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# Development of New Rural Cooperative Economic Organizations from the Perspective of Institutional Analysis

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**Abstract** Appearance of new rural cooperative economic organizations is the result of institutional change and also important institutional arrangement and innovation promoting rural development of China. At present, development of rural cooperative economic organizations is faced with problems of unsmooth operation and management mechanism, lack of supervision mechanism, internal system defect and imperfect law, weak policy support, and imperfect financial system. In this situation, government should take due responsibility from improving legal system, strengthening policy support, deepening rural market reform, and improving rural financial system.

**Key words** Rural cooperative economic organizations, Agricultural cooperatives, Rural development

## 1 Introduction

From the emergence of real sense cooperative organization, Rochdale Society of Equitable Pioneers founded in small town Rochdale in north of England in 1844, rural cooperative organizations have been developing vigorously. The Rochdale Pioneers is most famous for its design of the Rochdale Principles, a set of cooperative principles providing the foundation for the principles on which cooperatives around the world operate to this day. The model the Rochdale Pioneers used is a focus of study in the sense of co-operative economics. China is a large agricultural country. Promoting rural economic development and changing rural poor situation are major issues of Chinese government all the time. In recent years, Chinese government has abided by giving first priority to the work on agriculture, rural areas and farmers, to adopt a series of important policies and measures to boost the development of agriculture and rural areas, promote greater initiatives of farmers in production, bring in large numbers of essential factors of modern agricultural production, and make extensive application of agricultural scientific and technological achievements. Rural economic cooperative organization is an essential organization form promoting rural development, and it plays a key role in increasing farmers' income, protecting farmers' benefits, and promoting agricultural modernization. Local government is supplier of institutions and executor of rules. Rural development can not do without policy support of government, and healthy and sound growth of rural economic cooperative organizations needs various institutional arrangements of local government.

## 2 Institutional analysis on appearance and existence of new rural cooperative economic organizations in China

Similar to foreign farmers' cooperatives, China's rural cooperative

economic organizations are economic organizations established by agricultural workers on the principle of voluntary participation and mutual benefit through equal consultation for seeking, maintaining and improving common benefits<sup>[1]</sup>, or economic organizations founded in rural communities for seeking economic benefits. Concept expressions of rural cooperative economic organizations include cooperatives, farmer cooperatives, agricultural cooperatives, and rural cooperatives, *etc.* In this study, we will make analysis from appearance of new rural cooperative economic organizations and institutional logic for existence of new rural cooperative economic organizations in China.

**2.1 Institutional analysis on appearance of new rural cooperative economic organizations** From the perspective of institutional change, rural cooperative economic organization is a kind of institutional arrangement and innovation. Institutional innovation of rural cooperative economic organizations is the process of substitution, transformation and transaction of organization institution, and is change, transformation, and improvement of new organizational form for traditional organizational form. North stated that the process of institutional change is the process of organizations establishing new rules for seeking maximum benefits, and is the process of change of resource allocation. In this process, labor, capital and technology are reallocated to adapt to new organizational form. The process of institutional change is of relatively minor interest, since the outcome of the change is definite: the most efficient institutions will win. Generally, there are two types of institutional changes: induced institutional change and imposed institutional change<sup>[2]</sup>. From the perspective of new institutional economics, causes for appearance of institutional changes include pursuit for scale economy, risk sharing, and reduction of transaction cost.

The appearance of China's rural cooperative economic organizations is the result of institutional changes. On the whole, there are three factors promoting constant improvement and change of China's rural cooperative economic organizations. The first is change of economic and social environment. For example, promotion of urbanization changes price of production factors. Competi-

tive market mechanism and price mechanism are also external factors inducing change of cooperative economic organizations. The second is enterpriser spirit. The enterpriser spirit not only brings up a good many farmer enterprisers bold to innovate, but also transforms farmers' traditional idea. This is internal factor for appearance of new cooperative economic organizations. The third factor is institutional supply of government. This includes people's commune system, household contract responsibility system, and land collective ownership system. Institutional supply of government and appropriate guidance and encouragement accelerate development and improvement of new rural cooperative economic organizations. In sum, China's rural cooperative economic organizations are result of induced institutional change and imposed institutional change. There are bold attempts of rural elites with farmer enterprisers as representatives and reform in the scope of laws.

**2.2 Institutional logic for existence of new rural cooperative economic organizations in China** From the perspective of transaction cost, appearance and existence of new rural cooperative economic organizations are based on income of institutional innovation higher than cost for institutional maintenance construction. Otherwise, a new organizational form will appear to complete a new round of institutional change.

