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1. Inclusive Financial System: Practice of China Rural Banks

Abstract: Inclusive financial system is a powerful tool to fight poverty. Poor people need a variety of financial services, not just loans, but also savings, insurance, and money transfer services. Inclusive financial system means building financial systems that serve the poor. Over late years, the inclusive financial system represented by rural banks has rapidly evolved and expanded in China. However, we still have a long way to go in practice when compared with other countries. The key bottlenecks of rural banks in China are: the shortage of strong institutions and managers, and a government who enables financial services instead of providing them directly.

Key words: microfinance; inclusive financial system; rural bank; sustainable development

Over late years, the inclusive financial system represented by rural banks has rapidly evolved and expanded in China. Although we still have a long way to go in practice, when compared with the countries that started building inclusive financial systems earlier, China does not lose on theory studies. Formal theory of inclusive financial system was brought out in foreign countries at about year 2005, while China put forward similar concepts and theory framework almost at the same time.

1.1 Principles and Characteristics of Inclusive Financial Systems

A. Key principles of inclusive financial system

Internationally, people are divided into the poor and the non-poor by the poverty line. From the perspective of concerning poverty, this could be further divided into: destitute, extreme poor, moderate poor, vulnerable non-poor, non-poor and wealth. Below the poverty line, 10% is destitute, 40% is extreme poor, and another 50% is moderate poor. According to the Consultative Group to Assist the Poor (CGAP), the target clients of inclusive financial systems range from extreme poor to the vulnerable non-poor and a few non-poor. However, practice is always complicated than theory. In fact, some inclusive financial institutions or products have extended their clients to small and micro enterprises (SMEs) and medium-sized enterprises.

The key principles of inclusive financial system developed and endorsed by
CGAP were:

1) Inclusive financial system is a powerful tool to fight poverty. Poor people need a variety of financial services, not just loans. In addition to credit, they want savings, insurance, and money transfer services. Inclusive financial system means building financial systems that serve the poor.

2) Inclusive financial system is about building permanent local financial institutions. Inclusive financial institutions can pay for themselves, and must do so if it is to reach very large numbers of poor people. Inclusive financial providers should charge enough to cover their costs.

3) Inclusive financial system is not always the answer. Other kinds of support may work better for people who are so destitute that they are without income or means of repayment.

4) The job of government is to enable financial services, not to provide them directly. Governments can almost never do a good job of lending, but they can set a supporting policy environment.

5) Donor funds should complement private capital, not compete with it. Donor subsides should be temporary start-up support designed to get an institution to the point where it can tap private funding sources, such as deposits.

6) The key bottleneck is the shortage of strong institutions and managers. Donors should focus their support on building capacity.

7) Inclusive financial institutions work best when it measures-and discloses-their performance. MFIs need to produce accurate and comparable reporting on financial performance (e.g., loan repayment and cost recovery) as well as social performance (e.g., number and poverty level of clients being served).

B. Main beliefs of inclusive financial system

Inclusive financial institutions are usually founded by non-government organizations, committing to help the poor, provide financial service for the poor and low-income people by innovative financial ideas, systems and methods. Over years’ efforts, inclusive financial system has managed to expand from the relatively narrow field of microenterprise credit to the more comprehensive concept of inclusive financial system (which includes a range of financial services for poor people, including savings, money transfers, and insurance) to the enormous challenge of building inclusive financial systems.

While seen as a kind of marginal and small informal financial activity, Inclusive financial system has grown into an un-ignored economic form over the past 30 years.
In China, Inclusive financial system represented by rural banks has also achieved great accomplishment.

The good news is, formal financial institutions have been the main providers of inclusive financial service in a few countries. More and more people begin to realize that, today’s inclusive financial system should not be marginalized, but should be a necessary part of the country’s whole financial system. In practice, inclusive financial institutions and larger financial institutions are starting to learn from each other, extend business across fields, mix clients and services, thus blurring the borders of financial service between different institutions. Inclusive finance systems are gradually accepted.

The main belief of inclusive financial system is to provide finance services for the poor and low-income people. It emphasizes there should have equal access for all who needs financial services. The executors of the inclusive financial systems, are the providers of diversified and all level financial services.

The framework for an inclusive financial system recognizes that the massive number of excluded people will gain access only if financial services for the poor are integrated into all three levels of the financial system: micro, meso, and macro. Ultimately, integration into the financial system could open financial markets to the majority of people living in developing countries, including poorer and more geographically remote clients than are currently reached.

