



# Report and Recommendation of the President to the Board of Directors

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Project Number: 52150-001  
July 2018

## Proposed Loan Zhujiang Financial Leasing Company Limited Small and Medium-Sized Enterprises Finance in Underdeveloped Regions Project (People's Republic of China)

This is an abbreviated version of the document approved by ADB's Board of Directors that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

Asian Development Bank



## CURRENCY EQUIVALENTS

(as of 26 April 2018)

Currency unit	–	yuan (CNY)
CNY1.00	=	\$0.1581
\$1.00	=	CNY6.3269

## ABBREVIATIONS

ADB	–	Asian Development Bank
CAR	–	capital adequacy ratio
CBRC	–	China Banking Regulatory Commission
CEO	–	chief executive officer
CRO	–	chief risk officer
ESMS	–	environmental and social management system
GDP	–	gross domestic product
GRCB	–	Guangzhou Rural Commercial Bank
PRC	–	People's Republic of China
ROAE	–	return on average equity
SMEs	–	small and medium-sized enterprises
ZFL	–	Zhujiang Financial Leasing Company Limited

## NOTES

- (i) The fiscal year (FY) of Zhujiang Financial Leasing Company Limited begins on 1 January and ends on 31 December.
- (ii) In this report, "\$" refers to United States dollars, unless otherwise stated.

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## PROJECT AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 52150-001</b>	
<b>Project Name</b>	Small and Medium-Sized Enterprises Finance in Underdeveloped Regions Project	<b>Department /Division</b>	PSOD/PSFI
<b>Country</b>	China, People's Republic of		
<b>Borrower</b>	Zhujiang Financial Leasing Company Limited		
<b>2. Sector</b>		<b>ADB Financing (\$ million)</b>	
✓ Finance	Small and medium enterprise finance and leasing		60.00
		<b>Total</b>	<b>60.00</b>
<b>3. Strategic Agenda</b>		<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
<b>4. Drivers of Change</b>		<b>Gender Equity and Mainstreaming</b>	
Private sector development (PSD)	Promotion of private sector investment	Some gender elements (SGE)	✓
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Rural	Medium
Household Targeting	No	Urban	High
SDG Targeting	Yes		
SDG Goals	SDG1, SDG8		
<b>6. Nonsovereign Operation Risk Rating</b>			
<b>Obligor Name</b>		<b>Obligor Risk Rating</b>	<b>Facility Risk Rating</b>
Zhujiang Financial Leasing Company Limited			
<b>7. Safeguard Categorization</b> Environment: FI    Involuntary Resettlement: FI    Indigenous Peoples: FI			
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
ADB		60.00	
Nonsovereign LIBOR Based Loan (Regular Loan): Ordinary capital resources		60.00	
<b>Cofinancing</b>		<b>0.00</b>	
Others		0.00	
<b>Others<sup>a</sup></b>		<b>0.00</b>	
<b>Total</b>		<b>60.00</b>	

<sup>a</sup> Derived by deducting ADB financing and Cofinancing from Total Project Cost.



## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan of up to \$60,000,000 (or its yuan equivalent) to Zhujiang Financial Leasing Company Limited (ZFL) for the Small and Medium-Sized Enterprises Finance in Underdeveloped Regions Project in the People's Republic of China (PRC).

2. The project entails the Asian Development Bank (ADB) providing longer-tenor financing to ZFL for lease finance to small and medium-sized enterprises (SMEs) located in the underdeveloped central and western regions of the PRC. ADB's financing will meet ZFL's funding requirements for medium-term funding, which is in short supply in the PRC. This will enable the company to provide longer-tenor lease finance to underserved segments, improve its asset-liability profile, and diversify its funding sources. Being the first development finance institution lender, ADB will also add value by helping ZFL enhance its safeguards capacity.

## II. THE FINANCIAL INTERMEDIARY

### A. Investment Identification and Description

3. After more than three decades of strong economic growth in the PRC, the real gross domestic product (GDP) growth rate slowed to 6.7% in 2016 and 6.9% in 2017. ADB estimates that GDP growth will be 6.4% in 2018.<sup>1</sup> Despite rapid economic growth since the 1980s, regional disparity and income inequality remain a major issue. Economic development in central and western regions lags significantly behind that in the coastal region in the east, where most foreign direct investment and export-oriented industries are located. Measured by GDP per capita, all provinces ranked in the lower half are located in the central and western regions. In 2016, the GDP per capita in the western province of Gansu was only 23% of that in Beijing, and the disposable income per capita was only 28%. Strong economic growth has lifted more than 600 million people out of poverty between 1990 and 2010. However, over 65 million people were still living below the national poverty line (average annual income per person below CNY2,300) in 2016 most of whom lived in the central and western regions.<sup>2</sup> There are currently 592 poverty-stricken counties designated by the central government, covering large rural areas in the central and western regions of the PRC.