Institutional costs of rural cooperative economic organizations mainly include two aspects. One is the cost incurred in the process of formation of the organization, including manpower cost, communication cost, training cost, cost of regulations and rules, negotiation cost, contract signature cost, *etc.* The other is cost for maintenance of institution, including cost for organization management, internal friction cost, supervision cost, incentive and committed cost, cost for implementation of organization plan, and market transaction cost, *etc.* Income of rural cooperative economic organizations comes from three points. The first is reducing the market transaction cost of farmers. The second is increasing farmers' income. The third is reducing operating risk. Separate household production is not favorable for resisting market risks, not able to fully grasp market information, and not favorable for production and operation of agricultural products.

Only when the income of institutional innovation is higher than cost of institutional change, may the institutional change happen. The existence of new rural cooperative economic organizations is the objective result of income higher than cost and also the result of institutional change. In the combined action of economic, social, policies, laws and non-institutional factors, new rural cooperative economic organizations increase farmers' income, reduce farmers' risk of entering market, promotes agricultural modernization and large-scale production, and promotes rural economic development, so the new rural cooperative economic organization is an institutional arrangement suitable for economic and social change and present national conditions.

**2.3 Types of new rural cooperative economic organizations in China** Since the reform in rural China, new rural cooperative organizations have mushroomed, such as rural community coopera-

tives, rural cooperative foundations, rural shareholding cooperative enterprises and farmers' specialized associations. They play a very important and indispensable role in boosting China's rural economy. However, when comparing China's rural cooperatives with standardized foreign cooperatives in the controlling decision-making power and residual claimant right, only a small number of cooperative-oriented organizations are similar to their foreign counterparts. Besides, some cooperatives are, in fact, investor-oriented companies. Since there is no legislation that covers cooperatives in China, governments at different levels may vary in their attitudes and actions towards different types of rural cooperatives. Furthermore, the existing national income distribution system and macro-economic framework together with the imperfect commodity and production factors market make governments intervene directly in the economic activities of rural cooperatives in order to realize their macro-economic goals.

New rural cooperative economic organizations in China have many types. There are many division methods. According to attribute of major members, rural cooperative economic organizations can be divided into two types: cooperatives made up of farmers and cooperatives made up of farmers and entities in the market industrial chain. The first one includes three types. (i) Rural specialized cooperatives. These are established by farmers through buying shares, provide purchase, selling, processing and marketing services, relationship of members are close, take democratic management and assume sole responsibility for its profits or losses. (ii) Rural specialized technology associations. These are established by farmers engaged in production and service of similar agricultural products on the principle of voluntariness and mutual benefit, not for profit. At present, there are three types of rural specialized technology associations, *i. e.* technology service, agricultural product purchasing and selling service, and integrated service types. Compared with specialized cooperatives, specialized technology associations stress specialized production technology cooperation and service sharing. (iii) Community joint share cooperatives. Such cooperatives are established on the basis of transformation of some rural areas in the process of urbanization. The second one has two types. (i) The production and supply cooperatives. These are established by farmers and enterprises. Farmers and enterprises sign contract and perform the contract in accordance with contract provisions and complete the transaction. (ii) Rural joint share cooperatives. These are established by farmers and market production entities. Generally, leading enterprises attract farmers to join through sharing bonus.

### 3 Institutional vacancy of new rural cooperative economic organizations in China

Institutional vacancy is a major problem in the development of new rural cooperative economic organizations in China. It greatly impairs development of new rural cooperative economic organizations. To realize healthy development of new rural cooperative economic organizations, it is required to solve this problem at first.

To solve this problem, we have to make clear specific content of institutional vacancy. Institutional vacancy of new rural cooperative economic organizations in China includes vacancy of internal institution and insufficient supply of external institutions.