On the level of clients, poor and low-income clients are at the center of the financial system. Their demand for financial services drives the actions of those at all the other levels. On the level of micro level, the backbone of financial systems remains retail financial service providers that offer services directly to poor and low-income clients. These financial service providers include informal moneylenders to commercial banks.

Moreover, inclusive financial systems on the meso level should include the basic financial infrastructure and the range of services required to reduce transactions costs, increase outreach, build skills, and foster transparency among financial service providers. It includes a wide range of players and activities, such as auditors, rating agencies, professional networks, trade associations, credit bureaus, transfer and payments systems, information technology, technical service providers, and trainers. These entities can transcend national boundaries and include regional or global organizations.

On the macro level, an appropriate legislative and policy framework is necessary
to allow sustainable inclusive financial system to flourish. Central banks, ministries of finance, and other national government entities constitute the primary macro-level participants.

In fact, traditional financial systems at present fail to realize or conduct the conditions above in different degree. Therefore, transferring traditional ideas shows great significance in building inclusive financial systems.

C. Challenges for inclusive financial system

Inclusive financial systems aim to integrated and upgraded separate inclusive financial products and institution service into “inclusive financial industry” of the whole financial system development strategy, based on the experience of micro-credit and microfinance institutions, which is to construct a systematic inclusive financial service network.

Referred to the book *Building Inclusive Financial System* by United Nations, the final goal of inclusive financial systems is to build a complete financial institution system under a complete framework of policies, laws and legislations in every developing country.

The characteristics of inclusive financial systems includes: (1) All families and enterprises have access to get kinds of financial services, such as deposits, short-term and long-term loans, lending, agencies, mortgages, insurance, pensions, payments, domestic and international remittances, at reasonable prices. These services used to be access only to those who are “accepted by banks”. (2) Complete institutions. These institutions have reasonable inner management system, industrial performance standards and market legislation mechanism, and have prudential regulations in need. (3) Financial sustainability is the key to provide long term financial services. (4)Diversified financial service providers (including individual informal providers, Nongovernmental Organizations, and formal financial institutions) should provide cost-profitable and variable financial service under any feasible conditions.

In global version, three major challenges define the frontier of financial services for the poor: scaling up quality financial services to serve large numbers of people (scale); reaching increasingly poorer and more remote people (depth); lowering costs to both clients and financial service providers (cost).

1.2 Practice of Rural Banks

A. Path for China’s inclusive financial systems
The developing process for China’s inclusive financial systems is full of obstacles and controversies. It combines with the reform of rural financial system. Whether the inclusive financial system can achieve commercial sustainability through mechanism reform? Who is going to fulfill the hole left by state-owned banks’ withdraw from the rural financial market? How does political finance and commercial finance implement nation’s preferential policies for farmers? How do market-oriented rural credit cooperatives come back to cooperation? When can the private finance become formal? All these problems are the rocks on the development of China’s inclusive financial systems and rural financial system reform.

(1) 1978-1993: the beginning of rural inclusive financial system. 30 years ago, fixed output to households is the first step of China’s reform, and the restoration of Agricultural Bank of China is the first step of China’s rural financial reform. With the implementation of the production quotas, more than 200 million farmers released from the system of people’s communes and production brigades, becoming the subject of the rural economy again. The trading objectives changed from 26,000 people’s communes to more than 200 million farmers. The old financial mechanism of uniting urban and rural, mobilizing savings could not adapt to the new changes, and building a separate rural inclusive financial system is necessary. This is the social background of first rural financial reform in China, whose symbol was the restoration of Agricultural Bank of China. ¹

(2) 1994-2002: “Troika” deviates from inclusive financial system. In the second round of China rural financial reform, the design of “troika” policy has brought light to reformers and farmers. In 1994, the Agricultural Development Bank of China was founded, bearing policy-oriented financial services stripped out from the Agricultural Bank of China, thus getting the mission of financial inclusion policy. Meanwhile, Agricultural Bank of China began the transition to state-owned commercial bank. The

