The Growth and Challenges of Small- and Medium-Sized Banks in China

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Table of Contents

List of Abbreviations 56

1. Introduction 57

2. The growth of China's SMBs and the changes of the banking market structure – a land of small- and medium-sized companies 58

2.1 The characteristics of China's banking market structure 58

2.2 The growth of China's SMBs 59

2.3 The changes of China's banking market structure 62

3. The opportunities and challenges facing SMBs in China 63

3.1 Opportunities 63

3.2 Challenges 65

4. Conclusion 69

References 70

List of Abbreviations

CBRC	China Banking Regulatory Commission
CDA	China Development Bank
CDB	China Development Bank
NPLs	non-performing loans
PBOC	People’s Bank of China
ROA	return on asset
ROE	return on equity
SBUs	special business units
SMBs	Small and medium-sized banks
SMEs	Small and medium enterprises
WTO	World Trade Organization

1. Introduction

It has been over ten years since China joined the World Trade Organization (WTO) at the end of 2001. During this period, China has gradually opened up its banking industry to the world and pushed forward its banking reform. Fortunately, not only has the overall strength of China's banking industry enhanced, but also small and medium-sized banks (SMBs) have grown very rapidly and their competitiveness has improved remarkably. With the increase of their asset size, the SMBs have obtained robust growth in the market share and have become an important force of China's banking industry.

In recent years, banks in some other countries have experienced a decline in strength after being heavily hurt by the global financial crisis. As a result, the number of their banks in *The Banker's* Top 1000 World Banks has declined steadily. In striking contrast to this, the number of Chinese banks among the Top 1000 ranking has greatly increased, resulting from fast and stable macro-economic growth in China (Wang and Peng, 2010). In 2007, only 31 Chinese banks entered the ranking, and 2008, the number increased to 45, and then rose to 84 in 2009. There were 111 and 110 Chinese banks in the ranking respectively in 2011 and in 2012, of which 5 are large banks, the rest are small and medium-sized ones. This fact has fully proven that though still small compared with large state-owned banks, some of them have grown into big banks by the international standards. Their rapid development has helped to improve the status and influence of China's banking industry in the world market.

The healthy growth of SMBs is of great significance. Their presence is important not only to maintain a reasonable banking market structure and appropriate market competition, but also to serve small and medium enterprises (SMEs) (Berger and Udell, 1998; Lin and Li, 2001). What's more, they play an indispensable role in narrowing the income gap between urban and rural residents and promoting transformation of dual economic structure (Peng and Li, 2006; Peng, 2010). Therefore, to promote their healthy development, it is necessary to understand their growth condition, analyze the causes of their growth and the challenges facing them.

This paper first analyzes the development of China's SMBs based on the banking market structure and its changes. Then, it moves to the discussion of the opportunities and challenges on the basis of the advantages and disadvantages of the SMBs, and finally concludes by providing feasible ways to promote their healthy development.

2. The growth of China's SMBs and the changes of the banking market structure – a land of small- and medium-sized companies

2.1 The characteristics of China's banking market structure

China's banking market structure is obviously characterized by oligopoly (see Figure 1) (Chen, 2007). The 5 state-owned banks have first-mover advantage. By virtue of their huge size and distribution of banking outlets throughout the country, they occupy most of the market share.[1] The average size of the two policy banks, China Development Bank and Postal Savings Bank of China, has achieved 3.1 trillion Yuan, but they can't operate as a full range of banking business for various reasons.[2] Most of the 12 national joint-stock commercial banks were born in the 1980s or 1990s, whose average asset size has reached 6.13 trillion Yuan.[3] Although their banking outlets are not so widespread as those of the state-owned banks, they also cover in most parts of the country. In addition, there are 144 city commercial banks, over 400 rural commercial banks and rural cooperative banks, and more than 2000 rural credit cooperatives in China. With a much smaller size, they mainly provide banking services to local residents and SMEs.[4] The average asset-size of 40 locally incorporated foreign banks has exceeded that of the total rural commercial banks, but still fall behind that of the city commercial banks.

