

# Strategy for Financing Development: Policies, Issues, and Prospects

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## Preface: future economic growth, financing support and supply channels

In the past 20 years, Chinese economy has been growing rapidly with y-o-y growth rate at 9.52% from 1978 to 2000. The growth rate was higher than that of 6.1% from 1952 to 1978, and roughly comparative to the high speed growth period of Japan and “Asian four tigers”.

After entering into 21st century, the growths of main developed countries become slow and get into decline; the world economy takes a sudden turn and then drops rapidly. According to IMF, the world economic growth rates during 2000 and 2004 were 4.7%, 2.3%, 2.8%, 3.7% and 4.5% respectively, in which developed countries take 4.1%, 3.9%, 1.2% and 2.5% respectively. While the global economy fluctuated, Chinese economy kept on growing rapidly with the average growth rate at 8.73% from 2000 to 2005. The momentum seems to continue for some time in future. According to expectation, during the period of “the 11th five-year plan” (from 2006 to 2010) Chinese economy will continuously keep growing with the growth rate around 8%.

The growth of economy needs a large amount of funds. The total financing was 10.78

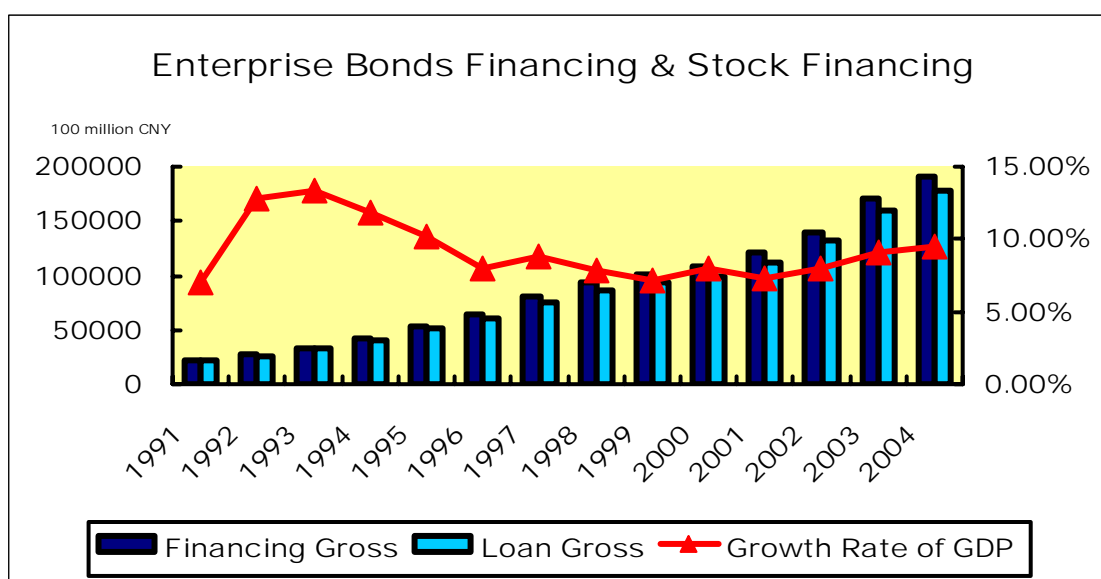
trillion Yuan in 2000 and 19.01 trillion Yuan in 2004, 5.32% y-o-y in five years. At the same time, the loan scale in financing correspondingly puts up an expansive trend, 9.94 trillion Yuan in 2000 and 17.82 trillion Yuan in 2004, with a 15.78% growth in five years. Growing at such a speed, approximate 171 trillion Yuan will be needed for economic growth of China from 2006 to 2010. Therefore, a steady and developed investment and financing system will be indispensable.

**Table 1 Chinese Economic Development and Financing**

Unit:100million CNY

Year	Financing Gross	Loan Gross	Growth Rate of GDP
1991	22008	21338	7.00%
1992	27695	26333	12.80%
1993	33936	32943	13.40%
1994	42436	40810	11.80%
1995	52500	50538	10.20%
1996	64750	61153	8.00%
1997	80338	74914	8.80%
1998	93273	86524	7.80%
1999	100495	93734	7.10%
2000	107859	99371	8.00%
2001	121087	112284	7.30%
2002	138640	131294	8.00%
2003	170661	158996	9.10%
2004	190132	178198	9.50%

SOURCE: China Statistical Yearbook (1992-2005), China Securities and Futures Statistical Yearbook (1992-2005)



The development of financing system in China has experienced a changing process, which was from the finance supply system under planned economy to the modern market system under socialist market economy. This process reflects a transformation from the traditional financing system to the modern market system. This changing process includes an inherent logicity between economic system reform and finance system reform of our country, as well as the general disciplinarians in the evolvement of credit system and financing system. In the period of economy changeover, whether the financing system is able to sufficiently mobilize the country deposit to provide continuous funds supply, determines the economic growth rate. There is always a high deposit rate during the economic development of our country, whereas some confliction and friction exist between the transformation of economy system and the development of financing system, and “finance dualism” is still in Chinese finance market. This situation leads to the high deposit rate is not able to translate to high investment rate completely; the capital supply is separated from effective investment opportunity; the financing system is in a low efficiency status, which is the reason why the actual economic growth in China is lower than the potential economic growth. Therefore, the main task to promote the economic development of our country is to improve the financing system and enhance the financing performance. Now, I would like to expatiate on actualities, problems, trends and developments of financing system in China from four aspects.

## Part 1: Direct Financing Versus Indirect Financing

### 1. The imbalance of indirect financing and direct financing

As the raise of securities financing in China, the direct financing get a rapid development, but it only takes a relatively small proportion of financing gross, and bank credit takes absolute dominance. Until the end of 2005, the proportion of indirect financing in the total financing amount of society is as high as 91.82%, while the proportion of direct financing is only 8.18%. In contrast, in the western market economy international and rising industrialization countries, it is commonly that the bank credit takes roughly 70% of the enterprise exterior financing sources, while the direct financing such as stock and bond takes the proportion of 20% to 30%. For instance, from 1970 to 1985, in the composition of exterior funds sources of non-finance institutes in the States, stock and bond take 29.8%, bank loan takes 61.9%. and others (including government loan, overseas loan and bargainer credit) take 6.2%; in the composition of exterior funds sources of non-finance institutes in the Japan, stock and bond take 9.8%, bank loan takes 62.9% and others take 27.3%; the direct financing proportion of enterprise department in Korea had reached 19.09% during 1970s, and increased to 42.55% in early 1990s, while the proportion of bank credit kept being around 40%.

**Table2 Proportion of Bank and Securities Financing**

Unit:100million CNY

Year	Financing Gross	Loan of Bank	Securities Financing	Proportion of securities Financing (%)
1991	22008.21	21338	670.41	3.05%
1992	27694.50	26333	1361.60	4.92%
1993	33935.72	32943	992.62	2.93%
1994	42436.18	40810	1626.08	3.83%
1995	52499.98	50538	1961.98	3.74%
1996	64750.17	61153	3597.37	5.56%
1997	80338.44	74914	5424.34	6.75%
1998	93272.51	86524	6748.41	7.24%
1999	100494.75	93734	6760.45	6.73%
2000	107859.18	99371	8488.08	7.87%
2001	121087.43	112284	8803.15	7.27%
2002	138640.00	131294	10114.05	7.30%
2003	171018.70	158996	12022.50	7.03%
2004	190459.37	178198	12261.57	6.44%

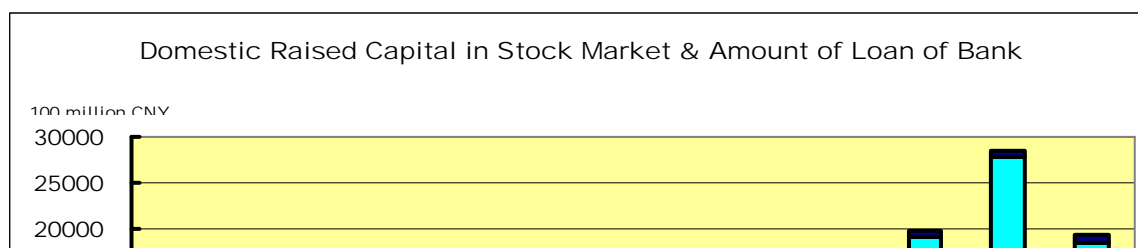
SOURCE: China Statistical Yearbook (1998-2005), China Securities and Futures Statistical Yearbook (1992-2005)

**Table3 Domestic Raised Capital in Stock Market & Amount of Loan of Bank**

Unit:100million CNY

Year	Amount of Loan of Bank	Domestic Raised Capital in Stock Market
1993	6335	315
1994	7217	138
1995	9340	119
1996	10683	342
1997	10712	934
1998	11491	804
1999	10846	897
2000	13347	1541
2001	12439	1182
2002	18979	780
2003	27702	823
2004	18367	863

SOURCE: China Statistical Yearbook (1998-2005), China Securities and Futures Statistical Yearbook (1994-2005)



