

# Research on the financing problem of private lending of small and medium-sized enterprises in Yulin city

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**Abstract:** In the process of China's economic development, small and medium-sized enterprises, as an important part of China's national economy, play an important role in promoting the rapid growth of the national economy, absorbing labor and employment, and building a harmonious society. Affected by the economic downturn since 2013, Yulin City, as the national energy and chemical industry base, has experienced a sharp drop in the prices of its pillar products, coal and oil. The economic situation of small and medium-sized enterprises in Yulin has become increasingly difficult, the credit system has been damaged, private debt has defaulted, and the non-performing rate of financial assets has continued to rise [2]. However, the rapid development of private lending, including direct lending, enterprise fund-raising - stock collection, capital intermediary, has the characteristics of rich funds, flexible and fast, to a certain extent, alleviate the financing difficulties of small and medium-sized enterprises. In this paper, the author chooses the private loans for small and medium-sized enterprises in Yulin city as the entry point, puts forward the current situation of private loans for small and medium-sized enterprises in Yulin City, and then puts forward the relevant problems. Finally, the author summarizes the countermeasures of private loans financing for small and medium-sized enterprises in Yulin City, and makes theoretical supplement for the development of private loans in China.

**Keywords:** Small and medium-sized enterprises; Private loans; Financing

## 1. Introduction

### 1.1 Research Background

Small and medium-sized enterprises (SMEs) play an irreplaceable role in promoting China's rapid economic development, enhancing employment opportunities for workers, and fostering harmonious development. Since the reforms, the rapid growth of SMEs has made them a major force in China's economic development [3]. They play a crucial role in expanding economic scale, transforming the mode of economic growth, and optimizing the industrial structure, despite facing significant challenges. However, due to various reasons, particularly the economic downturn since 2013, many SMEs have struggled with operations [4]. In Yulin, a national energy and chemical base, the sharp decline in coal and oil prices has had an even greater impact on local SMEs. The credit system has been severely damaged, private debt defaults have become concentrated, and the non-performing loan rate of financial assets has continued to rise [5].

Currently, private lending in China has a substantial volume, including direct lending, corporate financing, private equity funds, financial intermediaries, underground banks, and microloans. Private lending refers to various economic activities conducted outside government regulation. It is characterized by large financing scales, high liquidity, and rapid speed [6].

In recent years, private lending in Yulin has developed rapidly. While it has significantly alleviated the funding difficulties of Chinese SMEs and become a major channel for the development of the private economy, it has also brought numerous drawbacks. These include the prevalence of usury or high-interest financing, leading SMEs into a vicious cycle of debt, severely disrupting China's economic and financial markets, and posing great risks and social hazards [7].

### 1.2 Research Objectives and Significance

This study takes Yulin City as a case example. Despite the rapid development of private lending in

Yulin in recent years, which has alleviated the financing difficulties of SMEs to some extent, it has also brought about significant risks [8]. These risks include inflating asset and mineral resource prices, fostering illegal financing, and increasing the financing costs for SMEs.

Therefore, I believe it is essential to develop appropriate preventive measures based on the current issues and hazards associated with private lending for SMEs in Yulin City. These measures should aim to promote the healthy development of SMEs and the overall growth of the economic and financial sectors [9].

### **1.3 Literature Review**

Dai Chuyu (2020) indicated that in recent years, China has vigorously supported the development of SMEs, and private lending has become a key financing method to address the loan difficulties of small and micro enterprises [1]. According to statistics, private lending accounts for more than 50% of SME financing. Due to the lack of effective supervision systems, management models, and security systems, the financial system contains significant instability factors.

Wang Hai's (2019) research showed that private lending increases the capital costs of SMEs. The profit-seeking nature of capital results in higher costs for private financing compared to formal financing, thereby increasing the operational pressure on SMEs [10]. This can lead to bankruptcy crises and rapid restructuring of industrial structures, which is detrimental to the healthy development of the overall economy.

