The First Rural Mutual Financial Cooperative in China

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Abstract This paper introduces the emerging background, process and management status of the first rural mutual financial cooperative in China. It also discusses the existing problems and possible problems in future development of the mutual financial cooperative.

Key words Mutual financial cooperative; System; Rural cooperative finance, China

Development of agriculture and the improvement of peasant’s living standard are restricted by the financial problems in China. And the result of rural financial reform is still not significant at present. According to the investigation, only about 27% of the peasants’ loan comes from normal channel; and the rest are mostly from folk debit and credit. Formal cooperative financial institution in rural areas has been in the decline; and new cooperative financial institution is emerging. After the establishment of the first rural mutual financial cooperative in Lishu County of Jilin Province, this new mutual fund template has been promoted all through China. Establishment of mutual financial cooperatives in different areas will have an important impact on the rural financial reform and the entire rural economy in China.

Yanjia Mutual Financial Cooperative, the first rural mutual financial cooperative in China, is the most representative. Related researches are carried out in this paper according to the investigations on Yanjia Mutual Financial Cooperative and other cooperative in the years 2006 and 2007.

1 Emergence of Yanjia mutual financial cooperative

Mutual Financial Cooperative of Yanjia Village (Mutual Financial Cooperative for short) in Lishu Town of Jilin Province offers serves of basic financial business for stock holders with capital stock as the capital fund. It is approved officially by the China Banking Regulatory Commission on March 2007. In fact, eight peasant households had spontaneously formed a Yanjia Peasant Cooperative (Production Cooperative for short) as early as the year 2003 with the main business of cooperative buying and selling, and production cooperation. After two years’ operation, this Production Cooperative is basically at a standstill due to service capacity, management, funds and other problems. However, the two years’ operation has enhanced the peasants’ sense of cooperation. Moreover, Production Cooperative has offered organizational basis for the emergence of Mutual Financial Cooperative.

Certain economic conditions are needed for the establishment of Mutual Financial Cooperative. Yanjia Village is located in the major grain-producing areas with corn as its main crop and live pig as its main livestock. There are 684 households and 2,290 population in Yanjia Village. Its per capita arable land area is about 0.3 hm², but per capita net income of peasant is only 3,000 yuan. It is estimated that the total demand for loans in Yanjia Village reaches 680 × 10⁴ yuan in 2006. But the rural credit cooperatives only grants 300 × 10⁴ yuan. Thus, the financing gap of 380 × 10⁴ yuan can only be filled by informal credit and commercial credit sale. Without the intermediary organization, transaction costs and information costs are extremely high for individual peasant to enter the credit market. Therefore, regulating and developing new rural credit service organization have become the objective needs of peasants.

Thus, a new cooperative economic system comes into being in order to meet this need. Eight members of the original Production Cooperative voluntarily set up a Mutual Financial Cooperative in July 2004. Mutual financial system of this cooperative has simplified the complex process of informal credit, and made it more understandable and predictable. It also regulates the relationship among peasants, reduces the transaction costs of borrowing in certain range, and widens the channels of their borrowing. Compared with the rural credit cooperatives, it is easier for peasants to join the Mutual Financial Cooperative. Peasants can obtain corresponding rights as long as they buy a small amount of "qualification stock". Because there is investment leverage, members can require a loan several times higher than its capital loan under normal conditions. And the lending rate is determined by the collectivity according to market rates of interest, which is advantageous to the members. Compared with the rules of other credit, mutual financial system has significant advantages. Table 1 shows that peasants will choose mutual financial system after cost comparison under the premise of complete information and doubtless environment.

At the beginning of its establishment, the eight core members have mobilized 43 peasant households having blood relationship to enter the cooperative. They conduct self-employment and are trust in each other. When advocating the union of peasants, they also allow joint capital. Information symmetry during transaction process has obtained more transaction efficiency. In some cases, the motive for some members to join in the cooperative is for emergency. They immediately apply for
loan after the subscription of share. But after the transaction, they can not withdraw (but can transfer) the shares immediately due to the restriction of stockholding arrangement. However, the most members join the cooperative in order to cope with the uncertainty of future expenditure. They continue to subscribe for the investment shares, so that they can obtain more loans in future, because every one stock means a right to vote. As for the benefit distribution, this cooperative adopts the product dividend method. Product is the multiplication of the sum of share and the number of days keeping the share. Payment of dividends is calculated according to the product proportion. These different combinations of bundle of rights together determine the nature of this cooperative, that is a cooperative system with joint-stock factor. This property rights system is an inevitable choice under insufficient mutual fund supply. This ownership structure has a semi-closed nature, which is as follows: the exclusiveness of property rights can effectively prevent the "free ride" phenomenon of non-members; this cooperative adheres to the principle of autonomy, absorbs state funds, but does not allow state controlling; and big capital is restricted in order to ensure the relative proportionality of stock right.