4. Development of SMEs directly contributes to inclusive growth of the PRC economy, given the important role of these enterprises in employment generation. Small businesses with 300 or fewer employees account for 98.6% of all firms in the PRC.<sup>3</sup> SMEs contributed to over 60% of the PRC's GDP and approximately 50% of the country's tax income, and generated more than 80% of the urban employment as of YE2016.<sup>4</sup> More job opportunities associated with faster growth of SMEs in central and western regions will help reduce regional disparity. According to data from the National Bureau of Statistics, the number of SMEs in the central region grew by 5.8% in 2016 and in the western regions by 6.6%, which is much higher than in the eastern region (0.8%).<sup>5</sup> Despite the major contribution from SMEs to the country's economic growth and their role as a

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<sup>1</sup> ADB. 2017. *Asian Development Outlook Supplement: A Firmer Growth Outlook for Asia*. Manila.

<sup>2</sup> The World Bank. 2016. *Country Statistic*. <https://data.worldbank.org/country/china?view=chart>.

<sup>3</sup> Organisation for Economic Co-operation and Development (OECD). 2017. *Financing SMEs and Entrepreneurs 2017: An OECD Scorecard*. Paris.

<sup>4</sup> Government of the PRC, Ministry of Industry and Information Technology. 2015. *Made in China 2025: Promoting Development of SMEs*. Beijing.

<sup>5</sup> Government of the PRC, National Bureau of Statistics. 2017. *Report on 2016 China SME Operation*. Beijing.

growth driver in the underdeveloped regions, SMEs face significant barriers in accessing credit from financial institutions. Banks have shown a preference in lending to state-owned enterprises and larger enterprises operating in priority sectors identified in domestic industrial policy. As of the end of 2017 (YE2017), credit to micro and small enterprises represented only 24.7% of total bank loans.<sup>6</sup> SMEs in central and western regions have more restricted access to finance, with average borrowing costs 0.7% higher than those in the eastern regions.<sup>7</sup>

5. **Leasing industry.** The leasing industry can play an important role in a country's financial system as it is particularly suited for financing SMEs, which typically lack eligible collateral required for bank finance. The leasing industry has been growing rapidly in the PRC, filling a financing gap left by traditional bank financing. According to the World Leasing Yearbook, new leasing sales in the PRC expanded from \$21.88 billion in 2008 to \$136.45 billion in 2015, representing a compound annual growth rate of 29.9%. By YE2016, total assets reached CNY2.15 trillion, a 32.4% increase compared with the previous year. Total industry revenues amounted to CNY1.54 trillion with an industry aggregate net profit of CNY26.8 billion.<sup>8</sup> Despite rapid growth since 2008, the PRC's financial leasing industry still needs further development. Lease market penetration measured as the ratio of lease finance over all fixed investment in plant and equipment in 2016 was only 6.0%, compared with 21.5% in the United States, 33.7% in the United Kingdom, and high single-digit rates in developed Asian countries such as Japan and the Republic of Korea. The lease penetration rate measured as a percentage of lease finance to total GDP was 1.84% in the PRC in 2016, ranking it 17th among 50 countries.<sup>9</sup> The leasing industry is also much smaller than the banking industry, with assets totaling CNY232.3 trillion at YE2016.

6. ADB's nonsovereign operations have been actively supporting leasing in the PRC, targeting a diverse range of development subsectors. ADB has provided \$350 million in debt to four PRC financial leasing companies for clean buses and health care finance since 2013. In 2017, the ADB Board of Directors approved another \$200 million loan to one of the largest leasing companies in the PRC for green bus leasing.<sup>10</sup> ADB identified ZFL as a good partner to support access to finance for SMEs. Established by one of the PRC's leading rural commercial banks, the Guangzhou Rural Commercial Bank (GRCB), ZFL's operations have a strong development focus with a majority of its leasing portfolio being to SMEs and to clients located in the underdeveloped central and western regions of the PRC. ZFL has sound corporate governance, an experienced management team, developed risk management systems, and good financial performance.

