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The funding of small and medium companies by shadow-banks in China

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The Funding of Small and Medium Companies by Shadow-Banks in China

by

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Abstract

This paper looks at the current shadow-banking practices of Chinese SME´s and the question if these practices have a positive impact on the development of those SME´s. For this purpose, new primary data is examined: Four case studies and two supplementary sets of data. Although the data volume imposes limitations on the results, the two main findings are: First, shadow-banking does have such a positive effect. Second, interpersonal lending is by far the most important financing channel for this effect among all the shadow-banking types observed.

Key words: Shadow-banking, SME-funding, China's financial system

JEL classification: D82, K42, O17

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1 Introduction

This paper focusses on the intersection of the following three topical areas: SME´s, shadow-banking and China. Shadow-banking in China is either about direct loans or investment.[1] For Chinese SME´s obtaining financing is problematic, since they are chronically underserved by official banks in this regard, as explained later on in greater detail. It is known that Chinese SME´s make extensive use of shadow-banking. It is also established that official lending is skewed against them[2]. But these paradigms are established almost entirely on an aggregate level. It is the aim of the paper to find indications as to whether shadow-banking is perceived by the SME´s themselves to be better than official banking and if using shadow-banking has a positive impact on business. It is important to stress that a strictly SME-centric point of view is adopted. The reason for this specific angle is that not only the basic availability of official credit is a problem for SME´s, but also the attractiveness of bank loans as products. SME´s do not want to use bank loans, because they have a faster and more convenient solution at hand: Shadow-banking. But nevertheless, little is known about how exactly SME´s make use of shadow-banking as an individual business. The same is true for how these SME´s perceive their actions. This paper attempts to contribute a micro-level view on present Chinese SME´s and their use of shadow-banking to the literature.[3] Notwithstanding general benefits of official finance, this paper tries to exemplify the current, situational advantages of shadow-banking for SME´s. It also tries to show, from the point of view of Chinese SME´s, that shadow-banking is often something conductive to growth and development. But even more so that it is something that maybe was born from desperation, but is used today neither without alternatives nor uncritically. Much of these practices are in line with fundamental ideas of market economy.

[1] A) "Loans" refer to non-bank credit here. B) Partly debt-financed investment with no, or very short, chains of intermediation. This simplicity distinguishes Chinese shadow-banking from others.

[2] All official banks irrespective of any characteristics, like ownership structure (state-owned, private, etc.), are treated as being identical, since the Chinese entrepreneurs also did not differentiate.

[3] For a discussion of China's banking system in principle see, for instance, Chang and Löchel (2012) and Funke, Li, Löchel (2016).

SME´s are, both in terms of value- and employment creation, a large contributor to the Chinese economy[4]. As such, knowing and understanding the SME´s direct opinions is relevant. Also, SME´s and their financing behaviour cannot be comprehended only through an aggregate view. Taking the SME´s perspective is unsubstitutable, because their financial challenges are very situational and they usually have very limited choices. However, SME entrepreneurs regularly choose their most economical option, despite its illegality, which can be seen as an expression of free market economy.

Shadow-banking activities outside official banks are under-appreciated, as the following stylised facts illustrate: Cotterill (2013) values Chinese shadow-banking in 2012 at 27.3 trillion CNY, with the part conducted through official banks at 22.7 trillion CNY. That leaves the part this paper focusses on with 16.9% volume of Chinese shadow-banking, representing 4.6 trillion CNY. If measured as an expression of assets in the banking system it is 8.74%, or represents 4.75% as a share of the Chinese GDP.

The data employed consists of typical, yet dissimilar cases well suited for qualitative research, because it is extremely difficult to identify suitable individuals, build a relationship and be granted enough information. Also, existing data on the topic is far and between at best. Also the precision of data is an issue since shadow-banking is illegal and thus admitting to it is risky. Lastly, shadow-banking structures are opaque at best, even for Chinese outsiders, which aggravate these concerns. The data is comprised as follows: Case studies on SME´s (n=4), survey knowledge of shadow-banking types (n=13) and a dataset obtained from a shadow-bank active in online P2P finance (n=131). The amount of data does not support quantitative methods beyond descriptive statistics, which has certainly implications for the explanatory power. Constraints for the data are: Omission of macroeconomic aspects, especially systemic risks. Only China-related shadow-banking is considered. The interesting topics ´microfinance in China´, ´finance in rural areas´ and ´online-(near)-banking´ are excluded in order to keep a sharp focus. Lastly the variables of gender, age, migration background are omitted.

[4] SME´s make up over 97% of registered firms, employ nearly 65% of the workforce and generate 60% of the GDP. (Tsai, 2015, p. 1f)

The organization of the paper is as follows: The introduction states the goals and determinants. Next, in point two an overview over the major literature paradigms is presented. Point tree describes the research undertaken. In point four, core determinants for shadow-banking are established. Point five is about the primary data and is divided into datasets and cases. Point six collects and discusses the findings, with point seven attempting to answer the research question. Point eight concludes. Generally, the discussion proceeds from the general to the more specific. Within the data, the datasets first establish a rough baseline to contextualize the cases in order to increase their descriptive power.

2 Reception of shadow-banking

´Shadow-banking´, as the name implies, are banking services that are neither white nor black. Such services are, for many a reason, not legal yet not illegal either. But despite that they are often treated as a monolithic, homogenous thing, determined as a function of the official banking sector. A similar narrative is that shadow-banking is ´the next best thing´ in the absence of official loans, again seeing it as fully dependent. It can be concluded from the existing literature that shadow-banking is seen as not good. But because of various issues, it is the best option available for the SME´s under the given circumstances and therefore has a positive side. The general paradigm on SME lending in China is, that official lending is skewed against SME´s and that official banks in China discriminate against SME´s, as well as giving preferential treatment to SOE´s. Of course Guanxi is also a factor: On the one hand it is an important factor for attaining formal financing. And on the other hand it is also described as positive for attaining informal financing. It works as an inhibitor against opportunistic default behaviour, because the social fallout would make the opportunist a persona non grata. These are the dominant, recurring narratives.

This paper disagrees with the first fundamental notion of shadow-banking being bad, but agrees with the second, relative assessment insofar as shadow-banking presently is often a very good alternative to bank loans. Acknowledging the benefits of official financing as well as the drawbacks of unofficial finance, shadow-banking will retain its function in underserved market niches.

3 Research design

The question to be answered is: *"Do Shadow-Banking Practices in China Positively Contribute to the Development of Chinese SME's?"* It builds on the following assumptions: Firstly, Chinese SME´s currently use some form of shadow-banking. Secondly, these SME´s are able draw a direct connection between their shadow-banking use and the development of their business. Thirdly, these direct connections are, in the eyes of the SME´s, significant in the sense that they are required for these developments. Beyond that, some restrictions apply: Only currently practiced forms of shadow-banking are included, only practices that are used within Chinese business communities are considered, also channels that do not contribute to SME development, e.g. WMP´s, are excluded. The phrasing is used because the firm-specific assessment of the degree of success is difficult, since financing does not necessarily result in a measurable, much less comparable success and the availability of capital is rarely the only deciding factor. There are no limitations after geographic location, industry sector, company age or past success. Furthermore the question does not contain criteria on the source of the money, as long as the financing channel fits the employed definition of shadow-banking and the funds are used for purposes directly related to the business activities of the company.

The research question is of the Yes/No type, which leads to a hypothesis that directly affirms or rejects. The implied positive assumption within the research question further narrows down the possibilities for the hypothesis. Beyond these considerations, the expected limited availability of data is also well suited for a direct and affirmative hypothesis:

[H_1]"Yes, Shadow-banking does contribute positively." This hypothesis is affirmative and links directly to the research question, however it is also quite encompassing. This is why three sub-hypothesis are established so that the *H_1* hypothesis can be divided up and thus be answered easier: [H_a] *"Do SME´s prefer the use of shadow-banking over official banking?"* This part deals with what the SME´s want, as a basic orientation of the perceived importance of shadow-banks. [H_b] *"Do SME´s really use shadow-banks more than official banks for credit?"* The answer to that will reveal, if the preference from the first part is in line with the actions of the SME´s. [H_c] *"Is shadow-banking considered as something positive for business by the SME´s?"* This area is about the self-assessment from SME´s of their financing behaviour and its effects. The hypothesis as well as the sub-parts were tested against the case stud-

ies and additionally against the opinions of the Chinese entrepreneurs. Other datasets play a supportive role in contextualising findings and substantiating them beyond the case-studies.

The sample data for the cases is a purposive sample but mostly a convenience sample. This means that all respondents approached fulfilled the externally observable criteria of being ethnic Chinese and SME managers. However, due to the very high rate of approached individuals declining to participate, every respondent had to be included. Because of the difficulties of approaching Chinese SME managers and the illegality of the matter, this result was expected and unavoidable. The data was collected through semi-structured interviews with decision makers in Chinese SME´s. The questions were taken from a self-prepared questionnaire and the interviewees were informed of the circumstances and the role of the author as well as the goal of the interviews. Therefore the case selection follows the principle of unique availability of data.