<table>
<thead>
<tr>
<th>Channel</th>
<th>Fixed cost</th>
<th>Marginal cost</th>
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<tbody>
<tr>
<td>People-to-people usury</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Rural credit cooperative</td>
<td>Relatively high</td>
<td>Relatively high</td>
</tr>
<tr>
<td>Friends, relatives or credit</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Mutual financial cooperative</td>
<td>Relatively low</td>
<td>Relatively low</td>
</tr>
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</table>

Emergency of mutual financial system is a demand induced institutional change, which is organized and implemented by peasants spontaneously under the promotion of professionals. As system is a public goods, this new system is bound to run into the externality and "free-ride" problem. As early as the cooperative was first established, the initiators have taken the responsibility of the institutional change. Thus their apparent earnings are too small, which has weakened the driving force of the initiators. In order to realize the payment balance, initiators need to obtain the equivalent invisible benefits (value of non-wealth and so on) or to increase the significant income.

2 Operation status of Yanjia Mutual Financial Cooperative at Preparation period

This paper analyzes the operation status from the following aspects according to the accounting books of Yanjia Mutual Financial Cooperative from 2004 to 2006.

2.1 Financial status Total amount of mutual funds has increased year by year, but is still in short supply. Due to the restriction mechanism of capital (such as the restriction of the ratio of money loans to total equity capital), it generally provides short-term small loans less than 5,000 yuan. Credit worthiness of members is very high when there have been no bad debts and other losses. Members are able to pay off the loan early or on time, thus the capital risk ratio is zero with high security. Meanwhile, the asset-liability ratio is extremely low with small operation risk. Due to the function of risk control mechanism, amount of total risk assets is very small, so that the capital adequacy ratio becomes extremely high.

Only one liability is allowed and its amount is little. Deposit business is also not permitted at present, due to the lack of legal status of Mutual Financial Cooperative.

The total capital has increased year by year. But only one household subscribes for flow-through share. And the ending balance of this share is zero for three years, which has something to do with the income uncertainty and mobility of flow-through share at the preparation period of Yanjia Mutual Financial Cooperative. There is only one national public share, which comes from individual donation, indicating that government support is not enough.

2.2 Analysis of the cost There is no record of business cost in the book, but in fact it happens usually, the reason of which is that the expenditures of Mutual Financial Cooperative before the year 2005 are all in the account of original Production Cooperative. After 2005, initiators pay for all the expenditures due to business stagnation of the production cooperative, as well as the unsound financial system.

From the perspective of system operating costs, democratic management principle of the cooperative requires sufficient communication during collective decision-making. The cooperative has to pay more organizing and coordinating costs when facing with a large number of small households. Problem of asymmetric information happens during the process of cooperative expansion, which easily leads to acts of opportunism. Therefore, monitoring cost needs to be increased. Under the background of poor cooperation awareness of peasants and low professional quality, cooperative has to pay the cost of education. Although the member's transaction costs are saved, the cooperative is still a vulnerable organization, and has to pay higher transaction costs during market transactions. Most of these costs belong to implicit cost, which are undertaken voluntarily by the staff of the cooperation.

2.3 Result of operation Income of this cooperative only comes from interests over the past three years, which maintains stable. With the increase of business amount, the interest income increases year by year. Net profits in the book in these three years are 365.36, 1,249.1 and 4,289.4 yuan, respectively. Profits that could be allocated are very little in the first two years, so there is no distribution of dividends or extraction of surplus, and dividends received by household members are little in the early 2007. However, the main purpose for the peasants to join the cooperative is not to obtain the dividend, but to attain service. Meanwhile, the main purpose for the cooperative is not to obtain profit, but to offer more services for its members. Therefore, profit can not be regard as the main criteria to measure the operation status of a cooperative. And the service quantity, quality and ability of members should also be comprehensively assessed.