Ding Tao (2021) summarized the difficulties of SME financing and the risks of private lending, suggesting that regulatory authorities should be strengthened [2]. This includes legally standardizing the methods and qualifications of private financing and conducting relevant activities. Alternatively, establishing a specialized entity to regulate private lending should be considered. This would involve controlling behaviors through qualification certification to prevent potential risks.

In summary, the analysis of the current state of private lending for SMEs in Yulin City is mainly derived from data obtained through the local financial bureau, historical literature, and surveys. Some scholars have relied solely on historical literature or single-county surveys to obtain useful data, which may result in time-lagged or non-universal conclusions, thereby making the proposed countermeasures or conclusions detached from reality. I will focus on the specific region of Yulin City, narrowing the research scope. By drawing on methods used by domestic and international scholars, I will conduct a targeted analysis of the current state and issues of private lending for SMEs in Yulin City and propose solutions and recommendations suitable for the development challenges of private lending in Yulin.

## **2. Current Status of Private Lending for SMEs in Yulin City**

### **2.1 Scale of Private Lending for SMEs**

#### **2.1.1 Large Scale of Lending Funds**

In recent years, due to the economic downturn, SMEs in Yulin City have faced severe challenges. The market competition for their products has intensified, and SMEs are under increasing sales pressure. A large amount of working capital is tied up in the production process, accounts receivable have increased, and a significant amount of funds is tied up in inventory. Consequently, the demand for capital by these enterprises is growing.

According to a survey conducted at the 2018 Shaanxi Non-State-Owned Economy Forum, more than 80% of enterprises in Yulin City have financing needs, with total demand reaching 2.35 billion yuan. However, as the banking system in China primarily serves large corporations, state-owned and commercial banks in Yulin City provide limited support to SMEs. As a result, private lending organizations, microfinance companies, and pawnshops have become important financing channels for SMEs, providing some relief.

The scale of lending and the number of participants in Yulin City's lending market indicate that it is quite active and large. According to estimates by the Yulin branch of the People's Bank of China, the current private financing funds in Yulin City range between 70 billion and 90 billion yuan. This figure has risen rapidly in the few decades since the large-scale development of coal in the new century. Official data from the Yulin City Financial Office reveals that as of December 2019, there were 268 financial institutions in Yulin City that had been approved by relevant departments. These include microfinance

companies, guarantee companies, and pawnshops, with a total registered capital of nearly 40 billion yuan (see Table 1). This demonstrates the diversified nature of private lending entities in Yulin City and the relatively large scale of lending.

*Table 1: Table of registered capital of Non-governmental lending organizations in Yulin City*

| Financing Service Companies | Quantity | Registered Capital (Billion Yuan) |
|-----------------------------|----------|-----------------------------------|
| Microfinance Companies      | 107      | 202.9                             |
| Guarantee Companies         | 68       | 91                                |
| Pawnshops                   | 33       | 63.1                              |
| Others                      | 60       | 43                                |
| Total                       | 268      | 400                               |

### **2.1.2 Large Number of Lending Institutions**

As of March 2020, the Yulin City Administration for Industry and Commerce had registered over 500 investment companies, more than 300 investment guarantee companies, and over 50 pawnshops, totaling more than 900 companies. In addition, approximately 600 microfinance companies have been approved, covering all 95 areas within Yulin City, Shaanxi Province. In the Yulin region, low-threshold microfinance companies, pawnshops, and investment guarantee companies are widespread.

## **2.2 Characteristics of Private Lending for SMEs**

### **2.2.1 Simple Lending Procedures**

In the actual practice of private lending, most investors find investment channels through introductions by relatives or friends. As qualified investors, they generally lack awareness of risk prevention. Most investors believe that investment channels introduced or guaranteed by acquaintances are relatively safe and secure, with lower investment risks. Consequently, in practice, these investment channels often involve informal procedures such as issuing IOUs or making verbal agreements, with the entire lending process completed with just a simple note. There are no legally binding contracts between investors and institutions, relying instead on familial or friendly relationships to facilitate private lending. The convenience of such lending practices is evident.