The parts of the questionnaire used are as described here: At first part A ´Test of knowledge´, which lists forms of shadow-banking, grouped after lender-borrower-relationship. For every type of shadow-banking there were four answer types of which one had to be selected: i) YES-Made use of, ii) YES-Know of[5], iii) YES-Heard of and iv) NO-Never heard of. This part was prepared the interviewees for the more detailed questions that followed and also gave the interviewer hints where to direct additional attention. The part B of the questionnaire, ´Company use of Shadow-Banking´, features the core questions designed to cover all aspects of the business and shadow-banking use. These questions classify the company and describe the experiences with shadow-banking in standard brackets. Together with basic questions intended to shed light on the reasons for the shadow-banking experience and their overall evaluation. The last part features the additional questions to complete and enrich the case with contextual data. But it also contains the questions, which go into more detail on the shadow-banking experience. They are designed to broaden the view on the business and at the same time deepen the understanding what exactly the company did as shadow-banking.

Because of its importance for answering the research question, it is prudent to specify how the assessment of ´positively contribute´ is determined. At its root, it is a measure of

success, determined by the subjective goals of the companies, which makes it inherently subjective for every SME. This however, raises the problem that they cannot be directly compared. The solution to this obstacle is to adopt the company-specific self-assessments for this paper, which is also very well in line with the firm-centric viewpoint of the paper.

The part A was also used for the opinions from the industry, where interviews were conducted with persons that could provide insights into the subject matter, but were themselves not suitable for a case study. Limitations of descriptive power exist due to the number of respondents (n=13), but because of the tight fit to the target group of the paper, these responses offer good value. The dataset for the P2P firm is made of (n=131) observations of the same quality as used for internal purposes of the company and was downloaded from their website. Because the selection is from one firm and thus represents a very small share of the complete market, only descriptive statistics were applied. It is used for establishing an idea of what is usual in the market.

4 Aspects of shadow-banking

This section of the paper will introduce three separate, but interconnected aspects: First, what shadow-banking means at the moment for the Chinese SME´s. Second, why shadow-banking still persists. Third, how shadow-banking is defined for the purposes of this paper.

4.1 Relevant forms

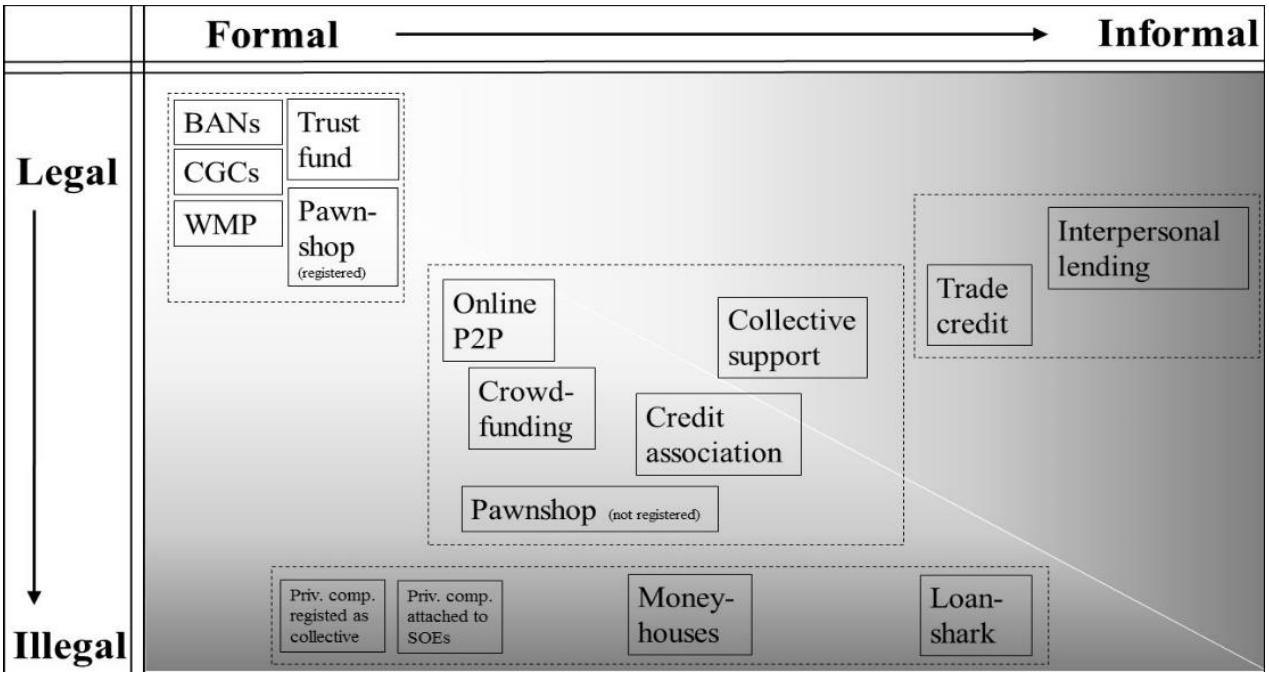
This part sheds some light on what shadow-banking means for Chinese SME´s at the moment, in the sense of which options are available and accessible to them: Shadow-banking is a very wide term that is used for a variety of practices. Chinese shadow-banking is about creating loans on a very direct, low-tech and independent basis. (International Monetary Fund, 2014, p. 65), (Dobbs, et al., 2015, p. 86) Essential characteristics are: a) Nonbanking credits generated between banks and nonbank financial institutions. b) Off-balance-sheet activities

[5] It was explained to the interviewees that it refers to direct functional knowledge, e.g. ´I can get this kind of shadow-banking at that address´ and/or ´I know exactly how the processes work´.

within the banking system itself. c) Credit guarantees. d) Nonbanking credits generated by financial systems and the real economy. (Lu, et al., 2015, p. 47) Whereas the first three occur within the institutions of the official banking system, e.g. via WMP´s, the fourth occurs outside the official banking system.

But "[w]hile China's shadow banking system is by no means simple, […] shadow banking credit is often directly extended to the real economy." (Tong, 2014, p. 198) Describing this shadow-banking outside official banks is further complicated by the fact that "… a range of financial intermediaries [exist] that are best described as semi-formal because central banking authorities do not regard them as part of the formal financial system, but they may be approved by some government agency or entity." (Tsai, 2004, p. 1503) Thus these ambiguities cause the shadow-banking landscape on the ground to be very diverse and ever changing. This is fuelled by new laws and regulations designed to steer credit (Tong, 2014, p. 206) that exert pressure on the shadow-banking market. On the one hand, this forces constant change, but on the other hand also provides new opportunities for regulatory arbitrage. (International Monetary Fund, 2014.b) In the past years constant high interest rates could be realised, which customers now have grown accustomed to. In order to stay competitive, shadow-banks are now compelled to produce 10 – 15% interest to attract investments. Even in Chinas high-growth environment, such opportunities have become rare. (Dobbs, et al., 2015)

A list of all encountered forms of shadow-banking is attached. However, based on the distinctions made above, not all of them were included in the research. The chart below attempts to organize of the most important forms presently active in China, classified after legality and formality to facilitate a better understanding. Legality refers to the vast range between ´forbidden by law and actively persecuted´ and ´legal with active enforcement´. Formality refers to how standardised and fixed the processes are. As can be seen from the graph, even the selection of shadow-banking types covers nearly every combination of the legality / formality matrix. Furthermore the forms can be loosely grouped as indicated by the dashed lines.



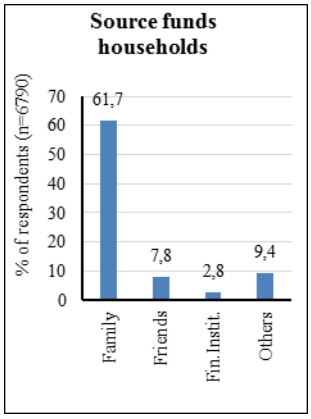
Sources: (Tsai, 2004, p. 1493),(Tsai, 2015, p. 16), (Tsai, 2002, p. 39). Selection of types driven by importance and sources.

4.2 Composition and persistence

This part tries to offer an explanation for why there was shadow-banking in China and why it continues not only to exist, but to thrive. For that purpose, a brief overview prepares for the following parts on size, persistence and attractiveness of the market: Shadow-banking started slowly in the reform and opening era and experienced rapid growth in the aftermath of the 4 trillion CNY stimulus package of 2008. Generally, "[n]on-state firms, especially private firms, have a restricted access to bank loans from the state-controlled banking system… " (Allen, et al., 2005), which is reflected by the fact that "…only 7% of loans were allocated to non-state firms in 2005. Thus, the state dominated banking sector of China has favoured[sic] SOEs. Although its share of China's total GDP has surpassed 60%, the private sector has received less than 20% of the formal bank credit in most of the last decade …". (Garnault, et al., 2005) The long existence of shadow-banking and the size of GPD which depends on it, suggest a sustained competitive advantage over official banking. One of the most important segments believing in this advantage are SME´s. They experience the bank-side undersupply

and experience satisfying shadow-banking. This understanding of why shadow-banking is so attractive to SME´s is another building block for understanding the cases.

Describing the size of the Chinese shadow-banking market is a difficult task. Although China accounted only for 4% of global shadow-banking assets in 2013 that still comes to 17.5 trillion CNY [6]. Other sources put it at 30 trillion CNY. The differences in calculation stem from which elements are included. The largest part of shadow-banking is closely affiliated with official banks, about 22.5 of 30 trillion CNY in 2013. These loans usually need collateral either in real estate or implied state guarantees. For these reasons, this loan volume is largely inaccessible to SME´s.



