

The Analysis of the Participation of Private Capital in Rural Financial Institutions

—Based on the research in Wenzhou, China

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As one of the world's largest country, agriculture plays a significant role in China and financial support is of great important in modern agriculture. This paper is mainly based on the survey about the funds demand and funds supply of rural financing, focusing on the existing problems and obstacles of the current financing, the will, the tendency, the way and the path selection of private capital owners in Wenzhou to invest rural financial institution, as well as investment risk evaluation and management may meet measures.

Keywords: Wenzhou; Rural Financing; Private Capital; Informal Finance; Indirect Investment

Introduction

Informal finance is active in rural China and actually it occupies a large proportion. In recent years, new-type rural financial institutions such as village banks, as well as informal financial institutions such as small loan companies, Fund Mutual Cooperative are in growth. The growth is accompanied with some problems, in particular, the shortage of funds. On the other hand, as the GDP in China is experiencing a dramatic increase, the accumulation of private capital is larger and larger. Take Wenzhou City, Zhejiang Province as an example. Wenzhou has been a center for private economy for a long time. Since China's Reform and Opening up, Individuals and private corporations in Wenzhou has accumulated a large sum of social wealth. In 2010, Private capital in Wenzhou has reached to 600 billion yuan.

In 2010, the State Council in China issued the file "The Opinions on Encouraging and Guiding the Private investment to develop healthily", which released various incentive policies and measures to enable private capital entered the financial industry more easily. With this opportunity, private capital invests in financial institutions has become a trend, this will legislate the informal finance, and restructure composition of private investment, thus make a contribution to the stability of financial market. Additionally, farmers will have an easier access to financial support. So guiding the private capital investing into the rural financial organization is a "win-win" for private capital owners, rural financial organizations and farmers.

The body of this paper is divided into three parts, the first part is the introduction of investigation objects and methods; the second part is the results and analysis of survey, from funds demand and funds supply respectively; in the last section, suggestions are given based on the analysis of the research for investor and government. For investors, the suggestion is the possible investment paths, as for government, the suggestions is mainly about the policy and financial support.

Investigation Objects and Methods

We chose Wenzhou as researching place. Wenzhou has been a center for private economy for a long time. Since China's Reform and Opening up, individuals and private corporations in Wenzhou had accumulated a large sum of wealth. By the end of 2010, private capital in Wenzhou has reached to 600 billion yuan.

In this research we used simple random sampling and typical survey. The survey was carried from two sides: borrowers such like people in charge of professional agriculture cooperation firms and some individual farmers and investors such like people in charge of private capital investment service centers. **Charts 1** and **2** below are some information of the investigation objects.

Research Findings and Analysis

Research on Farmers

Following **Table 1** is the illustration of the farmers' demand for funds. Different types of firms and farmers have different requirement for funds according to its own needs.

One conclusion we can draw from the **Table 1** is that financing needs varied according to the categories of farming and scales, however though difference, the major available ways for financing are informal and further findings are presented below.

Farmers' Financial Demands Are Hardly Met by Formal Financial Institution

Agricultural firms and Specialized Cooperative are vulnerable to market impacts and lagged behind in agricultural technology. The construction and maintenance of farming and service infrastructure requires more fund supplies. 22% of the farmers interviewed claimed to get adequate funding in their fund-raising, most of them claim to get just a fraction of fund they need (41%) or nothing at all (37%).