¹ On February 1979, the State Council issued Notice on the Restoration of the Agricultural Bank, and economic experts Fang Gao served as president of Agricultural Bank of China. Out of political and social unity system during the people’s commune period, rural credit cooperatives became grassroots organizations of the Agricultural Bank, as “government-run”. It is not consistent with the original intention of the reform. On August 1984, the State Council approved “report on the Management System reform of rural credit cooperatives in the Agricultural Bank of China”, which proposed to build the rural credit cooperatives as real cooperative financial organizations, to restore “three nature”: mass organizations, democratic management, flexible operation. Financial services provided by formal financial institutions were far from meeting the needs of rural financing. Private lending found its living space. On May 1981, the State Council approved “report of Agricultural Bank of China on rural lending”, which affirmed the role of private lending. In 1984, Luijiaying township of Hebei Kangbao county, formally established China’s first rural cooperative fund. Thus began, rural cooperative funds rapid expanded around the country.
core of this reform was to pull back rural credit cooperatives, which went further and further away on the “government-run” road, back to the nature of the “private co-finance”. In 1996, the State Council’s *Decision on Rural Financial System* claimed that, rural credit cooperatives should separate itself from Agricultural Bank of China administratively, and supervise by People’s Bank of China, and gradually changed to “cooperative financial organizations which was farmers-owned, social democratic managed, and providing services primarily for members”. So far, the basic framework of “troika” in rural finance has been completed. According to the reform intention, the Agricultural Bank of China specializes at commercial lending, Agricultural Development Bank of China issues policy loans, and rural credit cooperatives mainly issue small loans to farmers, building a rural inclusive financial system consisted by commercial finance, politic finance and cooperative finance, to meet the rural financing needs.

However, the policy effects were not as perfect as expected. What we saw, was not the prosperity of “troika”, but deteriorating financing dilemma of supply and demand in rural areas. Why? In the late 1990s, the state-owned commercial banks have fled rural areas in chasing profit. The Agricultural Bank of China have also gradually merged and canceled grassroots branches, quietly withdrawing from the rural credit market. Postal Savings was the only county financial institutions throughout China, offering deposits, foreign exchange and other basic financial services to farmers, but they were “deposit-only” for a long time. Thus, rural credit cooperatives have become the “main force” in rural finance, even shouldering the policy function of supporting agriculture and inclusive finance. That’s the embarrassing situation “one support three” in rural finance at that time.2

(3) 2003-2005: The reform of rural credit cooperatives cast a shadow on inclusive financial system. In 2003, the president of Hebei Dawu Group, Sun Dawu, was arrested by the local police for “suspicion of illegal fund-raising”. The case shocked

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2 In the period of this reform, the biggest shock was rural cooperative fund storm in late 1990s. After the Asian financial crisis in 1997, the internal contradictions of rural cooperative fund came to the surface. A run on the banks broke out around county, threatening the stability of rural society. Guangdong Enping is the storm-stricken area. On December 1998, the city’s 20 rural credit cooperatives were all closed, and Enping Branch of the Agricultural Bank was forced to stop business. The city’s financial outlets sharply decreased from 266 in 1997 to 43. Some towns even had no financial outlets. Even today, Enping is still the only county area who has no rural credit cooperatives. Cheng Kun, chief finance professor of Economics and Management School of South China Agricultural University, believes that government’s directly involvement in rural cooperative funds violates the purpose of mutual cooperation fund. On January 1999, the State Council ordered to ban rural cooperative funds. From here, government’s attitude towards private lending has thus undergone a 180 degree turn. The informal finance was severely suppressed, and gradually went underground.
the whole country, which meant the repression of private finance would continue. The “troika” reform design of formal rural finance came to an end. The rural credit cooperatives became the only formal financial institution who stuck in the rural credit market. It was a great chance for rural credit cooperatives to be the leading actor in the third reform, instead of supporting players in the last two reforms. In 2003, the State Council announced *Notice about a Pilot Program to Deepen the Reform of Rural Credit Cooperatives*, officially opening the prelude to the third rural financial reform, which would expand from Jiangxi, Shandong, Zhejiang and other eight pilots to the whole country.³ New reform of rural credit cooperatives made a breakthrough. A multi-property system, including rural commercial banks, rural cooperative banks, rural credit cooperatives (unified corporate of county, corporate of both county and township), were gradually formed. In 2004, rural credit cooperatives achieved profitability for the first time, after 10 years’ overall loss.⁴

(4) 2006-2007: a new start for inclusive financial system. In March 2007, four new rural financial institutions were set up, Rongfeng Rural Bank of Jilin Panshi, Chengxin Rural Bank of Jilin Dongfeng, Huimin Rural Bank of Sichuan Yilong, and Huimin Loan Company of Sichuan Yilong.⁵ At the same time, China’s first rural cooperative financial institution whose shareholders were entirely voluntary farmers, Baixin rural mutual cooperatives was officially listed at Yanjia village, Lishu county.

