of venture capital markets in 2012, and a preemptive thaw in IPO exits is a necessary condition for restoring the vitality of venture capital market. On the other hand, venture capital exit diversification has also become a question which markets must face, while mergers and acquisitions and equity transfers as representative exits are an important choice for venture capital institutions. In recent years, the rapid development of the mergers and acquisitions market, the increasingly active mergers and acquisitions market has been of great significance in the capital exits of venture capitalists. Also, the secondary market downturn has also lowered corporate value expectations and has brought about opportunities for merger and acquisition investments. However, objectively speaking, this has created relatively low exit returns. From the perspective of returns disclosed in 2012, the average rate of return for merger and acquisition exit deals was only 1.10 times, indicating a large gap from the book rate of return for IPO exits. Moreover, as the “New Three Boards Expansion” was approved in August 2012, and the national SME share transfer system was officially unveiled in January 2013, with a movement to gradually shift small regional pilot programs of non-listed company share transfers to a national scale, all of these may inject vitality into share transfer exits.
7. Equity Markets: Developments amidst Adjustments and Reforms

Even though 2012 was the cold winter of Chinese equity markets, it was also a year of in-depth development for capital markets. During this year’s macroeconomic downturn, capital markets faced an increasing degree of uncertainty, the A-share market entered its eighth IPO freeze1, and various factors had an impact on the role of equity markets in corporate financing. Meanwhile, China’s capital markets have been experiencing a series of institutional adjustments and reforms: the GEM board delisting system was officially implemented, the OTC market received further improvements in terms of standardization and scale, and with the rapid construction of the “New Three Boards”, regional equity exchange markets throughout the country have been officially recognized by the CSRC and have experienced steady development. China’s multi-level equity exchange market is gradually taking shape amidst the process standardization, which is of great significance to the expansion and improvement of SME financing channels.

7.1 Deceleration and Specification of GEM Boards

7.1.1 Significant Deceleration in IPO Financing

In 2012, affected by the market downturn, only 74 enterprises were listed on the GEM board, 54 less than those in 2011; actual GEM board enterprise IPO fundraising amounted to RMB35,149 million, representing a decrease of 51.89% compared to RMB73,065 million in 2011, and average IPO financing amounted to RMB475 million, representing a decrease of 16.80% compared to RMB571 million in 2011 (see Figure 7-1).

![Fig. 7-1 Number of GEM Board Enterprise IPOs and Financing Statistics (2009-2012)]

Source: Wind Info.

Note: The horizontal axis represents the number of IPO enterprises, and the vertical axis represents the average IPO financing amount (RMB100 million). The number next to each bubble represents the size of the bubble, i.e., total IPO financing amount (RMB100 million).

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As for the financing scale of individual enterprises, the financing scale of GEM board IPO experienced a dramatic drop due to a decrease of RMB0.2 to 0.6 billion in medium-scale financing, and a drastic reduction of RMB0.7 to RMB0.9 billion and above RMB1 billion for relatively large-scale financing (see Figure 7-2).

![Fig. 7-2 Distribution of Total Funds Raised through GEM Board Enterprise IPOs (2011-2012)](source: Wind Info)

As for corporate scale, the scale of GEM board enterprise IPOs have experienced a gradual expansion, which is tantamount to raising the threshold on GEM board IPOs, which has limited practical assistance to smaller scale SME financing (see Figure 7-3).

![Fig. 7-3 GEM Board Enterprise Pre-IPO Operation Income Scale Distribution (2010-2012)](source: Wind Info)

As for an industrial distribution, 74 GEM board IPO enterprises were distributed across 8 industries in 2012 (see Table 7-1). Similar to previous years, manufacturing had the most listed enterprises, followed by information technology industry which accounted for 29.73%, a significant increase over 19.53% in 2011, which reflects the increasing support of the GEM board for emerging industries.
Table 7-1  Industry Distribution and Fundraising of GEM Board Listed Enterprises (2012)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number of Listed Enterprises</th>
<th>Proportion</th>
<th>Total Amount of Capital Raised in Industry (RMB100 million)</th>
<th>Average Amount of Capital Raised in Industry (RMB100 million/enterprise)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining and quarrying</td>
<td>1</td>
<td>1.35%</td>
<td>3.54</td>
<td>3.54</td>
</tr>
<tr>
<td>Communications and culture</td>
<td>2</td>
<td>2.70%</td>
<td>12.04</td>
<td>6.02</td>
</tr>
<tr>
<td>Construction</td>
<td>1</td>
<td>1.35%</td>
<td>2.60</td>
<td>2.60</td>
</tr>
<tr>
<td>Transportation and warehousing</td>
<td>1</td>
<td>1.35%</td>
<td>3.15</td>
<td>3.15</td>
</tr>
<tr>
<td>Agriculture, forestry, animal husbandry and fishery</td>
<td>1</td>
<td>1.35%</td>
<td>6.75</td>
<td>6.75</td>
</tr>
<tr>
<td>Social services</td>
<td>4</td>
<td>5.40%</td>
<td>13.72</td>
<td>3.43</td>
</tr>
<tr>
<td>Information technology</td>
<td>22</td>
<td>29.73%</td>
<td>127.6</td>
<td>5.80</td>
</tr>
<tr>
<td>Manufacturing:</td>
<td>42</td>
<td>56.76%</td>
<td>215.24</td>
<td><strong>5.12</strong></td>
</tr>
<tr>
<td>Incl.: Electronics</td>
<td>11</td>
<td>14.86%</td>
<td>58.40</td>
<td>5.31</td>
</tr>
<tr>
<td>Machinery, equipment, instruments</td>
<td>18</td>
<td>24.32%</td>
<td>97.75</td>
<td>5.43</td>
</tr>
<tr>
<td>Metals and nonmetals</td>
<td>4</td>
<td>5.41%</td>
<td>21.29</td>
<td>5.32</td>
</tr>
<tr>
<td>Petroleum, chemicals, rubber, plastic</td>
<td>6</td>
<td>8.11%</td>
<td>24.52</td>
<td>4.09</td>
</tr>
<tr>
<td>Pharmaceuticals and biological products</td>
<td>2</td>
<td>2.70%</td>
<td>9.75</td>
<td>4.88</td>
</tr>
<tr>
<td>Paper and printing</td>
<td>1</td>
<td>1.35%</td>
<td>3.52</td>
<td>3.52</td>
</tr>
</tbody>
</table>

Source: Wind Info.

As for regional distribution in 2012, 74 GEM board IPO enterprises were distributed across 15 provinces, with the most enterprises in Beijing, Guangdong and Jiangsu, followed by Zhejiang, Shanghai and other regions (see Figure7-4).

![Fig. 7-4 Regional Distribution of GEM Board Listed Companies (2012)](image)

Source: Wind Info.

7.1.2 High PE Ratio and Excess Fundraising Curbed

Since 2012, along with the gradual emergence of the effects of a series of new stock issuance reform policies released by the CSRC1 and a rational regression of A-share

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1 On April 28, 2012, the CSRC officially released Guiding Opinions on Further Reforming the Issue System of New Shares, requiring in-depth reform in six aspects including appropriate adjustments to inquiring scope and placement ratios, strengthening the regulation of
market valuations, the high price earning (PE) ratios and excess fundraising of new stock issuances have been effectively curbed. In 2012, the average GEM board issuance PE ratio was 33.58, at a decrease of 37.02% compared to 53.32 in 2011, with PE ratios in various industries declining by varying degrees (see Figure 7-5).

![Fig. 7-5 Comparison of GEM Board Average IPO Price-Earnings Ratios by Industry (2010-2012)](image)

Source: Wind Info.

In terms of excess fundraising, the excess fundraising phenomenon had somewhat eased in GEM board markets in 2012, with an average excess fundraising ratio of 114%, representing a decrease of 43 percentage points from 157% in 2011 (see Figure 7-6). On the other hand, excess fundraising has also experienced the characteristics of differentiation, reflecting, to a certain degree, the changes in GEM board industry hot spots. Moreover, affected by new IPO policies, the excess fundraising ratio exhibited a downward trend when distributed across the quarters, particularly evident in the months of April and May when the new policies were enacted (see Figure 7-7).
Fig. 7-6 Average Excess Fundraising Ratio of GEM Board IPO Enterprises in Different Industries (2012)

Source: Wind Info.

Note: For simplicity’s sake, values are rounded after the decimal point.

Fig. 7-7 Average Excess Fundraising Ratio of GEM Board IPO Enterprises in Different Quarters (2012)

Source: Wind Info.

7.1.3 Four Pioneering GEM Board Refinancing Companies

GEM board companies are categorized as growth venture enterprises, and along with their rapid post-listing development, their demand for refinancing has become increasingly prominent, and even though the CSRC had yet to open the doors to board
listed company refinancing, however, the CBRC’s *Decision on Amending the Provisions on the Material Asset Restructuring and Supporting Financing of Listed Companies* allowed companies to apply for supporting financing when carrying out significant asset restructuring, which has provided an alternative channel of refinancing for GEM board companies. As such, a total of four stocks raised funds of RMB1,026 million through additional GEM board issuances in 2012 (see Table 7-2).

<table>
<thead>
<tr>
<th>Securities Code</th>
<th>Stock Name</th>
<th>CSRC Industry</th>
<th>Date of IPO</th>
<th>IPO Proceeds (RMB 100 million)</th>
<th>Additional Listing Date</th>
<th>Proceeds of Additional Issuance (RMB 100 million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>300010.SZ</td>
<td>Lanxum</td>
<td>Information technology</td>
<td>2009</td>
<td>4.77</td>
<td>August 2, 2012</td>
<td>2.95</td>
</tr>
<tr>
<td>300026.SZ</td>
<td>Chase Sun Manufacturing</td>
<td>2009</td>
<td>7.55</td>
<td>November 16, 2012</td>
<td>1.14</td>
<td></td>
</tr>
<tr>
<td>300058.SZ</td>
<td>BlueFocus Communication and cultural industries</td>
<td>2010</td>
<td>6.77</td>
<td>June 25, 2012</td>
<td>3.26</td>
<td></td>
</tr>
<tr>
<td>300157.SZ</td>
<td>LandOcean Mining and quarrying</td>
<td>2011</td>
<td>12.67</td>
<td>September 7, 2012</td>
<td>2.91</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>10.26</td>
</tr>
</tbody>
</table>

Source: Wind Info.

