

China's Pawn-broking Industry and the Puzzle of Losses during the Global Financial Crisis in 2008-2009

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Abstract: In China, pawnbrokers not only provide financial intermediation services to individuals and households who need to finance their short-term gap between consumption and income like those in many other countries, but also serve as a supplementary financing channel for private entrepreneurs and small and medium-sized enterprises (SMEs) who face difficulty in obtaining formal credits. This paper uses the first-hand survey data in 2008-2009 in Zhejiang Province, one of the pioneering regions for developing pawn-broking business, to study the special characteristics of the pawn-broking industry and explain why it has become a viable and useful financing instrument in transitional China. Through examining why there was a serious setback and widespread loss in the industry during the global financial crisis in 2008-09, we argue that the crisis increased the default rate of export-oriented SMEs, which reduced their demand for pawn-broking loans. The strict regulations in the pawn-broking industry and the low efficiency of litigation in China also increased the operation costs of handling defaults by the pawnshops, leading to a temporary setback in an otherwise rapidly growing pawn-broking business during the crisis. However, the pawn-broking industry will continue to play an important role in financing SMEs in China in the foreseeable future.

Keywords: SMEs, World Financial Crisis, Pawn-broking, China

JEL: G14, G21, G38

1. Introduction

Although the financial industry has expanded rapidly in China over the last two decades, the intended clients of microfinance continue to draw on informal finance due to limited supply of formal credits.¹ In the meantime, the private sector plays an increasingly important role in the national economy². The rapid development of the private sector in China suggests that informal finance can facilitate firm growth more effectively than formal bank credits³. SMEs account for

¹ Tsai, K. "Imperfect substitutes: the local political economy of informal finance and microfinance in rural China and India", *World Development*, 32(9) (2004): 1487-1507.

² Ma, S., "Shareholding System Reform in China: Privatizing by Grouping for Stones". London: Edward Elgar Publishing Limited, (2010).

³ Meghana, A., D. Asli and M. Vojislav, "Formal versus informal finance: evidence from China", *The Review of Financial Studies*, 23(8) (2010): 3048-3097.

99.7% of the total number of enterprises and more than 80% of employment in China⁴. The formal financial institutions, particularly the big state-owned banks, can usually screen borrowers by providing only partial financing for projects, thereby forcing borrowers to resort to the informal financial sector for the rest of financial needs⁵. In addition, the commercial banks in China prefer lending to the state-owned large and medium-sized enterprises rather than SMEs as the former are considered to be more reliable for loan recovery than the latter. Consequently, most SMEs have to depend on informal financing for their operation and development⁶. The distortion between China's economic structure and financial structure is best manifested by the mismatch between the contribution of SMEs to economic growth and the amount of credits they obtain from the formal financial institutions⁷. According to Lin and Sun (2005), SMEs accounted for 59% of GDP, but over 98% of them had no access to formal financing in 2005⁸. Since SMEs are hindered by the lack of capital under financial depression, most of them have to seek financing sources outside the formal financial system including pawn financing and usury.

Pawn finance developed rapidly before the global financial crisis in China, but during the crisis, pawn-broking activities contracted and many brokers made losses. This was in sharp contrast to similar activities in other countries where pawn business was still profitable. The setback in China's pawn-broking industry during the crisis presents a puzzle which arouses us

⁴ Xinhua Net, China spends big to support SME's innovation, (2013), Available from: http://news.xinhuanet.com/english/china/2013-10/25/c_132831353.htm

⁵ Jain, S. "Symbiosis vs. crowding-out: the interaction of formal and informal credit markets in developing countries", *Journal of Development Economics*, 59(2) (1999): 419-444.

⁶ Allen F., J. Qian and M. Qian, "China's financial system: past, present, and future", 2005, available from: <https://www2.bc.edu/~qianju/China-finsystem-book-072105-ALL.pdf>.

⁷ Zhang, G.B., "The choice of formal or informal finance: Evidence from Chengdu, China", *China Economic Review*, no.19 (2008): 659-678.

⁸ Lin, Y.F. and X.F. Sun, "Information, informal finance and SMEs financing", *Economic Research Journal (in Chinese)*, no.7 (2005): 35-46.

to seek the answers to the following questions: Why did the pawn-broking industry in China suffer from losses while it was still profitable in other countries during the crisis? What are the main differences of pawnbrokers between China and other countries? How important is the pawn-broking industry in providing financial intermediation for the development of SMEs in the Chinese economy? This paper compares the features of the pawn-broking markets between China and other countries. We find that the global financial crisis increased the default rate of export-oriented SMEs, which reduced their demand for pawn-broking loans. The strict regulations in the pawn-broking industry and the low efficiency of litigation in China also increased the operation costs of handling defaults by the pawnshops, leading to a temporary setback in an otherwise rapidly growing pawn-broking business during the crisis.

This paper is organized as follows. Section 2 compares China's pawn-broking industry with that in other countries and discusses the unique features of China's pawn-broking market. Section 3 analyzes why the main pawn clients in China are SMEs rather than low income earners. Section 4 explains the puzzle of the setback in China's pawn-broking industry during the global financial crisis in 2008-09, and provides the survey evidence in Zhejiang province to verify our hypothesis. Section 5 concludes.