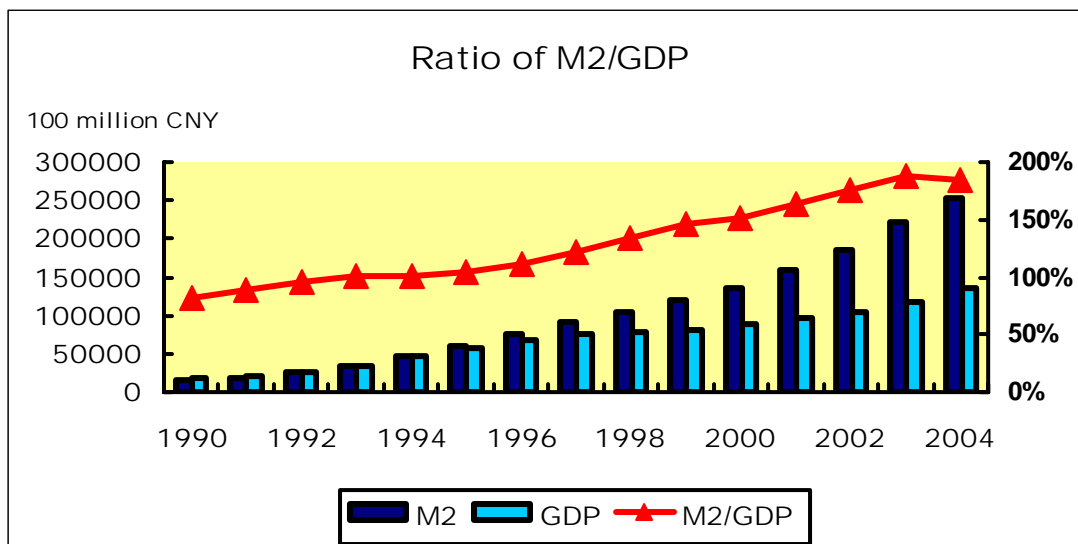
The consequence of over-relying on bank for enterprise financing, from the microcosmic point of view, the finance leverage rate of enterprise is commonly as high as 70% to 80%, and the finance risk is large. From the macrocosmic point of view, because the money supply is mainly from bank loan, the continual increase of loan leads to the ratio of M2/DGP getting higher and higher, the ratio is 187% in 2003, and 200% at the end of June in 2004, which is the peak level in the world. This indicates the economic growth of our country has the obvious characteristic of credit promotion. (M2/GDP table, figure and comparisons with other countries)

**Table4 : M2/GDP**

Unit:100million CNY

<b>Year</b>	<b>M2</b>	<b>GDP</b>	<b>M2/GDP</b>
1990	15293	18548	82%
1991	19350	21618	90%
1992	25402	26638	95%
1993	34880	34634	101%
1994	46924	46759	100%
1995	60751	58478	104%
1996	76095	67885	112%
1997	90995	74463	122%
1998	104499	78345	133%
1999	119898	82068	146%
2000	134610	89468	150%
2001	158302	97315	163%
2002	185009	105172	176%
2003	221223	117390	188%
2004	253208	136876	185%

**SOURCE : International Financial Statistics Annals, IMF**



The high proportion of indirect financing in financing gross inevitably leads to three aspects of consequence: Firstly, the changeover of financing system lags badly but the distribution situation of national income changes materially, residents lack of investment channel and have to choose to deposit saving in banks, which leads to the centralization of social credit and increase of social risk, and it is hard to realize the socialization of capital and risk. Secondly, the enterprises' over relying on bank loans makes indebted rate over high, interest burden over heavy, capital structure irrational, and increases the risk of enterprises' over-indebted operating and the bad assets of banks. Thirdly, under the restriction of the lacking of finance market product supply, for eliminating the redundant fluidity, putting a large amount of funds into limited finance market product investment may lead to interest low and investment yield rate decline. Let's take 2005 as an example, the difference of the increase of bank deposit and loan expanded continuously, a large amount of funds turned into being invested to the market among banks, the investment yield rate declined, the public bidding interest of 1 year public debit and central bank notes was only around 1.5%, far lower than the interest rate of 1 year fixed deposit, leading to the yield of using funds in commercial banks less than the cost, which increased the investors' interest risk.

## 2. Interior of indirect financing: the credit monopolization of nationalized banks

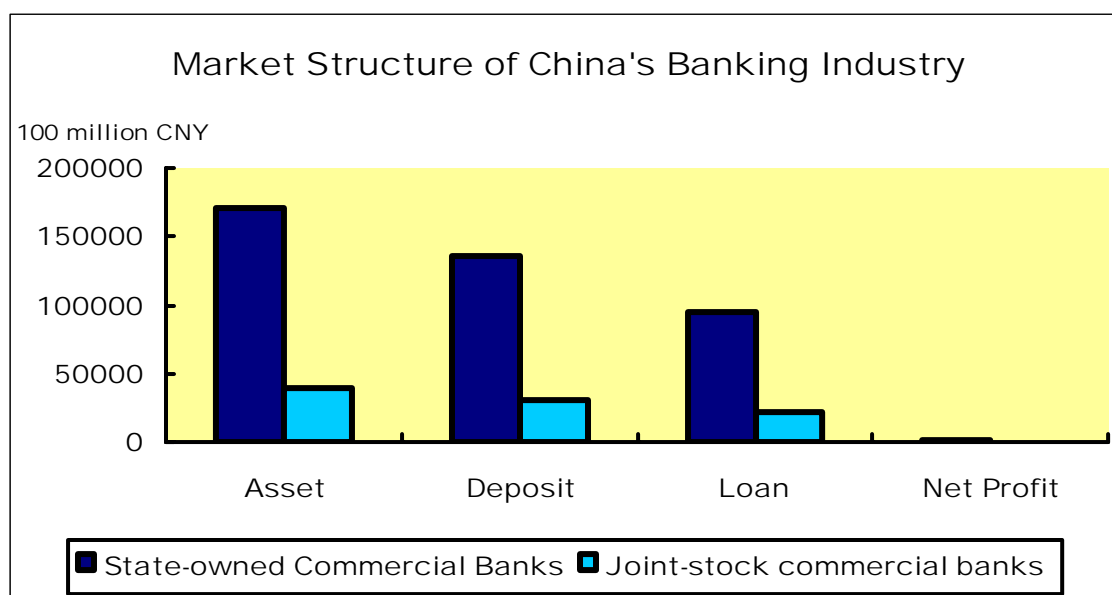
An important aspect of structure deficiencies in financing system is the credit monopolization of nationalized banks, and lacking of non-nationalized bank system to adapt to the development of non-nationalized middle and small size enterprises. At present, finance assets and finance business are mainly centralized in the four big nationalized commercial banks; their finance assets take 70% of the whole finance assets, and also take more than 60% of the deposit and loan market shares, forms, which forms the situation that the nationalized banks absolutely control the finance assets and finance markets.

**Table 5 Market Structure of China's Banking Industry(2004)**

Unit:100million CNY

		Asset	Deposit	Loan	Net Profit
<b>State-owned Commercial Banks</b>	<b>CBC</b>	56705.21	48055.86	34684.64	23.11
	<b>ABC</b>	40137.09	34173.22	25146.26	20.03
	<b>BC</b>	34896.39	21321.8	13822.5	209.32
	<b>CCBC</b>	39047.85	31988.34	21081.48	483.88
<b>Sum</b>		170786.54	135539.22	94734.88	736.34
<b>Joint-stock commercial banks</b>	<b>BCCOM</b>	11386.34	8801.4	5632.7	9.15
	<b>CNNB</b>	5148.22	3793.2	2913.9	3.18
	<b>HXB</b>	3043.26	2678.42	1811.12	10.17
	<b>CMBC</b>	4453.99	2748.16	2017.73	20.38
	<b>GDB</b>	3445.11	2809.56	2035.9	1.02
	<b>CMBC</b>	6027.65	5125.86	3759.07	31.44
	<b>SDB</b>	2042.86	1582.21	1210.24	2.9
	<b>CIB</b>	3405.22	2737.88	1979.22	11.01
<b>CZB</b>	103.07	77	51	0	
<b>Sum</b>		39055.72	30353.69	21410.88	89.25

SOURCE: Almanac of China's Financial and Banking (2004)



The consequence of the situation of nationalized banks' monopolization is that the administration organizations' monopolization builds up a high market rampart, keeps the market competition within the limits, and causes the deficiency of available competition, all of which block the development of non-nationalized middle and small size banks that adapt to the development of non-nationalized middle and small size enterprises. For the past many years, there has not been a non-finance institute which is developed or permitted to develop for adapting to the non-nationalized industries. In the past, there has

ever been some initial status, but suppressed or closed (such as non-governmental finance and agricultural cooperation funds), or merged into nationalized bank system with relatively large scale, and its intrinsic characteristic and superiority lost. This kind of kickback is multiple: firstly, nationalized banks operate by monopolizing, and the economic efficiency is low. This year the average asset profit ratio of four big nationalized commercial banks is 0.26%, and appears to be a continuous downtrend. At the same time the ratio of Shenzhen Development Bank and China Merchants Bank are 2.9% and 2.52% respectively, which approach to the asset profit level of the best banks in the world, and appear to be a steady uptrend. Secondly, the high monopolization of the four big nationalized commercial banks reduces the finance resource which can be obtained by the middle and small size finance institutes, restricts the capability of their services to middle and small size enterprises. But the nationalized banks are reluctant to issue more loans to middle and small size enterprises; this inevitably causes the difficulty in financing for middle and small size enterprises. Thirdly, the lack of middle and small size finance institutes and the high cost of direct financing keep many middle and small size enterprises out of the normal finance market.

