

A CREDIT POLICY STUDY OF CHINESE BANKS ON SMALL AND MEDIUM-SIZED ENTERPRISES

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Abstract

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In recent years, there is rising attention on the difficult financing problems of small and medium-sized enterprises (SMEs). With constant development and improvement in China's socialist market economy system, SMEs is becoming a pivotal part of China's national economy. It can be said that the development of SMEs makes a great contribution to China's national economy development. However, SMEs are facing financing bottlenecks at the same time. This is not only because of the limited financing capabilities of SMEs themselves but also because of the various commercial bank credit policies. It is necessary to solve credit policy problems between SMEs and banks, not only for SMEs but also for the further development of commercial banks. This paper analyses the problems and the reasons of "credit grudging" behavior of China's commercial banks and SMEs financing difficulties through a critical analysis. This paper also uses the method of the dynamic game theory to probe into credit problems between SMEs and commercial banks under the condition of information asymmetry. At the end of the paper, conclusions are made and suggestions are proposed for a win-win solution concerning credit policy problems between SMEs and commercial banks.

commercial banks, SMEs, China, credit policy, game theory

Financing difficulty among SMEs does not only exist in China, but also prevails worldwide. SMEs has been the major force of the national economy in recent years (Li, 2011; Hu and Zhou, 2011; Bai *et al.*, 2012), however, due to the adverse conditions of SMEs such as small scale, few assets, low credit degree and discriminatory treatments from government and the market, the difficulty of financing is gradually becoming the bottleneck for Chinese SMEs under the situation of banks' 'credit grudging' (Liu, 2007). This increasingly obvious problem is now the concern of the country, and several laws and regulations or specific policies have been carried out by government to support SMEs (ACFIC, 2012).

Taking loans from financial institutions is the major financial channel for Chinese SMEs (Meyer, 1998). As the major force of the SME credit market, Commercial bank is the key component of Chinese financial institutions (Xu, 2008). Nevertheless, commercial banks do not put much emphasis on SME financing service problems according to

previous research (Beck, 2006). Under the situation of close integration of Chinese and global economy, new challenges and opportunities would put Chinese SMEs in a strong position. By drawing on the experiences of foreign banking to eliminate credit risk, SMEs would certainly become another profit growth point for domestic commercial banks (Wu and Wang, 2012). In order to find a feasible solution for solving financing problem for SMEs, this paper aims to study domestic credit policies and strategies towards SMEs, in the context of current trend of banks' development and China's economy. The study on credit policy is helpful for achieving a win-win situation between commercial banks and SMEs. SMEs can broaden their capital source to maintain a sustainable development while banks can promote innovation in the field of financing system (Zhu, 2004).

In the literature an increasing number of researches have been carried out for studying the problem of commercial banks' sustainable development. Researchers conduct theoretical

research in the belief that the market of offering financial services to SMEs could be potentially profitable to commercial banks (Li, 2009; Xu, 2008; Zhu, 2004; Wan, 2010; Wang *et al.*, 2011). The theory of credit rationing refers to the circumstance in which the demand for commercial loan in the credit market is greater than the supply, given the fixed bank lending rate (Geng, 2011). There are different explanations for the emergence of credit rationing. Jaffe and Modigliani (1969) argued that the restriction imposed on monopoly power leads to credit constraint, which could finally cause credit rationing. Besides, according to the asymmetric information theory, moral hazard and adverse selection are considered as the major contributors to credit rationing (Stiglitz and Weiss, 1981).

Game theory is the study of strategic decision making between the subjective and the objective. In the game theory, every gamer would consider the possible effects of one action on other gamers, therefore every gamer would choose the best scheme to optimize their own interests (Ping, 2001). Game theory has been widely used in economics as an important analytical method. Asymmetry information is one cause of SMEs' difficulty in applying for loans. In this paper, game theory is used to analyse banks' credit process in order to shed some lights on credit policy problems.

RESEARCH METHOD

This paper analyses the causes of credit grudging from the perspective of commercial banks. In this paper economic game theory (Myerson, 1991) is first applied in order to make a full analysis of the dynamic information between commercial banks and SMEs. This paper also uses case study method (Yin, 2002) to point out the major problems as well as the causes of financing problems of SMEs. In the case study, the analysis of whether commercial banks should grant SME credit financing is carried out on the Tyron commercial Bank. In the following first we analyse the current situation of SMEs; secondly, we discuss whether commercial banks should perform credit operations for SMEs; finally, we work on how to solve SME credit problems.