### **2.2.2 High Interest Rates and Short Terms**

According to a survey on private credit conditions in Yulin City, it was found that even with guarantees, the annual interest rates for private loans generally remain at around 12%. In stark contrast, some private financial institutions charge annual interest rates that can rise to 30% or even 40%. While the average interest rate for private lending is typically around 20%, this is still significantly higher than the loan rates offered by banks during the same period. Consequently, the financing costs in the Yulin region are relatively high, and the agreements on loan interest rates tend to be somewhat arbitrary.

### **2.2.3 Concentration of Lending Funds in High-Profit Industries**

In the context of substantial asset holdings, addressing inflation and preserving the value of assets becomes an urgent issue. For those lacking cultural and financial knowledge, the 20% to 30% interest from personal loans far exceeds the average 15% to 25% profits from the real economy. Consequently, a large amount of private capital has flowed into "capital pools" like coal and real estate—industries that can yield substantial profits in a short time. When capital flows into a particular industry or region, it can cause "overheating" in that area or sector.

Ideally, private loan interest rates being higher than actual rates represent a significant risk. However, with the rapid development of the real economy, the private lending market has naturally emerged. When idle returns exceed those of the real economy, despite being associated with usury and high risk, people's "rationality" is often overshadowed by greed, ignoring objective development laws. As a result, a significant amount of private capital in the Yulin region has been invested in high-profit, short-term industries such as coal and real estate.

### **3. Issues in Private Lending Financing for SMEs in Yulin City**

#### ***3.1 Incomplete Legal and Regulatory System***

In China's private lending market, the legal and regulatory system related to SME private lending financing is not yet fully developed. There is a lack of specific laws dedicated to private lending, and relevant legal provisions are scattered across various regulations, making them relatively few, unsystematic, and incomplete. This fragmentation can easily lead to conflicts of interest in society. For instance, according to the "Measures for the Banning of Illegal Financial Institutions and Illegal Financial Business Activities," individuals are prohibited from engaging in financial business or establishing financial institutions without the approval of the People's Bank of China. However, the "Guiding Opinions on Several Issues Concerning the Trial of Private Lending Dispute Cases" stipulates that the interest rate for private lending should not exceed four times the benchmark lending rate set by the People's Bank of China for the same period. Any portion exceeding this rate is generally not protected by law.

This discrepancy highlights the inconsistencies within the legal framework. When adjudicating related cases, different regulations can lead to varying outcomes, resulting in differences in emphasis and inconsistencies in rulings. This impacts the level and authority of judicial practice enforcement, reducing the persuasive power of outcomes in private lending-related cases. Consequently, this inconsistency hinders the improvement of private lending regulatory standards and the establishment of a normative and orderly private lending system.

#### ***3.2 Susceptibility to Credit Issues***

In the private lending market, intermediary institutions are not clearly regulated by law, and private lending organizations do not require relevant business licenses, lacking supervision. Even though laws stipulate "no compound interest, no interest exceeding four times the benchmark rate, and no fundraising," intermediaries, acting between lenders and borrowers, can easily lend lenders' funds to borrowers arbitrarily. Lenders may not have accurate and detailed information about the borrowers and the flow of funds.

The most significant issue is the absence of direct loan contracts between borrowers and lenders, leading to information asymmetry. This situation allows intermediaries to charge upfront fees while delaying the repayment of funds, sometimes without explaining the deduction of these fees or their purpose to the borrowers. Since there is no clear regulatory body overseeing private lending in China, this lack of oversight can easily lead to credit problems, affecting the normal operation of the financial system.

#### ***3.3 High Costs of Private Lending***

In the private lending market, due to the uncertainty of securing returns on investment and the lack of formal legal protection, borrowers generally struggle to earn the trust of lenders. Consequently, many prioritize immediate, short-term gains, leading to relatively rational but short-sighted lending behaviors. In practice, if a borrower cannot repay on time, they may fall into a vicious cycle of borrowing, such as taking "new loans to pay old debts." In many lending markets, participants may repay bank loans through microfinance companies and then take new bank loans to repay these "bridge" loans from microfinance companies. However, this process carries significant financial risks compared to other financing channels. Should systemic risks arise, formal banking sector's financing channels may also be impacted by the risks inherent in the private lending market, destabilizing the entire financial system and leading to significant capital issues. In such situations, interest rates on private loans typically continue to rise. There are instances of high interest rates and usury in private lending. Since there is no clear legal definition of usury in China, many consider private loans with interest rates exceeding the legal maximum as usury.