³ Professor Wang Shuguang, China Financial Research Center of Peking University, analyzed that there were two focuses of the rural credit cooperatives reform. One is the property rights system of rural credit cooperatives, aiming at clearing property rights and improving the corporate management structure. The other is administration system of rural credit cooperatives, which means local government takes responsibility and establishing rural credit cooperatives on the province (city) level.

⁴ In 2005, the present director of Guangdong Finance Office, Luo Jidong, was required to found Rural Credit Cooperatives Union of Guangdong Province. Luo Jidong believed that the rural financial reform can only take the stock system, instead of going back to the cooperative system. He also brought up “one bank, two systems” model, which means merging to the provincial rural banks in developed areas, and keeping independent legal status of rural credit cooperatives in underdeveloped areas. Unfortunately, the idea has not yet been fully implemented. In August 2007, Rural Credit Cooperatives Union of Hainan Province was listed, which was the last opening of the provincial institution.

⁵ In April 2008, China’s first official microfinance pilot project with Grameen model quietly opened in Hainan Qiongzhong. The project specialized in providing small loans to poor rural women, successfully transplanted the Grameen Bank in Bangladesh. Therefore, professor Yunus, who founded the Grameen Bank, was known as “the poor’s banker” and won the 2006 Nobel Peace Prize. Chinese government was greatly motivated by this news. A reform to open rural financial market was brewing. In December 2006, the CBRC issued Several Opinions on Adjusting and Relaxing Access to Banking Financial Institutions in Rural Areas. For the first time, the government allowed the industrial capital and private capital to build new banks in rural areas, and proposed to build rural banks, loan companies and rural mutual cooperatives and other categories of financial institutions. The policy intention was clear. It has been called ice-breaking measure of China’s fourth rural financial reform by financial industry.
of Jilin Siping. The increasingly active new rural financial institutions and private finance, promoted the reform of traditional formal financial institutions. In March 2007, the Postal Savings Bank was established, telling the end of the “only-deposit” history of postal saving, and the opening of certificates of deposit, small pledge loan and other services.

B. The principal part of China’s inclusive financial system: Rural bank

Since 2008, China’s new rural financial institutions pilots have expanded from 6 provinces (regions) to 31 provinces (municipalities, regions), and a series of supportive and standardized policy documents of new rural financial institutions have been introduced. Official data shows, there are 903 rural banks up to March 2013, among which 836 are approved. For region, 557 rural banks are in the mid-west areas, accounting for 62% of the whole.

(1) Rapid expansion of asset scale. As of the end of March 2013, the total assets of all opened rural banks is ¥454 billion, among which there are the ¥263.6 billion loan balance, and ¥385.5 billion total liabilities (including ¥316.4 billion deposits).

(2) Deepening of agriculture support. As of the end of March 2013, all rural banks have issued a total of ¥97.4 billion loans to farmers and ¥132.2 billion small and micro enterprise loans, which accounts for 87% of the total loans. Since established, rural banks has issued loans to 880,000 farmers with ¥236.4 billion, to 210,000 small and micro enterprises with ¥419.8 billion, increasing the total supply of credit in rural areas.

(3) Overall compliance to regulatory indicators. As of the end of March 2013, weighted average capital adequacy ratio of all rural banks is 25%, core capital adequacy ratio is 23.6%; non-performing loans is ¥970 million, non-performing loan ratio is 0.37%, loan loss reserve adequacy ratio is 332%, provision coverage ratio is 601%, loan provisioning rate is 2.22%, and the liquidity ratio is 67.9%. Major indicators meet the requirements. The overall risk is under control.

(4) Enhancement of operation sustainability. In the first quarter of 2013, 640 rural banks achieve profit, accounting for 80% of all. Total profit is ¥2.27 billion, with an increase of ¥650 million and an increasing rate of 40%. Return on assets and return on equity is 1.66% and 11.7% respectively. The rural banks with no profit usually run for a short time, some less than 1 year.

6 Data is from the report of Sixth Forum on China Rural Banks Development, in June 2013, Zhengzhou.
Besides, the encouragement of private capital to build rural banks has also motivated foreign banks. They provide a strong complement to inclusive financial system.