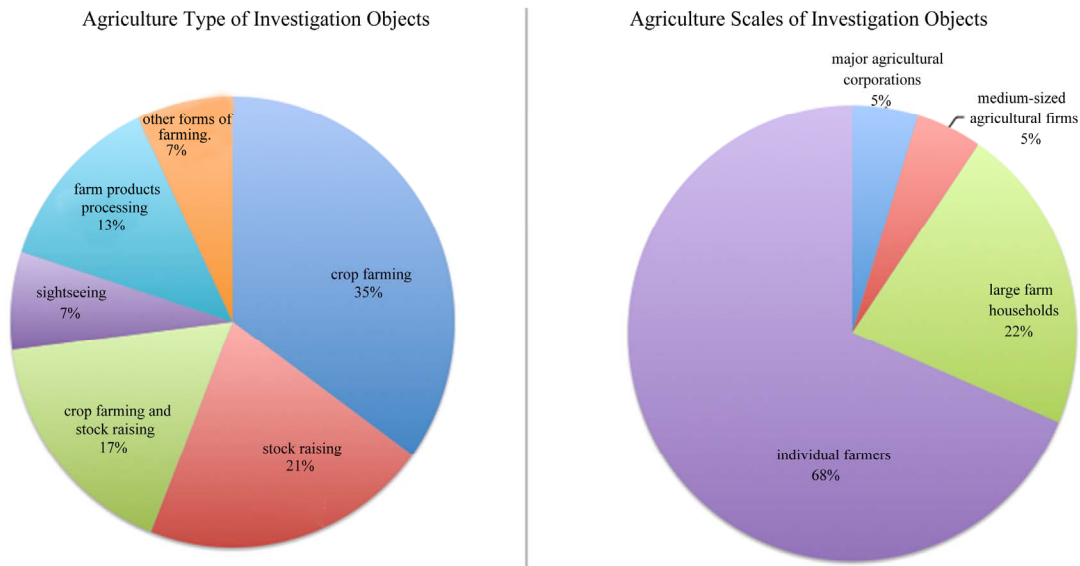


Chart 1.
Investigation objects-farmers.

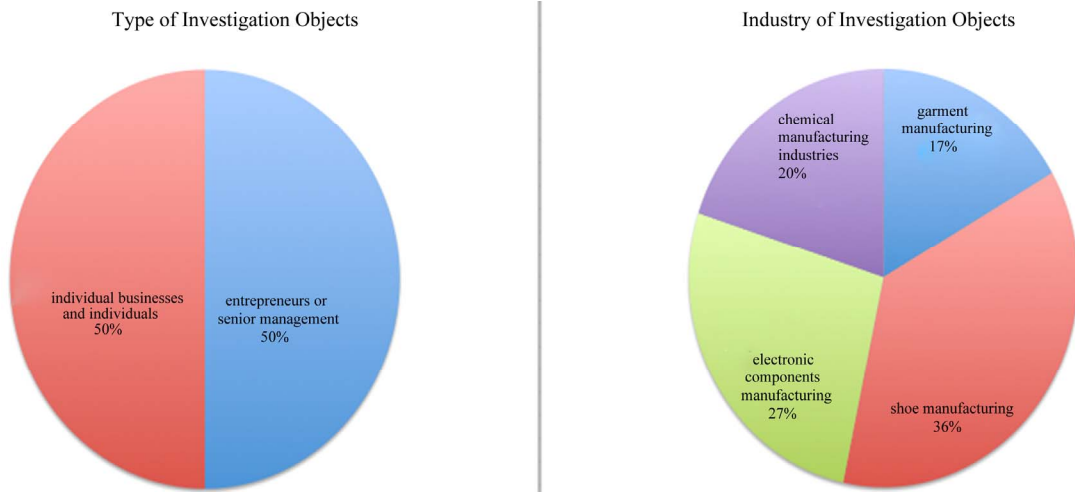


Chart 2.
Investigation objects-owners of private capital.

Table 1.
The categories of demand for funds of agricultural entities in Wenzhou.

Categories of borrower		Main reasons of finance demand	Available ways for financing
Farmer and rural cooperatives	Common farmer	Living expenses, loan demand for small-scale planting	Micro-credit, private loans, private lenders, government anti-poverty funds
	Specialized farmer	Farmer who do traditional farming	Self-owned money, microfinance, private lenders and some small business co-operation credit institutions
		Farmers engaged in large-scaled farming	Self-owned money, commercial loans and private lenders
Agricultural company	Micro company	Loan demand for starting business and expanding the market	Self-owned money, microfinance, private finance, venture capital, commercial loans, policy-oriented finance
	Company with certain scale	Loan demand for expanding the market	Self-owned money, commercial loans, venture capital
		Leading company	In early stage In mature stage

In addition, the numbers of conventional financial institutions (Commercial banks, credit unions) is far from enough to satisfy the need of farmers. The amount, time-structure, borrowing procedure, borrowing cost and collateral terms of the conventional financial institutions fail to meet the needs of farmers correspondingly, especially for those newly start-up farmers. 20% of the interviewees complain the biggest trouble they have to overcome is to get the loan from formal finance institutions, and 44% find it difficult to get a loan. The problems are:

1) Strict criteria for funding

The findings which presented in **Chart 3** shows that farmers need to put on collaterals (54%) or have guarantors in order to get a loan from commercial banks or credit unions. Strict loan requirements increase the difficulty to get access to loans and restricted the farmers obtaining loans from banks and credit union to an extent.