These four companies are categorized under the merger and acquisition restructuring model of equity- or cash-for-assets, with its private placement primarily for assets merger and acquisition, enhancing their level of profitability and restructuring industry resources, rather than pure refinancing. At present, GEM board refinancing through merger and acquisition restructuring has yet to be subject to policy restrictions, while there is no clear timetable for the time when the CSRC will allow companies to raise funds for the purpose of refinancing.

### 7.1.4 Formal Implementation of Delisting System

On April 20, 2010, the Shenzhen Stock Exchange officially released the *Shenzhen Stock Exchange GEM Listing Rules* (hereinafter referred to as the *Rules*), which has been implemented since May 1, 2012. This means that, after years of deliberation, the GEM board delisting system has finally been officially launched.

The *Rules* has improved the GEM board delisting system in six different aspects:

First, it amended the GEM board delisting standard system.

Second, it improved the re-listing audit standards, no longer supporting “backdoor” re-listing.

Third, it clarified the accelerated delisting of companies that do not correct the clear violations of accounting standards on their financial reports.

Fourth, it strengthened the disclosure of delisting risk information, eliminating the “delisting risk alert processing” section of the original rules which is no longer applicable.
Fifth, it increased the relevant regulations on the preparation period for delisting. In accordance with the Plan, the GEM board has implemented a “delisting preparation period” system and established a delisting preparation board.

Sixth, it clarified the circulation arrangements for GEM board companies upon delisting, clearly defining a unified shift to a agency share transfer system listing upon a company’s delisting from the GEM board.

The establishment and improvement of the delisting system will allow GEM board valuations to approach more reasonable levels, and stock will return to its real value, which will ensure the efficiency of the market, promoting a proper allocation of market resources to better server enterprises that are genuinely in need.

7.2 SME Boards Progress While Maintaining Stability

7.2.1 Continued Decline in IPO Scale

In 2012, SME board IPOs continued to cool down, with only 55 enterprises listing on the SME board, 60 enterprises less than that of 2011; the actual funds raised by SME board IPO enterprises amounted to RMB34,925 million, at a decrease of 63.49% from the RMB95,658 million in 2011, and practically on par with the level in 2010 prior to the period of explosive growth (see Figure 7-8).

![Fig. 7-8 Statistics on the Number and Financing of SME Board Enterprise IPOs (2004-2012)](image)

Source: Wind Info.

Note: The horizontal axis represents the number of IPO enterprises, and the vertical axis represents the average IPO financing amount (RMB100 million). The number next to each bubble represents the size of the bubble, i.e., total IPO financing amount (RMB100 million).

In terms of average fundraising, of the 55 companies, the average amount of funds raised per company amounted to RMB635 million, at a decrease of 23.65% when compared to the RMB832 million in 2011 (see Figure 7-9), a downward shift from the overall fundraising scale of 2010, which is closely related to macroeconomic downturn and stock market slump of 2012.
As for corporate scale, the total average pre-IPO operating income of SME board enterprises amounted to RMB955 million, representing a decrease of 37.38% compared to the RMB1,525 million in 2011, and on par with the RMB956 million in 2010, while the scale of SME board listed enterprises tended to aggregate in the middle (see Figure 7-10). Nevertheless, the scale of IPOs remained at a relatively high level, at a departure from the original purpose of the SME board. As to how the SME board can actually provide services to small and medium corporate listings and how the SME board threshold can be lowered are still serious issues that must be addressed.

By industry, average total fundraising ranged significantly from industry to industry (see Table 7-3), with the highest average total fundraising in the financial industry, and the lowest in the electricity, gas and water production and supply industry. The total

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1 In 2011, the pre-IPO operating income of BYD (002594) was as much as RMB48,448 million, net of the extremes, the average total pre-IPO operating income of SME board enterprises in 2011 was 11.13%, and in 2012, the average total pre-IPO operating income of SME board enterprises fell to 14.20%.
fundraising of listed manufacturing companies amounted to RMB602 million (see Figure 7-11), with only minor differences amongst sub-sectors.

Table 7-3 Industrial Distribution and Fundraising of SME Board Listed Enterprises (2012)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number of Listed Enterprises</th>
<th>Proportion</th>
<th>Total Amount of Fund Raised in Industry (RMB100 million)</th>
<th>Average Amount of Fund Raised in Industry (RMB100 million/enterprise)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information technology</td>
<td>2</td>
<td>3.63%</td>
<td>9.34</td>
<td>4.67</td>
</tr>
<tr>
<td>Social services</td>
<td>1</td>
<td>1.82%</td>
<td>10.75</td>
<td>10.75</td>
</tr>
<tr>
<td>Agriculture, forestry, animal husbandry and fishery</td>
<td>2</td>
<td>3.63%</td>
<td>9.42</td>
<td>4.71</td>
</tr>
<tr>
<td>Construction</td>
<td>2</td>
<td>3.63%</td>
<td>17.04</td>
<td>8.52</td>
</tr>
<tr>
<td>Wholesale and retail</td>
<td>2</td>
<td>3.63%</td>
<td>16.34</td>
<td>8.17</td>
</tr>
<tr>
<td>Transportation and warehousing</td>
<td>1</td>
<td>1.82%</td>
<td>4.24</td>
<td>4.24</td>
</tr>
<tr>
<td>Financial</td>
<td>1</td>
<td>1.82%</td>
<td>17.40</td>
<td>17.40</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>1</td>
<td>1.82%</td>
<td>7.92</td>
<td>7.92</td>
</tr>
<tr>
<td>Electricity, gas and water production and supply</td>
<td>1</td>
<td>1.82%</td>
<td>3.98</td>
<td>3.98</td>
</tr>
<tr>
<td>Manufacturing:</td>
<td>42</td>
<td>76.36%</td>
<td>252.84</td>
<td>6.02</td>
</tr>
<tr>
<td>Incl.: Electronics</td>
<td>4</td>
<td>7.27%</td>
<td>15.12</td>
<td>3.78</td>
</tr>
<tr>
<td>Machinery, equipment, instruments</td>
<td>19</td>
<td>34.55%</td>
<td>111.91</td>
<td>5.89</td>
</tr>
<tr>
<td>Metals and non-metals</td>
<td>3</td>
<td>5.45%</td>
<td>24.21</td>
<td>8.07</td>
</tr>
<tr>
<td>Petroleum, chemicals, rubber, plastics</td>
<td>4</td>
<td>7.27%</td>
<td>20.80</td>
<td>5.20</td>
</tr>
<tr>
<td>Pharmaceuticals and biological products</td>
<td>4</td>
<td>7.27%</td>
<td>25.96</td>
<td>6.49</td>
</tr>
<tr>
<td>Paper and printing</td>
<td>2</td>
<td>3.63%</td>
<td>11.22</td>
<td>5.61</td>
</tr>
<tr>
<td>Food and beverages</td>
<td>4</td>
<td>7.27%</td>
<td>30.80</td>
<td>7.70</td>
</tr>
<tr>
<td>Textiles, clothing and fur</td>
<td>2</td>
<td>3.63%</td>
<td>12.86</td>
<td>6.43</td>
</tr>
</tbody>
</table>

Source: Wind Info.
7.2.2 Initial Offering Valuations Continue to Fall

Similar to the GEM boards, the average SME board IPO price-earnings ratio also fell in 2012, with an average IPO price-earnings ratio of 28.71, representing a decrease of 34.12% compared to 43.58 in 2011, and practically retreating back to the 2009 level of 28.52. This illustrates the fact that valuation levels have stabilized, having fundamentally left the two years of explosive round of overestimations in the stock market. On an industry basis, the average price-earnings ratio of each industry experienced varying degrees of decline when compared to that of 2011 (see Figure 7-12, Table 7-4).
Fig. 7-12 Comparison of Average Price-Earnings Ratios of SME Board IPOs by Industry (2010-2012)

Source: Wind Info.

Table 7-4 Industry Statistics on Number of SME Board Corporate Issuances and Average Price-Earnings Ratios (2012)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Average Issued Price-Earnings Ratio (times)</th>
<th>Number of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Manufacturing</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery, equipment and instruments</td>
<td>25.13</td>
<td>19</td>
</tr>
<tr>
<td>Petroleum, chemicals, rubbers and plastics</td>
<td>22.09</td>
<td>4</td>
</tr>
<tr>
<td>Food and beverages</td>
<td>39.17</td>
<td>4</td>
</tr>
<tr>
<td>Biological and pharmaceutical products</td>
<td>29.41</td>
<td>4</td>
</tr>
<tr>
<td>Metals and nonmetals</td>
<td>25.65</td>
<td>3</td>
</tr>
<tr>
<td>Paper, printing and stationery</td>
<td>42.37</td>
<td>2</td>
</tr>
<tr>
<td>Textiles, clothing and fur</td>
<td>13.39</td>
<td>2</td>
</tr>
<tr>
<td>Electronics</td>
<td>27.55</td>
<td>4</td>
</tr>
<tr>
<td><strong>Industry Average</strong></td>
<td>27.84</td>
<td>55</td>
</tr>
<tr>
<td><strong>Other Industries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Information technology</td>
<td>34.80</td>
<td>2</td>
</tr>
<tr>
<td>Social services</td>
<td>33.10</td>
<td>1</td>
</tr>
<tr>
<td>Agriculture, forestry, animal husbandry, fishery</td>
<td>40.01</td>
<td>2</td>
</tr>
<tr>
<td>Construction</td>
<td>26.37</td>
<td>2</td>
</tr>
<tr>
<td>Wholesale and retail</td>
<td>24.99</td>
<td>2</td>
</tr>
<tr>
<td>Transportation, warehousing and postal services</td>
<td>22.08</td>
<td>1</td>
</tr>
<tr>
<td>Financial</td>
<td>48.33</td>
<td>1</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>26.78</td>
<td>1</td>
</tr>
<tr>
<td>Electricity, gas and water production and supply</td>
<td>27.16</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total Average</strong></td>
<td>28.71</td>
<td>55</td>
</tr>
</tbody>
</table>

Source: Wind Info.
As for actual IPO fundraising, the average SME board enterprise IPO excess fundraising ratio amounted to 76% (see Figure 7-13), with an overall downward trend in the excess fundraising ratio throughout the year (see Figure 7-14).

**Fig. 7-13 Comparison of Average Excess fundraising of SME Board IPO Enterprises by Industry (2012)**

Source: Wind Info.

Note: For simplicity’s sake, values are rounded after the decimal point.

**Fig. 7-14 Comparison of Average Excess fundraising of SME Board IPO Enterprises by Quarter (2012)**

Source: Wind Info.