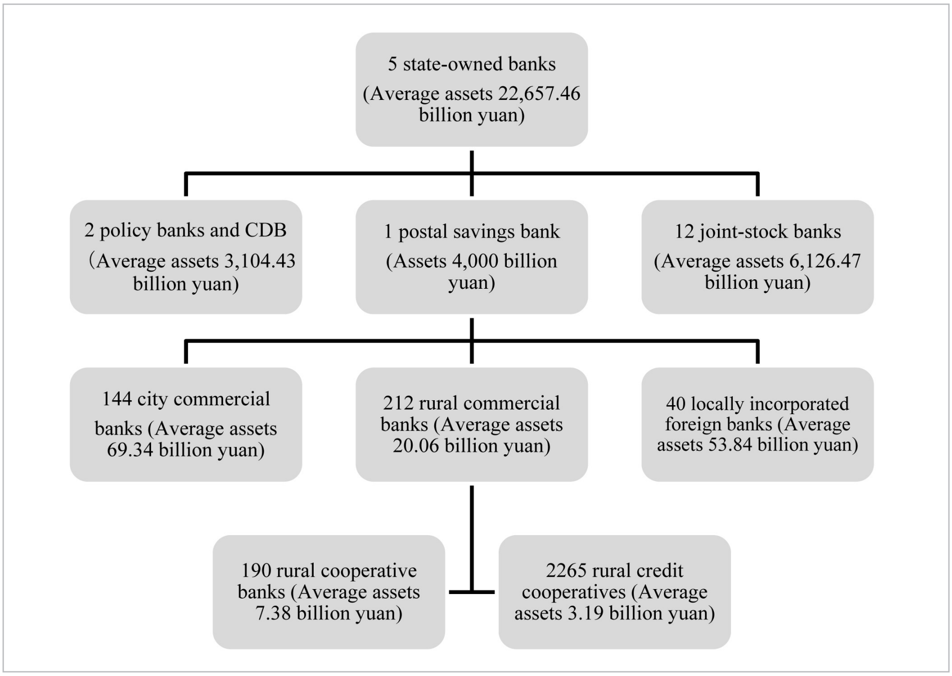
1 Bank of Communications, originally a joint-stock bank, became the fifth state-owned bank after being invested by Central Huijin Investment Ltd. (a state-owned financial investment cooperation responsible for managing state assets in financial industry) in 2004.

2 The two policy banks are China Import and Export Bank and China Agricultural Development Bank, which conduct policy financial business within specific areas. China Development Bank has no retail outlets in the process of the transformation from a policy bank to a commercial bank. Postal Savings Bank of China was established in 2007, and changed into a limited share holding company by the end of 2011. So the SMBs refer to the joint-stock banks, foreign banks, as well as city and rural small and medium-sized financial institutions in Figure 1.

3 Including China Merchant Bank, China Minsheng Bank, China CITIC Bank, Shanghai Pudong Development Bank, Industrial Bank, China Everbright Bank, Huaxia Bank, Ping An Bank (originally Shenzhen Development Bank), China Guangfa Bank (originally Guangdong Development Bank), China Bohai Bank, China Zheshang Bank and Evergrowing Bank (originally Yantai Housing Saving Bank).

4 In the last five years, about 700 village or township banks have bee set up by commercial banks to serve farmers as well as small and micro businesses. As their size is too small, their market share is negligible. Their data are not provided by the CBRC.

Figure 1: The structure of Chinese banking market



Source: Calculated according to data from China Banking Regulatory Commission (CBRC) Annual Report 2011

2.2 The growth of China's SMBs

Table 1 displays the number of legal entities and staff of China's various SMBs. When the five year transition period after China's accession into the WTO came to an end in 2006, China speeded up the banking reform. For SMBs, this was mainly reflected in the changes of the number of legal entities and staff. City commercial banks were formed on the basis of restructuring urban credit cooperatives, resulting in an increase of the former and a decline of the latter. Several urban credit cooperatives within a region or neighboring regions were restructured into a city commercial bank after stripping off bad assets and injecting capital, with the help of local governments. The formation of rural commercial banks and rural cooperative banks was also based on the restructuring of rural credit cooperatives (Su, 2012).

On the whole, the total of legal entities of SMBs shrank by a number of 16795, or 85.4 %, while the total of staff increased by a number of 343,537 or 35.8 % in 2006–2011. Considering the average number of staff per legal entity, there is a large difference among various banks. The number of joint-stock banks maintained at 12, while the total number of staff more than doubled, with an average staff of 23,171 persons per bank, nearly the same size as that state-owned banks. City commercial banks and rural credit cooperatives also witnessed an increase in the average number of staff by 541 and 203 persons, reaching 1550 and 236 persons per legal entity respectively. However, the average number of staff per rural commercial bank and rural cooperative bank that cut down redundant employees for improving efficiency fell by 805 and 96 persons respectively, to only 733 and 369 persons respectively in 2011. Affected by the financial crisis, the number of staff per foreign bank dropped at first, and rose after 2008, getting to 1057 persons in 2011, which was still smaller than the average number of 1195 in 2006.