2) Complicated Procedures

36% surveyed said that procedures for getting loans from commercial banks and credit unions are “too complex”, and 41% chose the level “complicated”. The reason is presented in **Chart 4**.

3) High Financing cost

The majority of respondents thought that the lending rates of banks and credit unions are too high (21%) or high (43%). In addition, up to 83% of respondents pointed out that it required additional costs to get loans from formal financial institutions for obtaining loans. For example, sometimes farmers have to bribe the officer with gifts or treat them dinner.

Many agricultural companies complaint that in order to have access to formal financial institutions, they need to do to go to the institutions several times, which takes they a lot of time and energy, resulting in the increase of time and economic costs of the companies.

These additional costs are, to some extent, keeping some farmers away from the formal institutions. Some interviewees complaint that even did they eventually got the access to loans, the amount of loans received might be halved, this is may lay in the reason that the financial institutions’ caution about the risk.

4) Loan period can’t meet the demand

68% of those surveyed said that the loan period could not meet the needs of production and operation. Many respondents said that considering the cost of capital, the will to get the loan as soon as possible and the underestimation of risk and uncertainties during the business process make the loans could not fully meet the demand for a longer period. 54% of those surveyed said that they could not repay loans in time. At the same

■ Credit guarantee ■ Other people's guarantee ■ property mortgage

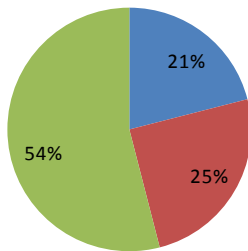


Chart 3.
Conditions of getting loans from banks and credit unions.

time, 57 percent of respondents said that sometimes people re-borrow funds to pay the loan. In fact, many agricultural companies have to conduct lots of loans. Especially due to limitation of the size of credit, they have to borrow many times for a certain amount of money, which no doubt increase financing costs a lot.

Informal Financial Institutions Is Welcome

Chart 5 are existing financing channels for farmers and the ratio, from which we can see that as formal financing institutions cannot well meet farmers’ demands, informal ones enjoyed more popularity. Some reasons are presented in the **Chart 6**. In addition, 78% of interviewees expressed that, they are looking forward eagerly to more new financing channels which can better fit their needs.

Research on the Owners of Private Capital

These interviewees are owners of private capital who were interested in investing in rural finance. What we find in the interview are as follows:

Intentions of Investment in Rural Finance

According to **Chart 7**, most of those surveyed are interested in investing in rural financial institution especially the new-type rural financial institutions such like micro-credit companies, venture capital and private equity funds as they think those new-type institutions are suppose to be more operational flexibility and have the ability to address the problem of asymmetric information and financial management efficiency.

Withdraw and Transfer Mechanisms

The majority of respondents believe that the withdrawal and transfer mechanisms are very important for private capital to enter the agricultural sector. 72% of those surveyed were worried about the liquidity of financial investment in rural areas is too slow, which result in a high investment risk and restrain enthusiasm to invest. A considerable part of investors want to improve the conversion flexibility, in particular, to establish a good platform for equity distribution and a trading market of property rights.

Risk in Policy Environment

At present there are still some problems in rural financial development such as the bottleneck of land resource. Agricultural policy may affect the confidence of private capital investors. In addition, policy for investment in rural financial institutions nowadays was not catering for the investors.

In the survey, 24% said that currently the investment project provided by government is not clear, 47% said that the investment information is far from enough. Previously the access to investment information mainly rely on personal relationships, but this result is limited. Therefore, a higher credit investment platform in badly needed to play the role of linking investors and investment projects.

Suggestions

Investment Paths for Private Capital Owners

New-type rural financial institutions including rural banks,

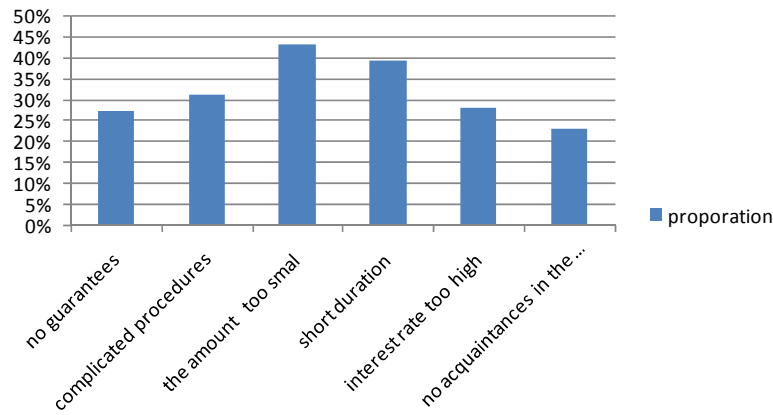


Chart 4.
Reasons of the difficulty for getting loans form formal institutions.