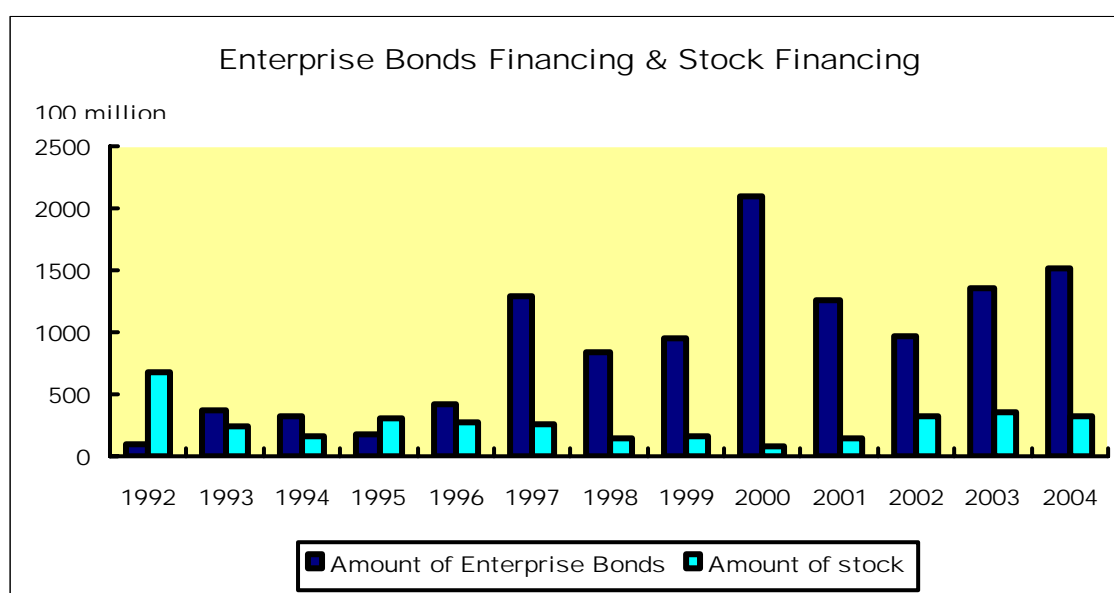
### 3. The interior of direct financing: the imbalance among various market levels

Firstly, the developments of stock market and bond market are imbalance, the development of bond market relatively lagged. Generally speaking, the bond market in China is underdeveloped, due to the small amount and inappropriate structure. The balance of the world bond market in 2002 was over 34 trillion dollar, taking 85%. If measured by the relative size of bond market (the ratio of bond market capitalization and homeland GDP), it was 32% in China, much lower than the average size of 116% in Group of Seven. As for the structure, the bond market in China appears to be a typical structure mainly occupied by the low risk government bond and finance bond, the proportion of debenture stock is very low. This situation is obviously inconsistent with the prevalent international experiences. For example, the circulation of debenture stock in the States was 711.2 billion dollar in 2004, roughly equal to the circulation of the public debt in the same period. The balance of debenture stock was 4700 billion dollar, 1.2 times than the balance of public debt, taking 20% of the whole bond store and 40% of GDP. At the same time, the development speed of stock market is much higher than that of enterprise bond market, thereby the imbalance between the two kinds of marks are shown itself.

<b>Table6 Enterprise Bonds Financing &amp; Stock Financing(1992-2004)</b>		
Unit:100million CNY		
<b>Year</b>	<b>Amount of Enterprise Bonds</b>	<b>Amount of stock</b>
<b>1992</b>	94.09	683.71
<b>1993</b>	375.49	235.84
<b>1994</b>	326.78	161.75



1995	180.32	300.8
1996	425.08	268.92
1997	1293.82	255.23
1998	841.52	147.89
1999	944.56	158.2
2000	2103.16	83
2001	1252.28	147
2002	961.75	325
2003	1357.75	358
2004	1519.94	327



**SOURCE: China Securities and Futures Statistical Yearbook (1993-2005)**

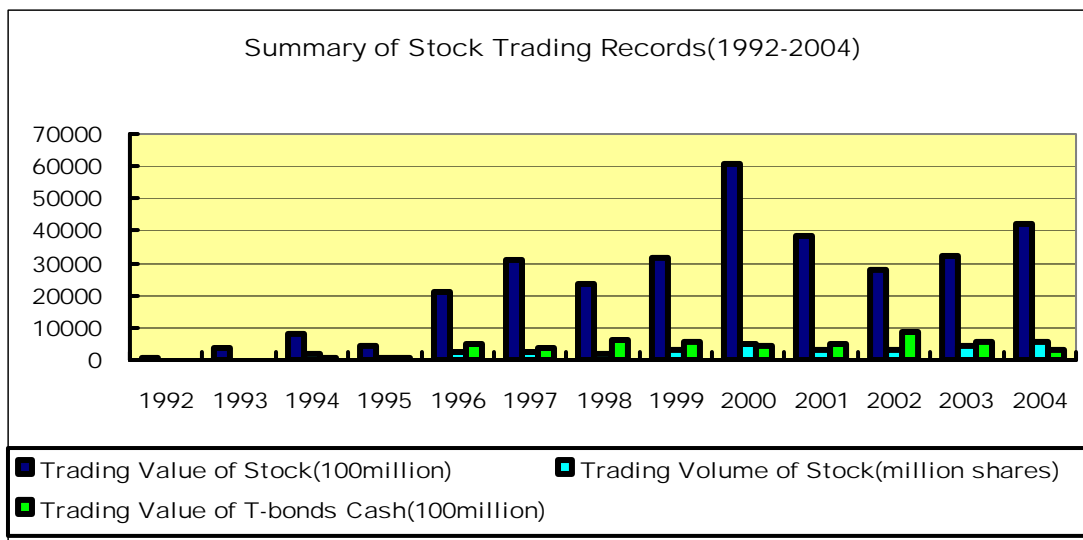
At present, more and more attentions are paid to the development of enterprise debt. A remarkable sign of finance market of 2005 is short-term financing bond, the restarting of the enterprise bond market, and a big step in the field of enterprise direct financing. 207.8 billion Yuan's short-term financing bond and enterprise debt were issued in 2005, which took 1.7% of the non-finance institutes' financing in the first half year, as 3rd times as that in the first half year of 2004. In the following years, enterprises short-term financing bond and enterprise bond will get a further development, and will become an important approach for enterprise direct financing.

**Table7 Summary of Stock Trading Records(1992-2004)**

Year	Trading Value of Stock(100million CNY)	Trading Volume of Stock(million shares)	Trading Value of T-bonds Cash(100million CNY)
1992	681	37.95	7.13
1993	3667	234.22	61.02

1994	8128	2013.34	468.37
1995	4036	705.47	775.20
1996	21332	2533.14	5029.24
1997	30722	2560.79	3582.75
1998	23544	2154.11	6059.95
1999	31320	2932.39	5300.87
2000	60827	4758.40	4159.49
2001	38305	3152.29	4815.59
2002	27990	3016.19	8708.68
2003	32115	4163.08	5756.11
2004	42334	5827.73	2966.46

SOURCE: China Securities and Futures Statistical Yearbook (1993-2005)



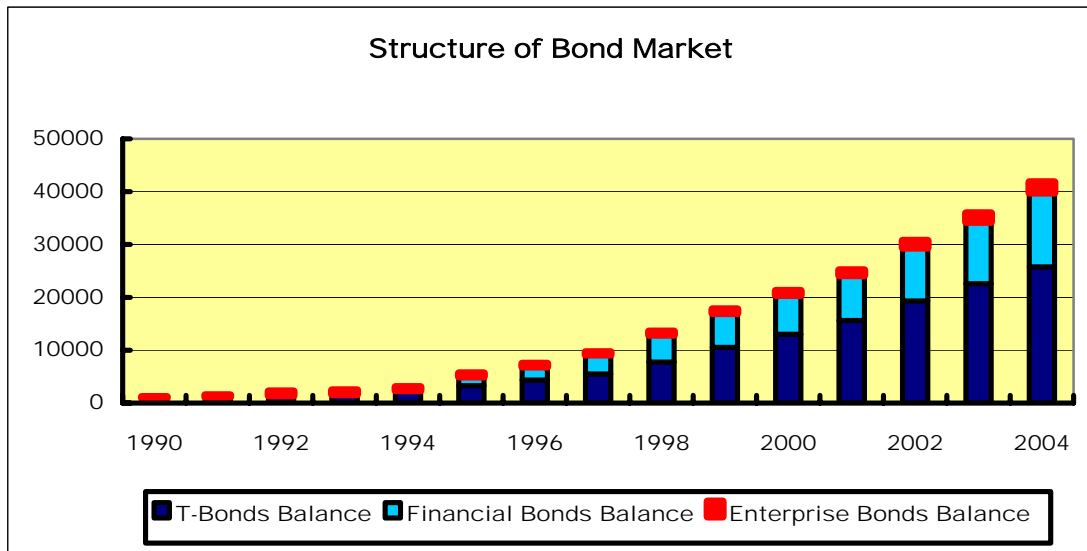
**Table8 Structure of Bond Market**

Unit:100million CNY

Year	T-Bonds		Financial Bonds		Enterprise Bonds	
	T-Bonds Balance	Proportion (%)	Financial Bonds Balance	Proportion (%)	Enterprise Bonds Balance	Proportion (%)
1990	890.34	76.05%	84.88	7.25%	195.44	16.69%
1991	1059.99	70.24%	118.12	7.83%	331.09	21.94%
1992	1282.72	57.06%	143.12	6.37%	822.04	36.57%
1993	1540.74	62.84%	108.83	4.44%	802.4	32.72%
1994	2286.4	74.63%	95.29	3.11%	682.11	22.26%
1995	3300.4	58.36%	1708.49	30.21%	646.61	11.43%
1996	4361.43	58.39%	2509.69	33.60%	597.73	8.00%
1997	5508.93	57.04%	3628.8	37.57%	521.02	5.39%
1998	7765.7	57.25%	5121.13	37.76%	676.93	4.99%