Table 2 shows that this cooperative is in stable development. With the increase in the number of mutual funds, member's service ability is also improved significantly, Cooperative only offers loans to peasants members, which has played a support role in agriculture. Most of the members have access to the services, and no one has dropped out of the cooperative.
yet. However, the channel of the source of mutual funds is single with limited amount. The total share capital in recent three years is only below 67 300 yuan with about 50 members. Therefore, the cooperative can only meet part of the most urgent financial needs of members; and closure in peak demand season is inevitable. It is estimated that the utilization rate of funds in the year 2006 is only 160%, and the cooperative can only offer 1/10 of total capital demand of members (50 households). Members are increasing slowly, and the mutual financial cooperative still needs to be developed.

Table 2 Summary of loan business of Yanjiang mutual financial cooperative in recent three years

<table>
<thead>
<tr>
<th>Year</th>
<th>Use of loan</th>
<th>Business quantity</th>
<th>Transaction amount yuan</th>
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<tbody>
<tr>
<td>2004</td>
<td>Agricultural production</td>
<td>3</td>
<td>6 200</td>
</tr>
<tr>
<td></td>
<td>Subsidiary production</td>
<td>5</td>
<td>13 800</td>
</tr>
<tr>
<td></td>
<td>Life</td>
<td>2</td>
<td>3600</td>
</tr>
<tr>
<td>2005</td>
<td>Agricultural production</td>
<td>6</td>
<td>9 900</td>
</tr>
<tr>
<td></td>
<td>Subsidiary production</td>
<td>10</td>
<td>28 000</td>
</tr>
<tr>
<td></td>
<td>Life</td>
<td>3</td>
<td>11 000</td>
</tr>
<tr>
<td>2006</td>
<td>Agricultural production</td>
<td>15</td>
<td>41 500</td>
</tr>
<tr>
<td></td>
<td>Subsidiary production</td>
<td>18</td>
<td>63 000</td>
</tr>
<tr>
<td></td>
<td>Life</td>
<td>4</td>
<td>14 000</td>
</tr>
</tbody>
</table>

After obtaining the financial license in March 2007, the number of mutual funds increases sharply with the rapid expansion of business. And peasants’ enthusiasm is greatly enhanced, which indicates that state support is a necessary condition for the establishment and development of Mutual Financial Cooperative.

3 Consideration on the development of mutual financial cooperative

Investigation on the actual situation of mutual finance in China shows that Yanjiang Mutual Financial Cooperative is in the leading position, and the mutual financial cooperatives in China are generally in the starting stage. Questions are existed, such as the relatively high establishment cost, ambiguous legal status, limited service ability, difficult expansion of the scale, and nonstandard financial performance.

3.1 Existing problems: (1) The initiators are responsible for the high cost of institutional innovation, which will easily lead to insufficient system supply. Therefore, government should impose a new system in order to mitigate or eliminate the imbalance of supply and demand system. We should consider the difficulty of weak organization, reduce the registration criteria of mutual financial cooperatives appropriately, and encourage them to establish cooperatives. A legal status of joint-stock cooperative enterprise should be given to Mutual Financial Cooperative; and the rights of abundant capital should be limited (especially the voting right) in order to prevent the variation of the nature of cooperation.

(2) Service capabilities and capital scale of mutual financial cooperative have run into a conflict dilemma. The small-scale capital leads to a lower service capacity. As a result, capital scale is hard to be enlarged. It is an inevitable phenomenon that the supply of mutual funds becomes insufficient due to the homogeneity of the funding needs of vulnerable households. This problem could only be solved by the support of abundant capital. Therefore, operating region of mutual financial cooperative should be enlarged appropriately in order to attract the urban capital. Meanwhile, the state should support the mutual financial cooperative from the aspects of finance, banking and so on.

(3) It becomes a problem to determine the sequence of loan under supply shortage of mutual funds. We can neither sort according to the amount of capital stock, nor achieve balance between supply and demand by the way of raising interest rates. Anyway, lending opportunities among members should be equal. Effective democratic consultation is needed in order to avoid rent-seeking behavior. The sequence can be determined according to the urgency.