However, current private lending faces the issue of high interest rates. According to statistics, the monthly private lending rate is 38% higher than the three-month and six-month rates, with annual rates reaching up to 40%. In comparison, the annual interest rate for guaranteed loans in banks is 41%, for microcredit companies it is 33%, and for mortgage banks, it ranges from 30% to 40%. This indicates that while private financing offers convenience to investors, it also invisibly increases the costs for financial institutions.

The duration of private loans is influenced by the supply and demand of funds. The length of

financing not only depends on the borrower's capital needs but also on the lender's expectations of the borrower's future repayment ability. Generally, private financing terms are within one year. Data shows that 89.7% of private enterprise loans in China are within one year, and 39.6% are within six months, indicating limited long-term financing options.

### ***3.4 Concentration of Financing and Capital Flows in Private Lending***

In Yulin City's private lending market, there are issues of concentrated financing and capital flows. Compared to other cities, Yulin has relatively abundant natural resources, and its economic development largely depends on the exploitation of these resources. In recent years, the rise of the coal industry in Yulin has led to rapid economic growth. Private enterprises contribute 37% of the GDP, playing a significant role in local economic development and accumulating substantial private capital for Yulin. As of the end of December 2021, the balance of RMB deposits in Yulin City's financial institutions was 554.452 billion yuan, an increase of 19.6% compared to 2020, with an average annual growth of 15.3% over two years. The balance of RMB loans was 258.459 billion yuan, up 11.45% from 2020, accounting for 48% of the city's total loans. This indicates a rapid accumulation of private surplus capital and an increase in disposable personal capital in Yulin.

In this context, people are eager to preserve their capital amid inflation and economic downturns caused by factors such as the pandemic, or to achieve capital appreciation. However, due to a lack of basic financial knowledge and understanding of investment tools, people often blindly follow investment trends. Investigations reveal that the main funds in Yulin's private lending market flow into the real estate and coal industries. As the economy continues to develop, driven by speculative and profit-seeking behaviors, funds typically flow back into high-profit sectors like the coal and real estate industries.

This creates a vicious cycle in capital circulation, where the real economy fails to receive adequate funding from the lending market, leading to insufficient development of the real economy. Consequently, the industrial structure becomes relatively single, and the industrial chain is insufficiently developed, resulting in unbalanced overall economic development in Yulin City.

## **4. Measures to Address the Private Lending Crisis for SMEs in Yulin City**

### ***4.1 Improve the Relevant Laws and Regulations for Private Finance***

#### ***4.1.1 Improve and Regulate Private Lending***

Given the imperfections in China's laws and regulations on private lending, this issue must be fundamentally addressed. To improve the laws and regulations related to private finance, the first step is to introduce specific private lending legislation. This will enhance the focus and effectiveness of China's regulation of private lending. Judicial authorities and relevant departments should formulate these laws and regulations based on actual conditions, examining public sentiment, observing the private lending market, identifying the issues, and creating targeted and relevant laws and regulations.

#### ***4.1.2 Implement Legal and Regulatory Pilots***

By implementing pilot legal and regulatory measures, we can observe their effects, summarize the issues arising from practical application, and make further improvements. This approach helps avoid discrepancies between theory and practice and results in comprehensive, practical, and operational laws and regulations.

We need to improve our country's relevant laws and regulations. This involves clarifying the legal attributes, specifying applicable principles and provisions, and providing strong legal protection for SME private loan financing. On this basis, we should legislatively define illegal fundraising, distinguishing it from private financing, and guide private lending toward regularized and procedural paths.