1999	10542	59.33%	6447.48	36.29%	778.63	4.38%
2000	13020	61.23%	7383.28	34.72%	861.63	4.05%
2001	15618	62.44%	8534.48	34.12%	861.63	3.44%
2002	19336.1	63.92%	10054.1	33.23%	861.63	2.85%
2003	22603.6	64.37%	11650	33.18%	861.63	2.45%
2004	25777.6	63.40%	14019.3	34.48%	861.63	2.12%

SOURCE: China Securities and Futures Statistical Yearbook (1991-2005)



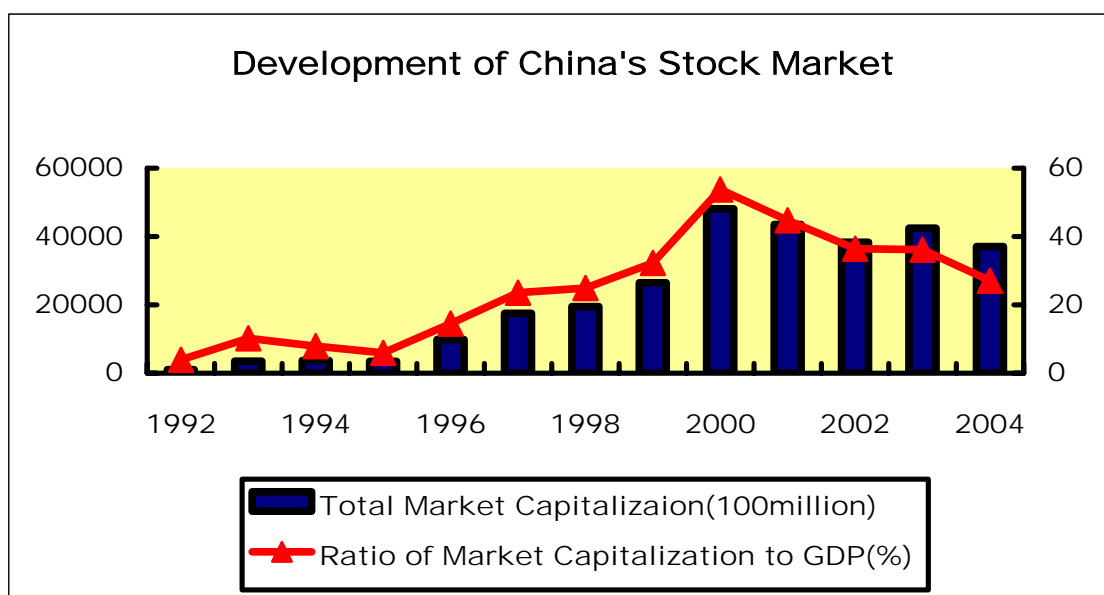
Secondly, the size of stock market is deficient, and the structure is defective.

(1) The stock market develops rapidly, but its size is deficient. Presently the stock market in China is at the third place accounted by market capitalization among the countries and regions in Asia, only inferior to Japan and China Hong Kong SAR. Until the end of 2004, the number of companies listed in domestic market is as many as 1,377, the total capital in A share market is 714.9 billion shares, the market capitalization of which is 370.6 billion dollar. Compared with the economic size, the stock market size is obviously small. The total market capitalization of stocks only took 27% of GDP in 2004; this proportion is not only much lower than that in the developed countries such as OECD, but also evidently lower than that in some developing countries such as India and Brazil. Analyzed from the enterprise financing structure point of view, the proportion of stock financing in 2005 was only 6%.

**Table9 Development of China's Stock Market**

Year	Number of Domestic Listed Companies(A,B share)	Total Market Capitalization(100million CNY)	Total Issued Capital(100million shares)	Ratio of Market Capitalization to GDP (%)
1992	53	1048.13	68.87	3.93
1993	183	3531.01	387.73	10.20
1994	291	3690.62	684.54	7.89

1995	323	3474	848.42	5.94
1996	530	9842.37	1219.54	14.50
1997	745	17529.23	1942.67	23.54
1998	851	19505.64	2526.79	24.90
1999	949	26471.17	3088.95	32.26
2000	1088	48090.94	3791.71	53.75
2001	1160	43522.19	5218.01	44.72
2002	1224	38329.12	5875.45	36.44
2003	1287	42457.72	6428.46	36.17
2004	1377	37055.57	7149.43	27.07



**SOURCE: China Securities and Futures Statistical Yearbook (1993-2005)**

(2) The non-public issue system and curb exchange market are lacking. Another important problem existing in Chinese stock market is lack of necessary levels; no multilevel markets are formed to correspond to the different sizes, payoff abilities and growing stages of enterprises. All the stocks are issued publicly; and the all the exchanges take place in Shanghai or Shenzhen Stock Exchanges. Due to there is not a definite approach to issue stock non-publicly, and also due to the position of the curb exchange markets besides stock exchanges is not clarified, most enterprises, especially the middle and small size enterprises are hard to get financing through stock market.

#### 4. on-going reform and effect

(1) The indirect financing is being consummated and developed. The reform of nationalized commercial banks beginning in 2004 makes the indirect financing channels increasingly standardized. Having experienced the government's fund infusion, bad assets disposal, cooperation govern structure reform, personnel and payroll system reform, issuing secondary debt to complement capital and introducing strategy investors, China Construction Bank took the lead in being listed in Hong Kong in October, and Bank of China's entrance to the market is expected to be completed in 2006, Industrial and

Commercial Bank of China Limited has been set up in October, and the introduction of strategy investors will be completed in this year. The market reform of nationalized commercial banks, which occupied 53.6% of the finance assets in China, is meaningful for establishing a high efficiency indirect financing system. At the same time, the shareholding banks and city commercial banks adopt various methods to complement capitals, improve operating level. Bank of Communications is successfully listed; Huaxia Bank, Guangdong development Bank, and Pudong Development Bank introduce strategy investors or increase foreign capital shares, all of which are beneficial to breaking the credit monopolization situation of four big nationalized commercial banks, further standardizing and expanding the indirect financing system of our country. In addition, the deepening reform of rural credit cooperative beginning at August 2003 advances steadily. Until the end of June 2005, 43 bank institutes had been set up, including 9 rural commercial banks, 34 rural cooperative banks, and 13 bank institutes were authorized to prepare. Various administration institutes adapted to local situation were set up, which promoted the initial formation of new supervision and administration system. Besides, in term of the overall need of economic development and reform, some new banks begin to set up, such as Bohai Bank which has started doing business, Northeast Development Bank which is prepared to set up, and Postal Savings Bank. With these "fresh blood" infused, the indirect financing of our country will be more efficient, various and consummate.

(2) The direct financing system is being consummated and developed.

Firstly, the share structure reform is a historical transformation of stock market. On 29th April 2005, China Securities Regulatory Commission announced to start the pilot reform of share structure. On 12th September, Shanghai and Shenzhen Stock Exchanges announced that 40 listed companies such as Shanghai Automotive and Minsheng Bank started the share structure reform, which indicated that the significant system transformation of capital market in China officially carried out after 4 months' pilot. The significance of share structure reform is to rectify the double-track system in the field of capital market, promote the reform of securities market system and listed companies' govern structure, reconcile the opposition relationship between tradable and non-tradable shares, steady the market expectation and promote the securities market to develop continuously and healthily. This is very meaningful for the development of direct financing system.

Secondly, since 2004 the finance reform and creativity of bond market in China are promoted actively, the criterions of main issue body are enlarged continuously. The issue of secondary bond of commercial bank, the release of short-term financing bond of Stockbrokerage Company, and the naissance of Panda Bond which is the first CNY bond issued in China by international exploitation organization all further promote the development of bond market, also promote the extent and deepness of bond financing. More and more attentions are paid to the enterprise debt. A remarkable sign of finance market of 2005 is short-term financing bond, the restarting of the enterprise bond market, and a big step in the field of enterprise direct financing. 207.8 billion Yuan's short-term financing bond and enterprise debt were issued in 2005, which took 1.7% of the

non-finance institutes' financing in the first half year, as 3rd times as that in the first half year of 2004. In the following years, enterprises short-term financing bond and enterprise bond will get a further development, and will become an important approach for enterprise direct financing.

## Part 2: Domestic Financing versus International Financing

For the past few years, the enterprises of our country have a high enthusiasm to being listed abroad. The early big enterprises which are listed in Hong Kong have been expanded to the present middle and small size enterprises which swarm into the oversea carving out broad market; the early dominant position of Hong Kong has been expanded to the present wider spread among New York, Tokyo and Singapore Markets etc.; the large manufacturing and energy enterprises have expended to the finance board. Carelessly, "sailing abroad" flares up to become a fashion for the enterprises of our country; and the "red hurricane" in the international capital market are very durable without calming down. What will the "hurricane" bring to us?