### 7.2.3 General Trend of Equity Refinancing Reforms

After years of exploration, SME boards have gradually formed such equity refinancing methods as private placements, public offerings, allotments, and convertible bond issuances, providing a range of more extensive selections for listed SMEs. In 2012, a
total of 39 listed enterprises carried out refinancing on SME boards, less than the 64 enterprises in 2011, and refinancing amounted to RMB39,466 million, representing a decrease of 11.48% from the RMB44,584 million in 2011 (see Figure 7-15).

Since 2009, although the overall scale of SME board equity refinancing was on the rise, however the role of refinancing in SME boards is nowhere near that of the main boards. During this period of time, the refinancing scale of the main boards has always been greater than the scale of IPOs, while the refinancing scale of the SME boards has long hovered at less than 50% of the scale of IPO financing. Although the refinancing scale exceeded the scale of IPO financing in 2012, this was not due to a growth in the scale of refinancing, but rather a sharp reduction in the scale of IPO financing (see Figure 7-16).

One of the reasons as to the small scale of SME board refinancing is that China has yet
to build a system of refinancing. First of all, the threshold to publicly issued refinancing is relatively high. For instance, in order to apply for placement, the weighted average return on net assets over the last three fiscal years must not be less than 6% of average financing achieved in a one year interval. The high corporate refinancing threshold has shuttered the door on relatively long-term SMEs. Secondly, the refinancing system lacks the ability to differentiate. China’s current refinancing system does not distinguish listed companies, and regardless of the object of issuance or the scale of refinancing, the same policies and procedures are carried out, which is not conducive for improving the efficiency of SME refinancing. On the contrary, in overseas securities markets, especially in the United States, waivers in place for small scale refinancing, satisfy the refinancing demands of SMEs for quick, small-scale and low-cost refinancing.

Regulatory authorities have, to a certain degree, begun to consider pilot programs for shifting the authority of SME refinancing auditing to the exchanges (including SME and GEM boards), however these considerations, for one reason or another, have been shelved repeatedly. Nevertheless, there remains a general trend for a variety of institutional reforms and innovations such as lowering refinancing thresholds, simplifying refinancing procedures, and diversifying refinancing, but only featuring fully integrated SME financing with “small amounts at high frequencies” can markets better meet the refinancing demands of SME board listed companies.

7.3 New Progress in OTC Markets

Since 2012, with the official founding of the “New Three Boards”, the supervision of OTC exchange markets was unified, the foundation was laid for China’s multi-level capital market system, and the capital market structure became more reasonable. Regional exchange markets throughout the country ushered in new development opportunities, having experienced the comprehensive clean-up of 2011, and the standardization of the “New Fourth Board” market is conducive to providing better MSME financing services, the development of which will become a focus of much attention over the next few years.

7.3.1 Formal Release of the “New Three Boards”

On January 16, 2013, the opening ceremony for the National SME Share Transfer System Limited Liability Company was held on Financial Street in Beijing, signaling the formal release of the “New Three Boards”, and marking the fundamental construction of China’s multi-level capital market system.

In 2012, the unlisted corporate shares of a total of 103 non-listed companies in the Zhongguancun Science and Technology Park were transferred in a pilot program for quotation, overtaking the growth of the last four years in one action, however trading

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1 The micro-financing waiver system originated in the United States, which EU countries gradually began to adopt in the late 1990s. The 1933 U.S. Securities Exchange Act Section 3(b) authorized the U.S. Securities and Exchange Commission (SEC) to waive the protection of the Act for those registered securities which the SEC deemed as “small issuances” or “limited public offerings”. In 1996, Section 28 further clarified the authority of the SEC to “exempt any securities, or transactions, or any class of persons, class of securities or transactions from any provisions” of the Exchange Act, as long as “this exemption is necessary or appropriate for protecting public benefits and is consistent with maintaining investor profits”. The micro-financing waiver system embodies the “promotion of financing facilities”. Qualified enterprises issuances can be carried out without necessity to conduct routine SEC registrations, thereby avoiding the petty and lengthy process of application, investigation, certification of accountants and lawyers and other such operating procedures. Such micro-financing has the characteristics of short issuing cycles, low issue costs, fewer information disclosures and a guaranteed investment group.

2 Regional equity exchange markets throughout the country, also known as the “New Fourth Board”, refer to inner-provincial enterprises, particularly SMEs, that provide equity and bond transfers and financial services, as well as equity registration, trust management, equity pledge financing, private bond placements, and other value-added equity services, thereby expanding corporate financing and private fund investment channels, standardizing corporate governance, improving the management capabilities of enterprises, and actively transferring SMEs into national securities exchanges.
was relatively lukewarm, with only 638 “New Three Boards” listed company transactions, involving 115 million shares, with an annual turnover of less than 2% (see Table 7-5).

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Number of Listed Companies</th>
<th>Total Equity (100 million shares)</th>
<th>Number of Transactions</th>
<th>Turnover Volume (100 million shares)</th>
<th>Amount of Turnover (RMB100 million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>41</td>
<td>18.86</td>
<td>479</td>
<td>0.54</td>
<td>2.93</td>
</tr>
<tr>
<td>2009</td>
<td>59</td>
<td>23.59</td>
<td>874</td>
<td>1.07</td>
<td>4.82</td>
</tr>
<tr>
<td>2010</td>
<td>74</td>
<td>26.90</td>
<td>635</td>
<td>0.69</td>
<td>4.17</td>
</tr>
<tr>
<td>2011</td>
<td>97</td>
<td>32.57</td>
<td>827</td>
<td>0.95</td>
<td>5.60</td>
</tr>
<tr>
<td>2012</td>
<td>200</td>
<td>55.27</td>
<td>638</td>
<td>1.15</td>
<td>5.84</td>
</tr>
</tbody>
</table>

Source: Official share transfer system website of the Zhongguancun Science and Technology Park Non-Listed Shares Co., Ltd., excluding 7 companies that have already transferred to SME boards (1) and GEM boards (6).

As for the transfer of listings, as of the end of 2012, a total of 7 enterprises achieved transfer to different boards by “New Three Boards”. Moreover, there was one group of listed enterprises which were queued for approval to transfer boards.

The original design of the “New Three Boards” was to provide SME financing, however, faced with the market conditions of insufficient supply and inactive transactions, the financing function of the “New Three Boards” has yet to fully kick in. Meanwhile, SMEs should rationally consider the so-called “transfer” function, because a blind pursuit of a “board transfer” will only reduce the “New Three Boards” into a queuing market for medium and large-scale, high-quality enterprise IPOs, thereby losing its significance as an instrument for solving MSE financing difficulties.

We believe that, following the continuous progress of institutional reforms such as those rules relevant to market access, trading and financing systems, and those related to institutional investors, the “New Three Boards” market activity, the degree of investor participation and the speed of expansion will be significantly improved, with an increasingly strengthened role in the cultivation of the healthy growth of a large number of high-tech MSEs.

7.3.2 Long Road Ahead for Regional Trading Markets

2012 was a year of in-depth development for capital market, and with the accelerated construction of the “New Three Boards”, regional equity markets across the country have been officially recognized by the CSRC, ushering in a new stage of development, having experienced the OTC market clean-up of 2011.

Specifically, the most notable instance is that of the Tianjin Equity Exchange (hereinafter referred to as the “TEE”) which has continued to maintain the momentum of strong growth of the previous two years. As of December 31, 2012, TEE listed enterprises covered 26 provinces, with a total of 247 listed enterprises, of which 118 enterprises were newly listed; the scale of market capitalization reached RMB23,037 million, representing an increase of 35.5% when compared to 2011; the markets accumulated a total of RMB4,218 million in financing, and additional financing amounted to RMB1.72 billion, representing an increase of 73.5% when compared to
In addition to the TEE, compared to the construction of regional equity exchange markets throughout the country in 2011, there was remarkable progress in 2012, of which, the Qilu Equity Trust Trading Center and the Guangzhou Equity Trading Center have expanded rapidly, at the forefront of Chinese regional equity markets (see Table 7-6). Moreover, the construction of equity exchange centers in Dalian, Shenyang and many other places throughout the country are actively under preparation.

<table>
<thead>
<tr>
<th>Exchange</th>
<th>Establishment Date</th>
<th>Number of Listed Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tianjin Equity Exchange</td>
<td>September 2008</td>
<td>247</td>
</tr>
<tr>
<td>Qilu Equity Trust Trading Center</td>
<td>December 2010</td>
<td>135</td>
</tr>
<tr>
<td>Guangzhou Equity Trading Center</td>
<td>August 2012</td>
<td>134</td>
</tr>
<tr>
<td>Chongqing Share Transfer Center</td>
<td>December 2009</td>
<td>90</td>
</tr>
<tr>
<td>Zhejiang Equity Trading Center</td>
<td>September 2012</td>
<td>57</td>
</tr>
<tr>
<td>Shanghai Equity Trust Trading Center</td>
<td>July 2010</td>
<td>48</td>
</tr>
<tr>
<td>Wuhan Equity Trust Trading Center</td>
<td>November 2011</td>
<td>21</td>
</tr>
<tr>
<td>Hunan Equity Exchange</td>
<td>December 2010</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: Official websites of the various equity trading centers.

1 Source: Based on the monthly reports and related statistics of the official website of the Tianjin Equity Exchange.
8. Bond Markets: A Gradual Return

In 2012, bond markets again brought about a new surprise for SMEs. Although collective SME bonds remained stagnant, the scale of collective SME note issuances grew significantly, with a continued expansion of the issuing area into Central and Western China. More importantly, private placement SME bonds as a new financing instrument for entering capital markets, albeit a fairly new variety which were not sufficiently market-oriented, had actually provided SMEs with a financing channel with an even lower threshold. MSE financial bonds dominated commercial bank financial bond financing in 2012, effectively supporting the development of commercial bank MSE loan operations and providing an even more sufficient and steady source of funds for MSE financial services. The bond market promotion of the mainstream model and direction of MSME financial service development is becoming increasingly clear.