Table 1: Number of legal entities and staff of China's SMBs (2006–2011)

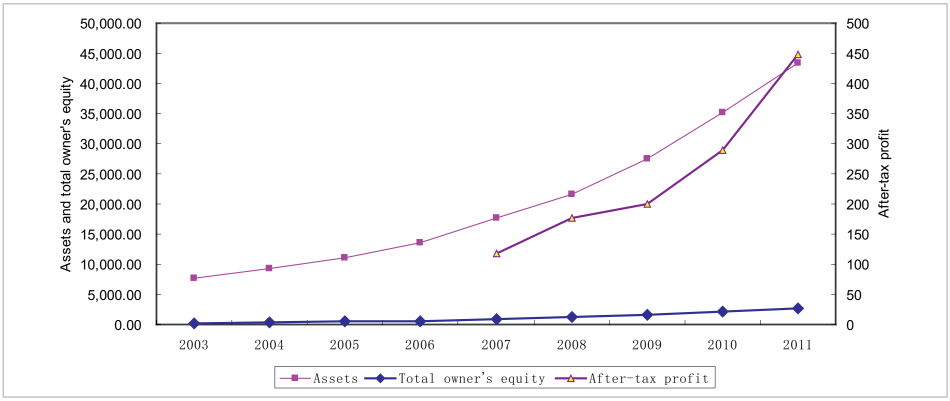
<table>
<tr><th>Number of legal entities</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th><th>2011</th></tr>
<tr><td>Joint-stock commercial banks</td><td>12</td><td>12</td><td>12</td><td>12</td><td>12</td><td>12</td></tr>
<tr><td>City commercial banks</td><td>113</td><td>124</td><td>136</td><td>143</td><td>147</td><td>144</td></tr>
<tr><td>Rural credit cooperatives</td><td>19,348</td><td rowspan="3">8509</td><td>4,965</td><td>3056</td><td>2646</td><td>2,265</td></tr>
<tr><td>Rural commercial banks</td><td>13</td><td>22</td><td>43</td><td>85</td><td>212</td></tr>
<tr><td>Rural cooperative banks</td><td>80</td><td>163</td><td>196</td><td>223</td><td>190</td></tr>
<tr><td>Foreign banks</td><td>14</td><td>29</td><td>32</td><td>37</td><td>40</td><td>40</td></tr>
<tr><td>Urban Credit Cooperatives</td><td>78</td><td>42</td><td>22</td><td>11</td><td>—</td><td>—</td></tr>
<tr><td>Total</td><td>19658</td><td>8716</td><td>5352</td><td>3498</td><td>3153</td><td>2863</td></tr>
<tr><th>Number of staff</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th><th>2011</th></tr>
<tr><td>Joint-stock commercial banks</td><td>118,036</td><td>139,943</td><td>167,827</td><td>197,657</td><td>237,158</td><td>278,053</td></tr>
<tr><td>City commercial banks</td><td>113,999</td><td>123,380</td><td>150,920</td><td>177,765</td><td>206,604</td><td>223,238</td></tr>
<tr><td>Rural credit cooperatives</td><td>634,659</td><td rowspan="3">716,058</td><td>583,767</td><td>570,366</td><td>550,859</td><td>533,999</td></tr>
<tr><td>Rural commercial banks</td><td>20,003</td><td>38,526</td><td>66,317</td><td>96,721</td><td>155,476</td></tr>
<tr><td>Rural cooperative banks</td><td>37,188</td><td>63,770</td><td>74,776</td><td>81,076</td><td>70,115</td></tr>
<tr><td>Foreign banks</td><td>16,724</td><td>31,343</td><td>27,812</td><td>32,502</td><td>36,017</td><td>42,269</td></tr>
<tr><td>Urban Credit Cooperatives</td><td>19,004</td><td>9,367</td><td>7,080</td><td>2,956</td><td>—</td><td>—</td></tr>
<tr><td>Total</td><td>959613</td><td>1,020,091</td><td>1,039,702</td><td>1,122,339</td><td>1,208,435</td><td>1,303,150</td></tr>
</table>