With the development and innovation of new rural financial institutions, not only rural banking coverage rate has been improved, but also increased the supply of rural finance. It is of great importance in encouraging farmers’ entrepreneurship, income increase and rural economic development in pilot areas. Making the new rural financial institutions a strong compliment to formal financial institutions, and making rural banks, loan companies and rural mutual cooperatives, small loan companies, etc. to be motivation for rural finance development, is the direction of Chinese rural financial system reform.

In fact, the establishment of these rural banks is an important step for China’s modern inclusive financial system. The more rural banks there are the more perfect the competition in rural inclusive financial markets will be. In order to quickly occupied and expand the market, rural banks speed up their business innovation, and develop a variety of credit models, such as farmers joint guarantee, civil servants guarantee, leading agricultural enterprises guarantee, and combining guarantee. Some rural banks even start conceptual mortgage, intangible mortgages, unsecured small loans to farmers and other products.

C. Villages, banks and rural banks

*Village is the basic unit of China’s rural society.*

Today, “village” is a redefined organization by the government of social space where farmers survive, and a community through which the state power runs down to the rural areas.

(1) Components of village. In Chinese vast countryside, the economic, political and cultural development is so uneven that there are significant regional differences in both internal structure and external environment. Nevertheless, there are some elements in common.

**Population:** every village has its definite population. The social members in rural areas are organized to one and another incorporated villages set by the government. Each rural social member knows the village name they belong to. What’s more, most members of the same village have kinship or clan relations to some extent.

**Village-region:** specific population of a village is always corresponds to a specific geographical boundary, which is clear between villages. In China, all rural lands (no
state-owned included) are distributed to villages, which are occupied and used by the population of the village. The population of the same village has common geographical concepts emotionally or psychologically, provincialism, thus having a sense of identity with each other.

**Community-based memory:** the information can transfer smoothly within the village. There are clear communication channels between individuals and villages. “Zhang’s long, Li’s short” is the normal internal information flow. By this means, one’s words, parade characters, merits and demerits, etc. can be long circulated in the village.

**Culture:** different cultures are formed because of their specific history, tradition and customs. The world is small for everyone in the village. They value family, and believe in “fallen leaves going back to roots”. To great extent, they have a deep dream of realizing their value in their own village.

**Common goal:** despite of some interest conflict between each other, the population of a village must have share more or less common interests and pursue implicit or explicit common goals. What’s more, the common goals among the village population largely rely on common property.

Overall, from the perspective of histology, the village is a collaborative system, a formal organization, and a special morphology widely existed in today’s Chinese rural society.

(2) Nature of village. As an organization, the first special provision of the village is the complexity of its organizational structure. The village is not only an economic organization, but also a political organization and a social organization.

In reality, village is an economic object, which occupies and dominates all lands within the village boundary, organizes and coordinates agricultural productions, and motivates and leads villagers to do non-agricultural economic activities. As an economic organization, the village can take independent property distinguished from individual villagers, in its own name legally. It can do economic activities distinguished from individual villagers in its name, as well. To large extent, the village, as an economic organization, is an economic community that members in it share all risk and interest. The results of the village’s economic activities, either risk or interest, will be shared by the villagers in the end.

Another name of the village, “incorporated villages”, hints another identity, a special political organization with certain political functions. In China, township government is the most grass-roots political organization. According to the laws, a
village should not be a political organization. However, there is no doubt that, village is the most administrative division in the countryside. That’s why village is also called “incorporated villages”. Particularly, the party branches established on villages, are the highest authority in village affairs decision-making. It is an effective tool to manage the rural society. Villages play an important role to convey the guidelines, policies and directives of the party and the state to all villagers timely.

Besides economic organizations and political organizations, villages are social organizations with social functions. The necessary agriculture ensures a village could exist as a relatively independent and closed social unit. Even today, for most farmers, it is still holds that “the society only exists within the village”. The village takes responsibility for sickness, death, education, disputes and other important issues in villager’s life, more or less.

_Banks are typical financial intermediaries._

Banks are the main force of the financial market. The New Palgrave Dictionary of Money and Finance explains “Banking Firm” as the intermediary of savers and investors, who takes savings from residents as current deposits and savings deposits, and places them into real investment capital.  

According to the definition in early banking theories (Meade, 1934), the function of a bank is mainly taking deposits and issuing loans. Certainly, there are difference between deposits and loans, under the requirements of uncertain current balance and legal currency or the central bank balance.