Current Credit Status and Problems

The rapid emergence and development of SMEs has become one of the mainstays in China's national economy since the reform and opening up in 1978. The development of SMEs has irreplaceable strategic importance to the national economy and the entire society. Financing channels for SMEs could be generally divided into two categories, endogenous and extraneous source financing (Shi, 2007). Endogenous source financing has a wide range, including equity fund, risk investment capitals, enterprise business financing capital, etc. There are two major kinds of extraneous source financing, indirect financing which means financing through commercial banks and direct financing which refers to financing without financial institutions.

However, certain problems still exist in SME's financing. The financing channel is quite simplex in our country because of the lack of intercommunication. Most SMEs consider applying for loans form commercial banks as the first option to deal with financial matter, and due to the short loan duration, SME hardly use the loan for scale-expanding reproduction. Currently SMEs are being too dependent on loan support from commercial banks, which indicates the lack of financing channels.

In addition, as shown in Tab. I, domestic listed threshold is too high for SMEs. Because of the late construction of domestic capital market, our country is not well developed compared with those developed countries. Although the board for SMEs is set in Shenzhen Stock Exchange, the financial restriction still made SMEs hard to go public. The listed threshold is set according to the provisions of Corporation Law, including three-year-profit of 30 million RMB and cumulative net value of cash flow over fifty million etc. Therefore nearly more than 70 percent of SMEs have no listing plan yet. Commercial bank plays an important role in the developing process of SMEs, the continuous optimization of credit structure stimulates our economic structure's development and financial service quality.

I: *The implementation of major financing in the last three years (divided according to the scale of enterprises, %)*

| | Large-scale enterprises | Medium-sized enterprises | Small-sized enterprises |
|---|-------------------------|--------------------------|-------------------------|
| Long-term bank loan | 82.4 | 78.4 | 67.7 |
| Private lending | 19.2 | 48.3 | 67.8 |
| Syndicated loan | 16.5 | 15.7 | 14 |
| Introduction of private equity/ risk investment | 12.2 | 11.8 | 9 |
| Issue short-term financing bonds | 12.9 | 2.4 | 1.7 |
| Going public | 16.1 | 2.7 | 0.7 |
| Listed companies issue additional stock | 11 | 1.3 | 0.5 |
| Issue converted bonds | 6.3 | 1.2 | 1.5 |

Data source: The growth of capital market and Chinese entrepreneurs: the present and the future, the problems and the suggestions – investigation report on the development of Chinese enterprise operators 2011.

SME credit market development is limited due to the problems of commercial banks' financial system (Garcia, 2005); SMEs could not meet the standard of credit rating policy, which is set for large-scale enterprises (Bai, 2012). Besides the biased assessment, commercial banks also make the examination and approval process taking too long, negative effects could be exerted on SMEs with short and urgent needs for money. As a matter of fact, most banks are reluctant to lend because of the risk. It is necessary for banking industry to improve financial service targeting SMEs. As a result of unstable operating status and insufficient guaranteed mortgage, domestic commercial banks discriminate against SMEs. By contrast, commercial banks in China have better relationship with large state-owned enterprises since it takes less risk. Currently, commercial banks still have not set up robust small business accountability system and tolerance policies, which lead to bank personnel's low initiative in marketing bank's services. Discounting the importance of SMEs led to the lack of product innovation in credit service. It would be difficult to meet the financing needs of SMEs without new credit products especially tailored for SMEs. Those existing products are rather traditional, attaching with many requirements such as providing security and mortgaged property. SMEs are facing a lot of barriers in financing in Chinese financial market.

The reasons behind the credit problems come from SMEs, commercial banks and the government. Chinese SMEs are generally in a weak position, given the small scale, weak competitiveness and small influence. The unstable international economic situation adds to the risk to SMEs, the prospect of Chinese SMEs is therefore full of uncertainty. In addition, SMEs' capital adequacy ratio is low with little capital; the small proportion of fixed assets causes a shortage of property for guaranteed property; financial system of most SMEs is not perfect. Another drawback of SMEs is the lack of managerial and administrative expertise and enterprise credit. Most SMEs' credit ratings are too low to reach the credit requirements of domestic commercial banks.