Source: CBRC Annual Report, 2006–2011

Figure 2 shows the assets, total owner's equity and after-tax profit of SMBs. From 2003–2011, their assets increased from 7,874.53 billion Yuan to 43,581.4 billion Yuan, while the total owner's equity rose from 175.6 billion Yuan to 2,740.1 billion Yuan, with a growth rate of 453.4 % and 1460.4 % respectively. The after-tax profit went up from 336.7 billion Yuan to 1584.6 billion Yuan during 2007–2011, an increase of 370.6 %. The growth rate of these three indicators was higher than that of five state-owned banks during the same period, which was 234.1 %, 418.4 % and 169.5 % respectively. What is specially worth mentioning is that the asset size of both urban and rural credit cooperatives increased by 157.57 %, and their total owner's equity boosted from -13.3 billion Yuan to 347.6 billion Yuan, though the number of their legal entities declined during 2003–2011.

By making an international comparison, we can better show the fast growth of China's SMBs, with an increasing number entering *The Banker*'s Top 1000 world banks ranked by Tier 1 capital each year (Table 2). Therefore, more and more SMBs have become large ones by international standard.[5]

Figure 2: The assets, total owner's equity and after-tax profit of China's SMBs (billion Yuan)



Source: CBRC Annual Report, 2006–2011

Table 2: The number of China's SMBs among *The Banker's* Top 1000 world banks

	2007	2008	2009	2010	2011	2012
Small and medium-sized banks	26	40	47	79	106	105
City commercial banks	14	24	28	50	65	62
Rural banks	3	4	7	17	19	25
Joint-stock banks	9	12	12	12	12	12
Foreign banks	—	—	—	—	10	6

Source: The Banker, July 2007–2012

5 According to the People's Bank of China (PBOC), the exchange rate of RMB against the US dollar changed from 7.8087 to 6.3009 during year-end of 2006–2011, or appreciation of less than 20 %. However, the increase of total owner's equity of China's SMBs was over 200 % during the same period.

In addition to merger and restructuring, China's SMBs have been replenishing capital through various channels, such as public listing and capital injection, so as to enhance bank strength. Up to now, among the 12 joint-stock banks, 8 are listed in the domestic stock market and 3 in Hong Kong stock market; there are also 3 city commercial banks: Bank of Ningbo, Bank of Nanjing and Bank of Beijing listed on domestic stock market. In 2010, Chongqing Rural Commercial Bank issued shares in the Hong Kong stock market, and has become the first and the only rural commercial bank listed in Hong Kong. More unlisted SMBs, for the purpose of boosting their capital strength, have brought in domestic and foreign strategic investors. In 2010 alone, the CBRC approved 23 city commercial banks' application for capital injection, changes of stockholders and increasing registered capital (Su, 2012).

Table 3: NPL ratio of China's SMBs (%)

NPLs/total assets	2006	2007	2008	2009	2010	2011	2012 Q1	2012 Q2
Joint-stock banks	7.5	2.1	1.3	1.0	0.7	0.6	0.6	0.7
City commercial banks	4.8	3.0	2.3	1.3	0.9	0.8	0.8	0.8
Rural commercial banks	5.9	4.0	3.9	2.8	1.9	1.6	1.5	1.6
Foreign banks	0.8	0.5	0.8	0.9	0.5	0.4	0.6	0.6