8.1 Significant Improvements in the Proportion of Corporate Bond Financing

For a long period of time, the scale of corporate direct financing through bond markets has been relatively limited. As early as 2002, annual corporate bond financing only amounted to RMB36,202 million, accounting for 1.80% of total social financing. After ten years, total Chinese social financing had already reached RMB15.76 trillion in 2012, of which, corporate bond financing accounted for up to 14.30%, with bond markets becoming increasingly prominent for providing enterprises with direct financing services (see Figure 8-1). Bond market development could provide medium and large enterprises with alternatives to bank credit financing, thereby resulting in a financial pressure for commercial banks to further lower their customer structure and expand their MSME customer base, which would indirectly promote MSE financial development, this trend has already been confirmed in the strategic transformation procedures of commercial banks over the last three years.
However, it cannot be overlooked that, under the economic growth model with capital investments as a driving force and the rise of local government financing vehicles (LGFV), there was a decline in the proportion of industrial and commercial enterprise bond financing. The invisible debt of local governments increased, further weakening the bond market financing capacity of industrial and commercial enterprises. Given the statistics on the scale of primary market bond issuances, this can be seen very clearly. In 2012, the total newly issued enterprise bonds, corporate bonds, medium-term notes (MTN) and commercial papers (CP) of non-financial enterprises in the primary market amounted to 2,568 bonds, with a financing scale of approximately RMB3.57 trillion. Of which, after excluding the 753 LGFV bonds, industrial and commercial

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1 Even though the bonds traded in both inter-bank market and exchange market have two codes, they are calculated together as a single type of bond.

2 The statistical financing scale here refers to the newly issued bond financing funds in the primary market. Because the amount of funds during the period of maturity was not deducted, the number is numerically greater than that of the related statistics from the People’s Bank of China on the total amount of social financing.
enterprises issued a total of 1,585 bond financing instruments, with an approximate financing scale of RMB2.67 trillion, accounting for about 74.79% of the financial scale of non-financial enterprises. However, in 2011, this proportion was 83.22%. In other words, the bond financing of local financing platforms experienced rapid development in 2012, which lead to a decrease in industrial and commercial enterprise bond financing of approximately 8.43 percentage points out of the total bond financing of non-financial enterprises.

We should be able to notice that, despite the greater mentioned in our 2011 report, the most obvious attraction of specialized MSE financial bonds was amount of bond market MSE financing concepts in recent years, the actual scale of SME direct financing was rather limited. In 2012, the SME direct bond financing scale amounted to RMB22,139 million (private SME bonds accounted for RMB11,856 million, collective SME notes accounted for RMB9,302 million and collective SME bonds accounted for RMB981 million), only accounting for 0.83% of the total volume of industrial and commercial enterprise bond financing for the year. This clearly illustrates that much work remains to be done in the bond markets for SME financial services.

8.2 Specialized MSE Financial Bonds Help Indirectly

As we had that corresponding loans can be left out of the numerator of the loan to deposit ratio, so that small and medium banks would not suffer from funding sources and deposit to loan ratio constraints. The issuance of specialized financial bonds has provided a richer source of funds for small and medium banks that engage in large-scale liabilities, such as urban commercial banks. Compared to SME direct financing, bond markets indirectly benefit SMEs by providing financing for small and medium financial institutions, one of the essential characteristics in accord with highly efficient bond markets.

8.2.1 Overall Development of Specialized MSE Financial Bonds

In 2012, a total of 18 specialized MSE financial bonds were issued, raising a total of RMB156.5 billion for 12 commercial banks, similar to the balance of deposits of Bank of Nanjing, a medium urban commercial bank in 2011. Consistent with our prediction in 2011, specialized financial bonds in fact ushered in significant growth in 2012, becoming an important means for promoting the commercial bank support of SME financing. Of the 23 commercial bank financial bonds issued in 2012, only 5 bonds were not categorized as specialized MSE financial bonds, with a combined financing scale of only RMB12,150 million. Driven by specialized MSE financial bonds, the financial scale of commercial bank financial bonds (excluding subordinated bonds) experienced significant growth from RMB38,650 million in 2011 to RMB168.65 billion, at a growth rate of 336.35% (see Figure8-2).

1 Standards for LGFV bonds come from Wind Info.
Fig. 8-2 Issuance of Commercial Bank Financial Bonds (Excluding Subordinated and Convertible Bonds) (2008-2012)

Source: Wind Info.

Actually, if we also consider the subordinated bonds of commercial banks and convertible bonds of listed commercial banks, the financing scale of regional small and medium commercial banks (urban commercial banks, rural commercial banks, and other key business types of provincial or semi-provincial non-national commercial banks) by bond markets remains very limited. From 2009 to 2011, the bond financing scale of regional small and medium commercial banks accounted for approximately 10% of the total national commercial bank bond financing. In 2012, with the support of a further expansion in specialized MSE financial bonds, the proportional scale of regional commercial bank bond financing increased significantly to nearly 19%.

Regardless of whether or not specialized MSE financial bonds will observe a systematic improvement in the proportional scale of regional small and medium commercial bank bond financing remains to be seen, however given the increase in commercial bank financing bonds (excluding subordinated and convertible bonds) of 336.35% and the fact that specialized MSE financial bonds accounted for 93% of the financing bonds issued by commercial banks, specialized MSE financial bonds had truly achieved a stage of merit for improving the absolute and relative scales of small and medium commercial bank bond financing.
8.2.2 Main Structure of Specialized MSE Financial Bond Investments and Financing

In 2012, the development of specialized MSE financial bonds directly contributed to the bond financing of regional small and medium commercial banks as represented by urban commercial banks, which has thus allowed them to provide more effective support for the development of MSE credit business.

In terms of the financier structure, the 12 commercial banks which issued specialized MSE financial bonds included four national joint-stock commercial banks (Minsheng Bank, SPDB, CMB and CEB), two foreign commercial banks (Mizuho Bank and DBS Bank), and six urban commercial banks (Bank of Hangzhou, Harbin Bank, Bank of Lanzhou, Hankou Bank, Taizhou Bank, and Bank of Nanjing). Specialized MSE financial bonds had made it easier for small and medium commercial banks to access bond market financing, given the issuer structure of specialized MSE financial bonds and the sharply reduced scale of ordinary commercial bank financial bonds issued. (see Figure 8-4 and Table 8-5).
In terms of the investor structure, given the fact that insurance companies can only invest in the financial bonds issued by commercial banks with net assets of greater than RMB10 billion, whereas the net asset scale of urban commercial banks such as Bank of Lanzhou, Hankou Bank and Taizhou Bank are less than RMB10 billion, coupled by the overall lack of liquidity and relatively low income levels of commercial bank financial bonds, the participation of brokers, funds and other trading institutions is insufficient, and at present, specialized MSE financial bonds are mutually held by commercial banks.

8.3 SME Private Placement Bonds Ascend the Stage

As early as October 2011, the CSRC issued the Announcement No. 29, stating that GEM board listed companies could apply for privately issued corporate bonds, marking
the official beginning of SME private placement bonds. However, GEM board enterprises were technically not “MSMEs”, and at that time, regulatory authorities and exchanges had yet to make ground on institutional arrangements for privately issued SME bonds. In May 2012, the Shanghai Stock Exchange (SSE) released the *Pilot Measures of the Shanghai Stock Exchange for the Issuance of Private Placement Bonds of Small and Medium Enterprises*, and within the same month, the Shenzhen Stock Exchange (SZSE) also released the *Pilot Measures of the Shenzhen Stock Exchange for the Issuance of Private Placement Bonds of Small and Medium Enterprises*, to be followed by the gradual release of relevant rules and guidelines. At that time, only those SMEs that had not been listed on a stock exchange and met the standards of the *Notice on Issuing the Provisions on the Classification Standards for Small and Medium-sized Enterprises* (G.X.B.L.Q.Y. [2011] No. 300) had access to privately issued bond channels. As of December 31, 2012, a total of 101 SME interest-bearing private placement bonds (50 SSE SME private placement bonds, 45 SZSE SME private placement bonds and 6 SZSE GEM board private placement bonds), raising a total funds of RMB11,856 million. Even though SSE and SZSE SME private placement bonds had only been available for six months and faced many problems during the process of development, their relatively flexible distribution mechanism and relaxed conditions and issuance requirements are enviable when compared to the privately issued corporate bonds of GEM board enterprises, which was also one of their greatest advantages in respect to publicly offered bond financing.

### 8.3.1 Key Features of MSE Private Placement Bonds

Compared to publicly offered enterprise bonds/corporate bonds, SME private placement bonds do not have strict requirements on the net assets and profitability of the issuer, and the issuer’s solvency and use of funds is secured by underwriters. In actual operation, underwriters will often set the standard size of the issuance so that it does not exceed 75% of the parent company’s debt-to-asset ratio and the issuance size is no more than twice their net assets. Some underwriters demand that the net profit of enterprises with relatively low cash flows and net profit generated from operating activities must be able to cover one year or two years of interest. Overall, the aforementioned standards are relatively loose.

Various elements of SME private placement bonds, such as the issuing amount, interest rate, maturity, and so on, are negotiated and determined by the issuers, underwriters and investors themselves with the rights and obligations of the parties determined by contract. As such, the majority of SME private placement bonds lack principal or bond ratings, and only 12 of the 101 SME private bond placements (including GEM board private placement bonds) had debt ratings.

SME private placement bonds adopt the issuance filing system of exchanges, but only the filing materials of the exchanges are checked for completeness. As for the completeness of filing materials, the SSE will issue an *Acceptance Notice of Filing* within 10 working days of receiving materials, after which issuers and underwriters can begin their work. Even in terms of the issuance cycle of corporate bonds at roughly one month, the issuance efficiency of SME private placement bonds is still superior.

### 8.3.2 Growing Pains of MSE Private Placement Bonds

However, the pace of SME private placement bond development in 2012 was slower than that of market expectations (see Figure 7-5). This surely does not exclude the possibility that market expectations for SME private placement bonds were relatively
China SME Finance Report 2013

high, however the primary reason was the bottleneck faced by price placement bonds themselves. Private placement bonds were not only a change in the way which SMEs raised funds, but they also served as a new type of fixed income to appear on the market. No matter investors, underwriters or issuers, many people have their own contemplations and hardships to deal with.