As a self-financing market participant, commercial banks will consider profitability, liquidity, risk and security in providing their services. Given the situation of government's requirement of controlling capital adequacy ratio and bad loan ratio, commercial banks would definitely choose large-scale enterprises with strong managerial and administrative expertise instead of SMEs with disappointing financial indexes. Therefore policy barriers were set in consideration of avoiding risks. Furthermore, since there is a lack of related motivation system, grassroots service personnel do not have the initiative to develop or serve SMEs. Many bankers attach so much attention to risk control that they ignore the profitability from providing services to SMEs. The information asymmetry makes small enterprises unable to carry

out repeated game, which causes banks to issue a loan on a lower equilibrium level. The number of SMEs' credit operation is therefore greatly reduced. Since the development of market economy in China started late with imperfect financial system, government does not have sufficient experience in instructing banks in the field of SMEs' financing. All kinds of rules and regulations increase SMEs' difficulty in applying for loans. Moreover, the distinct lack of small and medium-sized financial institutions in Chinese capital market makes loan obtaining even harder for SMEs.

In conclusion, SMEs' difficulty in applying for loans and commercial banks' credit reluctance to providing services to SMEs are caused by the shortages of small enterprises themselves, the government false instructions, and the unsound domestic financial market.

Credit Game Model Analysis

To apply game theory, the paper made the related hypotheses as follows: as the participants of credit game, commercial banks and SMEs are both risk averters. They are rational gamers who will not make irrational mistakes, and they are able to make rational decisions to optimize their own interests under certain circumstances; this paper sets the credit game as a dynamic game, in which SMEs firstly take decisions concerning the information they mastered, commercial banks will then determine their own actions according to SMEs' operation information; in the game process of this paper, the information that the two sides gain will be incomplete and asymmetry; the credit game is assumed to be a non-cooperative game with no collusions or conspiracy in any forms between commercial banks and SMEs; Only a part of applicants could receive a bank loan in this game, while other applicants could not obtain a loan with higher interest rates; no government's administrative intervention exists in this game process.

At the stage of applying for a loan, some SMEs with poor financial condition would provide banks with fraud financial statements or accounting statement to obtain loans. In this paper, as shown in Fig. 1, enterprises with high risk is assumed as High (H), low risk as Low (L); the probability of gaining a bank loan is P for the low risk type, and $1 - P$ for the high risk type; assuming loan principal is C , loan interest is I , the total of principal and interest is $R = C + I$. If the bank makes a correct decision to lend to SMEs with low risk, there will be profit space for the bank. Otherwise, the bank will take higher opportunity cost as well as the rising ratio of potential nonperforming loan and assets.

During the game stage, L can provide the real financial management information to banks to reflect the risk level, and they can repay the loan principal and the interest on schedule. Let the probability of receiving a loan for L be P , and the profits gained by the enterprises be $B(L)$, then the net income after paying the interest and principal