2. The main features of the pawn-broking industry in China

Pawn-broking is an industry that provides collateralized loans to households and individuals who pledge their property as collateral to get financing from pawnshops. In many countries, pawn-broking companies provide financial intermediation services to households and individuals who need to finance their short-term gaps between consumption and income.

China has a long history of pawn-broking activities since the ancient time⁹. The traditional pawn-broking industry in China mainly provided emergency funds for civilians (especially the poor)¹⁰ like that in many other countries.

After the founding of the People's Republic of China in 1949, pawn-broking was totally banned for more than three decades¹¹. In December 1987, nine years after the 1978 economic reform, Chengdu Hua Mao Pawnshop in Sichuan Province was established, marking the debut of the modern pawn-broking industry in China¹². In 2005, the Act of Pawn Management was enacted, greatly accelerating the development of the industry.¹³

The operation procedures of pawn loans in China are as follows. The pawnshop provides credits to clients who pledge their property as collateral to get short-term financing for usually one to six months. Our survey shows that the amount of pawn loan is generally much lower than the value of the collateral. When the pay-back deadline approaches, the client needs to repay the loan plus interest to the pawnshop. With the full repayment, the pawnshop returns the original collateral to the client. If the client defaults and cannot repay the loan within the prescribed time limit, the pawnshop will have ownership of the collateral. Therefore, the profits of a pawnshop mainly come from the interest of the loans and a comprehensive fee or the difference between the value of collaterals and the loan when the default takes place.

Pawning activities in China are distinctively different from those in the developed countries such as the US or the UK. In these developed countries, pawning is predominantly used by individuals for small value pledges rather than by SMEs as an alternative financing source. The

⁹ Liu, Q., *The History of China's Pawn-broking System (in Chinese)*, Shanghai Ancient Books Press, 1995.

¹⁰ Qu, Y., *The History of China's Pawn-broking (in Chinese)*, Shenyang Press, 2007.

¹¹ Li, S. *Pawnshops: The Unique Fast Mode of Financing (in Chinese)*, Beijing: Xue Yuan Press, 2006.

¹² Qu, Y., *The History of China's Pawn-broking (in Chinese)*, Shenyang Press, 2007.

¹³ Yan, Q. & Li, J. *Regulating China's Shadow Banks*, Abingdon: Routledge, 2016.

differences of pawn activities between China and some developed countries can be illustrated by the average size of pawns, clients and collaterals in Table 1.

Table 1 Average pawn sizes, collaterals and clients in China and some developed countries

Countries	Average pawn sizes (US\$)	Collaterals	Clients
USA (1998)	46-70.13	jewelry, tools and commodity	low-income earners
UK (2004)	160	jewelry, tools and commodity	low-income earners
Singapore(1998)	273	jewelry, tools and commodity	low-income earners
Japan (2001)	435-1,304	jewelry, tools and commodity	low-income earners
Canada (1996)	33	jewelry, tools and commodity	low-income earners
China (2011)	21,952	jewelry, tools and commodity real estate and property rights	low-income earners and SMEs

Sources: Data for the countries other than China are collected from the various references quoted in this paper. Data for China is based on authors' survey.

Caskey (1991) and Johnson (1998) investigated the police record of pawn-broking services in Wilmington, Delaware of the United States, which showed that the average pawn size was \$46¹⁴. Johnson (1998) recorded 1,207,160 pawn transactions in the 28 states of America, showing an average size of \$70.31¹⁵. Other studies showed that the average pawn sizes in Singapore, Japan, Canada and the United Kingdom were more or less the same^{16,17}. However,

¹⁴ Caskey, J.P., "Pawn-broking in America: The economics of a forgotten credit market", *Journal of Money, Credit, and Banking*, 23(1) (1991): 85-99.

¹⁵ Johnson, R.W. "Pawn-broking in the U.S.A.: profile of consumers", Senior Research Associate Credit Research Center, Georgetown University Washington, D.C.. 1998.

¹⁶ Xu, Q., "British pawn-broking industry research report, Archived Data of Commercial Section", Embassy of the People's Republic of China in the United Kingdom of Great Britain and Northern Ireland. 2005.

¹⁷ Li, S. *Pawnshops: The Unique Fast Mode of Financing (in Chinese)*, Beijing: Xue Yuan Press. 2006.

for some developing countries, such as Sri Lanka, India, the Philippines and Indonesia, the average pawn sizes were significantly smaller. In these countries, pawn is usually labeled as a penny economy¹⁸. In contrast, the average pawn size in China is substantially larger than that of other countries. According to our survey and field visits to 82 pawnbrokers in different cities of Zhejiang province in July 2010, the average pawn size was RMB 138,300 (about US\$21,952 based on the average official exchange rate in 2009).