## B. Business Overview and Strategy

7. ZFL was established in December 2014 as a wholly owned subsidiary of the GRCB and is a leasing company regulated by the China Banking Regulatory Commission (CBRC). The company has experienced rapid growth since its establishment. As of YE2017, its total assets were CNY12.50 billion and total equity was CNY1.38 billion. ZFL is headquartered in Guangdong

<sup>6</sup> CBRC. 2017. *Statistic of Micro and Small Enterprise Loans from the Banking Sector*. <http://www.cbrc.gov.cn/chinese/home/docView/ECFEC8EDD5404B5EB309B7045B81799C.html>.

<sup>7</sup> People's Bank of China. 2017. *2017 China Regional Finance Operation Report*. Beijing.

<sup>8</sup> Chinese Financial Leasing 30 Forum. 2017. *Financial Leasing Industry in China – 2017 Report*. Beijing.

<sup>9</sup> White Clarke Group. 2018. *Global Leasing Report*. London. Market penetration is defined as the ratio of lease finance over all fixed investment in plant and equipment.

<sup>10</sup> ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of China for the Clean Bus Leasing Project*. Manila; ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Yingda International Leasing for Health Finance in Underdeveloped Regions Project in the People's Republic of China*. Manila; and ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Minsheng Financial Leasing for Green Bus Leasing Project in the People's Republic of China*. Manila.

province, a region with a dynamic private sector and strong economic fundamentals. Unlike GRCB which is restricted to operations in select cities in Guangdong province, ZFL holds a national license. The company's leasing operations cover 28 out of the 31 provinces, with a strong presence in the underdeveloped central and western regions. Its exposures in Guangdong accounted for 26% of outstanding lease portfolio by YE2017, followed by three underdeveloped provinces of Henan (21%), Guizhou (11%), and Sichuan (9%). Overall, 63% of ZFL's portfolio was in the central and western regions of the PRC.

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### C. Ownership, Management, and Governance

8. **Ownership.** Integrity due diligence was conducted.<sup>11</sup> No significant or potentially significant risks were identified. Tax integrity due diligence was not required as the transaction does not involve intermediate jurisdictions or material related-party transactions.<sup>12</sup> As noted, ZFL is a wholly owned subsidiary of the GRCB, one of the leading rural commercial banks in the PRC and was founded in 1951. As of YE2017, the GRCB ranked 216th among all commercial banks in the world and fourth among all rural commercial banks in the PRC in terms of core tier 1 capital. It had total assets of CNY735.7 billion and a nonperforming loan ratio of 1.51% as of December 2017, well below the industry average of 2.95%. The GRCB was listed on the Hong Kong Stock Exchange on 20 June 2017 and is rated as *Baa2* by Moody's. The GRCB has a diversified shareholder structure. Its largest beneficial owner is the Guangzhou municipal government, which holds 18.32% of GRCB shares through 14 state-owned enterprises. The remaining shareholders are mainly private sector entities and individual investors. There are no other shareholders directly or indirectly holding more than a 5% stake in the GRCB.

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## III. THE PROPOSED ADB ASSISTANCE

### A. The Assistance

9. ADB will provide a senior secured loan of up to \$60 million (or yuan equivalent) with tenor of up to 5 years. The ADB loan will fund lease finance to SMEs located in the underdeveloped central and western regions of the PRC.

### B. Implementation Arrangements

10. **Use of proceeds.** ZFL will use the proceeds of the ADB debt financing to fund lease contracts with SMEs located in central and western regions of the PRC. The SMEs are defined per current policy and regulation promulgated by the government.<sup>13</sup> Similarly, the central and western regions are defined as per current government policy.<sup>14</sup>

<sup>11</sup> ADB. 2003. *Enhancing the Asian Development Bank's Role in Combating Money Laundering and the Financing of Terrorism*. Manila.

<sup>12</sup> ADB. 2016. *Anticorruption Policy: Enhancing the Role of the Asian Development Bank in Relation to Tax Integrity*. Manila.

<sup>13</sup> In 2011, the Ministry of Industry and Information Technology and three other government ministries promulgated *The Notice on Issuing the Provisions on Criteria for Classifying Small and Medium-sized Enterprises*, which is used by the CBRC for measuring and monitoring SME finance performance of financial institutions.

<sup>14</sup> Central and western regions are defined as provinces listed in the latest *Central and Western Regions Priority Industries for Foreign Investors*, promulgated by the National Development and Reform Commission and the Ministry of Commerce.