In absence of acceptably recent and fitting data, results from a household survey are used as approximation, because SME´s in their financing options and financial requirements have needs that are similar enough to private households. [7] The chart on the left (Zhou, 2014, p. 36) depicts where participants would first seek financing in case of a sudden need for liquidity. As can be seen, official financial institutions are only named by 2.8%, whereas 9.4% would go to ´Others´, i.e. shadow-banks and the large majority of 69.7% would first ask their of family / Guanxi network for aid. Similar to this data from 2003, a 2009 survey finds that "… 82.3% of the households borrowed from relatives and friends, while fewer than 20% […] from banks." (Zhou, 2014, p. 36) [8] In the words of Ms. Tsai: "One basic reason for the persistence of informal finance is that the supply of formal finance is limited and insufficient to meet the demand for credit. A second explanation is that official state policies are not being implemented properly." (Tsai, 2004, p. 1487) Both of these reasons are interlocked. Specifically on the supply-demand mismatch it is not about the total volume of credit being insufficient, but about the allocation between groups. That means that SME´s do not get enough credit, because too much is given to the SOE´s. A reason for this situation may be that banks depend on financial statements for information, on collateral

[6] Data from: Statista 13.02.2015; Global Shadow Banking Monitoring Report 2013 http://www.financialstabilityboard.org/wp-content/uploads/r_131114.pdf

[7] Private entrepreneurs have to rely largely on networks like family/relatives or friends for financing, (Allen et al., 2005; Ayyagari et al., 2010; a.o.) which is highly similar to what families do in times of financial needs.

[8] Both this citation and the graph quote percentages that are excluding those who did not borrow money.

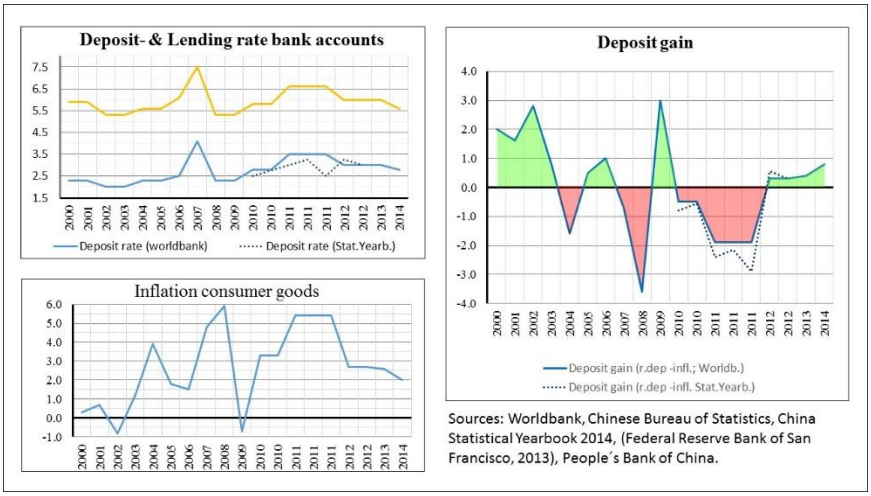
as security and on courts for enforcement, while shadow-banking depends on reputation for information, on networks as security and on forms of social sanction for enforcement. (Beck, et al., 2015, p. 38) These starkly different circumstances "… suggest […] that informal finance is not simply a manifestation of weaknesses in the formal financial system, but also a product of local political, institutional, and market interactions." (Tsai, 2004, p. 1487) The interactions just described are distinctly market-economic: In the face of one supplier performing unsatisfactory, here official banks, the SME customers turn to alternative market participants, here shadow-banks, to satisfy their needs.

There are also arguments for the attractiveness of shadow-banking from an official bank´s perspective. A part of the Chinese shadow-banking is conducted through official banks, for which the main drivers are: First, the RRR of up to 20% in China, which is very high if compared internationally. Second, the loan-to-deposit rate of 75%. Third the declining NIM that puts earnings pressure on banks. (Heep, 2014, p. 3) In theory the first two measures limit the amount of credit that can be generated from a given amount of deposits. In practice however, they spur regulatory arbitrage. The migration of capital from legal bank loans to other forms outside the definition area of the RRR and/or loan-deposit-ratio, flourishes. This allows the banks to maintain lending volume through other off-balance sheet channels, despite the regulatory measures. A very welcome additional effect is the possibility to separate risk and rewards with some of these constructs. These briefly outlined effects make up the attractiveness of shadow-banking through official banks.

Of far greater importance to SME´s are the procedural burdens of getting a bank loan. They are often portrayed as a matter of convenience. But for SME´s speed of financing is not about convenience, it is the usability of the credit. Bureaucratic requirements often constitute too high of an investment in terms of time and effort (Tsai, 2002, p. 68) for the credit to make sense and if it takes too long to access the funds, the business opportunity may have passed, or worse the reputation in the Guanxi network may have suffered. Scenarios that may well happen if "[g]etting approval for a bank loan takes anywhere from six months to a year. The informal networks, by contrast, can often deliver the cash within 24 hours." (Roberts & Chi-Chu, 2007) The other big issue of the vanishing attractiveness of bank deposits for private

households creates a supply of loanable capital outside the banking system. This increases the attractiveness of shadow-banking for SME´s as follows: Interest rates below or marginally above inflation rates made and still make depositing money with a bank an assured losing business. Thus, private capital became available for more productive uses.

On the graphs on the next page: ´Deposit gain´ is the ´real interest rate´ calculated as deposit interest minus inflation.



The right hand graph visualizes the unattractiveness of bank deposits: Since 2010 bank deposits have been losing, or at least only negligibly gaining, in purchasing power.

As a conclusion to this part of the composition and persistence of shadow-banking it can be stated that despite their importance for the economy, private enterprises have been and still do receive too little credit from banks. This has institutional and political reasons on the banks side and financial and documentary reasons on the SME´s side. Additionally it has to be mentioned that the frequent argument against attractiveness and persistence of shadow-banking, high interest rates, does not stick. Since such loans usually are taken as a last resort, the interest is not a core issue anymore. Lastly, shadow-banking was and is a deeply individual issue since almost all channels are mainly conducted along Guanxi-networks, which made and makes it a vastly diverse topic.

4.3 Definition

In theory all activities conducted through official banks should fall outside a definition of shadow-banking, however this is not always the case in China. What the market participants designate as ´shadow-banking´ covers the huge variety of financial intermediaries like

BAN´s, CGC-enabled loans, WMP´s, etc., which can be supplemented with "… off-balance sheet and informal bank lending [9] […]. [The outside] rationale behind this classification is that these activities generally involve regulatory arbitrage and have the potential to increase systemic risks." (Tong, 2014, p. 199) (Federal Reserve Bank of San Francisco, 2013, p. 1) The inside rationale of the Chinese market participants is that these types are not under the influence of regulations. Because of diversity, opaqueness and the fast pace of innovation within the Chinese shadow-banking sector, "… an official definition for China's shadow banking system does not exist as of this writing." (Tong, 2014, p. 199) Because of these issues, authoritative sources outside China and their definitions are used: From an economics-background the definition of the FSB and the European Commission are used. More humanities-oriented definitions are considered for their perspective on the degree of formalization or level of authority approval (Tsai, 2004, p. 1503) (Heep, 2014, p. 2). Since one important reason for the SME´s need to source their liquidity through shadow-banking is the organization-, regulation- and policy-driven behaviour of the banks, it is important to take the latter two angles also into account.

For the purpose of this paper and based on the core elements of the various definitions presented above, the following definition is constructed: *Shadow-banking in China involves two or more private- and/or legal persons that are engaged in credit intermediation and/or lending activities. This can entail, but is not limited to, accepting deposits, perform duration-, liquidity- or risk transformation, or create leverage. These transactions take place outside the official banking system and outside governmental regulation and supervision, which makes it informal. The range of applicability is the normal Chinese economy governed by standard central legislation.*[10]Shadow-banking activities that are intentionally targeted at harming others, like conscious Ponzi schemes, are excluded from the above definition, because they are

[9] Different vehicles and names exist to facilitate this, but the principle is the same: i) A borrower is prohibited of getting a loan, but the bank still wants to extend the loan. ii) The customer is directed to another company that is funded / controlled by the bank. iii) The customer then makes the loan with this company, or through it with the bank. iv) The loan is now in another, not regulated category.

[10] Specifications of terms: *´Two or more private- and/or legal persons´*: All different constellations from one lending another to several companies guaranteeing a loan for one other company. || *´Credit intermediation and lending activities´* include both organizations and actions. || *´Can entail, but is not limited to´* one act can have one or more of these elements. || *´Informal´*: The overwhelming majority of shadow-banking types targeted by this definition are in- or semi-formal. || *´Normal Chinese economy governed by standard central legislation´* that excludes special financial testing grounds / special local regulation.

a) almost always singular events due to Guanxi-networks, b) despite large individual size, inconsequential for shadow-banking in general and c) in essence crime, which is out of scope.

