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The Analysis of Obstacles to Rural Microfinance Development in China

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Abstract On the basis of presenting the terminology and classification of Rural Microfinance, this paper introduces the present situation of China's rural microfinance development and analyses the factors that hinder the highly efficient and sustainable development of rural microfinance in current China. These factors include the operational risk, the financial resource and the sustainability of development, the regulation issues, and the issue of financial supporting services. This paper also makes several suggestions concerning policy making: the government should vigorously promote innovations in systems and mechanisms as well as products, constantly improve financial supporting services, and put more emphasis on supervision and control, as well as policy support.

Key words Rural microfinance, Obstacles, Sustainable development, China

As one of the most important developing countries in the world, China now has more than 900 million peasants and 150 million poverty-stricken and low income people, most of whom live in the rural areas. At present, rural areas have an expanding demand for credit which has a feature of regional difference and diversity. At the same time, rural areas suffer from lack of financial services, especially credit facilities, which are short of diversity, causing low-income rural households to be excluded from getting the services and support of formal financial institutions. This imbalance between supply and demand has seriously hampered the economic development of rural areas and the increase in income of rural households. Rural economic problem is a major problem in the process of China's social-economic development. Therefore, striving to form a multi-institutional, multi-layer rural financial system and to develop rural microfinance is an important way to effectively relieve financial restraint, solve the problems facing agriculture, rural areas and farmers, and develop a new socialist countryside.

1 Definition and classification of Rural Microfinance

In a narrow sense, microfinance is the finance services offered to low-income clients or groups applying for loans (including consumers and self-employed entrepreneurs who lack bank lending sources and relative services in a traditional sense). In a broad sense, it is an activity aiming to offer a series of high-quality financial services^[1] such as loans, savings, insurance and transfer payment to as many poor and low-income people as possible. Microfinance is a kind of service especially for low-income groups in rural or agricultural finance. The relationship among Microfinance, Rural finance and Agriculture finance is shown in Fig. 1.

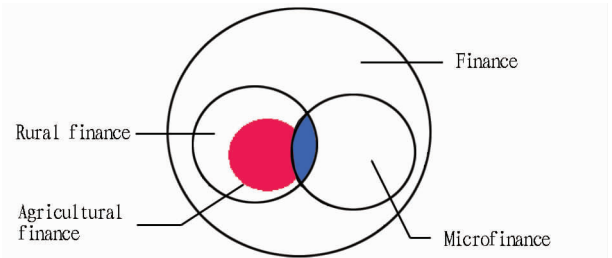


Fig. 1 The relationship among Microfinance, Rural finance and Agriculture finance

According to the different development objectives, agriculture microfinance can be divided into two types: the one for welfare and the one focusing on institution. The former takes poverty alleviation as its priority, like Bangladesh Grameen Bank (GB). The latter primarily considers commercial sustainability, like People's Bank of the Republic of Indonesia (BRI). According to the different formats of establishment, agriculture microfinance can be a non-governmental nonprofit organization like BRAC; a profit organization for agricultural mutual relief, such as our rural credit cooperatives, the former Rural Cooperative Foundation and the current loan corporations, rural banks, and financial mutual relief organizations in rural areas; and micro-credit projects^[2] introduced by formal commercial banks.

2 The present situation of Rural Microfinance in China

In 1994, projects to alleviate rural poverty like CFP, China Social Science Cooperation Fund of poverty, SMAP, etc. were introduced into China, which initiated the development of rural microfinance in China. In late 90s of the 20th century, the project "Policy-based Micro-credit for Poverty Alleviation" came into effect. In 2002, rural credit cooperatives started to carry out micro-credit projects on a large scale. At present, micro-credit projects in our country are becoming more and more

mature. Besides rural credit cooperatives, financial institutions like Agricultural Bank of China, Postal Savings Bank of China, and Urban Commercial Banks also offer micro-credit. Loan tenure has extended from the within one year to one to three years. New rural microfinance institutions which take micro-credit companies, rural banks and financial mutual relief organizations as the mainstay are being tried and established, and are developing at a certain speed in China. By late March in 2011, there have been 3 027 micro-credit companies all over China, with a loan balance of 240.8 billion yuan, the total new loans in the first quarter amounting to 4.27 billion yuan. 552 new rural financial institutions will be established, 448 of which have opened, 104 being planned to be established. 40% of the rural financial institutions are in the east, 60% in the central-west of China. 400 are rural banks. For the opened new rural financial institutions, the corresponding total loan balance is 73.3 billion yuan, 83.4% of the loans being offered to rural households and small enterprises^[3].