As for investors, particularly insurance investment institutions that serve to ensure the most important bond investors and stand out when commercial banks have a difficult time participating in SME private placement bonds, the Interim Measures for the Investment of Insurance Funds in Bonds (B.J.F. [2012] No. 58) requires that all non-financial enterprise (corporate) bond issuers that insurance companies invest must meet an net asset volume of at least RMB2 billion and a long-term overall credit rating of no less than A. However, the majority of SME private placement bonds do not have credit ratings, and it would be impossible for the issuers to reach such a large amount of net assets. To investment banking institutions, SME private placement bonds fall under the category of exchanges, however, the majority of commercial banks can only participate in interbank market bond transactions, and only listed banks can participate in exchange bond transactions, thereby constraining most small and medium regional commercial banks from participating in SME private placement bond transactions. In short, insurance and commercial banking institutions that give priority to allocation will only participate in SME private placement bond investments to a limited extent; while on the other hand, brokers and funds, as representative trading institutions, face numerous constraints in the process of investing in SME private placement bonds. Even though the CSRC issued the Notice on Issues concerning Securities Investment Fund Investments in the Private Placement Bonds of Small and Medium Enterprises to fund companies and custodian banks, making it clear that this was a new standard for opening up public offering funds, however this new investment standards capacity for bringing in significant net contributions from a public offering bond fund was very limited. In accordance with the provisions of the aforementioned Notice, exiting public offering funds must first receive approval from the general meeting of holders before SME private placement bonds can be included within its scope of investments, and although newly issued funds can directly include SME private placement bonds in their scope of investments inside their prospectus, funds can only allocate less than 10% of their net value to SME private placement bonds. In accordance with the Measures for the Administration of Operation of Securities Investment Funds, a fund manager can only manage less than 10% of the total securities which the entire fund holds in a certain company, and because the average scale of SME private placement bonds is only RMB117 million, there is little room for funds to enhance the performance of SME private placement bonds, which has significantly dampening their appeal. Similar restrictions also exist in the Administrative Measures for the Client Asset Management Business of Securities Companies. Even though there are methods in practice for avoiding such regulations, investor enthusiasm wanes when it comes to the extra time and energy required to carry out an internal credit assessment for SME private placement bonds, and investing in such bonds is not particularly economical.

As for underwriters, when it comes to underwriting fees and charges for SME private placement bonds, underwriters will typically negotiate pricing based on the qualifications of the different enterprises, charging 1%-2% of the underwritten amount. Given the average scale of RMB117 million, underwriters will only earn RMB1 to 2 million, at a gross margin significantly lower than that of the level of IPO underwriting. As for brokers that are relatively enthusiastic to participate in the business of SME private placement bonds, participating in this type of business is unrelated to an IPO
run-up. Some SME private placement bond issuers are also brokers who counsel companies set to be listed, and as such, the top five brokers who underwrite SME private placement bonds are known for underwriting small cap stocks. Following the fourth quarter IPO freeze, SME private placement bond issuances began to pick up again, which goes to further confirm this fact.

As for issuers, the performance of SME private placement bond financing is very limited. In 2012, the overall average interest rate on private placement bond issuances stood at 9.04%. As for the SMEs which met the conditions for private placement bond issuances, if the underwriter or parent company was of a relatively high quality, lending rates would tend to be 1.3 to 1.5 times higher than the benchmark rate, i.e., 7.80% to 9.00%, which was at a price significantly lower than the overall cost of current SME private placement bond financing. However, given the credit scale controls of commercial banks, many enterprises must still seek financing beyond that of bank credit alone, but the financing costs of alternative financing channels were at least 10% higher than that of private placement bonds, and as such, only private placement bonds can meet their financing needs. Of course, some of the SMEs that proposed listing carried out IPO pre-selling on exchange listed private placement bonds were also a major driving factor in the issuer participation in SME private placement bonds.

### 8.4 Steady Expansion of MSE Collective Notes

2012 is the fourth year after the launch of SME collective notes. Throughout the year, the number of SME collective note issuances reached 44, double that of 2011, and the number of issuers also increased by approximately 40%. 137 enterprises from 17 provinces (autonomous regions and municipalities) such as Jiangsu, Shandong and Zhejiang accumulatively raised RMB9,302 million in funds. Compared to 2011, issuers were added from Xinjiang, Inner Mongolia, Hebei, Anhui, Hunan, Jiangxi and other central and western regions. Of which, Xinjiang, Hebei, Anhui, Hunan and Jiangxi were the first regions to issue SME collective notes. The participation of issuers from
the central and western regions was a pleasant development for SME collective notes, indicating that SME collective notes had been expanding from the initial provincial pilot projects to a large-scale national promotion of collective notes, the significance of which, in terms of SME bond financing, had been increasingly intensified.

Table 8-1  Collective Note Issuances (2009-2012)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Collective Notes Issued</td>
<td>4</td>
<td>19</td>
<td>22</td>
<td>44</td>
</tr>
<tr>
<td>Number of Enterprises Involved in Issuance</td>
<td>23</td>
<td>72</td>
<td>98</td>
<td>137</td>
</tr>
<tr>
<td>Regional Distribution</td>
<td>2</td>
<td>11</td>
<td>11</td>
<td>17</td>
</tr>
<tr>
<td>Total Amount Issued (RMB100 million)</td>
<td>12.65</td>
<td>46.57</td>
<td>66.23</td>
<td>93.02</td>
</tr>
<tr>
<td>Average Nominal Interest Rate</td>
<td>5.33%</td>
<td>4.46%</td>
<td>6.47%</td>
<td>6.37%</td>
</tr>
</tbody>
</table>

Source: Wind Info

As for financing costs, in the context of weakening inflationary pressures and despite the general trend in 2012 for loose monetary policies, the benchmark lending rate for loans of above 5 years fell to 6.55%, and after considering the increased limit of 30%, indirect financing costs were near 8.5%. Also, the weighted average nominal interest rate of the 44 collective note issuances was at a slight decline of 10bps when compared to 2011, maintaining a level of 6.37%. Coupled with the underwriting fees, guarantee fees and other costs and rating fees of the note issuances, the financing costs were still at about 8%. As such, compared to the significant decrease in the cost of indirect financing, the advantages of SME collective notes, in terms of lowering corporate financing costs, had weakened.

As for the terms and financing scale of issuances, SME collective notes issued in 2012 were predominantly 3-year notes. Of the 44 newly issued SME collective notes, 32 were 3-year notes, 8 were 2-year notes and 4 were 1-year notes (see Figure 8-7). 3-year note financing amounted to RMB7,380 million, amounting for 79.34% of total financing. The higher proportion of 3-year notes was primarily due to the relatively weak solvency of SMEs. Also, because banks typically provided relatively short-term loans, 3-year collective notes offered a relatively low-cost means by which SMEs could obtain medium-term financing channels. The average number of enterprises involved in single collective notes dropped from 4 in 2011 to 3 in 2012, while the corresponding amount of financing per individual collective notes also dropped from RMB301 million in 2011 to RMB211 million in 2012. After approximately four years of development, the reasonable period, the number of participating enterprises and the proportionate scale of financing for SME collective notes had gradually become clear and reached a state of maturity.

1 The PBOC lowered the required deposit reserve ratio twice, both in February and March of 2012 and lowered benchmark deposit and loan rates in June and July.
As for credit enhancements, to alleviate the credit risks of SMEs, SME collective notes have already formed multi-layered guarantee models such as “general guarantees”, “joint guarantees”, “general guarantees + solvency risk reserves”, and “general guarantees + solvency risks reserves + stratified notes” as well as credit enhancement measures such as “buyback commitments” and “government subsidies”.

8.5 MSE Collective Bonds at a Standstill

On November 14, 2007, the “2007 Shenzhen SME Collective Bonds” were approved for issuance. With the characteristics of “a unified title, respective liabilities, uniform guarantees and collective issuances”, the SME collective bond business model broke the practice of single enterprise bond issuances, with high hopes for success. After five years, compared to the rapid growth of collective notes that began in 2009, SME collective bonds had not achieved any progress. In 2012, there was a total of 3 SME collective bond issuances, and even though the total number of collective bonds was greater than 2011 by a single bond issuance, however the number of service enterprises fell to 21, with an overall decline in the scale of financing when compared to 2011 (as shown in Table 8-2). In terms of the capacity for financing, SME collective bonds were unlikely to achieve the performance of SME collective notes. Moreover, in terms of the average costs of financing, SME collective bonds had also remained higher than that of the collective notes issued in the same year. Although the average financing costs were slightly higher than that of relatively long-term collective notes, however, when in combination with historical data, the issuance cycle of collective bonds was relatively long, and a definite relationship existed between high financing costs and the nature of the underwriter.
Table 8-2 SME Collective Bonds Issuances (2007-2012)

<table>
<thead>
<tr>
<th>Year</th>
<th>2007</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Collective Bonds Issued</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Number of Enterprises Involved in Issuance</td>
<td>24</td>
<td>8</td>
<td>18</td>
<td>26</td>
<td>21</td>
</tr>
<tr>
<td>Total Amount Issued (RMB100 million)</td>
<td>13.05</td>
<td>5.15</td>
<td>5.83</td>
<td>14.18</td>
<td>9.81</td>
</tr>
<tr>
<td>Average Nominal Interest Rate</td>
<td>6.19%</td>
<td>6.53%</td>
<td>4.91%</td>
<td>6.54%</td>
<td>7.31%</td>
</tr>
</tbody>
</table>

Source: Wind Info

Compared to 2011, SME collective bonds issued in 2012 exhibited the following three prominent changes:

1. The re-emergence of cross-market collective bonds. Following the Zhongguancun SME collective bonds of 2010, Yangzhou SME collective bonds again selected the SSE and interbank market for a simultaneous public trading. We believe that SME collective bonds that are traded inactively would become more acceptable for investors if they are traded on both the stock exchange and interbank market.

2. Pengyuan Credit Rating is the only rating agency that still participates. From 2010 to 2011, a number of credit rating companies participated in the business of SME collective bond credit ratings, including Dagong, Lianhe and Pengyuan, however, things had changed since then; in 2012, Pengyuan was the only remaining rating agency to participate in SME collective bonds. Even though we do not rule out the contingency resulted from the small number of SME collective bond issuances, perhaps this also reflects the decline in intermediary institutional enthusiasm brought about by the slow development in the scale of SME bonds.

3. A progressive interest rate has emerged\(^1\). With the “12 Yangzhou Collective Bonds (123009.SH)/12 Shijiazhuang SME Development Bonds (1280465.IB) of 2012, SME collective bonds had a progressive interest rate for the first time. This corresponded to the nominal interest rate adjustment clause which gave the issuer the right to raise the nominal interest rate after a certain period of time. Since this period was often associated with the investor sell-back, it provided the issuer with an opportunity to buy the bonds before an investor sold back, which thereby provided the issuer with more options for the tension of funds.

Overall, whether in terms of scale and the number of enterprises serving SMEs or the term of bonds, guarantees or other such factors, there were no significant changes in SME collective bonds in 2012. In contrast to the rapid development of SME collective notes, the value and significance of SME collective bonds seemed to be waning.