5. Cases and data

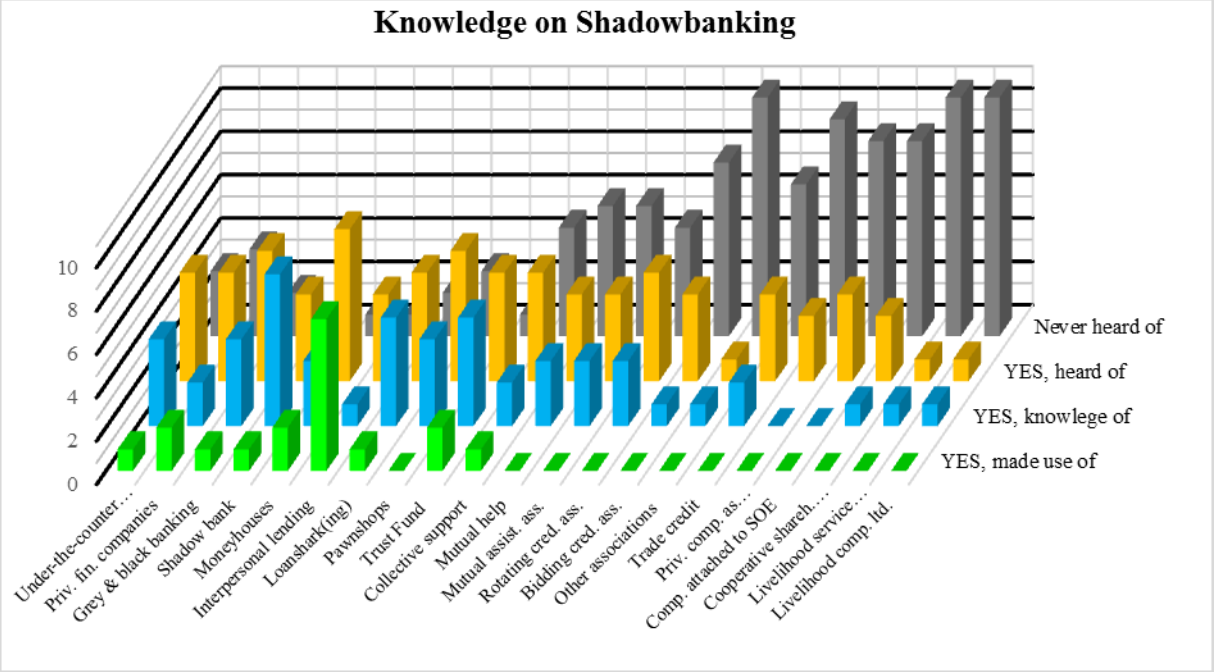
This section presents the gathered primary data, starting with introductory opinions and datasets to develop an initial understanding of the circumstances and normalities of the market. After that, the cases will cast a spotlight on exemplary uses.

5.1 Opinions from the industry

The first dataset to be presented is the part A from the questionnaire, which is also the base of the cases. This first part was independently used, especially when the interview partner was unable or unwilling to provide the in-depth information needed for a full case study. It is designed both as a test of the knowledge of the interviewee and as an indicator of current relevance of the different forms of shadow-banking. All in all this dataset consists of n = 13 observations (9 Chinese SME managers and 5 European/US Managers in Shanghai). This sample size can provide two things: First, an indication to which shadow-banking practices are currently prevalent with Chinese SME decision makers. Second, a narrow insight into how Chinese and foreign nationals see shadow-banking differently. The four answer possibilities for each shadow-banking type were: First ´No knowledge´, second ´Heard of´ the existence of this form, third ´Know of´ and fourth ´Made use of´. The types included are derived from literature and thus do not include types later encountered in China, e.g. P2P credit. Caveats are: First, some forms of shadow-banking, like “trade credit”, are industry-specific. Consequently responses differ strongly between trade-related SME´s and all others. Second, geographical influence: Respondents with a purely urban background know little about credit associations, whereas other respondents that grew up in the countryside, or live in Wenzhou, displayed knowledge about such forms.

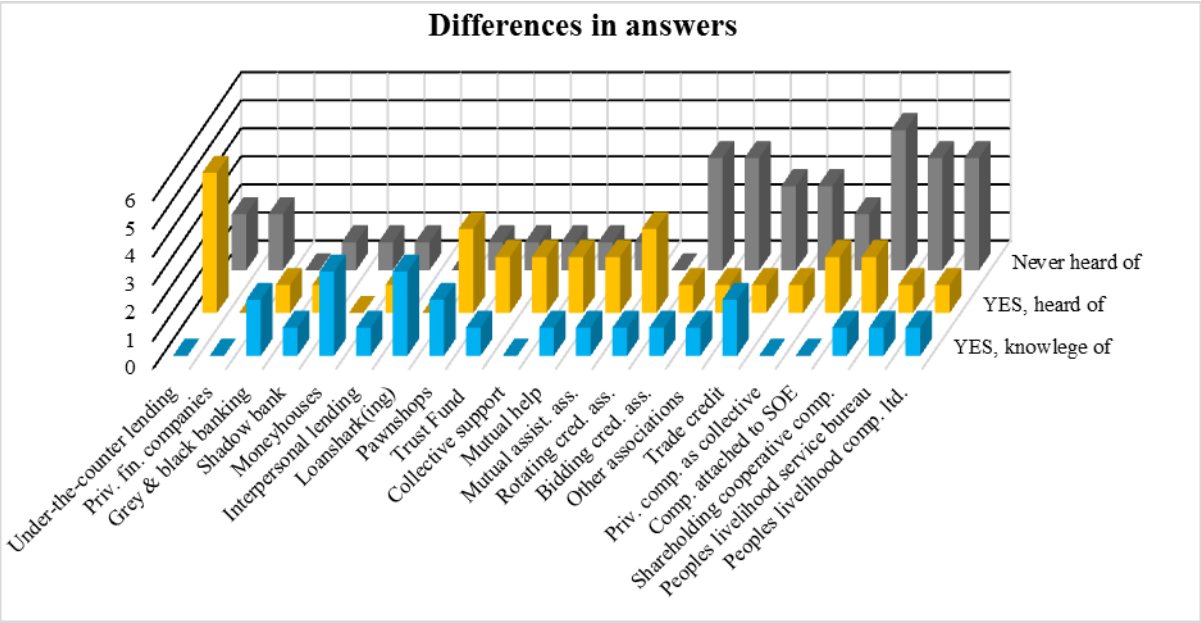
The chart below shows the results, which can be roughly divided in two areas: Far left the general terms, left individualistic types like interpersonal lending and trust funds and on the right side the community-based forms and special legal constructions. The community-based

forms and special legal constructions have only one admitted use, which is



surprising, but they also have many persons that know of, or have heard of them. Because of this, it can be suggested that these more general and collectivistic shadow-banking forms are widely known but rarely used nowadays and vice versa that individualistic, Guanxi based forms are dominant. The type ´Interpersonal lending´ deserves special attention: This type was by far the most frequently used and also by far the form seen most positively, if it was seen as ´shadow-banking´ at all. Some respondents characterised this not as financial interaction but as a normal part of social interaction.

Since the respondents could be easily and clearly divided in two groups, Chinese SME decision makers and others, it is revealing to look at the differences in responses (Measured in absolute numbers, to show the differences in perception more clearly). The chart below gives an overview.



The difference in ´Made use of´ is 100%, because Non-Chinese neither have the need for financing, nor the need to use shadow-banking. Their ability to access foreign credit markets excludes them from this diagram.

For the answer categories ´Knowledge of´ and ´Heard of´, a difference between the two groups can be found, however much smaller than expected. This can be explained through an inherent selection bias on the Non-Chinese side: The interviewees all responded because of their interest in the topic due to their professional connections to either banking or corporate finance. This predisposes them to an above average knowledge on shadow-banking. In the last answer category ´Never heard of´, the expected weaker, but similar distribution to the chart on knowledge on shadow-banking, can be found. From this data, the following general observations can be made: a) There is high awareness and knowledge for many shadow-banking types in the relevant groups. b) Individualistic types are clearly more present than collectivistic types. c) Interpersonal lending is by far the most used type.

After this first overview on usage, knowledge and awareness on different shadow-banking types, the following aggregated opinions from industry representatives and Chinese entrepreneurs will shed a little additional light on the above findings: Generally speaking, European managers are mildly sceptical towards shadow-banking, which may very well be influenced by the fact that neither they nor their companies are directly affected by shadow-banking. The recurring reasons were: A) Negative: High interest rates, which mean that the ROI of the un-

derlying business venue must be even higher. B) Relative: Benefits under a microeconomic view, threats from a macroeconomic view. C) Positive: No alternative from official sources of credit. When asked about the most important shadow-banking types for Chinese SME´s, opinions differed from other observations. Results named most frequently were loansharks and private money houses, then BAN´s, WMP´s and CGC´s together with interpersonal lending and then some other forms like pawnshops. Only occasionally did European managers mention things like zero-interest interpersonal lending, conduct and/or promotion of corruption.

Opinions of Chinese entrepreneurs, all Shanghai-based and 30-40 years, on the topic of shadow-banking were also collected. They pursue, to a surprising degree of agreement, a twofold strategy: First, using his own savings for part of the equity and taking equity partners in the company. Second, borrow the rest from family and friends, i.e. interpersonal lending. Financing through shadow-banking has been considered by all of them, but rejected. There seems to be a consensus that shadow-banking in general is an inappropriate business practice. Not so much because of ethical considerations, but mainly because of the very high costs, meaning direct interest and Guanxi-associated. But even if preconditions are very favourable for the SME, getting a bank loan is always the last resort, because it takes months, the application process costs too much and the loan volume is always uncertain.