Source: CBRC Annual Report, 2006–2011 and CBRC website

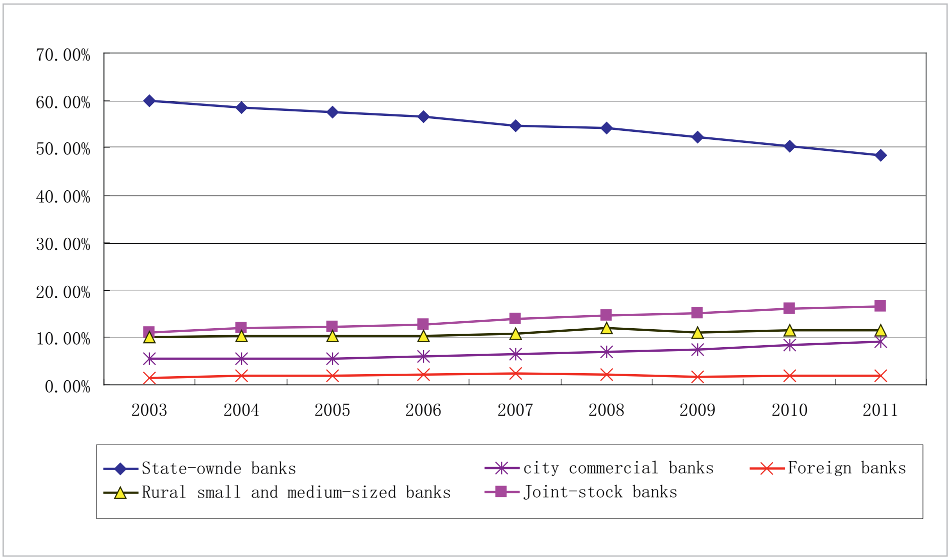
China's SMBs have also improved their risk control mechanism along with an increase in the bank size. From the data provided in Table 3, we can see that the non-performing loan (NPL) ratio of the SMBs declined year by year from 2006–2011. By the second quarter of 2012, the ratio fell to less than 2 %. However, there is a large gap between rural credit cooperatives, some of those in the less developed regions still have over 10 % or even higher NPL ratio (Xi and Ru, 2008). To restructure those rural credit cooperatives by getting rid of their bad assets so as to help them restore to normal health will be a hard task facing bank regulators and local governments.

2.3 The changes of China's banking market structure

As SMBs grow, the market concentration has been declining gradually, with the market share of the big banks decreasing and that of the SMBs increasing. As Figure 3 shows, from 2003 to 2011, the market share of the state-owned banks fell from 60.01 % to 48.46 %, and the market share of the joint-stock banks and city commercial banks rose from 11.07 % and 5.47 % to 16.61 % and 9.02 % respectively; while the market share of rural small- and medium-sized banks increased from 10.05 % to 11.62 %. The market share of foreign banks reached a peak of 2.4 % in 2007; and afterwards it has been decreasing.

By 2011, the market share of the foreign banks was only 1.95 %. However, considering the fact that foreign banks hold stakes in Chinese banks with a considerable market share, the degree of penetration of foreign banks in the Chinese banking market is higher than the data displayed (Lu, 2006).

Figure 3: The market share of Chinese banks calculated by the assets (2003–2011)



Source: CBRC Annual Report 2011

3. The opportunities and challenges facing SMBs in China

In the next few years, SMBs in China will face both opportunities and challenges due to the rapid change of domestic and international economic and financial environment.

3.1 Opportunities

First, the firm support of local governments is the most powerful boosters for SMBs. It is an advantage for China's SMBs to have good relationship with local governments. There is no doubt that local governments will spare no effort to promote economic development. As a result, to support the banks to better serve the local economy has become an important strategy in the social and economic development for the local governments (Huang, 2010; Fu et al., 2011).

In addition to promoting local economic growth, SMBs can develop by seizing opportunities brought about by local economic transformation and construction of social insurance system.
Second, government encouragement of SME banking provides a large space for the growth of SMBs (Su, 2012).

In recent years, the government has introduced various preferential policies to solve the financing problem of SMEs. The goal is to encourage commercial banks to improve lending to SMEs. Theses measures include: (1) Requiring commercial banks to achieve the “two no-lower targets”, i.e. the growth rate of lending to SMEs is no lower than the average growth rate of the total loans, and the yearly growth volume of the mentioned loans no less than that of the previous year; (2) Encouraging commercial banks to prioritize credit extensions to small and micro enterprises with a credit line under 5 million Yuan for a single customer, with 75 % preferential risk weight (instead of the original 100 %) being applied in the calculation of capital regulatory requirements, and with the preferential capital regulatory requirements of retail loan being applied under Internal Rating Based Approach; (3) Encouraging commercial banks to issue special financial bonds for extending loans for SMEs, and allowing the banks doing well in this business to open their city-wide branches; (4) Supporting commercial banks to further provide loans to SMEs through differentiated regulatory and incentive policies with the risk tolerance of SME’s loans being properly increased. All these measures have brought about great opportunities for SMBs which mainly serve SMEs.
Third, the entry of private capital into the financial sectors lays a good foundation for improving SMBs’ capital strength.

Insufficient capital is always a big obstacle in the development of China’s SMBs that have been experiencing consistently rapid asset expansion; that is because profit retaining or stockholders’ investments cannot meet the demand of 50 % or even higher yearly growth rate. The number of banks meeting the original 8 % capital adequacy ratio increased to 390 by the end of 2011, but there are still over 2000 SMBs whose capital adequacy ratio fell below 8 %.[6] What is more, the new capital regulation based on *Basel III* started to be implemented from January 2012, and by the end of 2016, the capital adequacy ratio of non-systematically important banks will have to reach 10.5 %.