Additionally, we must continue to improve the existing financial regulatory system. Using legislative measures, we should guide, expand, standardize, and regulate the sources and channels of funding for small and medium-sized enterprises. This will achieve the goal of regulating SME private loan financing. China's relevant laws and regulations need to be refined. By clarifying the legal nature, specific applicable principles, and provisions, we can provide strong legal protection for SME private loan financing. Furthermore, we should legislatively define illegal fundraising, distinguishing it from private financing, and guide private lending toward regularized procedures. Finally, we should continue to enhance the existing financial regulatory system, guiding, expanding, standardizing, and supervising the

sources and channels of funding for SMEs.

#### ***4.2 Establish a Credit Mechanism and Strengthen Regulatory Efforts***

##### ***4.2.1 Clarify the Regulatory Authority for Private Lending***

Establish relevant credit mechanisms and improve financial regulatory institutions. The state should establish specialized financial institutions for private lending, clarify the operational standards and related operational models of private lending, and provide institutional guarantees for private lending to a certain extent.

The state should set up specialized financial institutions for private financing, clarify the operational standards and related operational models for private financing, and provide institutional guarantees for private financing. Clarify the regulatory authority for private lending. There should be relevant laws and regulations to standardize private lending intermediaries, including the lending entities, interest rate ranges, information disclosure between the lending parties, and the allocation of funds.

Adopt flexible regulatory methods for the credit mechanism. Locally, a private lending transaction management department should be established to register and record private lending intermediary institutions. This will alleviate the disorder in the private financial order to a certain extent and promote the orderly conduct of private financial activities.

##### ***4.2.2 Strengthen the Punishment System for Credit Violations***

Currently, the issue of credit deficiency in Yulin City is quite prominent. A system for identifying credit violations, a legal system for dealing with breaches of contract, a punishment system, an information disclosure system, and a compensation system should be established based on the current credit status and standards. Additionally, efforts to combat illegal financing and financial fraud should be intensified, and public awareness campaigns should be increased to enhance the protection of citizens' legal and personal rights.

As the market economy develops, the vitality of SMEs continues to grow, highlighting their increasing role in boosting the national economy. They have gradually become a major force in the country's economic development. To ensure the health and stability of our financial market, it is essential to monitor financial risks from several aspects. This supervision should cover various types of financial intermediaries, such as investment companies, guarantee companies, and financial firms. Strengthening the regulation of these entities through the effective collaboration of relevant departments such as the China Banking and Insurance Regulatory Commission (CBIRC) and the China Securities Regulatory Commission (CSRC) is crucial. By implementing an admission system and strictly cracking down on illegal fundraising activities conducted through legitimate platforms, we can create a favorable financial market environment for the development of SMEs.

It is also important to emphasize the operational management work of various institutions. Focus on regulating the operations of different types of financial intermediaries, promptly investigate and address illegal activities, and eliminate illegal fundraising from the source. This will prevent private lending, a crucial financing channel for SMEs, from becoming a hotbed for illegal fundraising and usurious practices.

#### ***4.3 Regulating the Development of Private Finance***

##### ***4.3.1 Strengthening the Development of SMEs and Broadening Their Financing Channels***

Emphasis should be placed on the development of enterprises themselves, enhancing their comprehensive capabilities, and improving their development mechanisms. With development as the goal and optimizing operations as an important guiding principle, enterprises should enhance their credibility and raise idle capital to improve their operational mechanisms and management systems. By leveraging their own comprehensive capabilities and economic strength, companies can earn the trust of banks. At the same time, companies can standardize their financial management and accounting systems to provide true and comprehensive financial reports that reflect the company's production and operational status. Enterprise management should understand and master basic financing knowledge and be familiar with loan-related processes to increase the success rate of loans. Secondly, ensuring the quality of the products produced by the enterprise and improving production and operational efficiency are crucial. I believe that the survival and development of SMEs depend on their products and marketing. Therefore, companies must promote development through technology and innovation, and pursue a path of

specialization and innovation with high-quality new products. Additionally, companies should improve internal systems, strengthen internal governance, reduce production costs, and improve operational efficiency.