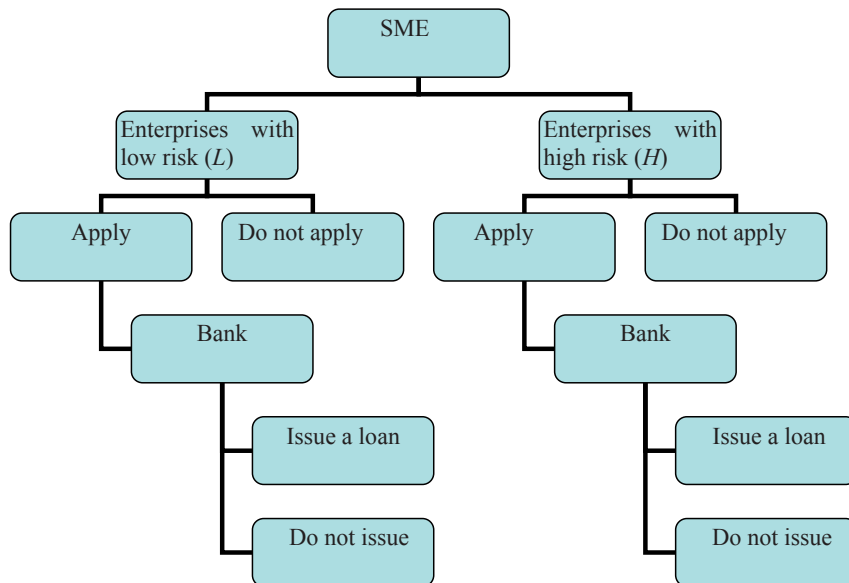
will be $NE = B(L) - R$, and the net income is larger than zero. If L cannot receive a bank loan, then there will be no extraneous income for SMEs or banks. H may withhold information about its financial position; let the hidden cost be F and the probability of obtaining a loan for H be $1 - P$. A high-risk enterprise usually intends to delay bankruptcy time or gain personal wealth by obtaining a loan. Assuming the income for H is $B(H)$, which is larger than zero but smaller than C ; banks would have difficulty in regaining the credit amount, which could lead to a rising non-performing loan ratio. In order to minimize the loss, coefficient a ($0 < a < 1$) is introduced. The bank's income would be $a \times C$, and $a \times C = C - B(H)$, therefore $B(H) = (1 - a) \times C$. On the contrary, if false information of H is seen through by banks, the loan requests would be rejected. The income of H would be $-F$ and the bank would retain the principal.

After getting hold of SMEs' information, banks would decide on whether issue loans or not. In the ideal situation, banks could accurately discriminate the risk coefficient. The banks would lend to L since the interest income is I ($I > 0$), and they would not lend to H since the profit is $a \times C < C$; rather, banks would lend to H instead of L due to poor judgments.

In order to guarantee maximum income, it is better for banks to acquire as much as they can. Moreover, the smaller the coefficient a is, the larger loss banks will bear. Enterprises would default on payment obligations to get more benefits. In practice, moral hazard still exists because credit managers are the specific participants. The possibilities of credit managers' violation would exert influences over the credit game between banks and SMEs.

In Tab. II, if L receives a loan, business income would be $B(L) - R$, let the reward amount for bank credit personnel be W , which is a kind of incentives. If the bank does not lend to L , both incomes of the enterprise and credit managers are zero. Assuming the cost of bribing credit officers for H is P , business profits would be $B(H) - F - P$, thus bank officials would lose the bank's reward but receive a bribe P , the income for bank officials would be $P - W$. If H gains no loans, the enterprise income would be $-F$ and credit managers' income would be zero. When P is greater than W , there is great possibility that credit managers take the risk of conducting illegal operations. The game result would be as shown in Tab. III:

The process of credit is always repetitive; it cannot be finished once for all. An enterprise can gain



1: Game map tree

II: Different game results of banks' successful or poor judgments

| Game results under successful judgment | | |
|--|------------------------|-------------------|
| | Provide a loan | Unwilling to loan |
| Enterprises of high risk (H) | | (C, -F) |
| Enterprises of low risk (L) | (R, B(L) - R) | |
| Game results under poor judgment | | |
| | Provide a loan | Unwilling to loan |
| Enterprises of high risk (H) | (a × C, C - F - a × C) | |
| Enterprises of low risk (L) | | (C,0) |

III: *The game result of bank credit managers and enterprises*

| | L | | H | |
|------------------------------------|-----------------|----------------------|-------------------------|----------------------|
| | Obtain a loan | Do not obtain a loan | Obtain a loan | Do not obtain a loan |
| Credit managers make violations | $(W, B(L) - R)$ | | | $(0, -F)$ |
| Credit managers make no violations | | $(0, 0)$ | $(P - W, B(H) - F - P)$ | |

profits by making default at the expense of damaging the reputation. However, after several times of game process, banks would get real financial information of enterprises which defaulted too much, thus banks would no longer lend to those SMEs. Therefore in the long-term perspective, enterprises should adhere to the lending treaty in order to improve credit and win trust; it is beneficial to establish a win-win situation for banks and SMEs.