Another difference in the pawn-broking industry between China and other countries lies in the nature of clients and collaterals. In many other countries, most clients of pawn-broking are low-income households. For example, more than 80% of pawn-broking clients in the UK were low-income people, especially women in their thirties, and more than two-thirds of those families had school age children¹⁹. The pawned collaterals included various types of gold and silver jewelry, vehicles, musical instruments and farm tools. Although the level of economic development in Sri-Lanka, India, the Philippines and Indonesia is far lower than that in the UK and the US, the types of clients are similar, including merchants, shopkeepers, craftsmen, millers, blacksmiths, carpenters or handicrafts makers. The main collaterals are gold and silver jewelry, commodity, common life equipment, and even farming tools²⁰.

In contrast, the main clients of the pawn-broking industry in China are SMEs and all kinds of investors. The poor and low-income people rarely go to pawn shops for loans. The collaterals are usually real estates and property rights. For most clients, the purpose of pawning is to cover

¹⁸ Bouman, F.J.A. and R. Houtman, "Pawn-broking as an instrument of rural banking in the third world", *Economic Development and Cultural Change*, 37(1) (1988): 69-89.

¹⁹ Xu, Q., "British pawn-broking industry research report, Archived Data of Commercial Section", Embassy of the People's Republic of China in the United Kingdom of Great Britain and Northern Ireland. 2005.

²⁰ Bouman, F.J.A. and R. Houtman, "Pawn-broking as an instrument of rural banking in the third world", *Economic Development and Cultural Change*, 37(1) (1988): 69-89.

the funding gap in the investment instead of paying for their daily consumption. In summary, pawn-broking is mainly used for investment purpose in China whereas it is mainly for consumption in other countries.

3. Pawn clients are mainly SMEs in China

Why do low-income people in China hardly go to the pawnshops for financing? Firstly, “pawn” has a negative image in the Chinese society historically. Going to the pawnshops is considered as a disgrace. After the Chinese government banned the pawn-broking activities in 1949, “pawn” was excluded from daily consumption and the financial system until 1978 when China started its reform program²¹. Secondly, modern pawn-broking activities have restrictions on pawn objects. Low-value objects require storage space and incur relatively high costs. Consequently, although modern pawnshops do not limit the types of pawn objects, pawnshops usually do not accept low-valued items as collaterals. Thirdly, there are relatively few pawnshops, and the network is far and apart. The density of pawnshops in China is far less than that in the developed countries such as the United States. Furthermore, most Chinese pawnshops are located in the cities and few in the countryside, where most of the poor and low-income people live. Finally, the low-income people in China usually overcome their financial problems through borrowing from their relatives or friends. Sometimes the financial support provided by employers or the government can also help overcome their financial difficulties.

From the supply side perspective, lending to the low-income people is a mutual aid loan

²¹ Qu, Y., *The History of China's Pawn-broking (in Chinese)*, Shenyang Press, 2007.

based on interpersonal relationships rather than business transactions like pawn financing. Among the low-income population in the urban areas, there are a large number of migrant workers coming from the countryside. When they cannot earn a living through borrowing or obtain aid from their relatives and friends, they may go back to the countryside.

However, as a special informal financing instrument, pawn-financing is popular among the SMEs in China as they find it difficult to secure credits from the commercial banks or other formal financial institutions. Excessive intervention and regulation in the financial industry by the government result in unfair treatment of SMEs when they need credits from the formal financial institutions.²² Moreover, self-fundraising is also one of the most important financial sources for Chinese SMEs²³.

Pawn financing for Chinese SMEs has many advantages over bank loans. They differ in collateral, credit conditions, loan duration and lending speed. For example, the commercial banks in China mainly accept properties as collaterals, but pawnshops accept almost any valuable objects as collaterals, including chattel, rights pledge and real estate. Although the bank lending rate is much lower than that of pawn loans, the credit conditions of bank loans are much more stringent than those of pawnbrokers. Due to the small size and financial irregularities, it is not easy for some SMEs to obtain bank loans. In contrast, pawn financing has no credit threshold and ownership discrimination, and clients will be eligible for loans as long as they have collaterals. The application for a pawn loan can be completed within a few hours or even a few minutes. However, the duration of pawn lending usually lasts for no more

²² Zhang, G.B. "The choice of formal or informal finance: Evidence from Chengdu, China", *China Economic Review*, no.19 (2008): 659–678.

²³ Allen, F., Qian, J., Qian, M. "Law, finance, and economic growth in China", *Journal of Financial Economics*, 77(1) (2005): 57-116.

than 6 months. Although the duration of bank loans is longer, it usually takes a few months for the SME to obtain a loan.

The Chinese government has implemented strict laws to ban usury. For a long time, the usury is considered as an exploitation of the poor people. As a result, the Chinese government always tries to crack down on usury and imprison the people undertaking such activities. Pawn-broking, which is a legal business, has relatively high entry barriers and needs to go through a strict examination and approval process by the government. Usury has low entry barriers, but it is highly risky and illegal. Pawnshops follow the official lending rate while usury usually charge very high lending rate. For example, the average usury rate hit 43% in Wenzhou City, Zhejiang Province in 2010²⁴.