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\(^1\) Progressive rate bonds refer to bonds with nominal interest rates that are pegged to their terms or have the certain characteristics of segmented interest accrual.
9. Private Financing: Patterns of Innovation Trigger Hot Debate

In 2012, the financing difficulties that MSEs faced with formal financial institutions were still outstanding, and private financing, due to its efficiency and convenience, had become an integral means by which MSEs obtained financial services. Private financing existed in various forms, and conventional ROSCA\(^1\) and underground banks\(^2\) had remained active while continuing to innovate and develop in mode.

9.1 Private Financing Boosts MSE Development

Private financing has always been the main channel by which MSEs have obtained funds, especially in the context of monetary tightening and a serious shortage in the credit supply of formal financial institutions, which have added to the difficulties of MSEs when obtaining loans from formal financial institutions. As such, private financing has served as supplement to formal finances, and its importance to MSEs has become more prominent. Potential market demand has also caused private capital to flow towards MSEs.

9.1.1 Continued Expansion in Scale of Private Financing

As for the overall growth in the scale of private financing in recent years, due to ample liquidity prior to 2010, the private lending balance remained relatively stable, and after 2010, the implementation of austerity measures drove the development of the private lending market, which had grown to RMB3.8 trillion\(^3\) by mid-2011. According to the statistics of UBS Securities and the China Economic Indicator Database (CEIC), as of the third quarter of 2012, the scale of Chinese private lending\(^4\) had already exceeded RMB4 trillion, with the scale of shadow banking (RMB24.4 trillion) accounting for 16.4% (see Figure 9-1).

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1 ROSCA (Rotating Savings and Credit Association) is a type of shared savings amongst members of an association which is also a type of member-based rotating lending activity. In other words, ROSCA is an approach to private lending of the mutual funds of members, which also involves both savings and credit services.

2 Underground bank: a special type of illegal financial organization which is divorced from the financial regulatory system and fully or partially utilizes the settlement network of financial institutions to engage in illegal foreign exchange trading, the international (cross-border) transfer of funds, the saving or lending of funds or other illegal financial operations.

3 According to the results of the 2011 PBOC investigation into the current status of private financing, the total volume of private financing was approximately RMB3.38 trillion as of the end of May 2011. Besides, according to CICC estimates, this scale had grown to RMB3.8 trillion by mid-2011, accounting for 33% of shadow banking, which was equivalent to 7% of total bank loans.

4 Private lending is the primary form of private financing, which is the general term for a variety of private financing.
The scale of private financing has gradually grown year after year, and its business model is also in a stage of innovative development. Conventional ROSCA and underground banks have remained active, risk events have occurred frequently with massive amounts of money involved, conducive to facilitating the concealment of operations, money laundering and other criminal activities. Apart from ROSCA, underground banks and other conventional forms of private financing, the field of private finance has been also trying the Internet tools to enable private financing to emerge from the darkness, towards standardizations, while breaking through its original geographical constraints to greatly exceed its services for MSEs and individuals, providing faster and more convenient lending services.

9.1.2 Policies Driving the Standardization of Private Financing

Private financing comes in various forms, however the majority of which are unsupervised, and the government has no way of monitoring the real-time status of their operations and risks. As such, most forms of private financing exist in a gray area on the edge of formal forms of finance. Regional governments recognize the important role of private financing in SME development, and the conventional method of “blocking” is anything but effective for alleviating the crises and disorder rampant in private financing, and as such, a series of policies have been introduced to improve relevant supporting measures and build a platform by which the development of private financing can be standardized, which may bring private financing from the “underground” out into the “open”, promoting its healthy development.

As put forth in the Guiding Opinions on Providing Judicial Guarantee by People’ Courts to Avoid and Mitigate Financial Risks and to Promote Financial Reform and Development by the Supreme People’s Court, people’s courts at various levels will act
in accordance with the spirit of the *Notice of the Supreme People’s Court on Legally and Properly Hearing Cases on Disputes over Private Lending to Promote Economic Development and Maintain Social Stability*, shall give a proper hearing to private lending and other financial cases, and shall protect the positive role of private lending as a complement to formal financing.

The *Ordos Interim Measures for the Specification of Private Lending* released by the Ordos Municipal People’s Government is the first domestic private lending system with comprehensive specifications and regulatory documents, forming systematic specifications in terms of civil, administrative and economic law. Moreover, in accordance with the actual circumstances of the latest developments in private lending, there has been an emphasis on the need to pass measures for information technology, leading to the healthy development of information-oriented private financing, thereby encouraging and supporting the establishment of a corporate information platform for private lending operations.

Of the various policies launched by regional governments in 2012 concerning the promotion of financial development or support of SMEs, 70% of the regulations and policies were related to the standardization of private financing, the promotion of the healthy development of private financing and the process by which the standardization of private financing can be accelerated.

**9.2 Growing P2P Online Lending to be Standardized**

The P2P online lending platform 1 (hereinafter referred to as the “P2P lending platform”) is a type of imported idea, which, in the general sense only offers intermediary services but do not participate in the borrowing process. In this type of platform, borrowers and lenders communicate through information on the platform and complete lending transactions via third-party payments or through other financial service institutions, and the P2P lending platform charges intermediary and service fees (see Figure 9-2). This model intends to use the Internet as a means of disintermediation, which solves the issues of information dispersion and asymmetry at a relatively low cost.

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1 The P2P online lending platform is short for peer to peer lending and refers to a new financial service model that developed alongside the development of the Internet and the rise of private lending in which individuals with investment intention lend their funds to enterprises or individuals who need funds through an online intermediary platform in the form of a credit loan. The information, funds, contracts and other such procedures involved in the process are then carried out online.
Since the establishment of the first domestic P2P lending platform in 2007, the industry has experienced six years of development, but after even a short period of trial, as prompted by relaxed regulations and market demand, the industry ushered in explosive growth. From 2011, a large number of P2P lending platforms have gone online. According to incomplete statistics, there were nearly 1,000 P2P lending platforms in China at the end of 2012, contributing up to RMB30 billion in private lending (see Figure 9-3).\(^1\)

Given the imperfect social credit system of the domestic financial environment which lacked effective regulation, numerous problems began to emerge in P2P lending in 2012. Meanwhile, its inability to adapt to the local environment was quite apparent, which led to an extension of many business models “with Chinese characteristics”\(^2\). In the current legal framework, these have shaken the nature of P2P loans as an intermediate service and gathered a great deal of risks. A batch of malicious platforms like “UEwang.com” emerged, which utilized regulatory loopholes to get away with defrauding funds from investors, and such developments have overshadowed this industry.

Overall, the scale of P2P lending industry has taken shape, and the next stage of development is to address industry supervision, a means by which P2P online lending can be qualitatively measured, and to play a decisive role for future industry development.

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\(^2\) Business models “with Chinese characteristics” refers to business models which do not appear in the development of foreign P2P loans, yet appear domestically due to differences in the external environment and participating subjects, such as platform principal guarantees, instant bidding, day bidding, and false loan bidding by the platform, as described hereinafter.
PPDai was founded in August 2007 and was the first Chinese P2P (person-to-person) lending platform. Not involved in loan transactions, the platform only offered loan information services and did not assume guarantee responsibilities. PPDai is the domestic representative of a pure online platform.

Eloancn.com was founded in 2007, is headquartered in Wenzhou and is one of the two P2P lending platforms of the Wenzhou Private Lending Registration Service Center. With service networks constructed in multiple first and second-tier cities throughout the country, this platform uses third-party lenders’ buy-backs to ensure the safety of investor funds.

My089.com was established in March 2009 and belongs to Shenzhen Honglingchuangtou E-Commerce Co., Ltd. This platform is the first domestic P2P lending platform to promote online guarantees, and the guarantor is Shenzhen Trustworthy Guarantee Co., Ltd. under Hongling.

Daibang.com was established in 2009 and has been committed to the management of micro and small financial loans, the loans of which are primarily directed towards the “Three Rural Issues” to support non-agricultural operations in rural areas. By establishing offices, this platform carries out due diligence offline.

Yinongdai.com was established in 2009 and is a platform which is positioned towards public financial management to assist farmers. With four years of operations, it provided farm loans worth over RMB 40 million to 7,876 farmers with the participation of over 8,000 investors.

Renrendai.com was established in April 2010 with 34 employees that utilize its own auditing and technology platform that was developed by itself independently. In 2011, the platform entered into strategic agreements with both hc360.com and DHgate and became one of the two P2P lending platforms of the Wenzhou Private Lending Registration Service Center.

Lufax.com was established in September 2011 and is the P2P platform of Ping An Insurance (Group) Company of China, Ltd. With a registered fund of RMB400 million, platform transactions are guaranteed by Ping An Insurance Company.

Gkkxd.com was established in December 2012, funded by CDB Capital and Jiangsu Jinrong. This platform is distinct in that it selects high-quality micro-credit companies within Jiangsu to serve as its offline auditors and guarantors and receives the support of a Provincial Financial Office.

9.2.1 Intensive P2P Online Lending Industry Competition Passes the 10 Billion Mark

According to the statistics on information released by the 66 P2P lending platforms, 56 platforms (84.8%) were established after 2011; registered capital typically fell between RMB1 million and RMB10 million, and an average amongst the 66 P2P lending platforms was RMB13.85 million with a median of RMB5 million (see Figure 9-4). The 66 platforms were primarily registered in relatively active regions of Beijing, Shanghai and Guangzhou, with a total of 53 platforms in the five provinces and cities including Guangdong, Zhejiang, Shanghai and Beijing, of which the registered capital of P2P lending platforms in Guangdong and Shanghai was the highest (see Figure 9-5).
Fig. 9-4 Scatter Diagram of Establishment Time and Registered Capital of 66 P2P Lending Platforms

Source: Wangdaizhijia.com

Fig. 9-5 Regional Distribution and Average Registered Capital of 66 P2P Lending Platforms

Source: Wangdaizhijia.com
We have selected six representative P2P lending platforms (PPDai, Renrendai.com, My089.com, 51qian.com, esudai.com and Zhongbao Investment), and according to the collated data, platform turnover in 2012 exhibited an overall rising trend month by month (see Figure 9-6), which may reflect the strong supply and demand and the rapidly expanding scale of the overall P2P lending industry in 2012.