**3.1 Vacancy of internal institution** Vacancy of internal institution is mainly manifested in two aspects. The first is imperfect internal operation and management mechanism, weak democratic management awareness, lack of systematic regulations and rules, existence of unfair benefit distribution. All of these damp enthusiasm of farmers' participation. In the actual operation, decision-making power is held by few people and member assembly becomes a mere formality. Benefit distribution mechanism of rural cooperative economic organizations is not reasonable. Their capital return is high, but the profit allocated as per transaction amount. Internal management is chaotic and there is no rule to follow, while most management personnel conduct management by experience and lack modern management awareness and means<sup>[3]</sup>. The second is vacancy of supervision mechanism. Internal managers may seek personal benefit taking advantage of their office. The third is obscure property right. Property right is the core of institutional arrangement and exerts influence on operation efficiency. Harold Demsetz, a founder of the field of managerial economics, stated that property right is the power of making oneself or others obtain income. In *Toward a Theory of Property Rights*, Harold Demsetz presents the argument that in a world of zero transaction costs. The output mix that results when the exchange of property rights is allowed is efficient and the mix is independent of who is assigned ownership. The property right is not the relation between men and thing, but the relation between men formed around use of things. Distribution of property right needs specific and detailed regulations for guidance, and people signing contract must observe these regulations to obtain lawful income. Within an organization, blurred definition of property right easily leads to hitchhiking of members and increase of investment risks. At present, internal property right relationship in rural cooperative economic organizations is chaotic and dim. The property right subject of owners is vacant, and equity property right is not clear. As a result, nature of the organization is changed, and decision-making power and control power of members are lost. Once there is conflict of benefit, farmers' benefit can not be guaranteed.

**3.2 Insufficient supply of external institutions** Insufficient supply of external institutions is mainly manifested in following aspects. (i) Defects of laws. *The Law of the People's Republic of China on Farmers' Specialized Cooperatives* is aimed at rural specialized cooperatives. It defines farmers' specialized cooperative as a mutual-aid economic organization, which is voluntarily formed by production and business operators of similar agricultural products or by providers or users of similar agricultural production and business operation services on the basis of rural household contractual management and which is subject to democratic management. It does not cover all types of rural cooperative economic organizations. Therefore, some organizations lack special laws to define at-

tribute, form, legal personality and status and there is difficult problem of legitimacy of status. On the one hand, registration is difficult. The administration for industry and commerce of most areas does not register rural cooperative economic organizations<sup>[4]</sup>, so rural cooperative economic organizations have to register in civil affairs department as mass organizations and can not carry out operation activities as independent economic entities<sup>[4]</sup>. On the other hand, it leads to chaotic internal management and brings much inconvenience to raising funds and signing contract and negotiation. (ii) Weak policy support. Government provides weak support for rural cooperative economic organizations in finance, tax, and credit. Firstly, fund source channel of cooperative organizations is single, and their self-financing ability is weak, they can not effectively raise funds from market, and the financial support for cooperative organizations is weak. Secondly, tax policy for supporting rural cooperative economic organizations is not well established, the scope of preferential tax is narrow, and tax preference for agricultural byproducts processing is insufficient. Thirdly, it is financial environment. Although the state provides financial support for some qualified rural cooperative economic organizations, rural financial institutions still have not listed cooperative organizations into the support object. Besides, financial and accounting system of rural cooperative economic organizations is not perfect and lacks corresponding credit rating. As a result, it is difficult for them to obtain loan guarantee of other economic organizations and the loan application is greatly limited.

## 4 Path for promoting development of rural cooperative economic organizations through institutional supply

Now, the definition of rural cooperative economic organizations becomes clearer in the relevant policies. No. 1 Document of central government in 2014 has specially called for developing new rural cooperative economic organizations. The Third Plenary Session of the Eighteenth Central Committee further proposed development of rural cooperative economic organizations. In this situation, we should develop rural cooperative economic organizations from following four aspects, specifically, improving legal system, strengthening policy support, deepening rural market-oriented reform, and reforming rural financial system.

**4.1 Improving legal system** China's rural cooperative development has gone through a tortuous process. Rural cooperative economic organizations need legal support and protection. American-European countries have established relatively perfect legal system in the development of cooperative economic organizations. As early as 1895, Britain had issued the special law on cooperative economic organizations, namely, *Law on Industrial Economic Cooperation*. The United States promulgated four laws from 1914 to 1933 to make clear legal status of cooperative economic organizations. At legislation level of rural cooperative economic organizations, it is feasible to formulate laws on the basis of prevailing international cooperative organization system, make clear internal

mechanism of rural cooperative economic organizations and internal and external relationships, to make them adapt to development of market economy. Besides, it is recommended to make clear legal status of cooperative economic organizations at grass roots level, make them to become legal entities of independent management and assuming sole responsibility for their profits or losses, so as to better perform production and processing of agricultural products, contract conclusion, fund raising, market expansion, information supply, and technological services, etc.<sup>[5]</sup>. Further, it is recommended to revise the *Law of the People's Republic of China on Farmers' Specialized Cooperatives*, which is enacted for the purpose of supporting and guiding the development of specialized farmers cooperatives, regulating their organization and behavior and protecting their lawful rights and interests and those of their members', and promoting the development of agriculture and of the economy of rural areas, or redraft *Law of Rural Cooperative Economic Organizations*, establish rural cooperative organization legal system combining general entity law and special entity law, to realize rural cooperative economic organizations having laws to comply with. Local government should formulate laws and regulations in accordance with local situations, support growth of rural cooperative organizations, and strengthen guidance of their operation activities.