However, as the traditional banking business lost its significance, modern banking theories (Leland, 1977; Kracaw, 1980; Diamond, 1984) emerged. According to modern banking theories, banks should focus more on assessing and supervising borrowers. Banks are regarded as assessors for investment opportunity in the primary market and secondary market. They could screen possible investment opportunity and calculate its expected return, from data showed by the demand and supply of funds, which is not always objective. In the process, the credit departments of banks play a central role. The credit departments assess possible investment opportunities, to help banks to transfer deposits from residents to successful, profitable investments in the public interest. Once invested, the bank should supervise the investment to ensure the maximum possible repayment of funds. This is the basic characteristic of risk loans in

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an incomplete information market.\(^8\)

**Rural banks are inclusive financial institutions set up in villages.**

In China, “rural banks” is defined as: banking financial institutions funded by domestic and foreign financial institutions, domestic non-financial corporates and domestic natural persons, set up in rural areas, and mainly providing financial services to local farmers, agriculture and rural economy. Rural banks are first-level corporations, rather than branches of banks. There are three characteristics of rural banks:

- **Property right structure:** Rural banks are joint-stock banks, with clear and diversified property right structure. They should be sponsored by at least one (including one) domestic banking financial institutions. In China, all kinds of new capital are encouraged to found rural banks that mainly provide financial services to local farmers in rural areas.

- **Meanwhile, the share proportions are limited:** single domestic regulations banking financial institutions shall be no less than 20%; single person, single non-banking corporate and its related parties in total should not exceed 10%. Any corporate or individual that holds more than 5% shares of rural banks and rural cooperative financial institutions should be approved by the regulators.

- **Corporate governance:** rural banks should be constructed with modern corporate system, setting up simple and flexible corporate governance, according to the characteristics of small scale and simple business. Business process and management process should be set scientifically to ensure efficient, safe and steady operation. The control and management of the decision-making process should be strengthened, the decision-making chain should be shortened, and operational efficiency of decision-making should be improved as well. Besides, the constraints of senior managers should be strengthened, in order to prevent power out of control. Rural banks as first-level corporations, is a flat structure with short decision-making chain, fast response. They can create financial products according to current agricultural and

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\(^8\) However, for some reasons, there are some temporary problems. Firstly, the market value of the program on one specific stage can’t reflect the possible return. Just as Diamond and Dybvig (1984) said, it leaves room for regulations and deposit insurances. Secondly, the requirements of liquidity and readily redemption of current deposits are threatens to banks. This kind of requirements, may come from cash needs and worries about asset value held by deposit institutions. It is very interest. It hints that banks are endogenous unstable, by modern banking theories. Models brought out by Gorton (1988) showed that, since incomplete information of banks’ asset value, macro conditions that lowers depositors’ expectation about economic stability, would cause the occurrence of bank panics.
rural economy, and operate in accordance with the principle of marketization.

Operation objectives: stand by farmers, support, help and benefit farmers, found “farmers’ bank” are the purposes of setting up rural banks. They are supposed to satisfy the needs of region and provide services for villages. Farmers could be divided into three kinds by income. The first level farmers are struggling to live with little education, skills and production elements. The second level farmers are getting rid of poverty and becoming better off, by doing some individual enterprises, farming and fishing. The third level farmers are enriched ones doing business activities of a certain scale. The supporting clients of rural banks are mostly the first two levels.

To understanding rural banks, we need to classify the connections and differences among common commercial banks, rural credit cooperatives, and rural cooperative funds.

(1) Rural banks and common commercial banks. Rural banks are small financial institutions in rural communities, operated by commercial principles, pursuing profit and avoiding risk, the same as common commercial banks. The differences are seen in the following three aspects:

Requirements for registered capital and asset scale are different. Compared to common commercial banks, registered capital and asset scale of rural banks are much smaller. According to Provisional Regulations on Rural Banks Management, rural banks set in county (city), registered capital should no less than ¥3 million; rural banks set in village (town), registered capital should no less than ¥1 million. While the minimal registered capital to set up a national commercial bank is ¥1 billion, a city commercial bank is ¥100 million, and a rural commercial bank is ¥50 million.

Market positions are different. The current banking system in China includes large banks, medium banks, but inadequate small banks, in management scale. Up to 2012, 4 large state-owned commercial banks own 0.01% institutions and 64% deposits of the whole country; 12 joint-stock banks own 0.03% institutions and 16% deposits; 112 city commercial banks own 0.32% institutions and 6% deposits; urban credit cooperatives and rural credit cooperatives owns 99% institutions and 13% deposits. Overall, the market positions of these banks and institutions are quite similar, which prefer large to small and prefer city to village for loans. More sadly, they act like “water pumps” to dry up the rural financial market, rather than supporting agriculture. On the other hand, rural banks are targeting at villages and farmers, to provide decentralized, small and personalized rural credit.

