

SECTOR OVERVIEW

A. Economic Overview

1. After four decades of economic progress, the People's Republic of China (PRC) has achieved upper middle-income country status and emerged as the world's second-largest economy. Driven by strong exports and improving consumption, economic growth in the PRC recovered to 8.1% in 2021 from 2.2% in 2020, although the economy showed signs of slowdown in the second half of the year, with gross domestic product (GDP) growth at 4.0% in the fourth quarter. Consumption was the main driver of growth, contributing 5.3 percentage points of the total GDP growth in 2021. Economic growth is moderating in 2022 because of lackluster domestic demand. The weak contribution of investment to growth in 2022 should revert in line with higher infrastructure investment, while net exports will ease. Consumption should continue to be the primary contributor to the growth. The Asian Development Bank (ADB) forecasts a GDP growth rate of 4.0% in 2022 for the PRC and 4.8% in 2023.¹

2. Downside risks to the outlook are both domestic and external. The unpredictability of the coronavirus disease (COVID-19) pandemic outbreaks and virus mutations could endanger the recovery in domestic consumer demand. Another domestic risk to the outlook is mounting credit risk in the financial system, especially at smaller banks, that could trigger a need for policy responses that induce temporary tensions in the financial market. The downturn in the real estate sector added further pressure to the economy. External risks are the impact of spillovers from the Russian invasion of Ukraine and frictions in global value chains from temporary supply shortages or transport bottlenecks. The Government of the PRC has implemented more proactive fiscal policies to boost the economy. According to a statement released on 23 May 2022, subsequent to the PRC State Council executive meeting, the government has decided to implement 33 measures in 6 areas to boost the economy, including an extension to value-added tax credit refunds, a fiscal move that is expected to increase tax refunds by more than CNY140 billion and bring the total amount of tax refunds and reductions to CNY2.64 trillion in 2022.²

3. The foreign currency sovereign rating for the PRC is A+ by Standard & Poor's, A1 by Moody's Investors Service, and A+ by Fitch Ratings.

B. Overview of Micro, Small and Medium-Sized Enterprise Access to Finance

4. Micro, small and medium-sized enterprises (MSMEs) represent an important part of the PRC economy.³ The development of MSMEs directly contributes to inclusive economic growth, given their important role in creating jobs. Small businesses with 300 or fewer employees contributed to more than 60% of total GDP, 50% of tax income, 79% of job creation, and 68% of exports.⁴

¹ ADB. 2022. [Asian Development Outlook 2022 Supplement: Recovery Faces Diverse Challenges](#). Manila.

² Government of the PRC, State Council. 2022. [Premier Stresses Stabilizing Economy, Bringing Economy Back to Normal Track](#). News Release. 5 August.

³ Based on Government of the PRC. 2011. [The Notice on Issuing the Provisions on Criteria for Classifying Small and Medium-Sized Enterprises](#). Beijing, MSMEs are defined and categorized into three types (medium, small, and micro) based on revenues, staff size, and/or total assets based on the characteristics of different industries. For instance, in agriculture, enterprises with annual revenues of CNY5 million–CNY200 million are defined as medium-sized enterprises; those with revenues of CNY500,000–CNY5 million are small enterprises; and those with less than CNY500,000 are microenterprises. The definition applies to all legal forms of enterprise, including individually owned businesses.

⁴ Organization for Economic Co-operation and Development. 2022. [Financing SMEs and Entrepreneurs 2022: An OECD Scoreboard](#). Paris.

5. Despite the significant contribution of MSMEs to economic growth, limited access to finance has always been a major constraint on them. Banks are not a major source of finance for MSMEs. Banks have shown a preference for lending to state-owned enterprises and larger corporates operating in the priority sectors identified in domestic industrial policy. According to the data from the SME Finance Forum, the financing gap for MSMEs in the PRC reached \$1.89 trillion in 2018, accounting for 43% of total MSME financing needs.⁵ Moreover, MSMEs in the underdeveloped central and western regions have more restricted access to finance with average borrowing costs 44 basis points higher than those in the eastern regions.⁶ More job opportunities associated with faster growth of MSMEs in central and western regions will help reduce regional disparities.