Fortunately, China has plenty of private capital, which is looking for investment outlets. To channel private capital into financial industry, the CBRC promulgated *Opinions on Encouraging and Introducing Private Capital into Banking Sector* (hereinafter referred to as “*the Opinions*”) in May 2012. In this document, it is stipulated that private capital should abide by the same access requirements as other categories of capital when entering into the banking sector. Private capital is encouraged to participate in the restruc-

6 CBRC Annual Report 2011, p. 25.

turing of city commercial banks, and private enterprises are supported to take part in the reform of rural credit cooperatives and capital injection of rural commercial banks. "*The Opinions*" further facilitates the entrance of private capital into SMBs. As of end-2011, private capital accounted for 42 % 54 % and 92 % of the total equity of joint-stock banks, city commercial banks and small-and medium-sized rural financial institutions respectively.[7] More private capital into the banking sector will provide easier access to capital resources for SMBs in need of capital (Su, 2011; Su, 2012).

3.2 Challenges

3.2.1 Challenges caused by the lack of deposit insurance system

The lack of deposit insurance system is a defect of China's banking industry. Without deposit insurance, ordinary residents and small enterprises prefer to put their money in the state-owned banks because they have the government's implicit guarantee while SMBs do not.

As Table 4 shows, the proportion of deposits in the total funding sources for both state-owned banks and SMBs tended to decline from the first quarter of 2010 to the second quarter of 2012, an obvious sign of financial disintermediation under the background of negative real interest rate.[8] But deposits taken by the four state-owned commercial banks still accounted for over 90 % of their funding sources, while the proportion was 73 %–80 % for SMBs. On the contrary, the proportion of inter-bank borrowing for SMBs reached 18.2 % in the second quarter of 2012 from 9.9 % in the first quarter of 2010, and the proportion of financial bonds had remained at a high ratio of over 9 %, while for the state-owned banks, these two types of sources together accounted for less than 9 %.

That is why the loan-to-deposit ratio of SMBs was always higher than that of the state-owned commercial banks (Figure 4). In 2011, when a tight monetary policy was implemented, the inter-bank interest rate shot up to 9 %, and the interest rate of financial bonds was also much higher than bank deposit rate, which had no doubt increased the cost of funds of SMBs (Su, 2011; 2012).

7 CBRC Annual Report 2011, p. 31.

8 The bank one-year deposit rate was below CPI most of the time during that period due to interest rate control.

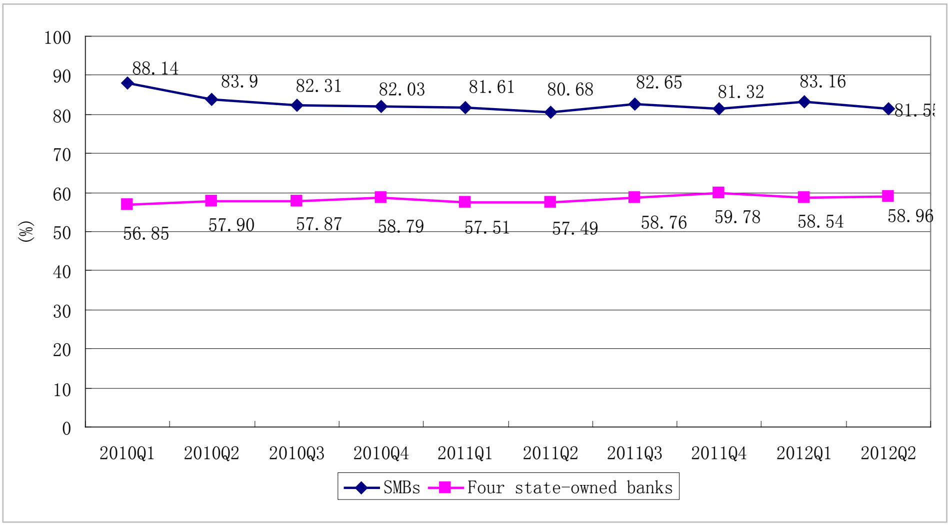
Table 4: The proportion of various fund sources of SMBs and four state-owned banks (2010 Q1–2012 Q2: %)