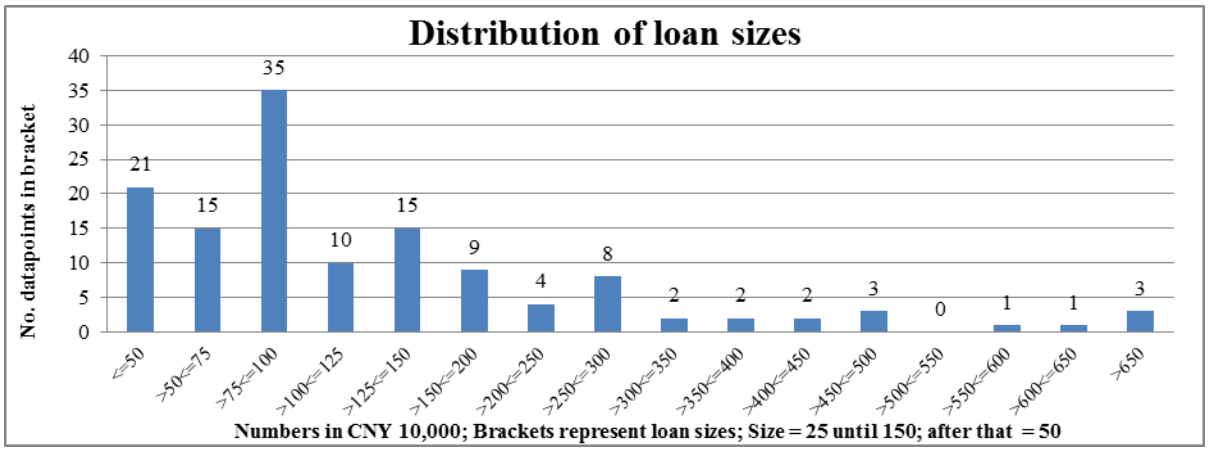
5.2 P2P lending

This section is about the data obtained from a Shanghai-based P2P lending firm. Founded in 2009, the company has grown rapidly and pursues its business model, one-on-one online credit intermediation services, consistently. This dataset gives a much broader, albeit less detailed, view on the range of the parameters in the shadow-banking sector in Shanghai. This allows to narrow down on what can be considered ´normal´ in the industry, which positively affects the evaluation of the cases, especially since many of the debtors in the dataset are SME´s. The results of this dataset are thus well comparable to the cases. [11]

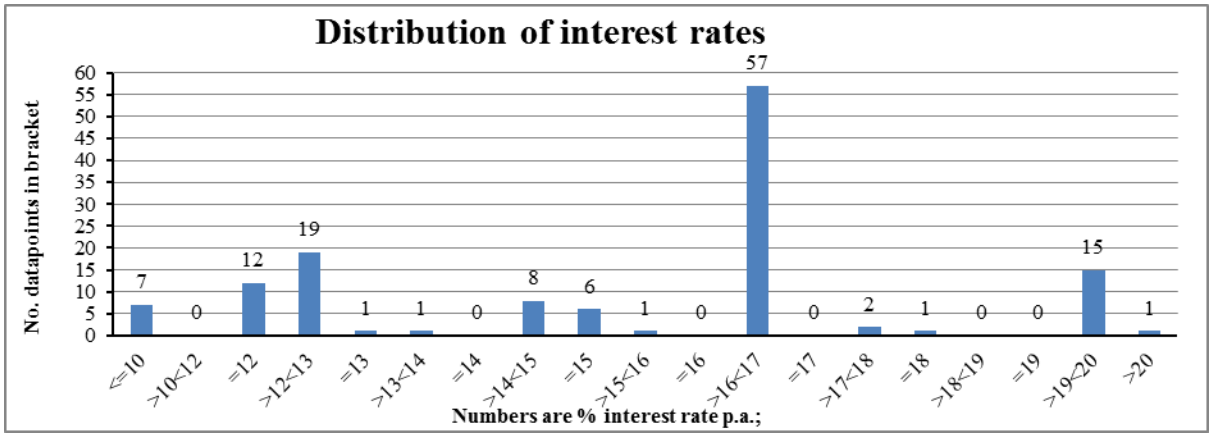
[11] The set has n = 131 observations from 09/2013 to 04/2015, with one observation consisting of: Name, sum loan, value collateral, percentage, securitization collateral, interest rate, fist/second mortgage, date, duration and some details on the collateral and the intended use of funds. The graphs and tables in this section derived from this data.

The modus operandi: First, individuals in need of loans, as well as individuals who are interested in and able to invest are sought out, primarily via cold-calling and word-of-mouth. Second, the creditworthiness, which is solely determined by their collateral is evaluated. Accepted collateral is real estate in Shanghai. The worth of the collateral, is verified by them through on-site visits and a legal check with the municipal authorities to ensure ownership- and securitization status. The maximum total accepted securitization of an asset is 70% of current market value, which hast to be at least 100% of the planned loan volume. Third, a loan contract between two individuals via an accrediting solicitor is facilitated. All in all, the entire process can take as little as 10 days, but 20 to 30 days is the norm and a standard commission of 4.00% of the loan is taken. Procedural expenses are carried by the debtor. The loan sum gets paid out in cash in a bank from the creditor´s account to the debtor in person. The commission is immediately taken in cash at this point.

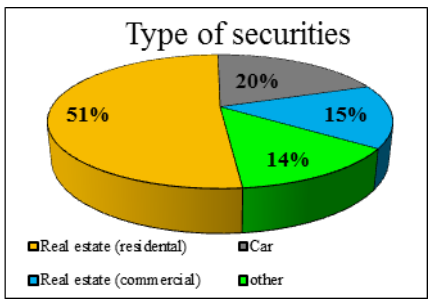
The following graphs offer descriptive statistics on loan characteristics. Loan sizes, as depicted first, vary strongly. But 80.2% of them are ≤ CNY 2,000,000, which shows that smaller loans make up the majority. They also fit the typical financing needs of SME´s.



Interest rates have also a large variance, ranging from 1.45% to 30.61% p.a. But as the graph on the next page clearly shows, almost half (43.5%) of all observations are in the largest cluster, the bracket of 16 to 17% p.a. Together with the other three large clusters, the respective observations make up nearly 90%.



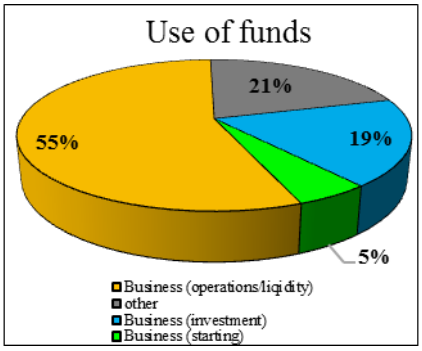
The very strong concentration in the distribution of interest rates cannot be explained alone by the clustered loan sizes[12] or other factors like duration and collateral quality. The visible peaks suggest that the assigned rates are to no small degree influenced by market rates. This is to say that the rates of the competition set the range. Loan duration is for 87% of loans one year, with 8% half-year contracts and 8% all other durations. Usually the cause for the loan (s. below) subsides after one year, or resurfaces in a very similar fashion, creating a rollover. Since all observed loans are entirely on a collateral basis, a closer view on the used securities is warranted: For 57% of the real estates, the mortgage used is the second hypothecation. The P2P company simply calculates the difference between the current mortgage and 70% of total current asset value and uses this difference as maximum loan volume that can by securitized by this asset.



But despite the claim of only accepting Shanghai real estate, the next chart shows the actual securities accepted. Real estate is still the major source, but other real estate outside Shanghai or even China, and other classes of collateral were accepted. The explanation for this discrepancy is that these other assets are also verifiable, traceable, liquid and bound to a natural person based on a legal title from a state authority. It is furthermore interesting to see that a large minority mixes different types of assets to reach the needed volume of securitization, e.g. the frequently used combination of putting up a flat and a car together.

[12] Distribution of loan sizes within the interest rate brackets gives no indication of a mutual influence.

So, mid-scale shadow-banking in Shanghai are, in this example, loans between 200,000 and 1,000,000 CNY, 15 to 16% interest rate and 12 months duration. They are 100% secured by collateral, mostly real estate, sometimes automobiles and if needed combined. After this characterisation, two important questions remain: First, for which purposes are these funds used? Second, how are they repaid? The dataset also provided answers for that: The use of funds they can be grouped as follows: i) Short-term liquidity needs for business, e.g. turnover finance. ii) Investment business purposes, e.g. expansion or renewals. iii) Initial investment for starting a business. iv) Others – everything from luxury to overseas education. Short-term liquidity needs, especially turnover financing, is the most frequent use. As expected, investment is the third largest share. The small share of starting a business is surprising but fits to the two testimonials from Chinese entrepreneurs above.



Sadly, the dataset does not include information on repayments. As far as could be discerned, the majority uses lump-sum payback at the end of the period. But also a fixed-sum payment in some sub-periods with a large sum at the end exists. Monthly interest and redemption payments seem not to be used at all. However repayment is not of central concern to the P2P company, because it is never exposed to credit risk. Only reputational damage of nonperforming loans impacts the company.