Clients are different. As the deepening of China’s financial system reform, the
state-owned commercial banks focus on structure transformation, and begin to withdraw from county economy. From 1998 to now, 4 large state-owned banks have canceled and merged 31,000 institutions at and below county level, taking back their loan authority. Statistics show that, in 2012, the average banking outlets of each county was less than 3, and 3302 counties even had no one. At the same time, the clients of commercial banks changed to high quality clients in the city, industry monopoly clients and high income groups in town, no more farmers, small and medium sized enterprises in rural areas. On the other hand, the clients of rural banks are just farmers, small and medium sized enterprises in rural community. They take the advantage of small size, direct management, short matching chain of demand and supply, deep understanding of local economy, low information collection cost and flexible operation, compared to common commercial banks.

(2) Rural banks and rural credit cooperatives. Though rural credit cooperatives focus on counties or even villages, they are cooperative rural financial institutions with strong policy functions, instead of commercial banks. More importantly, rural credit cooperatives can’t take the responsibility of “agriculture, rural areas, farmers” by their own. On one side, some rural credit cooperatives have great losses. The non-performing loan rate ranks first in the country’s financial institutions, which is more than 40%. On the other hand, driven by profit, rural credit cooperatives change funds from “agricultural to non-agricultural”, which is gaining attention. Instead of supporting agriculture, rural credit cooperatives have transferred large amount of funds to cities, thus weakening rural finance. As state-owned banks’ withdraw from rural financial market, rural credit cooperatives are the real monopolist in rural credit market. The service consciousness and methods can’t be effectively improved in an environment with inadequate competition. Rural banks and rural credit cooperatives could complement each other by following means:

Firstly, the existence of rural banks can prevent “Siphonage” of funds and release the demand-supply conflict in rural financial market. The imbalance of regional economy, difference of economic development among regions, and difference of urban and rural financial services can’t be solved in a short time. Therefore, local based rural banks can put funds absorbed from local market back to local market, thus preventing the “Siphonage” phenomenon which could result in negative effects, such as money shortage and private lending.

Secondly, it is good for improving services of rural banking industry. Since rural banks know better about clients and provide personalized services, rural credit
cooperatives may feel the pressure to do better in market segmentation and providing differentiated services. If so, the banking institutions will promote products and services innovations, thus improving the efficiency of the whole rural credit market.

Thirdly, rural credit cooperatives have great experience in years’ rural credit business, while rural banks just step into rural financial market, lack of experience. However, rural banks have the right to raise deposit rates and lower loan rates appropriately. Particularly, they can determine for larger loans, while rural credit cooperatives must get approval from higher levels. Time is important to seize opportunities in the changing market.

(3) Rural banks and rural cooperative funds. In 1990s, Chinese government established rural cooperative funds, trying to solve the loan difficulty in rural areas. It is a pity that they are gradually cancelled after 1998 for unclear property rights, disordered management, insider control and other problems. At present, rural banks are still in the pilot phase. If succeed, this pattern will be developed and extended to the nation. Learning from the rise and fall of rural cooperative funds, is meaningful for the healthy and sustainable development of rural banks.

In the first place, rural cooperative funds are informal funding organizations founded by rural collective economic organizations, without business license in law. Financial industry is highly monopolized by the government, not giving legal status to cooperative finance. That’s why the rural financial reform does not achieve desirable effects after so many financial system reforms. Rural banks are formal banks registered and regulated by China Banking Regulatory Commission (CBRC), belonging to formal finance in the financial system. They are independent accounting first-level financial corporations, instead of funding tools within collective economic organizations. What’s more, local governments’ direct involvement in rural banks management are prohibited, thus avoid manipulation of collective economic organizations and monopoly of local governments.

Furthermore, at least one shareholder of rural banks is licensed financial institution. This ensures rural banks will be managed as commercial banks in business pattern, in order to avoid financial risks of illegal operation. Once a time, some rural cooperative funds raised funds with high interest rate to invest blindly, causing the financial disorder. The lessons should be learned.