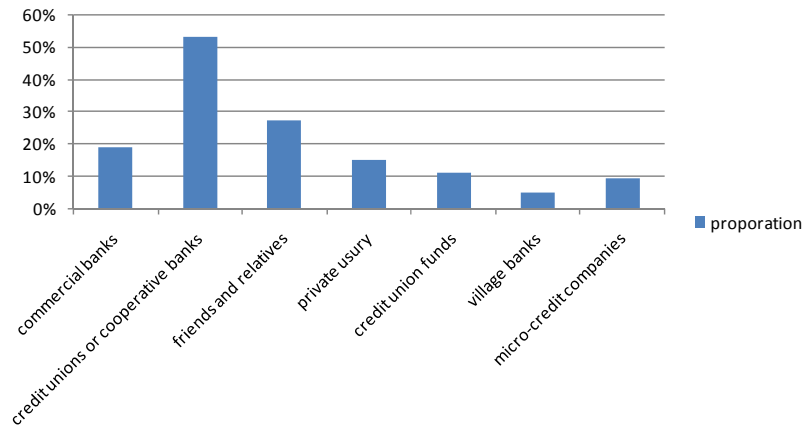


Chart 5.
Financing channels for farmers.

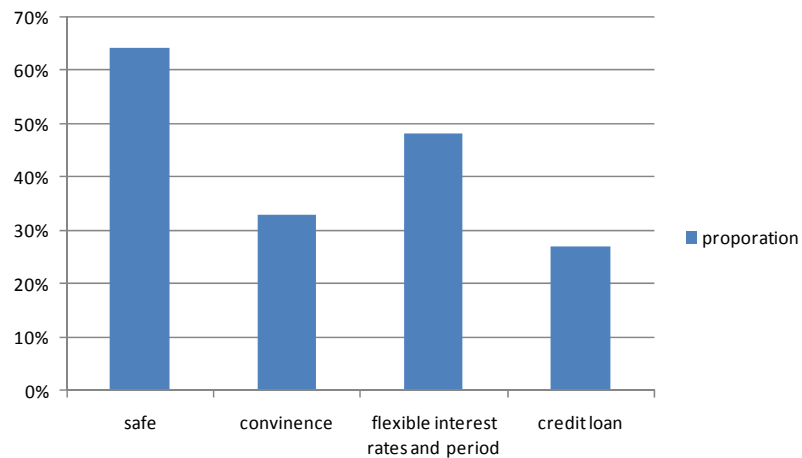


Chart 6.
Reasons of why farmers prefer lending from informal financial institutions.

small loan companies and other non-formal financial institutions etc. are easy to get access and have relatively flexible interest rate, term and fewer restrictions that meet the demand of farmers. On the other hand, we can see that the owners of private capital have an optimistic view on the outlook of the development of rural finance. Private capital entering the new

financial institutions is conducive to the effective funds flow and optimized allocation of resources. What we can draw to an conclusion is that private capital's entering rural financial organization is a "win-win" for private capital owners, rural financial organizations and farmers. Below we gave some suggestion of several ways for private capital entering the rural

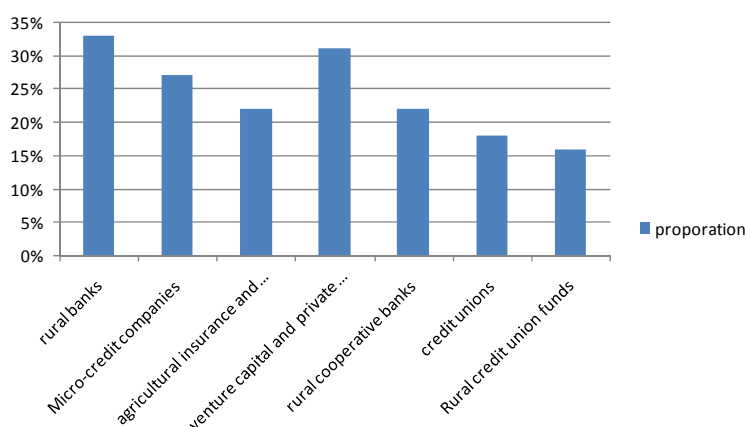


Chart 7.
Intentions of investment in rural finance.

financial system.