3 Factors that hinder the development of rural microfinance in China

After the development of all these years, rural microfinance in China has taken shape, but still has many problems like inaccurate goal setting, not all-inclusive services, lack of competition, poor anti-risk ability, low earning capacity, etc. This challenges rural microfinance's goal to obtain highly-efficient, sustainable and stable development so as to provide better service to agriculture, rural areas and farmers, and to continuously extend the range of social poverty alleviation. To sum up, the factors that hinder the development of rural microfinance in current China mainly lie in the following aspects:

3.1 Operating risk Agricultural finance suffers from greater risks than trade finance and Industrial Finance, for rural microfinance aims at rural low-income groups and thus has greater system risk. Churchill *et al.* summed up four kinds of risks: institutional risk, operating risk, financial risk and external risk^[4]. In China, the problem is mainly manifested in the following two aspects.

3.1.1 Factor of clients. The average net income per capital of rural households in 2009 is shown in Fig.2^[5]. In rural areas, the uncertainty and single source of client income together with the frequent manpower flow have seriously constrained the development of rural microfinance. Besides, the long-term absence of rural commercial finance has caused lack of normative evaluation system of credit. Shortage of collateral has even made evaluation even more difficult.

3.1.2 Factor of itself. Since rural microfinance has only a relatively short history, it is still groping for better transaction and operating mode. Compared with other more mature commercial finance institutions, its risk awareness, operation and management, as well as control capacity still need to be improved.

3.2 Source of funds and sustainability The biggest problem for rural microfinance institutions is the limited source of funds, especially the difficulty in deposit inducement. For micro-credit companies, its source of funds is generally a limited

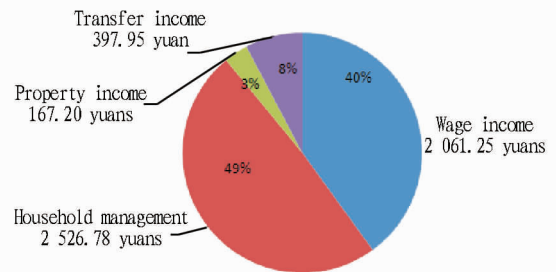


Fig.2 Average net income per capital of rural households in 2009

number of share-holding investment institutions and individuals. Rural banks as a novelty can not attract many deposits either, for it's small scale, single outlets and limited types of services result in lacking of credit and user acceptance. As for NGOs aiming at poverty alleviation, its source of funds depends entirely on Domestic and foreign donations on the whole.

Besides, the clients of microfinance are dispersive and apply for only small amounts of credit. The cost of loan collection is high, challenging the sustainability of microfinance^[6]. In this context, rural microfinance institutions are bound to adjust its market positioning regarding risk prevention and self interest as the priority, thus deviating from the goal of serving agriculture, rural areas and farmers and supporting the construction of the new countryside.

3.3 Supervision

3.3.1 The threshold for market entry. The controlling shareholder or only shareholder of rural banks must be banking financial institutions. Although this stipulation helps rural banks to obtain mature professional and technical forces, actually in many poverty-stricken rural areas, it is hard to find qualified and willing sponsors, causing rural banks to develop slowly. Micro-credit companies also face the two problems of fund-raising and supervision due to their not being financial institutions.

3.3.2 Supervising indicators. In terms of supervision, existing stipulations are too rigid^[7] for new rural financial institutions, taking no account of the features of rural economy. Take rural banks as an example, currently, supervision is mainly controlled by "insiders" of banks. Too rigid control deprives rural banks of their due vigor and vitality. Once operating risk appears, rigid exit mechanism is initiated which will cause unpredictable negative effects.