As a special financing channel lying between formal and illegal finances, pawn broking is a secure short-term financing instrument with easy access, thereby becoming a useful supplement to the formal financial sector in China, in particular when the SMEs are restricted to formal credits. Therefore, the pawn-broking industry has helped to alleviate the high demand pressure for usury and illegal shadow banking by the self-employed individuals and SMEs²⁵.

4. The puzzle of unusual losses during the global financial crisis

After the global financial crisis originated from the United States in 2007, the Chinese government implemented a RMB 4 trillion stimulus plan at the end of 2008. The stimulus plan greatly reduced the cost and lowered the lending threshold of bank loans for SMEs. As a result,

²⁴ Zhang, X.C., Xu, Z. & Qin, D. "Informal lending rates and the way out of the private capital in Wenzhou", *Journal of Financial Research*, no.3 (2013):1-14.

²⁵ Yan, Q. & Li, J. *Regulating China's Shadow Banks*, Abingdon: Routledge, 2016.

the relative borrowing cost of pawn financing increased compared to that of bank loans. Consequently, the global financial crisis led to a slowdown of pawn-broking activities in China during 2008-09.

However, China is not the only nation that introduced the fiscal stimulus plan. Many other countries and regions, such as the United States and the European Union, also carried out large-scale quantitative easing programs. But why was China's pawn-broking industry particularly affected by the quantitative easing programs? We argue that the pawn-broking industry in China has been driven more by investment demand of SMEs rather than consumption demand by low-income individuals or households in other countries or regions.

In the United States and the European Union, the funding of quantitative easing programs mainly flowed into the industrial sectors. As a result, they did not have a direct impact on the consumption-oriented pawn-broking industry. In sharp contrast, the fiscal stimulus plan in China had a powerful and negative impact on pawn-broking activities, which were mainly used as a supplement to the formal financial system to provide financial services for SMEs. Under the fiscal stimulus plan, as banks lowered their lending threshold and accelerated the approval process, the costs of bank financing were greatly reduced. In the meantime, the financial costs through pawning remained more or less unchanged. Consequently, SMEs were tempted to shift their borrowings from pawnshops to banks.

As Figure 1 indicates, the lending rate of commercial banks was lowered after the implementation of the fiscal stimulus plan in China. From September to December in 2008, the interest rate was cut five times consecutively. The lending rate of six-month bank loans was reduced from 6.57% to 4.86% while that of one-year loans was lowered from 7.47 % to 5.31%.

In the same period, the interest rate and the comprehensive rate of pawn-broking industry were basically unchanged (Table 2). Under the fiscal stimulus plan, some SMEs turned to bank financing instead of pawn financing.

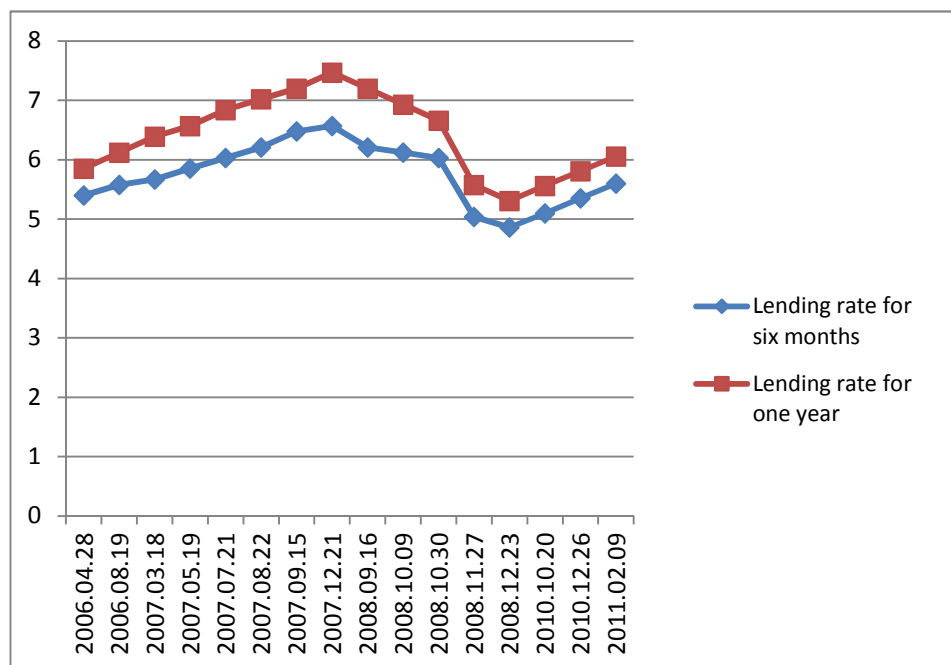


Figure 1 Bank lending rates before and after the world financial crisis

Sources: Compiled by the authors based on the data of lending rates provided by the People's Bank of China (2006-2011)

Table 2 Comprehensive rate and interest rate of pawn-broking in China in 2008

Collaterals	Comprehensive Rate (% / month)	Interest Rate (% / month)
Civilian Product	4.2	0.5
Real Estate	2.7	0.5
Motor Vehicle	4.2	0.5
Property Rights	2.4	0.5

Sources: Data are collected from *Pawn Management Methods*.