### 1. The oversea financing causes the marginalization trend of financing in domestic capital market

The opposite of marginalization is dominance; the essential of financing marginalization of capital market is actually losing the dominant position of financing. Generally speaking, the price of a listed enterprise is mainly determined by its mainland market, but at present the price is gradually determined by oversea market represented by Hong Kong market. The reflection of Hong Kong stock market is more sensitive to Chinese economic fluctuation and macroscopic policies than that of domestic market. Since 2003 the financing gross of Chinese enterprises through oversea IPO has been far more than that through domestic IPO for successive three years. There were 44 enterprises from Chinese mainland financing in Hong Kong in 2004, the total funds raised were 114 billion HK dollar, which was 41% of the total funds raised all year around, while the domestic market financing gross during the same term was 62.67 billion Yuan; the financing gross in Hong Kong market was nearly twice than that in domestic market. Since 2005, under the effect of suspending IPO for share structure reform, the domestic cooperation commonly has chosen to get financing abroad. There were 15 new stocks issued in Shanghai and Shenzhen Stock Exchanges in 2005, raising funds 5.7 billion Yuan, about 684 million dollar, which has been the lowest IPO gross since 1997; about 3,586 million dollar less than that in 2004; while the funds raised through oversea IPO by Chinese enterprises in the same term increased 10,079 million dollar compared with 2004. And the number of cooperation newly listed abroad is over four times than that in homeland; funds raised is about 31 times than that in homeland. The remarkable ones among them are China Construction Bank, Bank of Communications, Bank of China, Industrial and

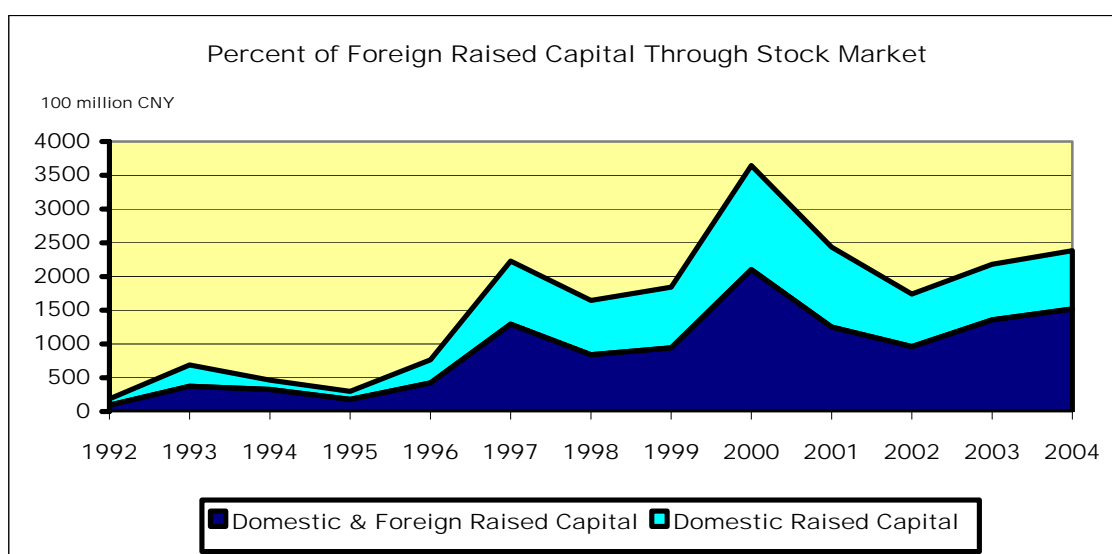
Commercial Bank of China which belong to finance board, plus the Shenhua Energy Company Limited getting financing in Hong Kong this year and Pingan Insurance getting financing in last year. Almost all of the good domestic assets have chosen to being listed abroad. This shows that the dominant position in financing of domestic capital market has been nearly lost, and the “marginalization” has been nearly “actualization”.

**Table10 Percent of Foreign Raised Capital Through Stock Market**

Unit:100million CNY

Year	Domestic & Foreign Raised Capital	Domestic Raised Capital	Foreign Raised Capital	Percent of Foreign Raised Capital Through Stock Market (%)
1992	94.09	94.09	0	0
1993	375.49	314.54	60.95	16.23
1994	326.78	138.05	188.73	57.75
1995	180.32	118.86	61.46	34.08
1996	425.08	341.52	83.56	19.66
1997	1293.82	933.82	360	27.82
1998	841.52	803.57	37.95	4.51
1999	944.56	897.39	47.17	4.99
2000	2103.16	1541.02	562.14	26.73
2001	1252.28	1182.13	70.15	5.60
2002	961.75	779.75	182	18.92
2003	1357.75	823.1	534.65	39.38
2004	1519.94	862.67	657.27	43.24

SOURCE: China Statistical Yearbook (1993-2005), China Securities and Futures Statistical Yearbook (1993-2005)

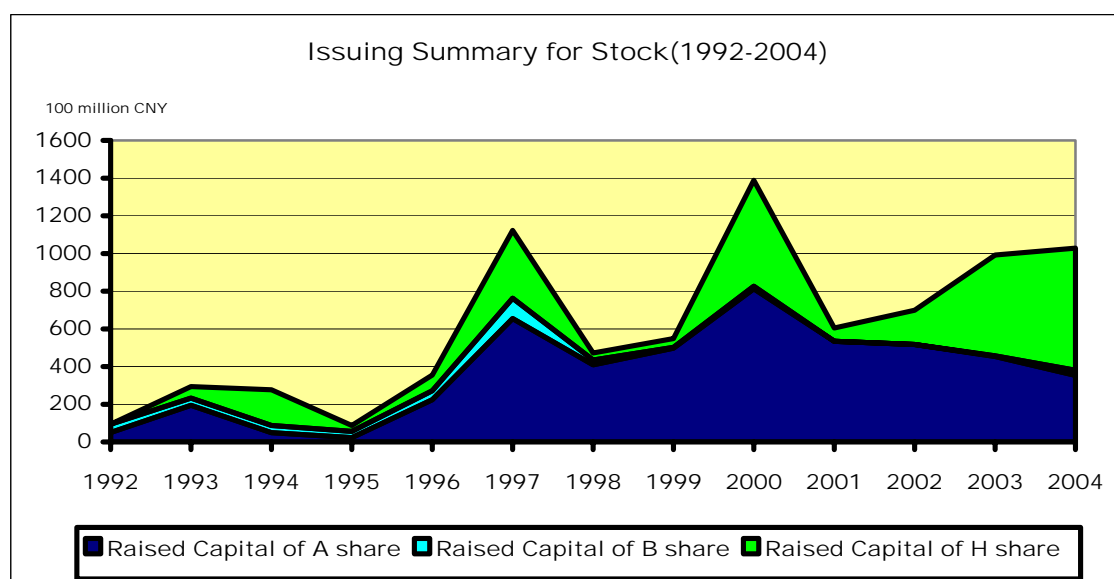


**Table11 Issuing Summary for Stock(1992-2004)**

Unit:100million CNY

Year	Raised Capital of A share	Raised Capital of B share	Raised Capital of H share
1992	50	44.09	0
1993	194.83	38.13	60.93
1994	49.62	38.27	188.73
1995	22.68	33.35	31.46
1996	224.45	47.18	83.56
1997	655.06	107.9	360
1998	409.09	25.55	37.95
1999	497.88	3.79	47.17
2000	812.37	13.99	562.21
2001	534.29	0	70.21
2002	516.96	0	181.99
2003	453.51	3.54	534.65
2004	353.42	27.16	648.08

SOURCE: China Securities and Futures Statistical Yearbook (1993-2005)



The marginalization is an austere challenge for the development of financing in domestic market. For investors, marginalization means the loose of a large amount of good assets, the narrowness of investment channel; and possible loose of insurance companies and enterprise annuity institutes. The investors lack the approaches to expand financing channels; domestic investor can hardly share in the fruit of economic growth in China. For financer, it is a bottleneck for development that the development of domestic capital market lags, the financing functions are blocked and a large amount of middle and small



size enterprises, high technology enterprises will not obtain the service of capital market. The development of derivatives such as stock index futures is also affected. The capital market of our country will miss the preemptive opportunity. The “hollow” capital market will lead to the loose of the self-determination right of price; and the underestimation of the value of domestic enterprises as a whole in overseas, etc. The marginalization has ringed the alarm bell for the financing of the domestic capital market. To solve this problem radically, it is essential to make change to the game rule of the domestic capital market, to build up a system that that all the market participator can get profit fairly from economic growth. From this point of view, the upsurge of numerous Chinese enterprises’ trying for overseas financing is just a forced ablution for the thoroughly remodeling of the financing system of capital market in China.

## 2. Can the capital market survive at marginalization?

The choice of enterprise financing is an analysis of cost and profit. From the aspect of apparent cost, the cost of overseas financing is actually not low; it includes accounting and auditing expenses etc. If the enterprises are able to get domestic financing, they would definitely not choose overseas financing. However, the domestic financing of domestic enterprises proves that the composite cost and profit ratio of overseas financing is higher, which is analyzed by many rational analyzers. The reason of this phenomenon is worth to consider. For example, there is unapparent cost in domestic financing, which includes the uncertainty of financing process, the long period of continuous financing, and the difficulty of continuous financing, etc. While in the mature market, the investment period is relatively shorter, and the continuous financing only needs the authorization of directorate. Moreover, there are still many problems in domestic market on training the financing institutes about good management, which makes it hard to realize the main aim of financing. Domestic enterprises have to go a long way to being listed abroad and find a suitable environment in overseas mature market. The lack of market strata is another reason why many middle and small size enterprises could not obtain enough supporting in financing through capital market, overseas financing of many enterprises is actually an only choice.