6. The outbreak of COVID-19 in 2020 significantly impacted SMEs in the PRC. They are vulnerable to shocks because of their financial weakness, lower degree of business diversification, smaller size, and lesser ability to withstand temporary disruptions in production and services. Because of their lower degree of digitalization, they are less resilient and flexible in adapting to changes in work processes and measures required for pandemic control. The prolonged pandemic with multiple lockdowns has pushed many small enterprises out of business or greatly reduced revenues. According to the Fudan Development Institute, the net income of SMEs decreased by more than 30% during 2019–2020.⁷ The registration–dissolution ratio for micro and small enterprises declined to a historic low of 1.41 in 2020.⁸ The number of liquidated micro and small enterprises in 2020 increased by 84.3% compared with 2019 and was equivalent to 12% of total existing micro and small enterprises as of November 2021 (footnote 7).

7. The government has implemented policies and measures to improve the business environment for SMEs and ease their access to finance. In September 2017, it amended the Law on Promoting Small and Medium-Sized Enterprises, which requires large state-owned banks to establish specialized branches or departments to serve small businesses. More small-scale village banks and micro credit companies were established to drive SME lending. The government has encouraged the development of small and medium-sized banks and non-deposit-taking financial institutions to better promote and support an inclusive financial system. During the COVID-19 pandemic, the government introduced additional policy initiatives to support MSMEs, including a temporary waiver of value-added tax during April–December 2022 for micro and small businesses with monthly sales of less than CNY150,000, deferred social security payment for MSMEs, and incentives for banks to lend to MSMEs such as raising central bank relending and rediscounting quotas and lowering the reserve ratio for SME loans. However, access to finance remains a persistent constraint to growth for MSMEs. Credit to MSMEs only accounted for 29.94% of total bank loans by June 2021.⁹

C. Energy Efficiency

8. **Energy efficiency in the People's Republic of China.** As the world's largest energy consumer, the PRC's efforts to improve energy efficiency are crucial to the global energy and climate outlooks. The country accounted for 25% of global energy consumption in 2019 and 26%

⁵ SME Finance Forum. 2018. [MSME Finance Gap](#).

⁶ People's Bank of China. 2021. *2021 China Regional Finance Operation Report*. Beijing.

⁷ Fudan Development Institute. 2022. [Analysis of the Development Status of Small and Medium-Sized Enterprises and Recent Relevant Policies](#). Shanghai.

⁸ Ren Zeping Research. 2021. [MSME's Operating Status in 2021](#). Shanghai. (In Chinese).

⁹ Government of the PRC, State Council. 2021. [CBIRC Issued the Statistic of 2021 Q2 Regulatory Indicators](#). News release. 11 August 2021.

in both 2020 and 2021.¹⁰ The government has developed comprehensive sets of energy efficiency policies and programs since 2010. Energy use per unit of GDP declined by 28.7% during 2010–2020.¹¹ Steady improvement in energy intensity was attributable to energy efficiency gains and structural shifts in the economy. The 14th Five-Year Plan contains mandatory national targets to further reduce energy intensity by 13.5% and carbon intensity by 18.0% during 2021–2025.¹² These targets contribute to the PRC’s nationally determined commitment to peak carbon dioxide emissions before 2030 and achieve carbon neutrality before 2060.¹³

9. Micro, small, and medium-sized enterprise energy efficiency potential. Whereas larger enterprises have undertaken substantial efficiency improvements, MSMEs’ energy efficiency potential remains largely untapped. MSMEs make up 99% of all enterprises in the PRC. Individually, they consume a modest amount of energy, but their collective energy demand is considerable. Industrial MSMEs consume 41% of the PRC’s total energy demand. With outdated equipment and low-efficiency processes, MSMEs are on average 40% less energy-efficient than large industrial enterprises in their sectors.¹⁴ MSMEs’ energy efficiency potential has been assessed at 25% of their energy demand.¹⁵ Energy efficiency enhancement measures in MSMEs typically yield more significant results than large corporates. Improving energy efficiency is a key way to reduce MSMEs’ energy costs, increase competitiveness, enhance resilience, and reduce greenhouse gas emissions. It is estimated that more than 50% of the total household and industrial carbon dioxide emissions in the PRC are attributable to MSMEs.¹⁶ The emissions from MSMEs are particularly intensive in upstream sectors such as manufacturing (nonmetallic mineral and chemical product manufacturing), transportation, and warehousing, whereas MSMEs engaging in downstream economic activities, such as retail and trading, have much lower carbon emissions.