On the other hand, many export-oriented SMEs in China received less foreign orders under the global financial crisis, lowering their demand for pawn loans. In addition, the

implementation of new financial regulations by the central government increased the operating costs of pawnbrokers, especially those arising from dealing with default collaterals. According to *Pawn Management Methods*, pawnbrokers in China are not allowed to raise the lending rates to cover their rising operation costs even when they are in difficulties. The ceiling lending rate of pawn-broking is stipulated by the government. In addition, the pawnbrokers in China are not allowed to be financed through the capital market. They can only secure the bank loans up to the same proportion as their net assets.

According to the traditional practice of pawn-broking transactions, the ownership of overdue pawn collaterals will be transferred to the pawnbrokers automatically. However, in China, a pawnbroker cannot obtain a pledge with its value exceeding RMB 30,000 automatically. According to Article 43 of *Pawn-broking Management Measures*, when a client defaults and does not redeem his/her collateral with its value over RMB 30,000, the pawnbroker must sell the collateral through public auction or take legal action against the client. The remaining of auction fund must be refunded to the client after deducting the auction fee, the pawn loan and its interest. During the global financial crisis, the number of disputes and litigations increased sharply. The low efficiency of judicial litigations increased the costs of pawnbrokers in handling default collaterals, thereby leading to the losses of the pawn-broking industry in China.

Our evidence is mainly based on a survey of 43 pawnshops in Zhejiang Province, China, which has witnessed the rapid development of pawn-broking business in the past three decades. Zhejiang Province has been well known for the rapid development of the private economy with

a high concentration of SMEs since China adopted its open door policy in 1978²⁶. The number of SMEs accounted for 99% of the total enterprises in the province, contributing to around 81.6% of exports, 82.9% of public revenue, 90.1% of employment and 81.1% of gross industrial output in 2011²⁷. The pawn-broking industry in the province has grown rapidly coupled with the rapid growth of private firms. Under the financial repression environment of transitional China, the financial demand of a large number of SMEs could hardly be met through the formal financing channels. Therefore, the informal financing channels such as pawn-broking has become one of the most important financing sources for some SMEs in Zhejiang Province.

The restoration of the modern pawn-broking industry in Zhejiang Province began when Wenzhou Jincheng Pawnbroker was established in February 1988. According to the Zhejiang Pawn Association, the pawn amount reached RMB 40.77 billion in 2011, 70-80% of which was lent to the SMEs. Table 3 shows the average size of each pawn and the business proportion of pawnbrokers with registered capital of more than RMB 10 million in Zhejiang in July 2010.

We conducted a survey with questionnaires and made the field visits to some pawnbrokers in Zhejiang in 2010. We distributed 82 copies of questionnaires and received 43 valid responses with an effective response rate of 52.4%. Among the 43 pawnshops, 24 were located in Hangzhou City, 8 in Wenzhou City, 3 in Jinhua City, 3 in Fuyang City, 2 in Jiande City, 2 in Longyou City, and 1 in Jiaxing City. These pawnshops had been engaged in a wide range of pawn-broking businesses for about five years with eleven employees on average.

Table 3 The pawnbrokers in Zhejiang under the survey in 2010

²⁶ Wang Jinmin, *Institutional Change and the Development of Industrial Clusters in China: Case Studies from the Textile and Clothing Industry*, World Scientific Publishing Co. Pte. Ltd. 2014.

²⁷ Shen Mengjiao, "An analysis of the current situation and development of Pawn-broking in Zhejiang Province" (in Chinese), *Reformation & Strategy*, 27(12) (2011):37-43.

Pawn Brokers	Registered Capital (Million RMB)	Property Rights (%)	Real Estate (%)	SME (%)	Average Loan (RMB 1,000)
Mingtai	15	24	60	89	32
Hengtai	12	0	70	70	100
Hengfeng	20	11	23	80	15
Jinrui	20	50	45	98	150
Zhongdu	20	13	45	84	25
Sanhang	20	83	11	99	31
Binsheng	30	82	17	90	520
Xizi	10	23	40	35	94
Dianlian	20	3	76	64	700
Gongxi	30	80	10	50	2000
Chengjiu	20	38	38	20	50
Guopai	10	80	0	10	50
Zheshang	30	23	40	35	50
Yuantong	49	0	55	90	150
Zhongcai	25	0.8	65	73	78
Xiangyi	50	16	74	34	23
Yuantai	100	68	30	79	500
Huifeng	20	13	53	70	1920

Sources: Compiled by the authors based on the survey data in July 2010.