Participate in Creating or Shareholding in the New Type of Rural Financial Institutions

For owners of private capital, investing from the set-up state of in the new type of rural financial institutions such as town bank, microfinance companies, the credit guarantee companies and agricultural insurance companies means the investor can, as co-founders, engage in the decision of regular management. Private capital's entering into this area means a lot. Firstly, it is a great complement to capital; Secondly, social influence, especially the influence of some large private capital owners can bring in many other potential investors; Thirdly, the rich managing experience of these investors can effectively improve and enhance the operational efficiency of the new type of rural financial institutions. Hengsheng Village Bank in Wenzhou Yongjia County is a successful example. Founded by Ou Hai rural cooperative banks, Yongjia County rural credit union and 21 rural credit cooperative enterprises, Hengsheng Village Bank has a great performance since its establishment.

Participate in the Reform of Rural Credit Cooperative Banks, Shareholding Agricultural Cooperative or Rural Commercial Bank

Private capital shareholding the agricultural cooperative or rural commercial bank on one hand can be the supplement of the lack of capital, on the other hand, through the clearing-up of the original shareholders and the entry of new blood, capital constraint can be strengthened. Many new capital owners have high quality which can help the banks optimize the structure of property rights and the management of banks.

Participate in Creating Agricultural Venture Investment Funds and Agricultural Industry Investment Funds

The previous investigation and analysis have shown that up to 31% of respondents will invest in private capital of private equity venture fund. The advantages are flexible investment options (44%), Management (42%), more controllable risk (36%). Private capital can cooperate with government, banking and financial institutions, enterprises, institutions and individuals to create professional private equity investment fund. Multi-joint strength will help to integrate the advantages of the different parts.

Policy Suggestions

Through government have released various incentive policies and measures to enable private capital entered the financial industry, there are still something need to be improve. In the research, the private capital owners call for some policy reform, details are shown in the **Chart 8**. According to the appeals, we gave some of our suggestions on policy.

More Preferential Taxation and Support Subsidies

Due to the underdeveloped investing environment in rural areas, government should give more incentives for private capital entering the rural financial institutions. More encouragements, whether material or non-material, should be given to some of the pioneers thus more investors would be willing to invest in this area which most of them are not familiar at all. As for farmers, more preferential taxation and support subsidies will in the end benefit them as the cost of the investors cut down so does the financing cost of farmers.

Risk Guarantees Should Be Given

As mentioned before, investing in the rural financial systems can be risky, which hinder many private capital owners from entering this area. Government, to some extent, should shoulder part of the responsibility through establishing government-based loan guarantee institutions or funds, providing insurance subsidy for loan default and so on.

Less Restrictions

The government should regulate, ease the circulation of rural land use and new financial institutions regulatory restrictions such as the shareholding ratio and establish a good circulation platform and property right trading equity market, guide and regulate industrial and commercial capital to invest in modern agriculture.

In all, to ensure the sound development of the market, on one hand government should encourage competition and innovation, speed up the reformation and attract more private capital into the rural financial market to support modern agricultural development, on the other hand government should guide and standardize the market order, introduce more support policies to ensure that participants are able to obtain a reasonable return on investment. In addition, the survey expressed the hope that local

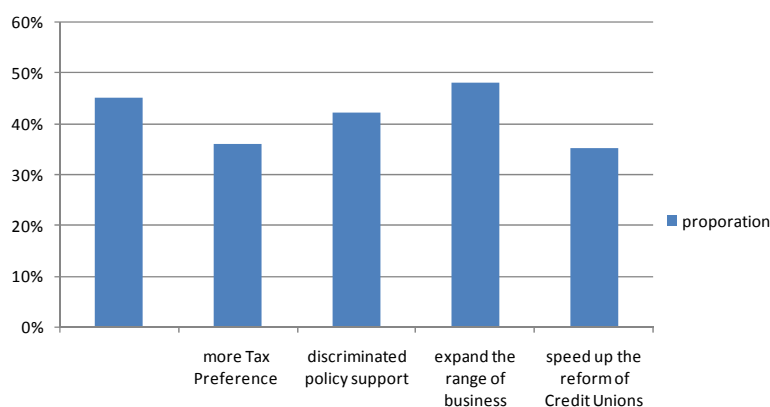


Chart 8.
Appeals for reform of rural financial institutions.

government should reduce administrative intervention of financial organizations and strict control seizing resources from the rural financial market.

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