**4.2 Strengthening policy support** Government should strengthen policy support for rural cooperative economic organizations. This includes four aspects. (i) Strengthening financial support. Governments at all levels should increase input of special funds, subsidy for equipment purchase, supply of means of agricultural production, sales of agricultural products, provide guarantee for rural cooperative economic organizations, strengthen fund use, and ensure proper use of subsidy funds. (ii) Credit support. Apart from discount loan and agricultural policy loan, government should also encourage financial institutions to provide certain amount of preferential loan for rural cooperative economic organizations, to solve their fund difficulty in purchase of agricultural products and processing and operation links. (iii) Tax support. It is recommended that income of rural cooperative economic organizations from processing of agricultural and forestry products should be exempted from income tax, and income from engaging in technological training related to services of agricultural production should be exempted from business tax, and income from sales of feeds and agricultural products should be exempted from value-added tax<sup>[6]</sup>. (iv) Other supports, including providing information and talent training for rural cooperative economic organizations, carrying out agricultural extension, establishing agricultural product safety and quality system, and improving agricultural infrastructure construction, etc.

**4.3 Deepening rural market-oriented reform** (i) Reforming administrative control system, breaking industrial segmentation of departments, eliminating monopolistic operation, and gradually establishing new agricultural management system of integrated agricultural product production, processing, sales and foreign

trade. (ii) Improving rural land property right system, ensuring farmers' full autonomous power of production and operation, and making clear possession, use, and income right of farmers over contracted land. (iii) Promoting reasonable circulation of land use right, to realize operation of agricultural production at moderate scale. (iv) Enhancing agricultural social service system, deepening vertical labor division for agricultural production, extending construction of scientific and technological extension system, construction of agricultural standardization system, and construction of intermediary service organizations. (v) Strengthening construction of agricultural product market system, accelerating construction of fund, technology and information market, and improving market service functions<sup>[7]</sup>.

**4.4 Reforming rural financial system** The objective of China's rural financial system reform should be established on the basis of serving rural development. The reform should be focused on following areas. (i) Strengthening supervision and guiding healthy growth and development of rural private finance, to promote them to become supplement of regular rural financial system. For rural informal financial institutions in economically developed areas, it is recommended to take effective supervision of their risk situation through granting legal status; for those rural informal financial institutions in underdeveloped areas, it is recommended to protect lawful borrow and loan relationship, and encourage to set up small sum credit organizations. (ii) Reforming rural credit cooperatives. It is recommended to transform rural credit cooperatives into specialized commercial banks or restore them to farmers' cooperative financial organizations based on regional differences<sup>[8]</sup>. (iii) Establishing rural insurance system with Chinese characteristics. Firstly, it is recommended to separate agricultural insurance business from existing commercial insurance, and set up policy agricultural insurance companies to do agricultural insurance. Secondly, it is recommended to set up new rural endowment insurance system combining rural commercial endowment insurance and rural social endowment insurance. Finally, it is recommended to set up deposit insurance system and integrate rural finance into the deposit insurance<sup>[9]</sup>.

## 5 Conclusions and discussions

At present, there are many problems in China's rural cooperative economic organizations, including small size, loose organization, imperfect internal administration structure, and lack of financial support. In view of these problems, government should bring into play its role in the development of rural cooperative economic organizations. Nevertheless, it should be noted that government should make definite its role orientation and avoid overstepping or misplacement.

From the perspective of role orientation, government should cooperate with market to build external environment suitable for rural cooperative economic organizations, to avoid embezzlement of public investment. Through external institutional supply, it is intended to create favorable environment, stimulate internal motive

force for development of rural cooperative economic organizations. Some scholars call this external conditional mechanism triggered internal driving mechanism. From the perspective of country-society, only those countries embedded into society are powerful. Therefore, in the process of participating in role orientation of rural cooperative economic organizations, government should make estimation at macro level, formulate suitable development strategy, and must embed into society, to make it become essential composition of external conditional mechanism in the development of rural cooperative economic organizations, and prevent change of government role from service supply to benefit predation. In fact, since the reform and opening-up, in the process of government participating in development of rural cooperative economic organizations, financial investment that should be used in public welfare services is changed to private capital. As a result, many public welfare investment and human resources become means of small groups or private capitals. To avoid such problem, government should establish strict supervision and restrictive mechanism.