10. Barriers to increasing energy efficiency in micro, small, and medium-sized enterprises. MSMEs face barriers that impede them from adopting energy efficiency measures. MSMEs have limited resources to explore energy efficiency options, and they lack information on where and how energy is used in their companies. Additional challenges arise from the prolonged COVID-19 outbreaks, which have pushed many small enterprises out of business or greatly reduced their revenues. MSMEs’ access to financing for energy efficiency improvements is constrained by their lack of collateral, less rigorous record-keeping, and vulnerability to market changes. Commercial banks, which are the dominant source of funding for enterprises in the PRC, traditionally consider MSME loans risky, with high transaction costs. Energy efficiency projects differ from mainstream investments as they generate cost savings rather than revenues. Therefore, it can be even more difficult for MSMEs to find collateral for energy efficiency projects and to calculate and verify energy savings. Consequently, banks often lack financial products or capacity to support MSME energy efficiency products.

¹⁰ [BP Statistical Review of World Energy](#) (accessed 7 September 2022).

¹¹ [CEIC database](#) (accessed 8 July 2022).

¹² Government of the PRC. 2020. [The 14th Five-Year Plan \(2021–2025\) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035](#). Beijing.

¹³ Government of the PRC. 2021. [China’s Achievements, New Goals and New Measures for Nationally Determined Contributions](#). Beijing.

¹⁴ International Finance Corporation. 2012. [Study on the Potential of Sustainable Energy Financing for Small and Medium Enterprises in \(the People’s Republic of\) China](#). Washington, DC.

¹⁵ International Energy Agency. 2015. [Policy Pathway – Accelerating Energy Efficiency in Small and Medium Enterprises](#). Paris.

¹⁶ B. Meng et al. 2018. [More than Half of China’s CO₂ Emissions Are from Micro, Small and Medium-Sized Enterprises](#). *Applied Energy*. 230. pp. 712–725.

11. **Access to energy efficiency finance for women.** Female entrepreneurship is rising in the PRC. At 0.8, the female–male ratio for entrepreneurial activity is higher than the global average.¹⁷ However, gender disparities continue to affect women’s access to finance. For instance, female account ownership at a financial institution or with a mobile money service provider is lower for women (76%) than for men (84%).¹⁸ Yet, Chinese women tend to be more open to energy efficiency than men. A recent study indicates that families where men are the main decision-makers use more energy and are less likely to buy energy-efficient products than female-dominated families (i.e. where women constitute the power core with respect to household decision-making). When women are the main decision-makers for household expenditures and purchases of large-scale commodities for the household, daily energy consumption is significantly lower and households tend to go green.¹⁹ Although the study was household based, women may be more likely to adopt green practices with the right purchase conditions.

12. **New energy efficiency financing option.** Financial leasing is a suitable financing solution for MSME energy efficiency. As the financial leasing companies (FLCs) retain the ownership of the energy-efficient equipment during the life of a leasing contract, they typically do not require additional collateral. MSMEs benefit from reduced energy costs from the use of energy-efficient equipment, which can help cover part of their regular lease payments. Adoption of new technologies, including the internet of things, alternative data, cloud computing, and artificial intelligence, can enable financial institutions to make quicker and more reliable credit decisions and offer faster and more convenient financial services. In turn, the digital innovation would help MSMEs improve their access to finance.

D. Leasing Industry Overview

13. The financial leasing industry has played an important role in the PRC’s financial system as an alternative to bank financing and has been growing rapidly since 2008. New leasing sales in the PRC expanded from \$21.88 billion in 2008 to \$300.21 billion in 2020, representing a compound annual growth rate of 24.39%.²⁰ Despite rapid growth, the PRC’s financial leasing industry still needs further development. Lease market penetration, measured as the ratio of lease finance to all fixed investments in plant and equipment, was only 9.4% in 2020 compared with 28.4% in the United Kingdom, 22.0% in the United States and 16.2% in Germany. The PRC’s lease penetration rate, measured as a percentage of lease finance to total GDP, was 2.02% in 2020 and ranked 18th among the top 50 global leasing markets (footnote 12). With total outstanding lease receivables of CNY6.2 trillion, leasing is much smaller than the banking sector, which had total outstanding loans of CNY165.0 trillion in 2021.

14. Before 20 April 2018, the China Banking and Insurance Regulatory Commission (CBIRC) or the Ministry of Commerce (MOC) approved and supervised FLCs in the PRC. On 20 April 2018, the MOC transferred the authority for formulating regulations governing the operations and supervision of MOC-approved FLCs to the CBIRC. The move was viewed as positive because it would increase regulatory oversight and transparency.²¹ In May 2020, the CBIRC issued interim management measures for governing and supervising those FLCs. The draft regulation (i) clarifies the business scope of FLCs, legitimate lease assets, and forbidden areas; (ii) raises requirements in corporate governance, internal control, and risk management of FLCs; and (iii) sets several

¹⁷ Global Entrepreneurship Monitor. [China: Entrepreneurial Behaviour and Attitudes](#).