5.3 Case 1 – Trade Company

The company was founded in 2003 in Hongkong and provides logistics services. It has expanded to 15 cities in China since then and together with this geographical expansion, the company also gradually expanded into import logistics services, warehousing services as well as import trade itself – meaning they now also import and sell goods online. The firm employs less than 25 employees, but has an annual turnover and total valuation both in excess of 100 million CNY. The business is the organisation of trade, to get goods from A to B, in principle everything that is in their scope to handle. Business activities are purely office work: Getting orders, bundling them and booking container space. At present the services end as soon as the goods are on a ship. Because of this, they miss out on some of the profit in the

value chain. To internalize these parts, they plan to expand into Europe or the US in the next few years. On the financial side of this core business model is a high need for liquidity. This also includes frequent, but short periods of excess liquidity between orders. To use this capital, they invest it in stocks but occasionally also in short-term WMP´s and make about 200,000 USD p.m. profit from these operations. Financing: Interestingly, the founder stated that they would not have any problems getting loans from official banks, but that this is not an option. The reason is that official bank loans are too slow, i.e. too much time passes from application to cashflow, mainly due to documentary needs. Consequently, they use shadow-banking to get loans. The preferred method is interpersonal lending, followed by using CGC´s. He found out about the guarantee companies he used through outdoor- and online advertisement as well as recommendations from friends. In total, he financed between 750,000 and 1,000,000 CNY through these channels, which make up 40-60% of the company´s total present liabilities. Based on his information in the Part B of the questionnaire, he uses shadow-banking frequently, usually for short-term engagements and for different volumes. Uses of the capital are predominantly to satisfy liquidity needs stemming from normal business operations[13] or investments.

	Risk of use	Duration	Interest % p.a.	Collateral	Use	Repayment
Interpersonal lending	Low	= 12m	0.5 - 6.0	none	Planned, thought-out things	Lump-sum
Guarantee Company	Average - High	≥ 6m	n.a.; variable	Flat, other fixed asset, stocks	Urgent issues	Lump-sum

His overall assessment on shadow-banking is positive. The methods he uses, interpersonal lending and CGCs for new liquidity and WMPs to utilize excess liquidity, are seen very positive. Reasons are mainly the speed and the convenience. For interpersonal lending and WMPs there is the additional fact of superior conditions, meaning lower interest rates and higher rates of return respectively.

5.4 Case 2 - Shoe shop

The owner-manager was scheduled for a routine follow-up meeting by its P2P creditor which could be attended. The meeting served two purposes: On the one hand to check upon the

[13] E.g. front-up payments for containers, for an average customer approximately 1.8 million CNY.

debtors liquidity situation and in order to the secure relationship. The shoe shop is very typical, catering exclusively to Chinese customers and about 40 km from downtown Shanghai. Within the suburb it is a prime location, because the surrounding shopping centre is new and at the intersection of the two major roads. The company is at least five years in business and targets both male and female customers of the Chinese lower-middle and middle class. Before as a street-side small-scale shop owner, the owner-manager only used inter-personal lending. First to start his business, for a first expansion to a larger street-side location and for financing turnover or little investments. Reasons were the extreme convenience, the speed of this method and that the needed loan volumes were small enough. Then five years ago, he expanded a second time to the mall and his financing needs outgrew the financing ability of his friends and relatives. However, he did not know shadow-banking at the time, forcing him to get a bank loan. To this day, he is very displeased with that decision, because it took ´a few´ months to get the loan. Also, in his opinion, the documentation demanded was inappropriate, too troublesome and the loan sum was not as high as desired. For a planned expansion of his store into a chain, he is sure to use P2P financing and not official bank loans. At the moment, he uses two financing channels: Interpersonal lending and P2P finance. He is using interpersonal lending not regularly, but frequently to quickly satisfy various short-term, small-scale liquidity needs, e.g. bridging regular expenses. As for P2P finance, he got to know about them through word-of-mouth from a friend who also uses it. He used P2P finance in 2013 for the first time, when he got a 12 month loan to clear his bank loan. He could only repay part of this first P2P loan, but got a new, second, loan for 2015 to repay the remainder of the 2014 one – a partly rollover and a second time 4% commission for the P2P firm. This loan had a starting volume of 150,000 CNY and ´standard terms´, which are 15-17% interest p.a. and a lump-sum repayment scheme for interest and principal. Despite these terms, He proudly told that he had already repaid 40,000 CNY until 05/2015. Both creditor and debtor were highly confident that the loan could be repaid without problems. Shadow-banking accounts for 100% of his business liabilities. For the owner-manager it is beyond question that he could not have achieved his present business success with official bank loans, because of the administrative hurdles.

	Duration	Interest p.a.	Collateral	Use	Repayment
Interpers. lending	≥ 12m	0 / n.a.	none	Small Exp.	Lump-sum
P2P lending	= 12m	15-17	Flat	Large investments	Theory: Lump-sum. Practice: Irregular

Shadow-banking was and is absolutely essential for his success. He sees both the interpersonal lending, which gives him credit-card like liquidity, as well as P2P finance that behaves like a bank loan without all the obstacles, as very positive and indispensable to him.

5.5 Case 3 - Electrical company

The firm employs >100 people in Wenzhou and produces basic pre-manufactured electrical parts and was active in metal moulding. Current business operations are reasonably well and expanding the scope and diversifying are considered. Fitting into the picture of the very localized and almost informal character of the business, private moneyhouses and loansharks as well as collective credit support and interpersonal lending have been used so far. Uses for the money were mainly for purchasing materials, or turnover finance. In sobering clarity the owner stated the reason for choosing these types to be ´because everyone does it [that way]´. He has financed between 100,000 and 250,000 CNY through these channels and is paying between 12 and 18% interest p.a. These rates refer to the private moneyhouses and loansharks. He stated that the interpersonal lending he experienced was without interest. On the matter of the transaction costs and how shadow-banking connections and loans are made, he said the most important occasions are dinner, having tea and office chat. This is where he gets information on new channels, credit conditions and opportunities, i.e. names and phone numbers. So if there is Guanxi with the creditor, the time from initial request to definitive answer is ´the duration of a dinner´. It is interesting that costs associated with having dinners, several hundred CNY at least, are neither considered transaction costs nor associated with the loan. He comes to the conclusion that shadow-banking, was not good for his business, because of associated costs. However, this does not imply the interest-free lending between friends, which is seen as ´getting help´ and not as entering into a credit obligation.

5.6 Case 4 – Alcoholic beverages importer

The owner-manager is from a Wenzhou family. As far as could be confirmed, his parents and one of his uncles have their own SME businesses there. This makes not for a rich, but wealthy background. The product range is mainly speciality beers and upmarket wines, but also mass-market beers and standard wines from Europe or northern America for wholesalers all over China. Suppliers are either the producers of speciality products or foreign wholesalers for mass products like American Budweiser. This division is directly linked to the order volume. At the moment, the company moves on average one shipping container per month, but targets ten containers per week. Because of operational difficulties and the extreme networking requirements in this niche market, a strategic reorientation of the business model towards online educational videos is targeted. The company financed approximately 1.3 million CNY through shadow-banking. A large part, ca. 0.6 million CNY, was borrowed at the beginning for starting operations with the largest cost blocks being warehousing and turnover financing. After that, a small part was borrowed in between for a specific project. Then a few months later again around 0.6 million CNY for turnover finance. These funds came all from interpersonal lending out of the family clan of the owner-manager. The interest rate of these loans is zero without any fixed maturity date. Transaction costs were extremely low, since the money literally stayed in the family. Beyond the 1.3 million, 325,000 CNY of own equity were used. The financing structure was insofar consciously designed as official banks were never considered, because of their lengthy processes, translating into strong inconvenience and high transaction costs and the firm expectation not to get a loan without of collateral. Other forms of shadow-banking were avoided, because they were ´mafia-like´ and/or lack of the ´right´ Guanxi. Interpersonal lending was absolutely essential for being able to start business operations, because the terms of all other channels, official and unofficial, were vastly inferior. Although this financing was not the only factor for achieving the present level of business activity, it was clearly the most important one.

6 Consolidation of findings

The *opinions within the groups*, European managers, young Chinese entrepreneurs and managers from the cases, are quite homogenous, albeit with outliers. Also there is a difference

between the Europeans and the other two groups. The entrepreneurs and the owner-managers are largely in agreement, but they do have disconnects on some topics.

The results from the questionnaire part A suggest a division of the observed types of shadow-banking running along what can roughly be designated ´general and individualistic´ versus ´collective´ forms. Whereas the general ones [14] and the individualistic[15] ones[16] have many use cases and high awareness, the collective ones [17] have only one use case and limited awareness. Among all the types, interpersonal lending is by far the most important form. Besides this, the data seems to indicate that on the countryside, older, collective forms of shadow-banking are still practiced, whereas in the city the more modern, individualistic versions dominate. The reasons for this claim are: a) The SME´s covered, which are all in urban areas, do not use collectivistic forms at the moment. b) Depending on whether the owner-manager grew up on the countryside or not, he displays awareness or knowledge about these collectivistic forms.

The *opinions from European managers* are in line: The assessment of shadow-banking is relative to the environment: On the micro level it is as best available alternative, on the macro level it is bad, because it clusters risks and promotes corruption. The main advantage is believed to be the rapid and easy access to cash, as well as having the element of personal trust. The main disadvantage is believed to be the high interest. The non-attractiveness of bank loans is caused by too much documentation and too long processing times. Besides this, shadow-banking conducted through official banks, e.g. via BAN´s, CGC´s and/or WMP´s, is believed to be epidemic and very important for SME financing.