Funds sources		10 Q1	10 Q2	10 Q3	10 Q4	11 Q1	11 Q2	11 Q3	11 Q4	11 Q1	11 Q2
Deposits	SMBs	76.6	79.0	80.5	80.0	76.6	79.0	80.5	79.9	71.5	72.0
	Large banks	95.6	94.5	95.4	93.5	95.6	94.5	95.4	93.5	91.6	92.0
Financial bond issue	SMBs	9.9	9.6	9.6	9.4	9.9	9.6	9.6	9.4	10.5	10.7
	Large banks	0.9	0.8	1.0	0.9	0.9	0.8	1.0	0.9	1.3	1.3
Interbank borrowing	SMBs	9.9	9.6	9.6	9.4	13.8	12.1	11.5	12.4	16.5	18.2
	Large banks	7.8	6.9	6.1	5.8	7.8	6.9	6.1	5.8	7.5	6.7

Note: SMBs refer to banks with total assets (both in RMB and foreign currency) of less than 2 trillion Yuan, and operate in more than one province (with bank asset size at the end of 2008 as criteria). The four large state-owned banks are those excluding Bank of Communications.

Source: Calculated according to the data provided by the People's Bank of China (PBOC): www.pbc.gov.cn

Figure 4: The loan-to-deposit ratio of SMBs and four large state-owned banks (2010 Q1–2012 Q2: %)



Note: The four large state-owned banks are those excluding Bank of Communications.

Source: Calculated according to the statistics provided by the People's Bank of China (PBOC): www.pbc.gov.cn

3.2.2 Challenges from the banking market competition

In recent years, competition in China's banking market has become increasingly fierce with a gradual expansion from large-corporation and personal banking to SME banking. To alleviate the plight of SMEs financing, the CBRC encourages large commercial

banks to provide financial services through a series of measures: establishing special business units (SBUs) in light of their own situations to provide financial services to SMEs; clarifying that the SBUs apply separate loan risk classification and the loss provision rules; implementing a separate NPL disposal policy and the quick writing-off policy to write off the non-performing assets in time. These policies have motivated large banks to provide loans to SMEs. As a result, SMBs, especially the local ones are confronted with the challenge created by the loss of SMEs customers (Su, 2011).
In addition, competition in bank deposit-taking has long been in existence. The lack of deposit insurance system, combined with insufficient number of banking outlets, put SMBs at a disadvantage. After the restart of market-oriented interest rate reform in 2012, nearly all SMBs increased their interest rate on one-year deposit rate by 10 %.[9] [10]

3.2.3 Challenges for banks' sustainable development caused by low profitability

In the past four years, the profitability of SMBs, measured by either ROA or ROE, was improving gradually, but still lagged behind that of the state-owned banks (see Table 5); thus, despite the rapid development, they still face the challenges for sustainable development caused by the lack of profitability.

Apart from the high borrowing cost resulting from low deposit-taking ability, another reason for the low profitability of SMBs is their simple asset structure and high operational cost. For SMBs, the loan size in proportion to total assets is as high as 60 %-80 %, while for the state-owned banks, the loan-to-asset ratio remained around 55 %. Most of the customers in the SMBs are SMEs with no standardized balance sheets, more opaque information, and higher risk. Although the interest rate on loans to SMEs is higher, relationship lending requires the acquisition of soft information from various channels, thus greatly boosting the cost of credit investigation, assessment and loan monitoring (Li and Su, 2010). As a result, bank profit is eroded.

9 In this market-oriented interest rate reform, the People's Bank of China decreased bank bench-mark deposit interest rates, but at the same time allowed each commercial bank to set its own interest rate not exceeding 10 % of the bench-mark rate.

10 Even with the same deposit interest rate, the joint-stock banks charged lower interest rate on loans, resulting in a narrower deposit and lending spread. See He (2010).

Table 5: The profitability of the SMBs and state-owned banks (2008–2011)

	Return on assets (ROA)				Return on equity (ROE)			
	2008	2009	2010	2011	2008	2009	2010	2011
State-owned banks	1.16 %	1.09 %	1.17 %	1.32 %	19.94 %	19.25 %	20.37 %	21.32 %
Joint-stock banks	1.04 %	0.90 %	1.02 %	1.20 %	21.56 %	18.40 %	19.67 %	21.12 %
City commercial banks	1.09 %	1.01 %	1.14 %	1.21 %	17.95 %	15.87 %	18.31 %	18.86 %
Rural SMBs	0.79 %	0.77 %	0.82 %	1.09 %	14.78 %	14.10 %	13.52 %	17.71 %
Foreign banks	0.92 %	0.48 %	0.50 %	0.86 %	9.20 %	4.17 %	4.41 %	8.45 %

Note: ROA=after-tax profit/the average of total assets of the two most recent accounting periods. ROE=after-tax profit/the average of total owner's equity of the two most recent accounting periods.