In a real-life scenario, the game between banks and SMEs would be different considering other factors such as collateral, staff ethics, transaction expenses and judicial efficiency. Banks could recover more loan cost if the risk parameter "a" is raised by the rising level of guarantee. Besides, if credit managers engage in illegal activities, banks would have a greater possibility of suffering loss by loaning to the enterprises with high risk. Furthermore, Banks would have to bear the expense of legal actions and time value if they choose to sue the enterprise instead of eating humble pie. In conclusion, information asymmetry is the crux of the credit contradiction between SMEs and banks. It is also necessary to improve justice efficiency as well as establish a sound credit rating system and good mortgage guarantee system.

Case Study

Tailong commercial bank of Zhejiang China focuses on providing financial services to SMEs and its service area covers multiple cities in China since its establishment in 1993. China Banking Regulatory Commission granted Zhejiang Tailong commercial bank with 2B level. Tailong commercial bank also ranks high in other appraisal of commercial banks. The success of Tailong commercial banks mainly relies on a big market created by credit business for SMEs. Furthermore, the unique enterprise culture makes its market positioning focusing on SMEs, Tailong commercial bank exploited its own strategy for the financing problem of SMEs. Therefore Tailong commercial bank earns a good reputation in the financial service market for SMEs. Its influence makes it known as Chinese banks' Yunus.

The achievement of Tailong commercial bank depends on good financing tactics. At the initial stage, Tailong commercial bank was forced to choose the market of smaller companies because it was pushed aside by other larger banks and financial institutions. However, Tailong commercial

bank began to realize that the market of small business loan has a huge potential. In order to deepen its market positioning, Tailong commercial bank extended its services to the group of community, rural-urban continuum and rural small clients, even including individual business, rural contractor, laid-off workers, unemployed farmers and migrant workers. The statistics show that over 99% of Tailong's clients are small enterprises, and over 95% of clients are unsecured. Although Tailong commercial bank seems to bear high risk, its non-performing loan ratio is far less than other commercial banks.

Tailong commercial bank developed a series of loan products with great flexibility for SMEs. For example, it issued loans for entrepreneurs who have no mortgage or savings, which greatly satisfied SMEs' need for entrepreneurial financing. Tailong commercial bank also issued moral loan, a guarantee type based on the relationship of local culture. This type of loans has now helped a large number of enterprises and people. Most products of Tailong commercial bank are aimed at SMEs. The convenient loaning procedure and low access threshold are very attractive to SMEs.

During the service practices in the past years, Tailong commercial bank developed its own characteristic mode of financial services for SMEs in order to solve the information asymmetry problem. This special mode is based on three requirements of qualities, form data and time limit. Firstly, it focuses on moral standing of the entrepreneur, the products of the enterprise and possessions owned by the entrepreneur. Secondly, it checks electricity meter, water meter and customs declaration forms to keep abreast of the enterprise's status of production and operation. By doing so, Tailong commercial bank can not only master more realistic information about enterprises, but also reduce the cost of obtaining enterprise information before carrying out lending transactions. Thirdly, Tailong commercial bank adheres to the concept of high efficiency, they guarantee that issuing loans to regular clients are within three hours and to new clients within three days.

Moreover, client managers occupy an important position in Tailong commercial bank. Up to 50% of the employees are client managers, the large team of client managers will bring a big pressure to the bank because of the high personnel costs. However, it pays back. Every client manager is required to follow up more than 200 clients to offer

all-around assisting services. Intensive visits and frequent contacts are made by client managers to get a thorough knowledge of the enterprise's real situation. The powerful social network, information network and enterprise network behind every client manager makes it easier for Tailong commercial bank to control risk as well as the non-performing loan ratio. The comprehensive comparison of data from computation using statistics tools and from real society enables Tailong to fully analyse clients' growth potential and debt-paying ability.