Presently, there are more than 3,000 domestic enterprises waiting for financing in China, but only 150 enterprises on main board or middle and small size enterprises board can get financing every year. The long time waiting, the large uncertainty and many manual control elements are not harmony with the fast and centralized development strategy of enterprises. The defect of issuing system is an important reason why the domestic capital market loses its attraction to domestic enterprises:

Firstly, the examining and verifying time for domestic IPO is very long. Generally the financing procedure can be finished in 3 months to one year in foreign countries; while this time is normally 2 to 4 years in the securities market of our country, which consumes much time cost, and might lose the opportunity of investment for market environment changed.

Secondly, in foreign countries, the financing process is open; the corporate can get a chance for financing as long as it reaches the standards of financing. While in China, because of the system, the uncertainty of the examining and verifying result is very large, usually unpredictable, which makes the enterprises are afraid of uncontrollable and unplanned domestic IPO.

Thirdly, the threshold of IPO and re-financing is high. Before the revision of “Corporation Law” and “Securities Law”, there is only a standard of issuing financing in our country. Many of the regulations are undoubtedly hard to reach for developing middle and small size enterprises. At present even through Shenzhen Stock Exchange set up the middle and small size enterprises board, different kinds of enterprises are not treated separately and set different standards as foreign securities market. There is still a uniform standard for re-financing and IPO. These inflexible thresholds are unfair for middle and small size enterprises, affect their financing efficiency and press their enthusiasm to enlarge the domestic financing.

Due to the issuing system of domestic stock market is drawback, financing efficiency is defective, the enterprises vote by foot and go to different directions. Therefore, the pressure becoming motivation, intensive introspecting and reforming the current issuing system have already been imminent. Specifically, the operating cycle and characteristic of enterprises should be considered; the financing issuing system which is suitable for enterprises' operating regular should be set up; the examining and verifying procedure should be simplified; the time should be shortened; the examining and verifying should be opener; the suitable threshold of financing and re-financing should be set up; there should be a distinction among different enterprises, especially a “green channel” should be built for the financing of middle and small size enterprises or high technology enterprises, etc.

## **Part 3: Traditional Financing versus Innovative Financing**

As I have mentioned above, there are many aspects of malpractices in the finance system leaded by banks under traditional finance system of our country. This has not able to satisfy the fund demanders from various aspects. The innovation of various financing channel is more than necessary.

### **1. Urbanization calls for the innovation of financing channels**

On the aspect of infrastructure, at the beginning of this century, the Nobel Prize winner Stieglitz predicted that the urbanization in China and the high technology development in the States would be the two topics which would affect the development of human being in 21st century. According to investigation, until 2020, the urbanization level of our country will enhance from 36.33% in 2000 to around 60%, which will enhance by 1.2% in the each following year. But according to the calculation of national infrastructure standard and the prize level in 2003, 90 thousand Yuan is needed as city infrastructure improves. If the

urbanization rate increases 1% in each year, then the newly increased urban population in each year is about 14 million. And the investment needs to increase 1.26 trillion Yuan. This amount of fund is far from enough if only depending on the city construction and maintenance tax and city commonality surtax. The product of city construction is built at a time and is utilized time after time. Whatever for individual or government, it is impossible to own so much fund, to balance the gap of fund by capital market, it is imperative to discover a new financing channel which is suitable for the development of national economy. On 11th September 2006, in the statement of APEC ministerial meeting concluded just recently, finance minister Jin Renqing expressed that Chinese government is considering authorizing the local government to issue bond under limitation conditions. This is the first open declaration from Chinese finance high position official about opening up the local issuing of debt, which means that this financing instrument repeatedly called is coming soon. In recent years, as the economic development of our country and the improvement of management level, our country has already possessed the condition of issuing bond:

(1) The healthy development of macro economy and the steady improvement of finance strength establish a good foundation for developing city planning bond. The recent three years' GDP increase rates are 10.1%, 9.9%, 9.1% respectively. According to related prediction, the increase rates in the following two years will keep above the level of 9%. At the same time, the local finance revenue will also keep a good increase tendency. In the first quarter of this year, the finance revenue of our country is 520.5 billion Yuan, increasing 36.7% compared with the same period in last year. The continuous increase of Chinese macro economy and local finance strength will be a solid foundation for issuing and developing the city planning bond.

(2) The development prospect of bond market provides a wide space for city planning bond. The people's investment consciousness boosts up; the investors recognize the "golden rim bond". The bond market is gradually standardized. And the relative laws and rules are gradually more comprehensive. All of these establish a good foundation for government to gradually open up the government bond.

(3) The large potential of fund supplying in Chinese finance market provides a powerful driving force to the development of city planning bond. China is one of the countries which have the highest saving up rate; the average saving up rate is as high as 30% to 40% until December 2005. The balance of resident saving deposit has break 14 trillion Yuan. For the population of 1.3 billion in our country, it is over 10 thousand Yuan per capita. The revenue of social insurance and premium of insurance companies increases by over 100 billion Yuan each year. This huge size of fund all need to find out a suitable investment channel.

Besides, some financing modes, such as BOT, TOT and PPP, which make the public utility more diversified, also have a wide development prospect. Presently related departments clearly express that they will broaden the permission entrance to the market, permit the

non-public capital to enter into the infrastructure, public utility and other industries or fields to which are not restricted. And according to the direction of consummating laws and rules, franchised operating right, business operating and professional services, they will expedite the establishment of enterprise and personal credit system. Therefore, public utility operating right and recomposing the stock share system can directly bring the competition system to some traditional monopolization industries. It is meaningful to develop new financing channel, improve the efficiency of infrastructure financing system.

## 2. Nongovernmental financing needs to be developed and standardized

Positively developing and standardizing the efficient nongovernmental financing channel is also an emphasis for moving forward the financing system innovation at present. For instance, in some financing activities in Wenzhou, zhejiang province, the bad asset level generated is obviously lower than that generated in governmental finance institutes. That is because these nongovernmental financing activities have already formed a very efficient risk control system, for example the debt and credit sides are neighbors, familiar with the payment capability of each other, and the level of information unbalance is relatively lower. This actually shows the nature and essence of financing industry. Just like what American famous financier J.P Morgan said, the standard used in finance industry to determine whether to provide loan to a person is not whether the person is rich or not, but the person's moral character. But in the constantly changing modern society, it is harder to know and possess a person's moral character. After part of the social fund divided from bank system, if it can be brought to nongovernmental financing market through suitable channels, changed to direct financing, especially equity financing, it would be positively meaningful to changing the pattern that the proportion of direct financing is too low in Chinese financing structure, and social financing over depends on bank loan.

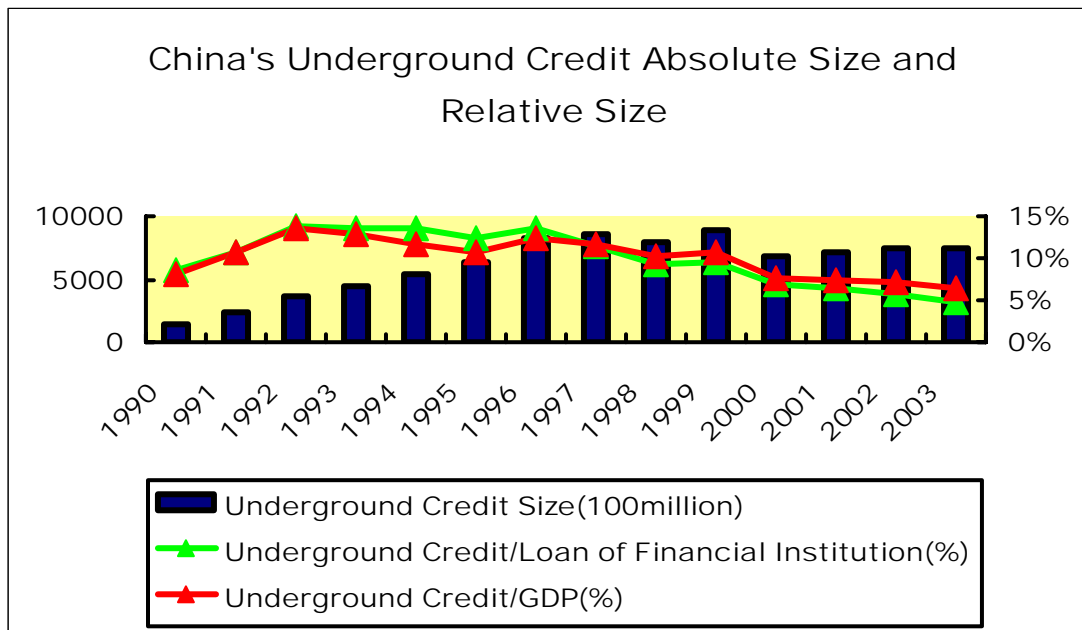
The development of nongovernmental financing (figure)

**Table12 China's Underground Credit Absolute Size and Relative Size**

Year	Underground Credit Size(100million CNY)	Underground Credit/Loan of Financial Institution (%)	Underground Credit/GDP (%)
1990	1505.1	8.51	8.11
1991	2305.1	10.80	10.66
1992	3638.9	13.82	13.66
1993	4432.8	13.46	12.80
1994	5468.1	13.68	11.69
1995	6317.6	12.50	10.80
1996	8325	13.61	12.26
1997	8599.5	11.48	11.55
1998	7952.7	9.19	10.15

1999	8828.7	9.42	10.76
2000	6894.5	6.94	7.71
2001	7172.7	6.39	7.37
2002	7397.5	5.63	7.03
2003	7462.4	4.69	6.36

SOURCE: Processing the Related Data.