Source: calculated according to the data provide by CBRC Annual Report 2011

In addition, scarce categories of products also have a negative impact on the profitability of SMBs. In 2011, the government eliminated some bank service fees of 34 kinds in 11 classes, while state-owned banks lowered the charge of their service fees or broadened the scale of their business discount which have brought greater pressure on SMBs.[11]

3.2.4 Challenges of risk management caused by rapid expansion

The rapid expansion of SMBs poses great challenges to the management and risk control abilities. In recent years, some city commercial banks have set up branches and sub-branches outside the cities of their headquarters, so that their original two-tier management system turns into three-tier model (headquarter, branch and sub-branch) which increases the personnel and management cost and lengthens management chain, thus leading to declining management efficiency (Fan et al., 2010, Chen and Ye, 2011). Challenges of organization management and risk control appear when management loopholes are exposed. During the year of 2010 and 2011, the cases of bank losses due to operational risk for some SMBs cropped up again.[12]

More importantly, as China starts structural transformation, the economic growth rate has slowed down. Compared with large enterprises, SMEs are much more fragile and more easily affected by external shocks. Therefore, SMBs whose customers are mainly SMEs are exposed to greater credit risk (Su, 2011). Since 2012, "the double drop" of NPLs

11 The government regulation of bank service fees was due to a survey that arose widespread attention. According to the survey, bank fees soared from 300 to more than 3000 types from 2003 to 2011. See "Beginning July 1, banks will cancel part of the service charge change fees", Chinahourly: wine http://www.chinahourly.com/bizchina/201207/127106.html.

12 For example, Bank of Qilu, a city commercial bank headquartered in Jinan, the capital city of Shandong Province, has been found to be involved in a massive loan fraud. See: Bank of Qilu probed for loan fraud, http://www.globaltimes.cn/business/industries/2011–01/609066.html.

(the drop of NPL balance and the drop of NPL ratio) in the Chinese banking industry has deceased, when all commercial banks witnessed a fall of or a unchanged NPL ratio as well as a rise of NPL balance. In fact, the joint-stock banks and rural commercial banks experienced both an increase of NPL ratio and NPL balance.[13] Therefore, it is the priority of SMBs to strengthen risk control and improve management efficiency in the rapid expansion.

4. Conclusion

In recent years, SMBs in China have obtained a robust growth in the process of gradual deepening of reform and opening up in the banking industry. Although the number of legal entities declined, the number of staff increased rapidly, together with their asset size, total owner's equity and after-tax profit growing exponentially. At the same time, the risk management was also improved, and the NPL ratio was cut down to a satisfactory level. As China's SMBs improved their strength, their market share grew remarkably, and their number was steadily increasing among *The Banker's* Top 1000 World Banks. By international standards, more and more SMBs have grown into large ones, and have become an important force in the Chinese banking market.

One of the comparative advantages of SMBs in China is their good relationship with local governments, with whose support they can conduct more businesses. The Chinese government encourages commercial banks to provide financial services to SMEs. That policy benefits SMBs which mostly serve SMEs. Allowing private capital into the banking sector further enhances their capital strength. But in the short time, the monopoly in China's banking market is unable to be broken down completely, and SMBs still face unfair competition due to the lack of deposit insurance system, and other difficult situations such as higher loan-to-deposit ratio. In addition, the profitability is unsatisfactory because of simple asset structure, high borrowing cost and so on. Last but not least, the difficulty to improve management efficiency and control risk has increased after the rapid expansion of their business scales.

In the foreseeable future, SMBs will differentiate. Those who can identify their market positions and form their own core competitiveness will grow further, and even be able to compete with large banks. Those with lower profitability and management skill will face acquisition or reorganization. Therefore, the Chinese government needs to provide a fair playing field, and at the same time maintain macroeconomic stability. At present, it is imperative to establish deposit insurance system, which is a precondition for further market-oriented interest rate reform and healthy growth of SMBs.

13 The CBRC's website: http://www.cbrc.gov.cn/chinese/home/docView/7E1679F277BC4161982E2BCF068E5DDA.html.

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