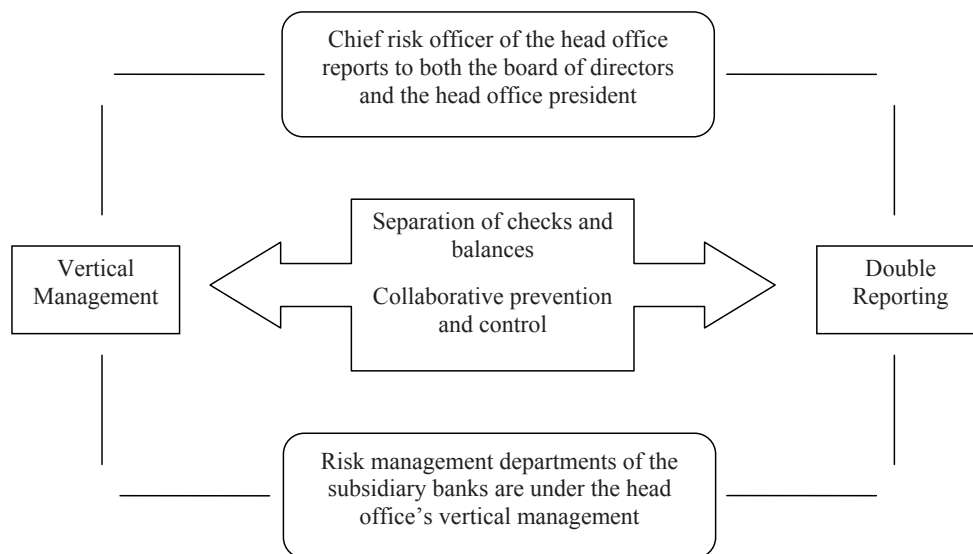
Since most SMEs have a lack of effective mortgage, Tailong bank weakens its emphasis on mortgage, over 95% of Tailong's products are without any collateral. Instead, multi-person guarantee loan and moral loan are developed in order to transform limited liability to unlimited liability. In addition, adaptive reputation mechanism is developed by Tailong. Traditionally reputation mechanism is based on village culture in the rural areas and economically underdeveloped areas, but in mega cities such as Shanghai, reputation mechanism is based on communalized marketing, focusing on a specialized market of similar industry. The lending mechanism with guarantee from legal persons and affiliated persons reduces the chance of default and the amount of non-performing loan. Therefore, the problem of the shortage of effective loan collaterals for SMEs is relieved to some extent.

There are many advantages for Tailong to focus on SME financing. The scale of Tailong is smaller than state-owned banks so that Tailong can set up a flexible managerial mechanism to satisfy its clients to the maximum extent. Tailong implements the mechanism of mutual surveillance with check and balance. Under this mechanism, the middle level operating managers can have full autonomy in management of their departments; individual employees' incomes can be connected with their performance. A flexible incentive mechanism arouses everybody's enthusiasm for SME credit business; it also satisfies SMEs' financing demand and improves lending efficiency. Meanwhile, Tailong establishes a standard corporate governance and risk prevention mechanism on the basis of their unique managerial system.

Tailong commercial bank is always known as the bank for the poor. Its former grassroots history and market positioning have brought advantages for itself. Since Tailong is used to be an SME, it insists on the self-positioning to focus on SMEs. Moreover, Tailong is able to withstand the temptation of high margin and big clients in order to be the best in its own field on serving SMEs. The significant cost advantage of Tailong owes to its close connection with clients and low labor costs. In the light of the market positioning, Tailong keeps track of every client, which is convenient to gain information at a low cost and in turn it reduces the costs of default and supervision. Furthermore, Tailong has a small number of staff, which makes lower labor costs than those large-scale banks; the frequent

communication between Tailong's shareholders and agents also reduces the agent cost. Another key factor that contributes to Tailong's success is their emphasis on talent training. Tailong College is established by the bank in order to cultivate professional talents to better serve SMEs; all employees must go through vigorous courses and assessments in order to offer better services to clients. The increase of the investment on human resources satisfies the small-sized, wide-covered and short-term financial requirements of SMEs to the maximum extent. In particular, most customer managers are localized in order to make use of familiarity with local clients to solve the information asymmetry as far as possible; in addition, the restricting personnel selecting principle which puts an emphasis on selecting the most outstanding talents fully arouses employees' potential.