From the relationship between government and rural cooperative economic organizations, there is asymmetric empowerment relationship. In market environment, the institutional arrangement of rural cooperative economic organizations is situated at the edge of out of work of market mechanism and it has natural tendency for government support. As to the legitimacy of its existence, the social legitimacy of rural cooperative economic organizations comes from economic rationality in the context of market, while the administrative legitimacy and political legitimacy come from government. Therefore, as an institutional change guided by government, rural cooperative economic organizations have high dependence on governments at all levels and relevant departments from the beginning. To a certain extent, such dependency and tendency lead to complex endogenous connection between rural cooperative economic organization and government, and empower government space for intervening rural cooperative economic organizations. However, the boundary of such intervention is indistinct and the degree of intervention is difficult to control. As a result, many wrong intervention actions appear in the government participation in development of rural cooperative economic organizations. Firstly, in normal condition, rural cooperative economic organizations should be spontaneously and voluntarily established by farmers according to demands of production and operation and market development, rather than by local government or administrative organizations. In practice, however, some local governments take establishment of rural cooperative economic organizations as a means of political performance, ignoring actual situation of local economic development, and simply combine local leading enterprises, cooperative organizations and farmers. This neither brings benefits to farmers, nor promotes development of rural cooperative economic organizations. In consequence, the development of rural cooperative economic organizations is not smooth. Farmers start doubting about essence and function of rural cooperative economic organizations and accordingly it dampens enthusiasm of farmers' participa-

tion in rural cooperative economic organizations. Secondly, improper administrative intervention brings fuzzy objective and direction of rural cooperative economic organizations. Especially, some cooperative organizations founded with government as leader are not dependent, and their development is closely connected with progress of government work. Once there is change of government system or fund input, such cooperative organizations will be dissolved. Finally, with government as leading part, cooperative organizations stress auxiliary functions of government, such as information services and policy recommendations, but weaken the purpose of "protecting and serving farmers' benefits". Since administrative forces take dominant position, in addition to information asymmetry, domestic management, decision making and financial disclosure systems perform practically no function within cooperative organizations. Therefore, in the process of development of rural cooperative economic organizations, government should make clear its role orientation, build favorable external condition through institutional supply, respect farmers' willingness, get rid of improper intervention, give legal status to rural cooperative economic organizations, guide, encourage and support development of rural cooperative economic organizations, and promote organizational process of farmers.

The issues concerning farmers, agriculture and rural areas are key issues in the development of China. Rural cooperative economic organizations play an enormous role in increasing farmers' income, promoting scale, specialization and industrialization of agriculture. Government is maker and implementer of laws and policies. Through institutional design and supply, it is expected to effectively improve external environment of rural cooperative economic organizations, and provide necessary guarantee for their sound development. If local government is helmsman leading rural development, rural cooperative economic organizations are oar rowers of rural economic growth. They complement with each other and perform their own functions. Besides, through institutional supply and embeddedness, it is expected to jointly build a network structure promoting development of China's rural areas.

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essentially different in induced factors and development modes of family farms.

(i) Changes in relative price of resources lead to increase of farmer households' labor productivity and expansion of specialized labor division, evolution of industrial organizations and endogenous demand of institutional change. Outflow of rural labor, rural land circulation, agricultural leading enterprises increasing input of agricultural production, as well as popularization of agricultural production technologies and machinery are exogenous forces. In the combined action of endogenous forces and exogenous forces, micro conditions of family farm become gradually mature and institutional environment is gradually created. Besides, in the process of formation of family farms, both non-human and human actors play important role. In other words, heterogeneous actor network consisting of human and non-human actors is the basis of formation of family farms.

(ii) In social environment of China, governments at all levels are always key actors with lawful granting rights. Since most rural areas are underdeveloped, farmers are relatively conservative, few farmers have enterpriser spirit, and farmers lack knowledge of family farms, involvement and influence of governments are essential in the process of establishing family farms. However, policy support of government must combine with micro environment of formation of family farms and should be consistent with development speed and progress of family farms. If basic condition of family farms is neglected and government policy support is relied

on solely, it is impossible to promote development of family farms, and it may lead to unfair market competition due to abuse of power.

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