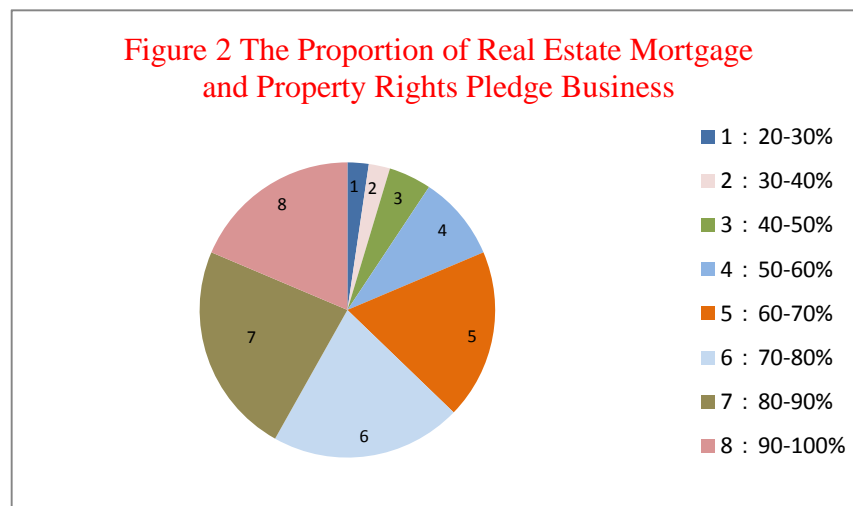
Notes: Only those pawnbrokers with registered capital of more than RMB 10 million are listed in the table. ‘Property Right’ = clients using property as pledge, ‘Real Estate’ = clients using real estate as pledge. SME = lending to SMEs. % = as percentage of total lending values by the particular broker.

The survey data indicates that the average size of each pawn loan was high: the lowest average loan was RMB 15,000 (US\$2,197) while the highest loan reached RMB 2,000,000 (US\$292,912). Most of them lied between RMB 50,000 (US\$7,323) and RMB 150,000 (US\$219,684). The pawnbroker with the lowest average loan was the Hengfeng Pawnshop established in 1988, which was mainly engaged in civilian products. The pawnbroker with the

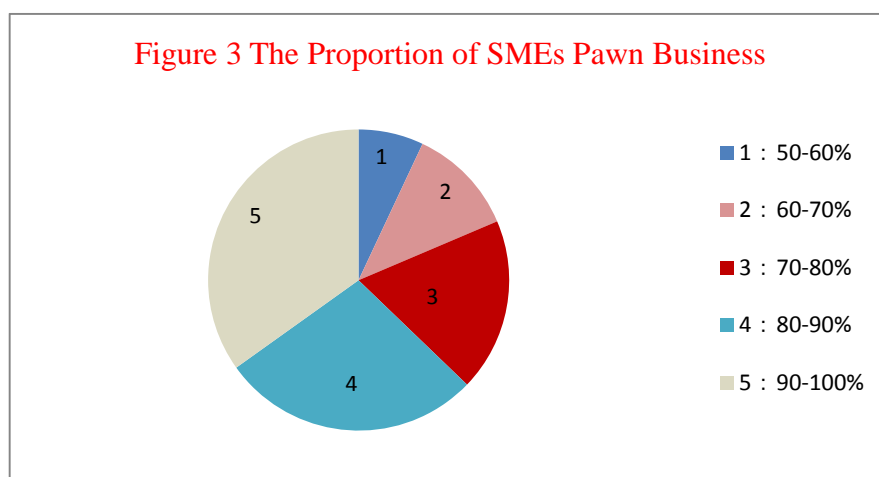
highest average loan size was Gongxi Pawnshop founded in 2006, which was mainly engaged in real estate mortgages and property rights pledge.

Figure 2 provides more information about the proportion of real estate mortgage and property rights pledge business for the surveyed pawnshops. For 70% of the 43 surveyed pawnshops, the proportion of real estate mortgage and property rights pledge accounted for more than 60% of their total business. For 40% of the pawnshops, their real estate mortgage and property rights pledge accounted for 80% of their total business. For example, the proportion of real estate mortgage and property rights pledge at Jinrui Pawnshop accounted for 95% of its total business.

Figure 3 shows that the vast majority of pawn-broking clients are SMEs, accounting for more than 50% of all the clients among all the surveyed pawnshops. For some pawnshops, more than 90% of their clients were SMEs. Two pawnshops, Zhongdu and Sanhang, conducted their businesses exclusively with SMEs.