11. **Monitoring.** Monitoring of the project will be carried out by ADB over the life of the project. ZFL will provide ADB with financial and other reports at predetermined regular intervals and as requested. These reports will include (i) semiannual unaudited financial statements, (ii) annual audited financial statements, (iii) annual reporting of the SME lease portfolio financed under the ADB loan, (iv) annual reports on selected development indicators agreed upon between ADB and ZFL, and (v) an annual social and environmental performance report on safeguards and social protection compliance.

12. **Evaluation.** ADB's Private Sector Operations Department will prepare and submit monitoring reports at least annually. The first report will be submitted no later than 12 months after the first disbursement.

### C. Value Added by ADB Assistance

13. **Provide access to longer tenor debt in support of small and medium-sized enterprises.** The ADB 5-year loan will provide critically needed longer tenor funding to SMEs in underdeveloped regions of the PRC, which face significant barriers in accessing finance. Leasing is a modality particularly suited for financing SMEs, which typically lack collateral required by commercial banks. The ADB loan will improve SMEs' access to longer term lease finance in the target regions, thus broadly contributing to economic development and poverty alleviation.

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14. **Enhance ZFL's environmental and social safeguard capacity.** ADB will be the first international finance institution to provide any financing to ZFL. As a condition precedent for disbursement, the company will be required to establish an environmental and social management system (ESMS) that meets the requirements of ADB's Safeguard Policy Statement (2009). ADB will continue to work with the company throughout the period of ADB investment to enhance the safeguard capacity of the company and support the company's adherence to high safeguard standards and promote gender-inclusive measures in its operations.

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## IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

### A. Development Impacts, Outcome, and Output

15. **Impacts.** The project is aligned with the following impacts:

- (i) **Improved access to lease finance for micro, small, and medium-sized enterprises and agribusiness companies through financial leasing.** Despite the importance of SMEs in job creation and output generation, SMEs still face significant barriers to accessing credit from financial institutions. This project will promote access to finance for SMEs, thereby contributing to economic development. By targeting SMEs located in underdeveloped central and western regions, the project will contribute to inclusive growth of the PRC economy and help reduce regional disparity.
- (ii) **Developed financial leasing industry.** By providing longer tenor finance to a young leasing company and introducing international best practice in safeguards, the project will support the development of the financial lease industry. Despite

rapid growth since 2008, the PRC's financial leasing industry is still underdeveloped, with a leasing penetration rate that is below that in other developed markets. The current project extends ADB's support to the leasing industry beyond the top tier leasing companies previously financed by ADB.

16. **Outcome.** The project will have the following outcome: enhanced sustainability of ZFL's lease financing capacity to SMEs.

17. **Output.** The output will be an increase in ZFL's lease financing capacity to SMEs, particularly those located in underdeveloped regions.

## **B. Alignment with ADB Strategy and Operations**

18. **Consistency with ADB strategy and country strategy.** The project supports four priorities identified by ADB's Midterm Review of Strategy 2020: (i) poverty reduction and inclusive economic growth, (ii) environment and climate change, (iii) middle-income countries, and (iv) private sector development and operations.<sup>15</sup> ADB's Midterm Review of Strategy 2020 highlights ADB's focus on reducing vulnerability and inequality and promoting inclusive growth in middle-income countries. It is consistent with ADB's country partnership strategy, 2016–2020 for the PRC, which prioritizes supporting inclusive economic growth, reducing poverty and inequality, and promoting private sector development through improving access to finance.<sup>16</sup>

19. **Consistency with sector strategy and relevant ADB operations.** The project is aligned with the Review of ADB's 2011 Financial Sector Operational Plan, which notes that ADB will support enhanced financial inclusion of the traditionally underserved, such as SMEs.<sup>17</sup> The finance sector operational plan review also called for increased support to leasing and other finance subsectors such as credit guarantee and factoring, which supplement the commercial banks and play an important role in improving SMEs' access to finance. ADB's enhanced poverty reduction strategy also states that ADB seeks to promote sound and efficient financial markets to improve access to finance and achieve pro-poor growth.<sup>18</sup> As noted, the project builds on previous ADB support to the leasing industry in the PRC.