### 3. Financing innovation in the bond market is attractive

As the enlargement of financing body in bond market, the variety of bonds and the level of credit are plentiful, and the issuing and exchanging mode is gradually plentiful as well. The development of asset securities is especially worth being noticed. On 6th September 2005, "China Unicom CDMA network rent profit plan" is listed in the large exchange market of Shanghai Stock Exchange; National Development Bank also fixed the concrete scheme for the first product of credit asset securities in September 2005. Moreover, the restart of enterprise debt market is a big step in the field of enterprise direct financing. The development of enterprise debt (figure)

### Part 4: the large enterprises financing versus the small & middle size enterprises financing

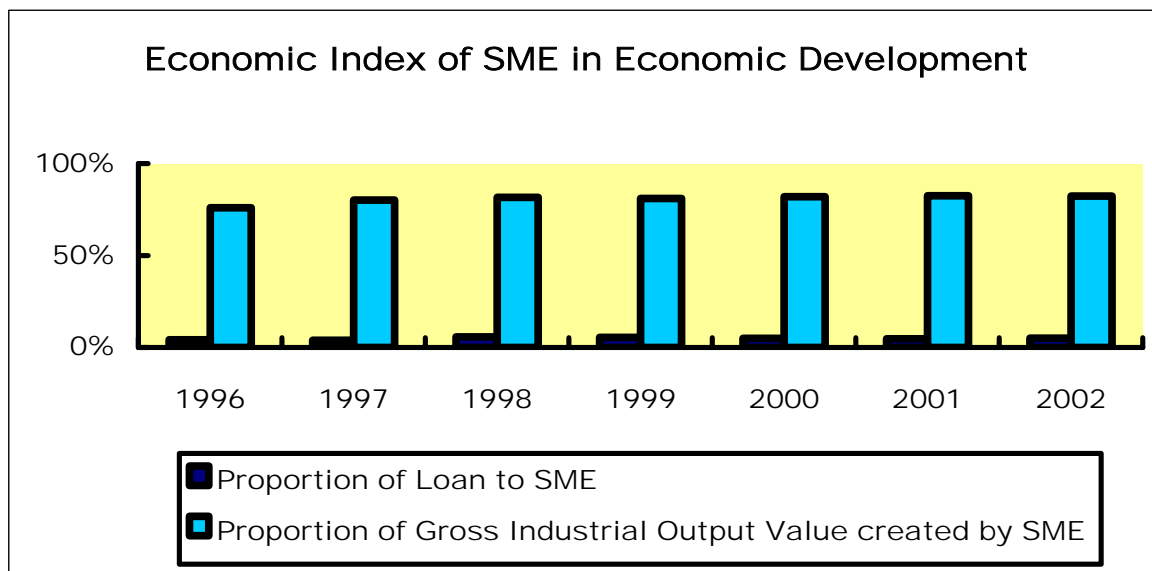
The difficulty of financing is one of the bottlenecks which bother middle and small size enterprises at all times. When providing loans, the large banks always pursue the principle that large enterprises are much more important than the small enterprises, and are reluctant to put time and energy on small size enterprises loan. Since China Banking

Regulatory Commission issued the “guidance of bank providing loan to middle and small size enterprises” in July 2005, various banks all get into the loan business to small enterprises on a grand scale. However, the statistical data shows that middle and small size enterprises take 99.7% of all the registered enterprises, with the number of more than 10 million, and the realized production value takes 60% of the national wide. Only 10% of middle and small size enterprises can get the loan supporting, the loan gross takes 14% of the entire banks loan in China. It is reported that though various banks propagandize their loan services to small size enterprises on a grand scale, most pilot branches only centralizes around Zhejiang province where the small enterprises developed well. It is still a difficult problem for most small enterprises financing in other areas.

**Table13 Economic Index of SME in Economic Development**

Year	1996	1997	1998	1999	2000	2001	2002
Proportion of Loan to SME	4.22%	3.92%	5.71%	5.47%	4.96%	4.73%	5.02%
Proportion of Gross Industrial Output Value created by SME	76.00%	80.20%	81.60%	81.00%	82.00%	82.50%	82.30%

SOURCE: China Statistical Yearbook (1997-2003)



**Table14 Degree of Financing Obstacle to SME**

	No	Small	Moderate	Serious
China	10.7	8	12	69.3
Malaysia	28.2	26.9	19.2	25.6

<b>Singapore</b>	44.1	14.7	29.4	11.8
<b>Thailand</b>	4.3	18.1	33.5	44.1

**Table15 Degree of Financing Obstacle to SE**

	<b>No</b>	<b>Small</b>	<b>Moderate</b>	<b>Serious</b>
<b>China</b>	6.7	11.1	6.7	75.6
<b>Malaysia</b>	18.4	26.5	22.4	32.7
<b>Singapore</b>	23.1	17.9	46.2	12.8
<b>Thailand</b>	4.9	15.4	35.8	43.9

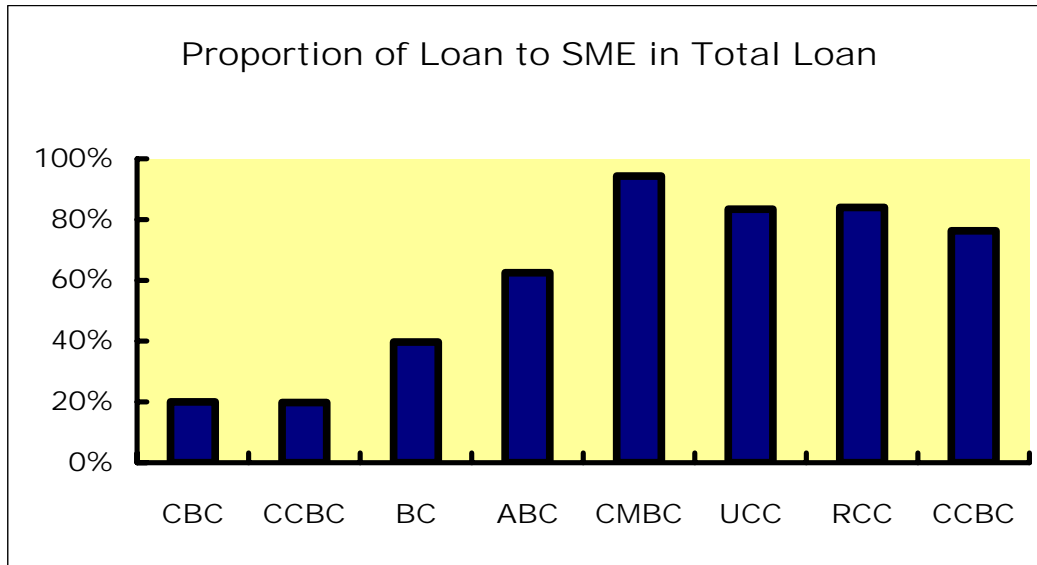
SOURCE: Processing the Related Data.

## 1 . It's difficult to expect commercial banks to play a greater sole role in SME financing now

The risk preference of the commercial bank determines that this form of financing for SMEs is difficult to effectively meet the high-risk financing and the long-term funding needs. In general, SMEs take higher risk, globally, the probability of SMEs bankruptcy is more than big enterprises. In the United States where SMEs are relatively active, the life of approximately 70% is less than 5 years, the commercial banks will naturally ask a higher interest rate for the riskier SME loans, but the fact is that in the current interest rate environment, the level of interest rates are not high enough to offset SMEs' risk, and then which will inevitably encourage commercial banks to stay away from these high-risk loans to SMEs and shift to the creditable big enterprises. We can say that the difficulty of SMEs financing is realistically reasonable, even if the amount of commercial banks loans to SMEs may occupy a larger percentage of the total, which is just because they dominate the relatively large proportion of the financial resources. In some sense, the strategy of avoiding high-risk loans to SMEs is a positive performance of the stricter internal risk control. Therefore, in the current financial environment, we should not expect too much that the commercial banks play a more active role in SMEs financing.

**Table16 Proportion of Loan to SME ( 2004 )**

	<b>Proportion of Loan to SME in Total Loan</b>
<b>CBC</b>	20%
<b>CCBC</b>	20%
<b>BC</b>	40%
<b>ABC</b>	63%
<b>CMBC</b>	94%
<b>UCC</b>	83%
<b>RCC</b>	84%
<b>CCBC</b>	76%