The position of the Chinese entrepreneurs differs from these views: When borrowing for business purposes, interpersonal lending is the type of choice, followed by own equity. Creditors are most often family, then friends and then Guanxi. Other forms of shadow-banking are known but avoided, because of the high interest rates. BAN´s, CGC´s or similar are not an option either.

[14] Under-the-counter lending, private financial companies, grey & black banking, shadow-banking.
[15] The loan from one single party is provided by another, single party. Trust funds do not fit precisely, but fit even less in the collective category.
[16] Moneyhouses, interpersonal lending, loansharking, pawnshops, trust funds.
[17] Collective support, mutual help, all types of associations, trade credit, private companies as collective or attached to a SOE, cooperative companies or livelihood bureaus.

The *findings from the P2P lending firma*, are: A typical loan is >1 million CNY with 16-17% interest p.a., 12 months duration and is repaid as lump-sum at maturation. It is 100% secured by collateral in the form of real estate or cars and is used for business operations or investment. Again such loans are 100% collateral-backed, which make them only accessible for already successful businesses. The use of real estate collateral exposes the creditor to the risk of the real estate market and since the collateral value is calculated on current market prices, sudden illiquidity and price pressures are a danger. Interest rates seem to be driven by market power and not by loan characteristics.

The *findings from the cases individually* are: The trade company can get bank loans, but chooses not to, because bank loans are too slow and have too high documentary needs. The preferred method is interpersonal lending, followed by using CGC´s. For investment of excess funds, WMP´s are used. These channels are known through advertisement and word-of-mouth. 40-60% of the company´s total liabilities come through these channels, which are used frequently for short-term needs. The overall assessment on shadow-banking is very positive, mainly because of speed and convenience, together with superior conditions. The shoe shop got a bank loan for an expansion, which is strongly regretted because it took too long and was too troublesome. He is now using interpersonal lending because of convenience, speed and because the individual loan volumes needed are small enough. For larger investments, he now uses P2P finance (in 2014: 150,000 CNY, 12 months for 15-17% p.a.). Together these account for 100% of his liabilities. The owner deems shadow-banking as absolutely essential for his success. The electrical company used so far private moneyhouses, loansharks, collective credit support and interpersonal lending for turnover finance and investments. The reason for choosing these channels is ´because everyone does it´. They financed 100,000 to 250,000 CNY through these channels until now. Current loans from these sources make up 20% of his total liabilities. With moneyhouses and loansharks he pays 12 - 18% p.a., while interpersonal lending is interest-free. Because of the cost of capital, he concludes that shadow-banking is not good for business. However interpersonal lending is ´getting help´ and not a credit obligation. The alcoholic beverages importer got 1.3 million CNY, representing 80% of total liabilities, from interpersonal lending. Main uses are warehousing and turnover financing. The conditions are 0% interest and no fixed maturation. Beyond this, the two partners used 325,000 CNY of their own equity. The financing structure

was consciously designed since banks were excluded, because of lengthy processes, strong inconvenience, high transaction costs and collateral needs. Other forms of shadow-banking, e.g. moneyhouses, were excluded, because they were ´mafia-like´.

The *findings from the cases collectively* are in declining importance: First, shadow-banking is overall positive for SME´s. Second, the best and most used type of shadow-banking is by far interpersonal lending, although it is sometimes not seen as part of shadow-banking. Its main advantages, besides the interest rate, are convenience and speed. Third, the used types of shadow-banks can be grouped into interpersonal lending and all others. Interpersonal lending is used for short-term, small-scale standard business uses of usually ≥100,000 CNY. Very low, even zero percent interest rates and few months duration are typical. Most other forms are for longer and larger one-time expenses with >0.1<1.3 million CNY, between 12-18% interest and one year duration. The attitude towards bank loans is very negative, because they are too troublesome (duration, process, documentation, collateral). Negative to the extent that SME´s which could get bank loan, do not want to take one. The share of shadow-banking liabilities from total liabilities is unclear, since interpersonal lending sometimes is not included in these figures.

The most important *overall findings from all the primary data* are, again in declining order: First, the shadow-banks surveyed can be grouped roughly in individualistic and collective forms. Within the individualistic forms a subdivision between interpersonal lending and all other forms can be made due to the strong difference in importance. Second, the attractiveness of shadow-banking generally stems from the rapid, easy access to cash. For interpersonal lending specifically, the attractiveness additionally comes from personal trust. Third, interest rates are very high for shadow-banking in general, but very low to zero for interpersonal lending. Fourth, the uses of shadow-banking are mainly in the areas of expansion financing and turnover financing. Fifth, external opinions and cases agree that on a micro level, shadow-banking is generally the best available alternative and conductive to SME business. Based on the findings just given, the statement that shadow-banking is in principle a bad thing can be refuted. Despite diverging voices, the overwhelming majority of respondents view shadow-banking as positive. Additionally, the conviction that shadow-banking is the best option available under the given circumstances and has a positive side, can be fully con-

firmed. All Chinese respondents, cases and entrepreneurs alike, name one form of shadow-banking as their preferred form of accessing credit.

The *main disconnects in the data* are: First, the non-attractiveness of bank loans. Neither the European managers, nor the Chinese entrepreneurs took an explicit stand in the matter, but the cases were clearly negative because of too much effort and time. Second, the use of own equity, which did not surface with the European managers, but were of high importance for the Chinese entrepreneurs and also some cases. Clear disagreement exists over the use of the forms of shadow-banking: The opinions of European managers on this are reversed to the responses from the entrepreneurs and cases. On the one hand, interpersonal lending is of far greater importance to the SME´s than the industry thought. On the other hand, other forms of shadow-banks, like CGC´s, WMP´s, BAN´s or loansharks, are far less important than the industry thought.

Further, *less strong findings are*: First, individualistic shadow-banking forms are perceived to be a viable option, just ´not as good as interpersonal lending´ in the cases. The result is that other individualistic forms are not used. Second, the notion that interpersonal lending is not shadow-banking, could be observed repeatedly. Interpersonal lending is often perceived much more as a social interaction, then a credit obligation. Because of this, altruistic motives topple financial considerations, which explains that observed interpersonal lending rates are below the inflation rate, making the creditor loose value.

When *comparing the findings to the literature*, a diverse picture of agreements and differences unfolds. The general notion, that ´shadow-banking is monolithic and homogenous, determined as a function of official banking´, can be refuted. Clear distinctions can be made between the different forms of shadow-banking, be it alongside the parties involved, the use cases or the involved institutions. Since the moderately negative assessment of shadow-banking for SME´s in the literature is based on aggregate data, there is a data mismatch. More often than not, the composition of the aggregate data, e.g. which shadow-banking types are included, is not evident. Without trying to derogate these empirical findings with the qualitative data employed here, the explanatory power of these findings is limited regarding the topic of this work. This is because of the type of data used, the viewpoint taken and especially

the argumentative point of origin ´bank´ are too divergent from this paper´s. Thus, their moderately negative assessment, as well as the idea of ´next best thing to bank loans´ for private businesses in China, cannot be agreed to. However, the characterisation of the market as low-tech and loan centric, compared against the US, can be affirmed. The paradigm that official lending is skewed against SME´s, is consensus in the literature and can be affirmed with the findings from the data. Loan attainment strategies are linked by various pieces of literature to ´entertainment and travel costs´, i.e. corruption. While the findings from the primary data are insufficient to affirm or refute this, there is anecdotal evidence endorsing it. The paradigm of the importance of Guanxi for SME´s is widely accepted within the literature. As expected, this finding can be indirectly affirmed. In the literature additional variables are usually employed in order to come to a clear conclusion. Similarily, this paper is also unable to wholeheartedly adopt shadow-banking as good or bad, since one of the cases states that shadow-banking was bad for business and another one describing shadow-banking as ´mafia-like´. But contrary to that, all cases agree in the high value of interpersonal lending for their business, which is technically also a shadow-banking type.

Due to the *quantity of the data employed* further data collection and research is indispensable for more robust statements on the subject matter. However the following statements can be made: First, some of the SME´s that could get bank loans, do not want them. This is because of a) shadow-banking loans are faster and have lower transaction costs and b) SME financing needs can still be sufficiently satisfied via interpersonal lending. Second, SME owner-managers and especially young entrepreneurs dislike the more illegal shadow-banks. Reasons are the high Guanxi-associated costs, but especially interest expenses and surprisingly also ethical considerations. Third, the paper highlights the importance of interpersonal lending. Fourth, the anecdotal findings of this paper challenge other anecdotal findings on the use patterns of SME´s concerning shadow-banking. Yet again, due to the data limitations, previous findings cannot be called outright into question, but these findings do cast a new spotlight on them, underscoring the need for further research.

Current developments after finishing the research bear implications for the Chinese shadow-banking market: During the course of 2015, but especially in August, the PBoC lowered the RRR, decreased NIM (Morningstar, 2015) and stunningly abolished the loan-to-deposit ratio (BloombergBusiness, 2015) (Xinhua, 2015) (AFP, 2015). All three moves are likely to

increase the attractiveness of shadow-banking. The lower RRR provides for an overall larger loan volume, of which a part will likely go into shadow-banking. The lower NIM is also suited to make shadow-banking investment products more attractive. And the discontinuation of the loan-to-deposit ratio frees additional deposits for loan generation, again increasing the overall loan volume. Even beyond that, the turbulent start of 2016 on the Chinese stock exchanges and the regulatory action that could be observed so far *go in the same direction.* So, all in all, further growth of shadow-banking seems probable in the near and mid-term future.