¹⁸ World Bank. 2017. [Global Findex database 2017](#). Washington, DC.

¹⁹ J. Wang, R. Long, H. Chen, and Q. Li. 2021. [Are Female-Dominated Families more Energy-Saving? Evidence from Jiangsu Province, China](#). *Sustainable Production and Consumption*. 27. pp. 2178–2192.

²⁰ Solifi. 2022. *2022 Global Leasing Report*. Minneapolis, United States and Milton Keynes, United Kingdom.

²¹ Fitch Ratings. 2019. *Outlook: Chinese Leasing Companies*. Hong Kong, China.

compliance ratios, including (a) a lease assets–total assets ratio not lower than 60%; (b) an assets-at-risk–equity ratio not exceeding eight times; and (c) selective concentration limits, including a single customer concentration ratio, a single group concentration ratio, and connected transaction ratios. The regulation aims to improve the supervision of the whole industry after the CBIRC takes over the supervisory role from the MOC, which will encourage further development of FLCs.

15. In terms of market share and business volume, the leasing industry is dominated by FLCs that were originally approved by the CBIRC. By June 2021, there were more than 12,000 FLCs in the PRC, of which only 71 were approved by the CBIRC.²² However, those FLCs accounted for 37.6% of total outstanding lease portfolio in 2019.²³ The CBIRC-approved FLCs are mostly sponsored by commercial banks but can also be initiated by nonbank financial institutions or large nonfinancial state-owned enterprises, and they have greater flexibility in funding given their access to the interbank market. However, some FLCs previously approved by the MOC were established by entities with strong positions in different industries, giving them a competitive advantage in terms of industry relevance. Such FLCs can leverage their corporate franchises, superior industry knowledge, and strong position in the whole value chain to improve customer relationships. Except for some large, established companies, such as Far East Horizon Limited, most are without operations or are small, local, niche players. After 10 years of rapid growth, the leasing industry has slowed since 2018 because of the macroeconomic slowdown. According to a KPMG industry report, the total assets of 42 sampled FLCs originally approved by the CBIRC increased by 7% in 2020.²⁴ Most major FLCs have achieved steady profit growth since 2015, mainly because of a supportive policy environment, adequate margins, and gradually diversifying funding channels. Asset quality of the major FLCs is generally satisfactory. In 2020, the average nonperforming asset ratio was 1.00% for sampled CBIRC-approved FLCs and 1.37% for sampled MOC-approved FLCs.²⁵

16. The PRC leasing industry faces challenges in terms of the business cycle, funding and liquidity risk management, and human resource shortages. Although the leasing industry has certain countercyclical characteristics, as some asset-heavy companies may choose to sell and lease back their fixed assets to obtain liquidity during economic downturns, overall demand for underlying assets is influenced by business cycles. Some FLCs may have a high concentration of risk from certain types of underlying assets, which makes them vulnerable to industry-specific shocks. Liquidity risk is another major concern for many FLCs. Leasing contracts usually have tenors of several years, but many FLCs rely on short-term wholesale funding. As such, they face large asset–liability maturity mismatches and thus are not only exposed to liquidity risk, but also to unfavorable changes in interest rates as they roll over short-term debt. Because the industry is relatively young and growing rapidly, some FLCs also suffer from a shortage of management and qualified staff with relevant experience and expertise. While liquidity remains a key structural constraint for most FLCs, some have started to diversify their sources of funding by tapping the capital markets, including by issuing bonds and securitizing lease receivables. However, FLCs seeking to access the capital markets face regulatory restrictions, as they need to go through a lengthy approval process before any bond or asset-backed securities issuance.

²² Forward-the economist. 2022. [2022 PRC Financial Leasing Industry Roadmap](#). Shenzhen. (2022年中国融资租赁行业全景图谱 In Chinese).

²³ Forward-the economist. 2020. [The Competitive Landscape of the PRC Financial Leasing Industry](#). Shenzhen. (2020年中国融资租赁行业发展现状与市场竞争分析 In Chinese).

²⁴ KPMG. 2020. *Performance Review on Chinese Leasing Industry*. Beijing.

²⁵ The sampled CBIRC-approved FLCs were top 42 CBIRC-approved FLCs, with each of them having total assets of more than CNY16 billion. The sampled MOC-approved FLCs were top 40 MOC-approved FLCs, with each of them having total assets of more than CNY14 billion.