**SOURCE: Almanac of China's Financial and Banking, China Statistical Yearbook**

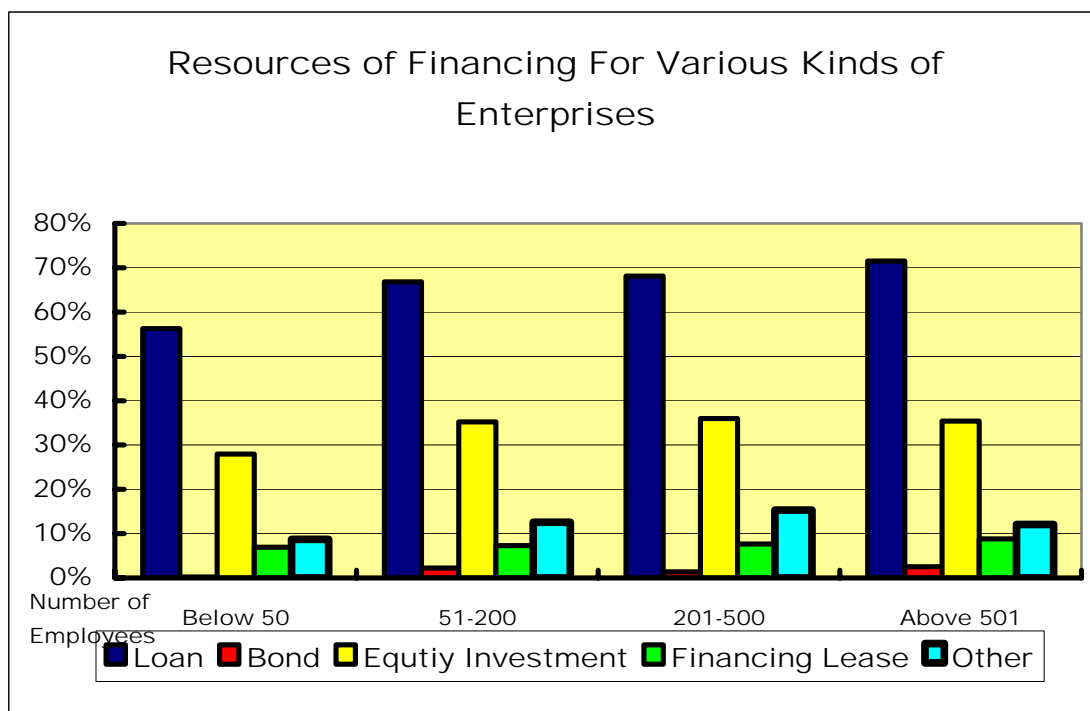
As for the term of the loan, although the SMEs is most lacking of the source of long-term funding, in the existing commercial banks indirect financing system, the term of loan to SMEs is usually less than 1 year, and few commercial banks offer SMEs long-term financing ,such as the infrastructural and technological loans . In order to meet long-term liquidity needs, some have to revolve the short-term loans, which increase the cost of financing. Meanwhile, the existing commercial bank financing channels for SMEs essentially can not meet the financing needs of the SMEs' technological innovations. Therefore, the SMEs financing absence in the traditional banking system needs supplement of the innovative advance of the financing system.

## 2 . Promote diversification of the SME market debt financing

**Table17 Resources of Financing For Various Kinds of Enterprises**

		Loan	Bond	Equity Investment	Financing Lease	Other
<b>Number of Employees</b>	<b>Below 50</b>	56%	0%	28%	7%	9%
	<b>51-200</b>	67%	2%	35%	7%	13%
	<b>201-500</b>	68%	1%	36%	8%	15%
	<b>Above 501</b>	72%	3%	35%	9%	12%





**SOURCE: Almanac of China's Financial and Banking, China Statistical Yearbook**

In order to expand financing channels for SMEs we can begin with the following aspects.

First, as far as the level of financial institutions development, the government should encourage the development of SME-oriented financial institutions, especially the cooperative financial institution. Strictly speaking, until now, there hasn't been any cooperative financial institution in China in very real sense. In the early period, some rural credit cooperatives had partly cooperative characteristic, but it was quickly incorporated and became the Agricultural Bank offices. Urban credit cooperatives, from its outset, have been operating in form of the commercial banks. The government should also encourage the development of other non-bank financial institutions. For example, we can consider setting up some financial companies which on one hand, take a portion of funds from the commercial banks, and then rely on the information advantages and thoroughly understanding of the local economy to make loans. At present, there are some investment companies, venture companies and investment companies for SMEs, similar to the financial institutions in a certain extent. What we now need to do is to encourage the standardized development of these organizations. The competitive advantages of these SME-oriented financing institutions are the thorough understanding of the local economy, local businesses, and local lenders, which is superior to the large commercial banks.

Secondly, as for the financing channels, we should actively explore the SME financing lease, assurance, insurance, and other financing forms. In the practical financing operations, lease for SMEs has a variety of functions, such as "collecting equipment" replacing the "financing", alleviating the debt burden, bringing more flexible repayment, inducing more efficiency funds using, reviving stock, accelerating depreciation, optimizing

financial structure, promoting technological improvement, enhancing capital liquidity, and strengthening asset management. Financing lease plays a unique role in the SMEs' financing and development, and is the most suitable financing channel for SME. And the relevant government institution should pay sufficient attention to it. Financing Lease is one of the most popular financing tools, which is only inferior to bank credit in western developed countries, and now nearly one-third of the world's investment is completed in this way. Because most of China's enterprises and local governments do not have enough understanding of this, the leverage function of the financing lease has not been exploited. In U.S., there are more than 1000 leasing companies mainly providing SMEs loans and the consumer credit, whose total assets size reaches to one trillion U.S. dollars. However, the asset size of domestic leasing company is at best several tens of billions. The government should also consider promoting the support of insurance to SME financing. For the local governments, comparing with directly investing a project, it's better to cooperate with the insurance companies, in the market-oriented means, to provide guarantees for SMEs and develop assurance credit insurance. Meanwhile, we should support the development of assurance companies and the civilian credit assurance system. It's recommended to lower the entrance threshold for society capital which wants to come into assurance companies. At present, if fiscal and other departments establish an assurance system for SMEs, there may be some effect which is surely inferior to the effect of the market-oriented and enterprise-operating assurance system. Actually, SMEs in Jiangsu and Zhejiang provinces, voluntarily join together to form a union. If one member has need of money, several members guarantee it and charge a certain amount of costs. In this way, they got a good result and the non-performing assets ratio is not high.

(3) Third, as for the financing approach, the SMEs-oriented financing innovation should be actively promoted.

To promote the SMEs-oriented financing innovation, lowering the threshold for issuing debt, expanding the debt issue scope should be first taken into consideration in order to change the current enterprise bond issue which mainly focuses on the state-owned and state-guaranteed enterprises. For the SME generally facing financing difficulties, it is really a good financing channel to issue bonds. Therefore, the security supervising institution should formulate a standard as soon as possible for SMEs bonds issue, in which we should consider not only the nature of an enterprise, but also the size, credit of the enterprise and the future use of funds.

Secondly, the commercial banks should also do their best to improve the credit decision within the limits of ability. Globally, some commercial banks in developed countries are now providing the package loan which is always used by investment banks for SMEs. In this way, banks approval a loan amount for SMEs in the community according to the overall situation. Meanwhile, in the current loan decision-making process, the strict control to SMEs' mortgage, assurance, credit loan and other aspects should be relieved. Some SMEs are sole proprietorship enterprises, some are partnership enterprises, and some are limited liability companies with small registered capital. The loan use of these

enterprises is not large, but they have the relative few assets, therefore, banks should allow them mortgage family house property, or property ownership certificate borrowing from friend or relative to get loan, which can expand the source of mortgage assets.

### 3 . Establish the multi-level SMEs equity markets

At present, it's especially significant to actively develop SMEs equity financing system, which can not only help alleviate the difficulties of SMEs financing, but also can wholly improve the China's financing structure which is unduly single. In this SMEs equity financing system, the SME board is of great significance, which is determined by both the characteristics of the stock market and the interactive mechanism of the stock market and other direct financing approach. Starting with the SME board also further promotes the development of GEM (Growth Enterprise Market). The development of GEM will certainly stimulate and promote the development of venture capital market, because the quit mechanism of GEM will inevitably stimulate venture capital enter SME financing market in a greater scale. Active venture capital market will also put forward the requirement of building a multi-level market demand, so there is a new impetus to develop the Third Board Market. Meanwhile, the problem of SMEs issue register and exemption should also be taken into agenda. The development of the equity market requests to improve the enterprise bond market, which undoubtedly makes contribution to establish a stable financing market and system. Judging from the international scope, the amount of SMEs financing through the bond market is often 3-10 times of the size of its financing through the stock market. A trend that should be concerned is that, after the Asian financial crisis, Asian countries began to expand the enterprise bond market, only taking the example of the South Korea and Malaysia, the ratio of enterprise debt to GDP sharply rose from the 29.5% and 16.5% to 38% and 31.7% in 2001. The development of the enterprise bond market has become a major impetus of improving financial structure and efficiency in those countries.

4. In the next stage, the key points of SME financing innovation should be relieving the financial control, developing the active and Multi-level financial market and diversifying financing channels

In practice, most private middle and small size enterprises have ever utilized private raising or informal creditor's right and stock share market financing in a wide scale. According to related institute's investigation, a unique standard has been formed in this operating of private raising market, providing more illuminations to our next step finance reform. For example, in the process of nongovernmental debt and credit, the interest rate is basically the bank interest plus the intermediate expenses;

Actually, the development of western middle and small size enterprises also faces the difficulty of financing. Most rapid growing middle and small size enterprises' financing could not be obtained from conservative commercial bank loans, and could not reach the level requirement of bond market investment and the financing conditions, or is not favored by stock market. But because the financing control in these markets are relatively weak, the innovation space of financing is relatively large, a series of finance innovations faced to middle and small size enterprises appear. For example, the appearance of American junk bonds is a very good example, In the middle of 1970, many middle and small size enterprises which accumulated funds could not reach the requirement of bank loan or the requirement of issuing investment level bonds, at the same time they did not conform to financing conditions. Michael R. Milken brought up junk bond, a new instrument which can satisfy both issuer and investor. It made many industries major in development, such as medicine, chemical industry, computer, semiconductor, instrument and appearance, get a rapid development with the help of junk bond.

Therefore, not only from the aspect of many innovation practices of middle and small size enterprises financing in China, but also from the aspect of financing development of middle and small size enterprises in oversea market, reducing the over-supervision on finance system, encouraging the financing innovation to middle and small size enterprises, and positively developing multilevel finance markets and diversified financing channels should become the emphasis and key point for the financing of middle and small size enterprises in the next stage.