Nevertheless, there are still some inevitable problems for banks like Tailong. It is easy to trigger crisis of confidence for small and medium-sized banks since they are small-scaled and not state-guaranteed. Crisis of confidence is the situations that when public trust expectation towards banks is smaller than their psychological expectations, people trigger early withdrawal agitation which would turn into a run on the bank. It would bring serious consequences, which are very difficult for banks to handle. The market of SME credit business is also facing threats since large-scale national banks gradually realize the development potential and profit margins of SMEs and other small and medium-sized banks would just copy Tailong's successful pattern. With loosened credit policy for SMEs, public identity and high credibility, the involvement of national banks may lead to more intense competition in grabbing SME market share; more business pressure would come from other banks' imitating of Tailong's business model. Last but not the least, internal operations carry risks. Capital size of banks is the last line of defence for compensating unexpected loss and safeguarding depositors' interests. In the light of the restriction of bank's asset liability ratio, banks cannot unlimitedly expand proportional relationships between assets and liabilities. Meanwhile, the source of smaller banks' capital is relatively single and the expansion path of capital is quite narrow. The issuance of subordinated debt and hybrid capital debt is therefore restricted by various government regulations. Since most small and medium-sized commercial banks were established by private capitals, the employees may not be very professional and some shareholders may be given too much power in the board of directors, which could lead to structural distortion of the organization and confusion of operation power and management power. In addition, it is easy to have the problem of relationship lending or inclined lending if the phenomenon that lending needs to be decided by relationships with shareholders is not under control, it could even cause credit risk for banks.



2: The sketch map of risk prevention system (source: the official website of Tailong commercial bank: <http://www.zjtlcb.com>)

In conclusion, the business model of Tailong surely can be copied; the success of Tailong is no accident. Tailong's focus on SMEs brings itself enormous profits, and the high profits stimulate the company to grow faster. Thus it is possible to copy this successful model with adequate capital and profits. Moreover, inherent mechanism is the starting point of dealing with SME credit gap. Commercial banks should make innovations in providing financial products to SMEs in order to deal with SME financing problem. To develop small and medium-sized banks and regional commercial banks is an important direction for future domestic banking industry, and economic policies will continue to make it easier for SMEs to receive loans. China's current situation of diversified consumer groups creates an increasing need for small and medium-sized banks and regional commercial banks since they can help people solve problems more conveniently.

RESULTS AND DISCUSSION

Apparently, SMEs need to improve their credit reputation, since the credit crunch is closely related to the qualifications of those smaller enterprises (Davies, 2006; Hsu, 2006). First, SMEs should improve their operation management in order to reduce the operation risks. By starting with an examination and improvement of current organizational system, technical concept and market innovation, SMEs can improve their profitability, repaying ability and credit degree. SMEs should also develop a normalized and scientific financial management system to increase the reliability and transparency of financial statements in order to reflect the real situation. It is also important for SMEs to build up the system of repaying loans on time to set up their good corporate images.

The next step that SMEs should take is to handle their relationship with banks very carefully, reducing banks' credit cost consciously by presenting their real information to the banks to create a mutually-beneficial and win-win situation. SMEs can also connect saving account with credit amount, making it convenient for banks to gain a comprehensive knowledge about borrowers. In the case study, Tailong commercial bank strived to establish a close relationship with SMEs for information gathering and credit evaluation. This is the effort from the bank side. From SMEs' side, they should also take a proactive attitude to establish a close and good relationship with banks.

Given the low level of national economic development and imperfect social credit system, banks are always reluctant to issue loans to SMEs (Li *et al.*, 2012). It is necessary for SMEs to look for practical and effective intermediation. The involvement of private capital could also be encouraged to expand the coverage of credit guarantee. Through the platform of intermediary credit, credit information of SMEs and credit files of enterprise managers could be shared on the Internet. The establishment of social credit system would solve the problem of information asymmetry. The Tailong case shows that a sound social credit system has been established in limited regions for limited SMEs and it worked very well. Both the bank and the SMEs can benefit from the credit system. Therefore the social credit system needs to be expanded to the whole country taking into account the economic and cultural imbalances in different regions. A healthy and efficient social credit system lays a solid foundation to solve the financing problems for SMEs.

As Tailong shows, the team of customer managers is at the forefront of the SME credit chain, it is essential for commercial banks to improve the

team structure of customer managers for entering small business credit market quickly. In the highly competitive market, commercial banks have to enrich the marketing team and improve marketing service level. In order to ensure that the number of customer managers match the business scale and business goal, a specialized team of customer managers should be built to carry out targeted marketing. While regional business centres for SMEs are set up for specialized marketing, more branches should be established at very basic level to maintain good customer relationships and know customers' financial status well. Apart from employing innovative, honest, self-discipline individuals with strong business ability, it is important to set up an incentive and risk evaluation mechanism to further prevent credit risk. On this basis, business performance appraisal system with the core of economic value added is beneficial to overcome the existing defects in the present SME credit assessment mechanism. Moreover, customer managers should take periodical trainings for integrating theory with practice to continuously attune to SMEs' financing wants and needs.