The *generalizability of the findings* is given within the limitations imposed by the data. The wide array of different circumstances covered by the cases, meaning size, age, employees or turnover, as well as the opinion of the Chinese entrepreneurs are all very similar. This indicates that their commonalities, as laid out above, might be true on a general scale for SME´s. Because of this, general statements on SME´s and shadow- banking are made, but they would need to be substantiated by further data. Therefore, the first general statement is: Interpersonal lending seems to be the most important financing avenue for SME´s. This is because uniformly every Chinese respondent, uses it to a significant degree and values it highly. Especially because of its near-immediate availability, which is and will remain a key requirement for their corporate liquidity management. Second, interpersonal lending could be considered the most attractive financing channel. Seen from the perspective of the SME, interpersonal lending provides a sufficient quantity of liquidity at the lowest cost and with the highest speed. Additionally, lending-related incremental transaction costs are very small, because the lending-Guanxi are the normal personal Guanxi that are present anyways. Third, other shadow-banking types might not be as important for SME´s as currently believed. In part this stems from the observed uses, knowledge and awareness of non-interpersonal lending types of shadow-banking, which are unexpectedly low in their totality. Fourth, shadow-banking will likely remain a very important part of Chinese SME financing for the foreseeable future. Interpersonal lending is engrained in the culture and there is no indication that it might change. But most of the other forms of shadow-banking came into being as answers to the official financial framework. As long as this framework structurally underserves SME´s, some form of shadow-banking will exist to satisfy this need and make a profit from it.

7 Answering the research question

For answering the hypothesis, at first the three sub-hypotheses will be answered before concluding with the reply to the main H_1 hypothesis. *[H_a] Do SME´s prefer the use of shadow-banking over official banking?* This was verified and found correct, because of the findings clearly show that SME´s prefer shadow-banking over the official system. This entails the attractiveness of shadow-banks as well as the non-attractiveness of bank loans. *[H_b] Do SME´s really use shadow-banks more than official banks for credit?* This can be accepted, because the frequency as well as the volume of shadow-banking use is higher than that for bank loans. This remains true even if viewed for the entire history of the businesses which responded. The table below summarizes the respective numbers. *[H_c] Is shadow-banking considered as something positive for business by the SME´s?* This was verified and found correct, because the owner-managers from the cases directly voiced this opinion. Although there were critical voices to some types of shadow-banks, every Chinese respondent identified at least one type of shadow-bank as positive for his business.

(numbers at present)	**Bank loan**	**Shadow-b. excl. interpers. lending**		**Shadow-b. incl. interpers. lending**	
	CNY	**CNY**	**%**	**CNY #1**	**%**
Trade company	0	750,000 - 1,000,000	40-60%	n.a., "frequently"	100%
Shoe shop	in the past once	150,000	n.a.	n.a., "frequently"	100%
Electrical company	0	100,000 - 250,000	>20%	n.a., "frequently"	100%
Alc. Beverages imp.	0	0	0	three times, 1,300,000	100%
#1 This column cannot be calculated as a difference between shadow-banking excl. and incl. interpersonal lending because of the various, described imprecisions in the respondent´s answers					

[H_1]"Yes, Shadow-banking does contribute positively." – The main hypothesis can be accepted, because: First, all three sub-hypotheses could be accepted. Second, all respondents from the cases directly stated that at least one form of shadow-banking contributed positively to their business. Third, other Chinese respondents also stated that at least one form of shad-

ow-banking contributed positively to their business. This is in line with the general tone of the other detail findings from the data, too.

Based on the data gathered, its interpretation and the accepted hypothesis, the research question - *"Do Shadow-Banking Practices in China Positively Contribute to the Development of Chinese SME's?"* – can be answered with: *"Yes, it does contribute positively to the business activities, but there are differences between the types of shadow-banks and their importance for the SME´s."* The assumptions associated with the question[18] are not challenged by the findings. Beyond that the implied suggestion of the research question was proven right and is thus reflected in the answer. The difficulties in the assessment of the degree of success materialized as expected. Although a form of shadow-banking was almost always stated as very important for both big and small financing needs, an objective assessment was impossible due to a lack of access to facilities or documents. As expected, only taking the companies self-assessment was feasible. This has the advantage of being a very direct measurement, which is in line with the orientation of the paper. Adjacent to the assessment of the contribution, is the element of which sort of development this shadow-banking supported: ´Business activities´ in the answer encompasses the two major areas of expansion financing and turnover financing.

8 Conclusion

In conclusion of this paper, an underappreciated fact, namely that "[w]hatever else you might say about it, *shadow banking is a market-based financing system…*" (Wildau & Zhang, 2013) is the point to begin with. After hearing all the different angles and asking the people involved, the following picture presents itself: Shadow-banking in China - and this especially true for SME´s - is mainly about direct loans. The decision where to take out the loan is driven by market-economic considerations. A prime example for this is the finding that a) Chinese SME´s are impacted by financing constraints, hindering their operations and growth, b) the fact that this imbalance stems from dysfunctional banks and c) that the thereby caused

[18] a) SME´s currently use a form of shadow-banking, b) SME´s are able to draw a connection between shadow-banking use and development and c) these connections are significant in the eyes of the SME´s.

undersupply is offset by private actors realizing an opportunity in the market. It is such a powerful market-economic force that it even goes against the law.

As for the limitations arising within the paper, the amount and composition of data is the foremost, albeit unavoidable caveat. Suggestions for further research are thus the validation of this paper´s qualitative findings through more robust quantitative research, allowing for the application of statistical methods to achieve representativeness for the entire population of Chinese SME. Also, P2P – lending in its different forms makes for a shadow-banking type, which just recently (2013) started to experience explosive growth. It is en vogue and just beginning to appear in the literature. Lastly, changes in market behaviour due to regulatory changes, like changes in the legality of shadow-banking types, would have to be considered.
The general *outlook on shadow-banking* for Chinese SME´s is likely as follows: It will remain the main source of external liquidity for Chinese SME´s. It will also remain highly volatile regarding the types prevalent in the market. Credit conditions and regional differences will retain their extreme ranges. Regulatory intervention will very likely continue to frequently reshape the market, but it is highly unlikely that a) the bank loan allocation to SME´s will improve or that b) shadow-banking would be curtailed because of it.

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Attachment encountered forms of shadow-banks

General terms		
影子银行	yingzi yinhang	Shadow bank.
钱庄	qianzhuang	"Private money house". It refers to a place, often a residential real estate, where one can use basic banking services.
灰黑色金融	huiheise jinrong	Grey & black financing.
地下接待	dixia jiedai	Unofficial / illegal / under-the-counter lending.
私营金融企业	siying jinrong qiye	Private financial companies
个体户	getihu	Small privately owned enterprise. This is a very general and neutral term that is generally used for normal, e.g. goods producing, companies. But in rare cases it can also refer to shadow-banks.
Private and person-to-person		
私营金融	siying jinrong	Private, for-profit lending.
民间接待	minjian jiedai	Interpersonal lending.
Company-to-Person		
高利贷	gaolidai	Loanshark (person)

放高利贷	fang gaolidai	Loansharking (activity)
当铺	dangpu	Pawnshop
银杯	yinbei	Middlemen, brokers
(基于互联网)一对一投融资服务商	(Jīyú hùliánwǎng) Yī duì yī tóu róngzī fúwù shāng	(Internet-based) one-on-one financing service provider
对冲基金	Duìchōng jījīn	Hedge funds
货币市场	Huòbì shìchǎng	Money market funds
银行承兑汇票	Yínháng chéng-duì huìpiào	BAN´s, Bankers acceptance note.
商业票据	Shāngyè piàojù	Commercial papers
信用担保公司	Xìnyòng dānbǎo gōngsī	CGC´s, Credit guarantee companies
理财产品	lǐcái chǎnpǐn,	wealth management products, Investment products
投资产品	tóuzī chǎnpǐn	Investment products
股份合作企业	gufen hezuo qiye	Shareholding cooperative enterprises (that pool capital and issue shares)
民生企业经济服务部	minsheng qiye jingji fuwubu	Peoples livelihood enterprise economy service bureau
民生企业经济有限公司	minsheng qiye jingji youxian gongsi	Peoples livelihood shareholding enterprise
Company-to-company		
行业行用	hangye xingyong	Trade credit
带红帽子	dai hong maozi	"Company wearing a red hat". This refers to Chinese private companies that illegally fund themselves through a series of shell companies and subsequent M&A´s or equity stakes.
挂户企业	guahu qiye	"Attached enterprises". Private companies paying SOEs to technically become a collective and to be treated by banks as a state-owned company
Associations		

民间金融	minjian jinrong	Collective (credit) support
互助形式	huzhu xingshi	Mutual (financial) help
农村合作基金会	nongcun hezuo jijinhui	Rural cooperative foundations
互助会	huzhu hui	Mutual assistance associations
旋转信贷协会	xuanzhuan xindai xiehui	Rotating credit association
论会	lunhui	Interest-free (old-fashioned) credit association with dynamic interest (after ranks)
(贷协)会	biaohui	Bidding credit association
Pyramid schemes		
老鼠会	lǎoshǔhuì	Pyramid (or ´Ponzi´) scheme
庞式骗局	pángshì piànjú	Pyramid (or ´Ponzi´) scheme
层压式推销	céngyāshì tuīxiāo	Pyramid (or ´Ponzi´) scheme

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