![Fig. 9-6 2012 Monthly Turnover of Each Platform and Total Monthly Turnover of 6 Platforms](source)

We analyzed two factors behind the industry’s rapid expansion. On the one hand, private financing itself has prompted a strong supply and demand. The development of private financing has always existed in a gray area of laws, however the market supply and demand is enormous, and given the fact that private capital lacks effective investment channels and MSEs face an insufficient supply of credit, there has been an urgent need to solve the availability of credit, and the loan amounts of P2P lending platforms are positioned between several thousand to several million renminbi, with relatively low barriers to entry for investors. As such, P2P platforms have provided private capital and MSEs with a new channel for financing. On the other hand, the current P2P lending industry lacks industry access standards, and because the costs to set up a platform are relatively low, the industry has attracted a large batch of enterprises which lack any industry background in corporate and private lending. Such enterprises have set foot in the P2P lending business, and some of them aim to “fish in troubled waters”.

### 9.2.2 Chinese-Style Variations in Business Model

We can see that the P2P lending industry has not yet had time to accumulate the necessary domestic experience, but even so, the industry has experienced fierce, vicious competition, plus the imperfect social credit system and different ideas between borrowers and investors, lending platforms have created a wide range of business models to attract even more customers and some of these models are
involved in illegal operations or have even been suspected of illegal fund-raising, which thereby increases the risks of such platforms.

■ Principal Guarantee Models

As online lending investments also belong to the field of high-risk investments, platform operators must consider competition with their peers, and in order to meet investor demand for a safe recovery of their investment capital, operators have launched principal guarantees. At present, principal guarantee models can be divided into two categories. The first model is when the platform establishes a risk reserve, extracting a proportion of turnover which is then added to the risk reserve so that as soon as borrowers are late on payments, the platform can use the risk reserve to pay the investors their principal in advance, and the platform can become the new creditor, extending the time by which borrowers can recover (see Figure 9-7). This is currently the more widely used approach to guarantee principal. The other model is when the platform carries out its principal guarantee operations through an outside third party, who will deduce a guarantee fee from the transaction amount. As soon as a borrower is late on payments, the third-party guarantee agency will pay the investors their principal in advance, which is independent from the platform itself (as in Figure 9-8). For instance, Ping An Insurance Company provides third-party guarantees for Lufax.com and Shenzhen Trustworthy Guarantee Co., Ltd. provides third-party guarantees for My089.com.

![Fig. 9-7 Principal Guarantee Model 1: Platform Establishes Risk Reserves](image-url)
The second model is a means of external credit enhancement, ensuring the position of P2P lending platform as providing matchmaking trading service. In reality, however, as the risks are high and the earnings are low, guarantee companies are not interested in small credit loans. To this end, the guarantee agencies which work with Lufax.com and My089.com, respectively belong to a single group of financing guarantee companies.

In contrast, most platforms prefer to use the principal guarantee model in which they establish risk reserves, however this model increases the operational risk of the platform significantly as much as it attracts new customers. First, the principal guarantee models have shaken the positioning where P2P lending platforms are only liable for matchmaking trading and the nature of the platform upon incorporation is nothing more than a consulting company, information service company or e-commerce company; whether or not the company is qualified for the business of guarantees, the highest leverage ratio possible for such guarantees and other such questions are not yet clear. Second, principal guarantees increase the risk control capabilities required of such platforms, and if the platform’s guarantee fees cannot cover the overdue debts, the platform’s operations are thereby unsustainable. Over the last year, more than just a few platforms had gone out of business for this reason.

### Wealth Management Products and Loan Asset Management Business

The nature of P2P lending should be to provide financial matchmaking services for borrowers and investors, however, some P2P lending platforms are imperfect within the social credit system, and given the uncontrollable pressure of pure online lending risks, some have had to take their business offline, with the Internet serving only as a channel by which they can promote their corporate image and products. As such, investors and borrowers develop their relationships offline, platforms offer financial management products to investors, thereby forming an entrusted loan relationship. Furthermore, through their offline teams, these platforms then issue loans to provide micro and miro-credit asset management services to investors.

Information on such operations is extremely opaque, investors and borrowers do not...
make direct contact, and the platform participates in the actual borrowing transactions. Its essence, then, is to provide financial services as a financial intermediary. Hence, there is a risk of illegal fund-raising, and regulators have issued warnings against such practices.

### Instant Bidding, Day Bidding, Net Value Bidding and Other Unconventional Forms of Loan Bidding

In order to attract investors, some platforms may act as borrowers and issue unconventional bids such as instant bids, day bids and net value bids. Firstly, these borrowing bids do not reflect an actual demand for loans, and such loans will not flow into real production, nor can these bids solve the financing problems of MSEs. Secondly, platforms can gather a large amount of money by issuing borrowing bids. If there is no effective supervision on the capital trusteeship of third parties, it will be convenient for platforms to run away with the money they have obtained, which can be defined as illegal fund-raising.

By comparing borrowing bids of several P2P lending platforms limited to the term of 1 month from the time when the platform became active to the end of 2012, we discovered that the turnover for short-term bids (30 days or less) accounted for 90% of the number of total transactions and 80% of total amount of transactions (see Figure 9-9).

![Fig. 9-9 Comparison of the Number and Turnover of P2P Loan Bidding of Less than 1 Month and Greater than 1 Month (February 2012-December 2012)](source: Wangdaizhijia.com)

On June 3, 2012, the P2P lending platform Taojindai.com went live, using “instant bids” to attract a large amount of funds from investors. On June 8, the website was down, and on June 9, police in Shanghai and other places placed the case on file, confirming that over RMB0.88 million had been involved. On June 12, the suspects were arrested in Gansu Province. This was a premeditated crime that utilized the bait of “instant bidding”

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1 Instant bidding refers to the issuance of high-yield, short term borrowing bids on popular loans issued by P2P lending platforms in the hopes of attracting more customers, usually on a fraudulent site where investors bid and fight for money. Once the bidding is complete, the site quickly makes interest payments, while day bidding refers to the repayment of loans with interest within a day. Net value bidding refers to when the investor uses the net investments on the P2P lending platform as a guarantee by which he or she can publish loan bids of the given net value.
under the pretext of loose supervision.

■ Fictitious Borrowing Bids

As there is no supervision over P2P lending platforms at present and a lack of monitoring over the daily operations and background data of a website, you may find that many of the borrowing bids on a platform are released after the platform has received the application, instead of allowing the borrower to independently post the bid online. In such circumstances, the platform has every right to modify the content of the underlying loans and can utilize this flaw to forge borrowing bids. After the funds have been received, the platform can use it for other purposes such as lending it to other people at high interest rates. If credit risks spread to a large range of loan projects, it could lead to a break in the capital chain, and investors would suffer losses. However, if the platform continues to take in capital from the platform, it would be difficult to discover whether or not the platform was using funds appropriately. To investors, this is an enormous risk, and as soon as the truth comes out, they may lose everything.

Even though the P2P loan industry experienced explosive growth in 2012, but the quality of the large influx of entrepreneurs varies greatly: some entrepreneurs are only in the industry to speculate before formal rules are established. As such, the P2P loan market has experienced many cases in which platforms, one after another, have taken the money and run.

9.2.3 P2P Lending Platforms Must be Standardized

Generally speaking, current Chinese P2P lending platforms can be described as “having demand, supply and intermediary service providers with gathering of funds, talent, high-technology and high risks but lacking barriers to entry, industry standards and regulatory agencies”.

As a complement to formal financing, increasing the market supply of credit, P2P lending has its own value and significance, however in the process of development, it must become consolidated and reshuffled, eliminating a number of poorly managed companies and even crippling a number of gangs connected to illegal and criminal activities by P2P lending. After the reshuffle, some massive, powerful online lending companies will likely emerge through the merger and acquisition of small and medium online lending companies, while other P2P lending companies will solely focus on platforms by which they can introduce and foster a number of partnerships with financial service institutions, linking the online lending industry to upstream and downstream cooperation, thereby optimizing the industrial chain and forming a large, Internet-based financial cluster. Speculating upon the various Internet financial trends that we have seen this year, we expect that, if the policy and legal environment does not deteriorate significantly, that perhaps several large online and offline integrated P2P companies will emerge in China over the next three to five years, possibly in the form of franchising. With the current round of financial reforms and regional cooperation and combined with capital markets, regional expansion can be furthered and functions can be optimized after investments are obtained.

The standardization of the P2P lending industry has already become an industry consensus. At present, three developmental paths have already been formed:

The first path is to regulate private lending service centers. The second path is to

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regulate information service industry associations, which is already being tested in Shanghai. The third path is to establish a self-disciplinary league for the P2P industry. Because the establishment of a Chinese industrial association requires the approval of an administrative authority, and because the P2P industry does not have one, approval would be incredibly difficult to obtain. Also, some P2P-related organizations are private organizations with no official background and no strong normative role. In such cases, these organizations must rely on corporate self-regulations.
10. A Prospect of Development in MSME Financial Services

In 2013, the new administration formally took office, and China’s economy entered a new stage of development. With the arrival of the break point for demographic dividends as well as the weakening supportive force of the natural environment and natural resources, the speed of economic development will inevitably slow down under current levels of technology, and the structural reform has to be done. The new session of the Central Government has realized the importance of economic restructuring, become increasingly tolerant of an economic slowdown, and further shifted resource allocation rights to the market. Only through the promotion of scientific and technological innovation, shifting from extensive to intensive policies, can the economy return to a level of potential high-speed growth. In this process, the status and role of MSMEs is irreplaceable. The development of MSME financial services will also play an even more important role in China’s economic transformation.

In 2013, alongside the accelerated pace of financial reforms, interest rate marketization will be further carried forward. Reforms to the capital price formation mechanism will play a vital role in the optimization and enhanced efficiency of resource allocation. Over the past years, we have clearly seen the positive effect that interest rate marketization has had on promoting the restructuring of commercial banks. In 2013, we optimistically predict that interest rate marketization and financial disintermediation is expected to replace policies as the true diving force of MSME financial services. In 2013, commercial banks will continue to ramp up MSME financial services, and MSE financial service product innovation will become more active. Commercial banks will continue to attach more importance to MSE financial services and further increase MSE loan facility arrangements while also upping the pressure to the performance of MSE financial managers. Meanwhile, the increased risk of MSE loans cannot be avoided, and the issue of striking a balance between the expansion of MSE financial business and risk management must attract a high attention from various banks in 2013. In 2013, many more commercial banks will enter the ranks of retail-oriented MSE financial services, and retailing financial services to small and micro-enterprises will become an important initiative of their strategic transformations. Moreover, it is foreseeable that all commercial banks, in order to get away from the homogenous state of competition, will make proper customer orientation, provide specialized products and continue to enhance the core competencies of their MSE financial services. The issue of properly handling the balance among competitive, revenue, innovation and risk is bound to become the future subject of focus for the small and micro-financial business of all commercial banks.