## **V. POLICY COMPLIANCE**

### **A. Safeguards and Social Dimensions**

20. The loan is classified category FI for impacts on the environment, involuntary resettlement, and indigenous peoples. ZFL's existing and likely future portfolios, which are mostly in the SME subsector with a strong focus on agriculture, health, education, tourism, clean energy, and environmental protection; its corresponding environment and social risks and impacts; and its commitment and capacity for environmental and social management have been assessed. The majority of ZFL's business activities have no or minimal adverse environmental impacts, and are unlikely to impact involuntary resettlement or indigenous peoples. ZFL has committed to establish an appropriate ESMS satisfactory to ADB prior to first disbursement and appoint designated staff

<sup>15</sup> ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

<sup>16</sup> ADB. 2016. *Country Partnership Strategy: Transforming Partnership: People's Republic of China and Asian Development Bank, 2016–2020*. Manila.

<sup>17</sup> ADB. 2017. *Review of ADB's 2011 Financial Sector Operational Plan*. Manila.

<sup>18</sup> ADB. 2004. *Enhancing the Fight against Poverty in Asia and the Pacific: The Poverty Reduction Strategy of the Asian Development Bank*. Manila.

responsible for the implementation of the ESMS, and provide appropriate staff training. The ESMS will include procedures to screen and categorize transactions, and exclude those having significant impacts (category A) on environmental and social impacts and on indigenous peoples from ADB finance. ZFL will also apply ADB's prohibited investment activities list, ensure that investments abide by applicable national laws and regulations, and comply with ADB's Safeguard Policy Statement.<sup>19</sup>

21. ZFL will comply with national labor laws and, pursuant to ADB's Social Protection Strategy (2001), will take measures to comply with the internationally recognized core labor standards. ZFL will report regularly to ADB on (i) its compliance with such laws, and (ii) the measures taken. The investment is categorized as having some gender elements and ZFL has set targets to incorporate gender measures into its operations.

## **B. Anticorruption Policy**

22. ZFL was advised of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, and remedies for ADB in the event of noncompliance.

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## **C. Assurances**

23. Consistent with the Agreement Establishing the Asian Development Bank (the Charter),<sup>20</sup> ADB will proceed with the proposed assistance upon establishing that the Government of the PRC has no objection to the proposed assistance to ZFL. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the ADB Board of Directors.

## **VI. RECOMMENDATION**

24. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of up to \$60,000,000 (or its yuan equivalent) from ADB's ordinary capital resources to Zhujiang Financial Leasing Company Limited for the Small and Medium-Sized Enterprises Finance in Underdeveloped Regions Project in the People's Republic of China, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Takehiko Nakao  
President

7 July 2018

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<sup>19</sup> Summary Poverty Reduction and Social Strategy; Safeguards and Social Dimensions Summary; Financial Intermediary: Environmental and Social Management System Arrangement (accessible from the list of linked documents in Appendix 2).

<sup>20</sup> ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

## DESIGN AND MONITORING FRAMEWORK

<b>Impacts the Project is Aligned With</b>			
Access to lease finance by micro, small, and medium-sized enterprises and agribusiness companies through financial leasing improved (Government of the PRC, 2015) <sup>a</sup> Financial leasing industry developed (Government of the PRC, 2015) <sup>b</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Outcome</b>  Sustainability of ZFL's lease financing capacity to SMEs enhanced	<b>CONFIDENTIAL INFORMATION DELETED</b>	a.–e. ZFL annual development effectiveness monitoring reports	Demand for SME finance not as strong as expected  ZFL asset quality deteriorates
<b>Output</b>  ZFL's lease financing capacity to SMEs increased, particularly to those located in underdeveloped regions	<b>CONFIDENTIAL INFORMATION DELETED</b>	a.–d. ZFL annual development effectiveness monitoring reports	Demand for SME finance not as strong as expected
<b>Key Activities with Milestones</b> <b>ZFL's lease financing capacity to SMEs increased</b> 1.1 Execute the investment documents by Q4 2018. 1.2 Establish environmental and social management system by Q4 2018. 1.3 Disburse loan by Q1 2019.			
<b>Input</b> Asian Development Bank: Up to \$60,000,000 (or its yuan equivalent) (loan)			
<b>Assumptions for Partner Financing</b> Not applicable			

ESMS = Environmental and Social Management System, PRC = People's Republic of China, Q = quarter, SMEs = small and medium-sized enterprises, ZFL = Zhujiang Financial Leasing Company Limited.

<sup>a</sup> Government of the PRC. 2015. *Plans on Promoting Inclusive Finance Development (2016–2020)*. Beijing.

<sup>b</sup> Government of the PRC. 2015. *State Council Guiding Opinions on Healthy Development of the Financial Leasing Industry*. Beijing.

Source: Asian Development Bank.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=52150-001-4>

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1. Contribution to the ADB Results Framework
2. Country Economic Indicators