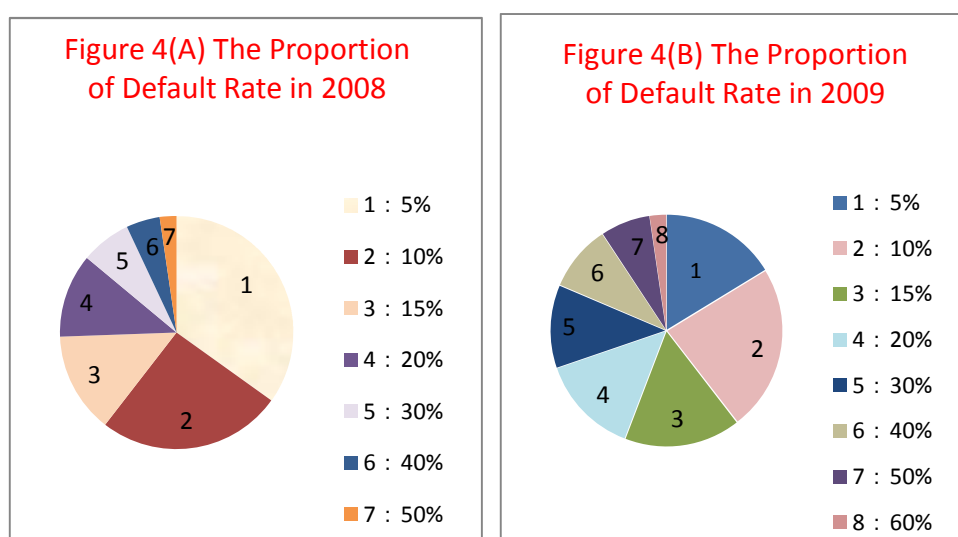


Sources: Compiled by authors based on the survey data



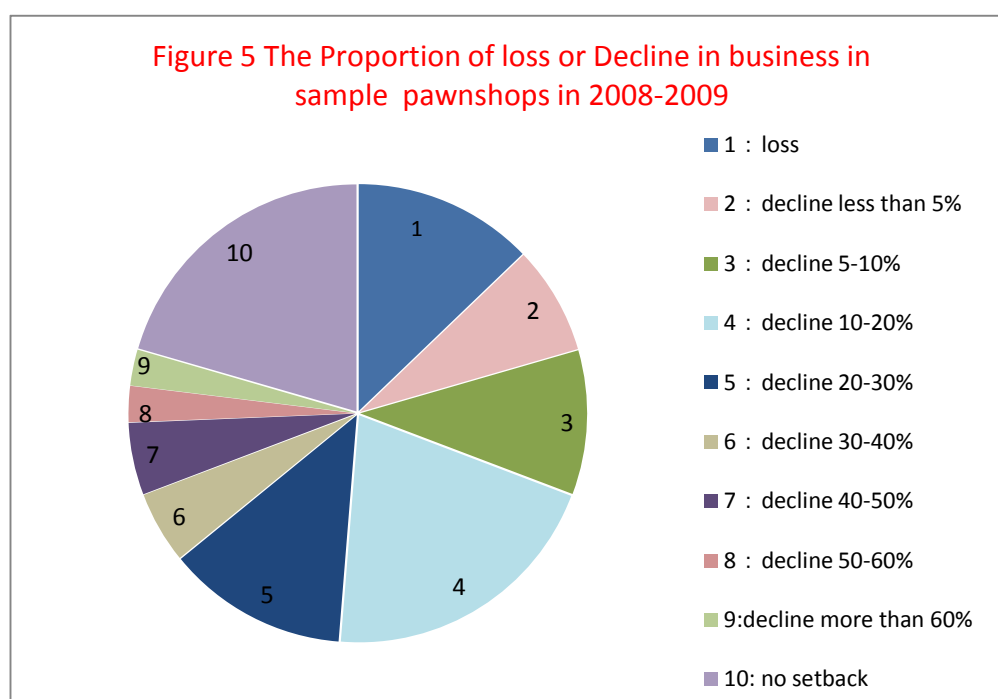
Sources: Compiled by the authors based on the survey data

According to the survey data and interview information, the default rate of clients in most pawnshops was relatively low before the global financial crisis in 2008-09, which was less than 10%. After the crisis, the default rate of clients increased significantly. According to Figure 4(A), the number of pawnshops, whose default rate was more than 15%, increased significantly in 2008 and reached about 40%. The highest default rate reached 50% in the Hengfeng Pawnshop. The default rate of clients rose further in 2009 as the number of pawnshops whose default rate was more than 15% increased by a further 10% to 50% (Figure 4(B)). The default rate in the Hengfeng Pawnshop hit a record high of 60%.



Sources: Compiled by the authors based on the survey data

Forty out of forty-three pawnshops in the survey suffered from business losses or a decline in business activities under the global financial crisis. Twenty-five pawnbrokers (62.5%) had witnessed a loss. When asked about the causes of losses or business contraction, most pawnshops in the survey responded that the global financial crisis resulted in a rising default rate, difficulty in dealing with the collaterals of real estates and property rights, and increasing costs of prolonged litigation. In addition, the fiscal stimulus policy of the central government reduced the bank lending rate, making some pawn-broking clients choose bank financing instead of pawn-financing. The inexperience of pawnbrokers in response to the global financial crisis resulted in some wrong decisions. For example, Hengfeng Pawnshop had a business default of bloodstone that was difficult to sell and circulate, resulting in one substantial bad loan of RMB 10 million. Zhongdu Pawnshop witnessed the biggest drop in business from RMB 212.2 million in 2008 to RMB 50.6 million in 2009 due to the suspension of real estate business.