In 2013, as regulations tighten and competition becomes increasingly fierce, a “reshuffling” or “exit tide” may occur in the miro-credit industry, after having experienced long-term rapid growth. As the growth rate of miro-credit industry slumps, more attention will be given to the inherent strength of the industry. We have already seen the efforts of regulators and self-regulatory organizations within the industry in promoting the true miro-credit services to MSEs, as have we seen the incredible rise of a considerable number of outstanding miro-credit companies who have performed well in the field of small and micro-financing and serve as good role models. We have reason to believe that the miro-credit industry will embark on a road of sustained and healthy development thanks to the concerted efforts of various parties, and we also look forward to the emergence of even more loan companies.
specializing in small and micro-financing. In 2013, the rapidly developing financial leasing companies will present clearer and more differentiated positioning. Although it is difficult to optimistically foresee a large number of leasing companies offering specialized SME financing, we expect that more and more financial leasing companies will pay greater attention to SME financial leasing opportunities, which will provide more flexible and convenient SME financial services for transformation and upgrade of more SMEs. Moreover, the pawn industry will maintain a steady growth, and MSEs have already and will continue to be their core customers. In terms of meeting the “short-term, small scale, frequent and urgent” financial services demanded by MSEs, pawnshops have an advantage in flexibility and speed which will further strengthen their competitiveness against other types of financial institutions.

Effected by the poor performance of the stock market, the venture capital industry is faced with many uncertainties after the “cold winter” of 2012. The need to adapt to a slowdown in investment has become a consensus amongst venture capital institutions, and the investment exit from the more active merger and acquisition market has become a popular choice for venture capital institutions, although it would be difficult to reproduce the high returns earned by several enterprises within the industry. In the context of the receding industry bubble, there would be a more intense scramble for high-quality SMEs. The expansion of venture capital institutional investors will have a major influence on venture capital markets or will bring about a recovery in the venture capital industry, while also further promoting a reshuffle amongst venture capital institutions. With the expansion of the New Three Boards, the accelerated construction of OTC markets and other such initiatives will lay down a solid foundation for the healthy and sustainable development of the venture capital industry. Although the short-term impact of such initiatives is limited, the long-term effects will be worth the wait.

With the arrival of an age of general asset management, although faced with a great deal of competitive pressure from insurance companies, funds and securities companies, trust companies, as professional asset management and financial planning, still have obvious advantages and unique, comprehensive competitiveness. During the process of high-speed development in trust industry, the investment structure of trusts is also experiencing changes, and the role of trusts in supporting the development of the real economy is only becoming clearer. We look forward to the continued stabilization of the position of industrial and commercial enterprise trusts, following its place as the number one major configuration area of trust assets in 2012, and we particularly look forward to the further increase in SME trusts as a proportion of industrial and commercial enterprise trusts. Additionally, we expect that trust companies will expand their cooperation with SME financial institutions, including miro-credit companies and financial leasing companies, which also indicate the advantage of trust industry in indirectly supporting the SMEs.

As for the stock market, in 2013, as there is more stringent supervision over the financial status of listed companies, we are not optimistic about the state of IPOs. As such, the volume of capital acquired from SME IPOs may continue to decline. Refinancing activities of listed companies will tend to become more active, however, small and medium-scale listed companies are not optimistic about funds which can be raised from refinancing. We look forward to breakthroughs in the GEM and SME board refinancing such as a simplified refinancing process and the marketization of price formation for refinancing, which will better satisfy the demand of listed SME
companies for refinancing. In the context of IPO restrictions, merger and acquisition is becoming a popular solution for going public, which can bring both opportunities and challenges for SMEs. Furthermore, we look forward to the positive long-term effects of a series of systematic adjustments and reforms to the stock market that were implemented in 2012, particularly the gradual establishment of a regulated, multi-level equity market, which will have a great deal of importance in expanding SME financing channels. Listings on the “New Three Boards” marks the fundamental establishment of China’s multi-level capital market, however the “top-heavy” Chinese capital market system is desperately to be changed so as to coordinate federal and regional governments and solve their disputes and address the issue of conflicting interests; the integration of market resources will promote the formation of a reasonable and effective hierarchy between connections and interactions. The eventual establishment of a national OTC market could maximize the coverage of all types of SMEs.

In 2013, in the context of interest rate marketization, the trend towards financial disintermediation will continue, which means that there is a high probability that corporate financing will increase as a proportion to total financing society, leading to two possible outcomes: On the one hand, bond market developments will offer an alternative form of financing to medium and large enterprises, beyond that of bank credit financing, thereby encouraging commercial banks to pay much attention to attracting and maintaining MSE customers, indirectly promoting the development of small and micro-credit loans. On the other hand, the further strengthening of the bond market is conducive to increasing the participation of a wider range of investors, and the abundant risk preferences of investors may give special significance to the direct financing of those SMEs with access to bond markets. Specialized MSE financing bonds will continue to offer a source of capital for commercial banks to increase their small and micro-credit business. SME privately raised corporate bonds will also become more important in matching SME financing needs with corresponding investors.

As for private financing, further local financial reforms will be carried out in 2013. Formalization of private financing is not an easy task and calls for efforts from all parties. Internet financing, represented by P2P lending, is as popular as ever in 2013, and alongside the exposed risks of P2P lending, further discussion and comprehension will be made within the industry on Chinese-style variation of P2P lending. The development of specification and self-discipline within the industry is a common consensus. Industry consolidation and reshuffling will create developmental opportunities for those institutions adhering to operating norms, and as such, capital tends to flow towards well-behaved institutions. With constant upgrades and improvements in information technology and credit systems, we are happy see the new energy brought by new technology and new ideologies to MSME financial services and expect to see more favorable innovations subject to the nature of finance.

We still must emphasize the fact that the real economy is the foundation for the development of financial services. Without the sound development of MSMEs, there is no source for MSME financial services. As the economy bids farewell to high-speed growth and enters into a period of in-depth restructuring, the operational difficulties that SMEs face will be difficult to reverse in the near future. Tax cuts have already become the most anticipated policy for many MSMEs, and although several structural tax cuts have been released in recent years, the intensity of tax cuts has been far below market expectations. Therefore, we look forward that, in 2013, the development of
various tax incentives which support MSMEs and individual businesses can be actually helpful and carried out in practice, creating new space for MSE growth in the market as well as new development opportunities, and therefore making a basis for MSME financial services which can maintain the momentum of sustainable development.
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Name</th>
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<tbody>
<tr>
<td>AACPIII</td>
<td>Asia Alternatives Capital Partners III</td>
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<tr>
<td>ABC</td>
<td>Agricultural Bank of China</td>
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<td>ACWF</td>
<td>All-China Women’s Federation</td>
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<td>BOC</td>
<td>Bank of China</td>
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<tr>
<td>BOCOM</td>
<td>Bank of Communications</td>
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<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
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<td>CCB</td>
<td>China Construction Bank</td>
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<td>CEB</td>
<td>China Everbright Bank</td>
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<td>CEIC</td>
<td>China Economic Indicator Database</td>
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<tr>
<td>CFPA</td>
<td>China Foundation for Poverty Alleviation</td>
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<td>CGB</td>
<td>China Guangfa Bank</td>
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<tr>
<td>CICC</td>
<td>China International Capital Corporation Limited</td>
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<tr>
<td>CICETE</td>
<td>China International Center for Economic and Technical Exchanges</td>
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<tr>
<td>CMB</td>
<td>China Merchants Bank</td>
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<td>CMBC</td>
<td>China Minsheng Bank</td>
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<td>CMST</td>
<td>China Materials Storage and Transport Corporation</td>
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<tr>
<td>CNCB</td>
<td>China CITIC Bank</td>
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<td>CP</td>
<td>Commercial Paper</td>
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<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
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<tr>
<td>CUFE</td>
<td>Central University of Finance and Economics</td>
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<td>FOF</td>
<td>Fund of Funds</td>
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<tr>
<td>GEM/GEMs</td>
<td>Growth Enterprise Market(s)</td>
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<td>GP</td>
<td>General Partner</td>
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<tr>
<td>ICBC</td>
<td>Industrial and Commercial Bank of China</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<tr>
<td>IPO</td>
<td>Initial Public Offering</td>
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<tr>
<td>LGFV</td>
<td>Local government financing vehicle</td>
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<tr>
<td>LP</td>
<td>Limited Partnership</td>
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<tr>
<td>MSE/MSEs</td>
<td>Micro and small enterprise(s)</td>
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<tr>
<td>MSME/MSMEs</td>
<td>Micro, small and medium enterprise(s)</td>
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<tr>
<td>MTN</td>
<td>Medium-Term Note</td>
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<tr>
<td>NASDAQ</td>
<td>National Association of Securities Dealers Automated Quotation</td>
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<tr>
<td>NSF C</td>
<td>National Natural Science Foundation of China</td>
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<tr>
<td>O2O</td>
<td>Online to Offline</td>
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<tr>
<td>OTC</td>
<td>Over-the-Counter</td>
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<tr>
<td>P2P</td>
<td>Peer-to-Peer</td>
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<td>PBOC</td>
<td>People’s Bank of China</td>
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<td>PE ratio</td>
<td>Price Earning ratio</td>
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<td>QFLP</td>
<td>Qualified Foreign Limited Partner</td>
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<td>ROSCA</td>
<td>Rotating Savings and Credit Association</td>
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<tr>
<td>Rules</td>
<td>Shenzhen Stock Exchange GEM Listing Rules</td>
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<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<td>SME/SMEs</td>
<td>Small and Medium Enterprise(s)</td>
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<td>SML</td>
<td>Small, Medium and Large</td>
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<tr>
<td>SPDB</td>
<td>Shanghai Pudong Development Bank</td>
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<tr>
<td>SSE</td>
<td>Shanghai Stock Exchange</td>
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<tr>
<td>SZSE</td>
<td>Shenzhen Stock Exchange</td>
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<tr>
<td>TEE</td>
<td>Tianjin Equity Exchange</td>
</tr>
<tr>
<td>VTB/VTBs</td>
<td>Village and Town bank(s)</td>
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<tr>
<td>Yinhuotong</td>
<td>Hangzhou Yinhuotong Technology Co., Ltd.</td>
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<tr>
<td>Zhejiang Yongjin</td>
<td>Zhejiang Yongjin Warehousing Corporation</td>
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