(4) Professional quality of the accountants in mutual financial cooperative is generally low with nonstandard financial performance, which largely limits the development of cooperative. Professional training should be carried out as soon as possible; and the financial system should be improved in order to adapt to the requirements of business expansion. Thus, the state should develop specialized accounting system for mutual financial cooperative, and strengthen the guidance and supervision.

3.2 Possible future problems: With the enlargement of the scale of mutual financial cooperative, the transaction efficiency is gradually reduced and the transaction cost increases. Therefore, the scale of operative should be controlled in a certain critical point, which is a point that the transaction cost in the cooperative is equal to the cost of the same transaction in market.

Mutual financial cooperative has faced many risks during its development, which can be divided according to the causations. ① Management risk, which includes natural risk and market risk. ② Moral risk. With the enlargement of cooperative, the advantage of information symmetry is decreasing, and the opportunism may appear. ③ Liquidity risk. After business loans have been approved, the possibility that liquid assets can not meet the payments will increase. ④ Capital risk. Member’s withdrawal makes the cooperative in constant change. Especially after the expiration of the majority of equity capital, the instability of the organization is more serious.

In order to avoid or reduce the loss of risks, related measures should be adopted on time, such as establishing and improving the self-insurance of share and the joint guaranty of members, strictly limiting the credit loan, innovating the ways of mortgage guarantee, and carrying out risk insurance. At the same time, the cooperative should reduce the operating risk of member and cooperative, select someone to reduce bad assets, establish an open operating system, and regulate the supervision and management program; democratic management should be strengthened with the growth of cooperative in order to prevent internal control. It should also restrict assets by liabilities, ensure the symmetry of assets and liabilities in both scale and structure, control the capital adequacy ratio in order to deal with the capital risk, appropriately restrict the withdrawal conditions, and establish and perfect the capital constraint mechanism.
Mutual financial cooperative can also offer other cooperative business when developing into a certain degree. Eventually, the cooperative can grow into a comprehensive cooperative economic organization\(^1\). A mature cooperative economic system will be promoted in rural China in the future with mutual funds as the main body, so as to promote the cooperation in circulation, production and other fields, to construct cooperative economic system, and to enhance the rapid development of rural economy.

4 Conclusion

Peasants' mutual financial system has adapted to the needs of economic development, which is helpful to fill the vacancies of formal financial organizations in rural financial markets, and to meet the financial needs of peasants to some extent. However, there are still some problems during the development of mutual financial cooperative, such as relatively high establishment cost, ambiguous legal status, limited service ability, difficult expansion of the scale, nonstandard financial performance, and low transaction efficiency. Government should help the cooperative in order to solve these problems completely, to ensure the stable development of mutual financial cooperative, and to fully exert the advantages of this new system, such as reducing the access threshold appropriately, offering capital, technology, office condition and supports during its establishment, strengthening financial supervision without undermining the principle of cooperation, and promoting the standardization and legalization of mutual financial activities.

References


中国首家农民资金互助社的创建

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摘要 简述了中国吉林省梨树县榆树台镇国永村资金互助社创建的背景和条件。2003年组建的国永村农民合作与农村资金互助社的创建提供了组织基础；在没有其他中介组织的农村市场交易中，农民独占进入市场的交易和信息成本较高，因此，规范和发展的农村信用服务组织成为农民的客观需要。分析了资金互助社较之农村信用社的优劣、农户入社的动机以及互助社的收益分配方式、模式等。介绍了2004-2006年国永资金互助社的组织状况：①互助资金总量逐年增加，但仍供不应求，信用社贷款较少，互助风险率为0，农户贷款利率较高，信用社负债率较高；②账面上没有费用账户，且由发起人自负盈亏；③互助金入社逐年增加，信贷保持稳定，2006-2007年没有分红，也没有转移公款。2007年除去少量红利，实现了资金互助社的发展问题：创建成本过高，易导致制度供给不足，服务能力与资金规模存在矛盾，资金规模与服务效率低下，从而无法吸引农户入社，资金规模难以扩大，贷款先后顺序影响着互助社的发展；财务人员业务素质低下、财务工作不规范，在很大程度上限制了组织的发展；面临着经营、道德、流动性等风险等问题。

关键词 资金互助社；制度；农民合作金融