Consistent profits also depend on the careful selection of customers, and commercial banks should choose quality SMEs based on the following criteria: seeking for quality clients from the industry chain such as SMEs related to local-supported enterprises; utilizing local websites and newspapers where SME information is gathered to make choices; choosing SMEs cultivated in high-tech zones. SMEs in a growing-up period should be the key target clients of commercial banks. Client sorting requires commercial banks to pay close attention to ongoing information updating.

The need of SMEs for diversified financial services is rising in line with the fast economic development in China. Commercial banks can make the most of the advantages of technology, settling accounts and bank outlets to offer tailored services to satisfy outstanding SME financing demands. The innovation in guarantee mechanisms is needed in the first place because insufficient collateral is the common feature of SMEs. Commercial banks could turn enterprise guarantee into group guarantee, which requires a close-related group like a family to compensate debt if the enterprise defaults on a loan. One of the secrets for Tailong's success is that it has a very innovative guarantee mechanism or credit mechanism which allows SMEs to use third parties for credit and debit payment guarantee. Therefore the consequence of defaulting for SMEs would not only be money, but also the high cost of moral conscience. Besides, members of the group who know much about the business's credit situation would not easily guarantee enterprises with poor credit, and it helps banks lower their risks. Commercial banks could also require SMEs to deposit a certain amount of money periodically until they pay off the credit, which could function as a supervision of payment. If SMEs pay principal

and interest on time, commercial banks could also return a part of interest as an incentive to reduce SMEs' loan risks.

Under the new economic environment, the government should play a guiding role (Sufian, 2012), to lead commercial banks to perform appropriate financing strategies towards SMEs by scientific economic means instead of forced intervention. Government could first encourage banks to carry out credit business for SMEs through moral persuasion, risk compensation and policy-related subsidies. Policy-based financial institutions and guarantee corporations could be introduced to SMEs by government with government's drawing from tax growth as supplementary fund. The transaction cost between banks and SMEs could be reduced by government's efforts in reducing processing fees and improving judicial efficiency of mortgage deals. Thus, when SMEs are in lack of collateral, policy-based financial institutions can guarantee for them to reduce banks' risk. If the enterprise defaults on the loan, those guarantee agencies would pay off debts and share the responsibility of debt collection. This would ensure safety of banks' capital and reduce the amount of bad loans.

The evaluation system of SMEs' credit grade needs to be improved as well for solving information asymmetry problem. It is the credit rating that makes SMEs become trustworthy enough to gain capital (Andreassen, 2008). Furthermore, government should establish credit management system to determine the credit ratings for different SMEs in order to ensure the money spent is an effective investment, and it is necessary to regularly update customer information database in order to implement corresponding surveillance measures and credit policies.

CONCLUSION

The objective of this paper is to study the credit policy problems between SMEs and commercial banks in China as this is a hot topic in recent years in Chinese economic development. This paper discusses the problems and the reasons of "credit grudging" behavior of China's commercial banks and SMEs financing difficulties. The paper also uses the dynamic game theory to probe into credit problems between SMEs and commercial banks under the conditions of information asymmetry. It is found that the banking industry's development prospect is closely related to the reshaping of its financing relationship with SMEs. It is important to find and cultivate quality SME clients since it has a great influence on commercial banks' future development and transition. In this paper the dynamic game model of credit is used to study the risks of commercial banks' credit business and whether to give loans to SMEs or not. Through a detailed case study of Tailong commercial bank, comments and suggestions are presented from three

perspectives of SMEs, commercial banks and the government, in order to solve the credit problems between commercial banks and SMEs and to reach a win-win solution.

At present, China's capital market is still not full-fledged, which makes bank-dominated indirect financing the principal part of the country's

financing system. However, reputable SMEs will soon become the targeted clients of the banking industry due to the strong competition and development in the industry, and SME credit business will become the key business of China's banking industry.

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