3.4 Supporting financial services Complete supporting financial services lay a solid foundation for the development of rural microfinance. Currently, supporting financial services of rural microfinance in our country have the following defects: first, the basis of law is not sound. The difficulty of guarantee has long existed. Second, Fiscal supporting policy hasn't formed a long-term mechanism. The Coverage and degree of support should be improved. Third, reforms relative to development of county finance and rural finance like land reform and investment environment reform are not completed. Fourth, relative agricultural insurance hasn't fully developed. Fifth, there are not enough professional management personnel and credit review personnel, etc. Sixth, the application of electronic pay-

ment system hasn't been popularized.

4 Policy Proposal

Microfinance services targeting at rural low-income groups satisfy the credit demand of rural households, greatly influence the reconstruction of financial system and the mode of economic development in China, and also lead to changes in social relations, authority pattern, culture type and other aspects in rural areas. Vigorously developing rural microfinance will greatly increase the income of farmers in poverty-stricken areas and promote the agricultural industry structure adjustment. To further promote the highly-efficient and sustainable development of rural microfinance in China, the following policy propositions are made.

4.1 Vigorously promote innovations in systems and mechanisms as well as products Make innovation in rural financial products according to the local conditions to satisfy multi-level and multi-mode demand of financial services of rural areas. Actively expand the range of collateral. Increase the funding for poor rural households. Try to accept collective forest right, land contract and management right, rights to housing site, and large farm machinery as mortgages, issue credit plus insurance products, and try small and medium sized enterprises collective notes and "farmer-benefiting cards".

Ensure that capital market and insurance market play an important role in financial services relative to farmers. Perfect distribution and transfer mechanism of credit risks relative to farmers, including trying farmer-relative guarantee insurance. Try to issue farmer-relative small and medium sized enterprises collective notes and farmer-relative credit asset backed securities. Expand the variety of agricultural products used in future trading.

Vigorously promote the innovation of rural financial service modes, such as popularizing one-stop service and creditor service for a whole Village in financial supermarkets; popularizing new types of rural financial service like mobile banking, networking mutual insurance, and migrant worker bankcards; and promoting rural financial consulting, insurance sales, farmer-relative financial services, *etc*^[8].

4.2 Constantly improve financial supporting services

Publicize the importance of trustworthiness. Push forward construction of trustworthiness archives and credit rating system for rural households. Expand the application of enterprise and personal credit system in rural regions all over the country. To upgrade credit terms of impoverished and low-income farmers, organizations like professional association can take into consideration the distinguishing features of rural areas in China and carry out credit construction on the basis of encouraging farmers to take part in all kinds of professional cooperative economic organizations for them.

Vigorously promote land reform, reform of collective forest right system and investment environment. Speed up the development of futures market of agricultural products. Encourage commercial insurance companies to explore the market in rural areas. Explore the establishment of bank and insurance inter-

action mechanism. Encourage the establishment of joint-stock guarantee funds or guarantee corporations in accordance with modern enterprise system.

4.3 Strengthen supervision and control, as well as policy support Properly keep the "low entry barrier" and level down acceptable entry conditions for new rural financial institutions and services to increase the coverage of rural financial institutions. Actively support layout of outlet. Allot rural financial institutions in county, town and village in a sensible way. Make definite the policies regarding reserves, interest rate, payment and settlement, accounting, credit check, financial statistics, and regulatory reporting of rural financial institutions. Establish a stringent corporate disclosure system.

Central finance and provincial local finance should establish farmer-relative credit risk compensation fund, bonus fund or special financial supplement fund, increase the coverage of agricultural insurance, increase the types of farmer-relative insurance, and improve insurance supporting services.

Emphasize the construction of rural financial basic service facilities and financial ecological environment. Improve the quality of rural financial services by applying modern technology; popularize the application of modern computer and mobile communications technology-based financial products in rural areas. Accelerate the development of financial professionals and constantly reinforce the internal motivation and sustainability of rural microfinance development.

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