Sources: Compiled by authors based on the survey data

According to Zhejiang Pawn Trade Association, the total amount of pawn loan in Zhejiang Province reached RMB 10.1 billion in 2005 and RMB 16.8 billion in 2006 respectively. It reached its peak in 2007 before the outbreak of global financial crisis with a total loan of RMB 25.2 billion. However, after the global financial crisis and the implementation of the fiscal stimulus plan, the total amount of pawn loan decreased to RMB 22.2 billion in 2008, and further to RMB 20.7 billion in 2009. In 2010, the amount of pawn loan rose significantly, reaching RMB 30.6 billion in 2010, and further up to RMB 40.8 billion in 2011. We found that the fluctuations in the amount of pawn loan had an obvious linkage with the fiscal stimulus plan implemented by the central government of China in 2008. The pawn-broking industry demonstrated a clear ascendant trend along with the implementation of tightening monetary policy by the People's Bank of China after 2010. As the fiscal stimulus plan was gradually phased out after 2010, the demand for pawn financing started to rise sharply again (Figures 6).



Sources: Compiled by the authors based on the data collected from the Zhejiang Pawn Trade Association (2005-2011).

We also interviewed some SMEs in Zhejiang Province in February 2011, and found that there were changes of their financing means during 2007-2010. The following two cases in the survey can illustrate our main argument further. Yong Kang XD Door Making Company and Long You YQ Cloth Art Firm, two small enterprises with registered capital of RMB 500,000 each, were the clients of Yong Kang HF Pawnshop and Long You HJ Pawnshop respectively. From 2007 to 2008, Yong Kang XD Door Making Company borrowed 9 times from Yong Kang HF Pawnshop altogether with 4 times in 2007 and 5 times in 2008. The amount of loan ranged from RMB 50,000 to RMB 300,000. The longest borrowing term was two months while the shortest was only seven days. However, when the central government of China carried out the stimulus package of RMB 4 trillion during 2008-2009, the Yong Kang XD Door Making Company only borrowed from the pawnshop once in March 2008 with a loan amounting to RMB 100,000. It borrowed twice from the same pawnshop with RMB 100,000 in July and RMB 150,000 in October 2010 respectively. There was no pawn loan record from April 2009 to June 2010. But during the period, a one-year bank loan of RMB 500,000 was granted to the firm by a local commercial bank under the guarantee of a large door-making industrial company in May 2009.

It was the same case for Zhejiang Long You YQ Cloth Art Firm. From 2007 to 2008, the firm had five pawn loan records, twice in 2007 and three times in 2008 with the amount of loans ranging from RMB 70,000 to RMB 200,000. The longest borrowing term was one month while the shortest term only ten days. However, there was no pawn loan record from 2009 to September 2010. During the same period, a bank loan of RMB

300,000 was granted to the firm in March 2010. In October 2010, it borrowed RMB 120,000 from Long You HJ Pawnshop.

The above two cases clearly indicate that when commercial banks lowered their credit thresholds, SMEs would prefer to borrow from them rather than from the pawnshops. However, under the tightening monetary policy, the pawn loans regained their advantage as the lending rate of commercial banks went up and the lending conditions became more restrictive to the SMEs.

5. Conclusion

In this paper we have analyzed the characteristics of China's pawn-broking industry and the reasons for a wider range of losses and decline in pawn business after the outbreak of global financial crisis in 2007. As one of the largest and fastest growing economies in the world, China differs from many other countries in financing the SMEs. The pawn-broking industry has become one of the important informal financing sources for the growth of SMEs. The business volatility in pawn-broking after the global financial crisis demonstrated some unique nature of SMEs financing in transitional China.

Since the pawn-broking industry was legalized in China in 1987, pawn-broking business has become a useful supplement to the formal financial system, providing an important financing channel for millions of SMEs, which are usually discriminated by the banking and other formal financial institutions.

When the global financial crisis broke out in 2007, China's pawn-broking industry suffered from a severe setback and many pawnshops made losses. This phenomenon emerged as a puzzle that required explanation. Because of the central government's fiscal stimulus plan to combat

global economic recession, the commercial banks in China lowered their lending rates and credit thresholds. However, the pawnshops could not do the same. As a result, SMEs borrowed more from the commercial banks and reduced their demand for pawn financing. In addition, the global financial crisis led to business contraction or failure for many export-oriented SMEs, resulting in a higher default rate for most pawnshops. The strict regulations imposed on the pawn-broking industry by the central government also increased the costs of handling defaults, causing unprecedented losses in the industry.

This paper provides some first-hand survey data in Zhejiang Province to have a better understanding of the development of the pawn-broking industry in China. The experience in Zhejiang Province implies that pawn-broking loans can provide a quick and efficient source of credits to break the SMEs financing bottleneck under financial repression. There are two important reasons for the fast development of pawnshops in Zhejiang. Firstly, Zhejiang has been historically short of bank loans provided by the state-owned banks. Secondly, numerous SMEs have to resort to usury to meet their financial needs. However, usury is illegal and costly. Pawn-broking is legal and its cost is substantially lower than that of usury (underground money shops). It can be expected that the deepening of financial reforms in China will create an even more open and liberal financial market for pawnshops and private banking institutions in China. Pawn-broking will continue to be a useful and beneficial supplement to the formal financial system, providing significant support to the rapid expansion of China's private economy, particularly the SME sector.