Thirdly, SMEs should expand their financing channels. Internally, they can adopt a shareholding system model. Huawei is a successful example in this regard. Huawei has increased employee enthusiasm, their sense of belonging, and cohesion. This shareholding system model not only improves employee efficiency but also properly guides the flow of private capital. Externally, enterprises can vigorously develop external investments to seek alliances with strong partners. Fourthly, enterprises should timely understand and grasp various policies and make full use of the funding support provided by governments at all levels. After the financial crisis, China has implemented a series of policies to help SMEs solve funding difficulties, and we should make good use of them.

Enterprises should strengthen financial management, establish a correct sense of integrity, build a sound financial management system, and enhance the transparency and authenticity of financial management work. They should also fully utilize the credit resources obtained from banks, establish a good reputation, and increase their understanding of SME financing and private lending. In the process of financing and private lending, enterprises should plan based on their credit levels, enhance their standards, and continuously expand their funding sources by forming partnerships with banks in development and loans. By continuously improving their development levels, they can also have the courage to adopt changes and utilize technological innovation to achieve breakthroughs in financing and loans despite the shortage of available capital.

#### ***4.3.2 Regulating Private Lending Interest Rates and Guiding the Healthy Development of Private Finance***

Currently, China does not have explicit regulations regarding the interest rates on private lending, leading to high-interest rates in the private lending market. For example, many people in China believe that if there are no explicit provisions on loan interest rates, the loan does not need to accrue interest. The "Contract Law" also clearly states that if the relevant interest rate is not specified by natural persons during the loan period, the loan will not accrue interest. However, the "Opinions of the Supreme People's Court on Several Issues Concerning the Implementation of the General Principles of the Civil Law of the People's Republic of China" indicate that if the interest is not explicitly stipulated in the written IOU, it can be calculated according to the bank's loan interest rate for the same period. This indicates that there are contradictions in the relevant legal provisions regarding private lending.

To thoroughly resolve issues such as usury and high-interest fund-raising, it is essential to fundamentally address these issues by formulating comprehensive legal policies. Specific and clear legal provisions should be established to limit the range of interest rates and specify standardized IOU formats. Such measures will help make private lending more standardized and scientific from a legal perspective. This will play a regulatory and decisive role in guiding the future development of private lending, providing an important financing channel for SMEs, and contributing to the stable development of the financial market.

## **5. Conclusion**

Due to the excessive concentration of private lending equity financing and related capital flows in Yulin, the main source of economic development is resource exploitation, given the city's rich natural resources. However, limited resources cannot sustain long-term development and cannot drive the comprehensive economic growth of Yulin. There is an asymmetry between the supply of private lending and the demand for working capital in Yulin. The limited capital provided by formal financing channels and the substantial market demand contribute to the high interest rates in the private lending market. Therefore, reform is urgently needed.

Efforts should be made to explore and develop non-resource-based industries, strengthen supply chain management, and deepen the industrial chain rather than simply focusing on resource extraction and sales. At the government level, advanced industrial equipment and high-tech innovations should be introduced to lead industrial development and promote the economic transformation of Yulin City.

Yulin City should adopt innovative development strategies by guiding the market through government initiatives and implementing relevant welfare policies to stimulate market vitality. This includes vigorously promoting the tertiary industry in Yulin, such as the service industry, transportation, wholesale, and retail sectors. By introducing skilled technical personnel and attracting investment, the city can

invigorate its market.

Following the directives of the 19th National Congress report, Yulin should focus on developing the real economy and advancing the construction of a modern economic system. The city should emphasize the development of the real economy by enhancing innovation efforts, integrating modern scientific and technological achievements, artificial intelligence, big data, and the modern economy to promote in-depth development.

Introducing advanced equipment and promoting the reform and innovation of production and management models are crucial. Yulin should actively incorporate advanced scientific technology and equipment to drive the reform and innovation of traditional industries. Simultaneously, the government should formulate favorable policies and create a conducive business environment to promote the deep reform and development of the real economy. For example, government-led initiatives in Yulin should encourage independent entrepreneurship through support programs, fostering creativity and innovation. Additionally, the government can actively attract other investments and businesses, creating more investment channels to achieve mutual benefits.

Monetary authorities should strengthen credit support for highly managed enterprises and products with market potential in line with national development policies, implementing policies that support SMEs.

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