The last but not the least, rural banks have clear property rights and proper structure. The essence of rural cooperative funds problems is the property rights. The virtualization of public collective property rights and instability of private personal
property rights, leads to individual shareholders’ careless about management of the funds. The collective property rights which are not allocated to persons, just as “everyone has but no one has”. It leaves room for government infringement and insider control. In contrast, diversified but centralized property rights of rural banks protect themselves from insider control. They take modern corporate management and strength behaviors of senior managers, in order not to lose the power.

To understanding rural banks, we should pay attention the connections and differences to other new rural financial institutions, showed in table 1.

**Table 1: Connections and Differences between Rural Banks and Other New Rural Financial Institutions**

<table>
<thead>
<tr>
<th>Market access</th>
<th>Rural banks</th>
<th>Loan companies</th>
<th>Rural cooperative funds</th>
<th>Microfinance companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered capital</td>
<td>county (city)≥3 million village (town)≥1 million</td>
<td>≥0.5 million</td>
<td>town≥0.3 million; village≥0.1 million</td>
<td>LLC≥5 million Joint-stock≥10 million</td>
</tr>
<tr>
<td>Number of shareholders</td>
<td>Refer to Corporation Law</td>
<td></td>
<td>≥10</td>
<td>Refer to Corporation Law</td>
</tr>
<tr>
<td>Qualifications of shareholders</td>
<td>Initiated by the banking financial institutions</td>
<td>Fully funded by commercial banks or rural cooperative banks</td>
<td></td>
<td>Voluntary farmers Any legal capital</td>
</tr>
<tr>
<td>Equity structure</td>
<td>Maximum banking financial institutions shareholding ≥20% Other single shareholding ≤10%</td>
<td></td>
<td></td>
<td>single shareholding ≤10%</td>
</tr>
<tr>
<td>Business Capital Adequacy</td>
<td></td>
<td>≥8%</td>
<td></td>
<td>——</td>
</tr>
</tbody>
</table>
### Reserve Requirement Ratio
<table>
<thead>
<tr>
<th>Operations</th>
<th>Ratio</th>
<th>Refer to local rural credit cooperative</th>
<th></th>
</tr>
</thead>
</table>

*Interest rate: Floating range: 0 ~ benchmark interest rate announced by the central bank*

<table>
<thead>
<tr>
<th>Lending rate</th>
<th>0.94 ~ 4 times of bank benchmark interest rate</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Others</th>
<th>No offsite loans</th>
<th>No offsite operation; No deposits for members</th>
<th>No offsite operation; No deposits</th>
</tr>
</thead>
</table>

### D. Develop rural banks in an orderly fashion

**Initial period (from December 2006 to the end of 2007)**

In December 2006, CBRC promulgated the *Opinions on Adjusting and Relaxing Access to Banking Financial Institutions in Rural Areas*, to better support the construction of new socialist countryside. 6 provinces (regions) including Sichuan, Jilin were chosen as pilots to implement the policy. It was a great breakthrough of China’s rural financial policies to encourage all equities to set up rural banks which provide financial services to local farmers. After that, CBRC issued *Provisional Regulations on Rural Banks Management* and *Approval Guidelines for Rural Banks Establishment*. The two documents provided institutional guarantee for the establishment and management of rural banks in 2007. The pilots were also extended to 31 provinces. In this period, rural banks began to be established around the country. On March 1, 2007, the first batch of three rural banks opened. At the same time, China Development Bank established the first rural bank in Pingliang of Shanxi province. HSBC began its layout of rural banks in Suizhou of Hubei province. Up to the end of 2007, there are 9 rural banks in total.

**Catalytic period (from 2008 to the end of 2009)**

After the early exploration, the establishment of rural banks accelerated in 2008.
Agricultural Bank of China took the lead to establish rural banks in both Hubei and Inner Mongolia, which initiates large commercial banks’ establishment of rural banks. Later on, China Construction Bank, Bank of Communications, China Minsheng Bank, and Shanghai Pudong Development Bank participated in this field. As of the end of 2008, there were 91 rural banks. In March 2009, in order to further develop rural banks, Ministry of Finance issued Notice on the Targeted Cost Subsidies to New Rural Financial Institutions. According to the notice, eligible rural banks could get subsidies equals to 2% loan balance of last year, from 2009 to 2011. In June 2009, CBRC promulgated the Provisional Regulations on Restructuring Microfinance Companies to Rural Banks, allowing qualified microfinance companies to transfer to rural banks. In order to develop the new rural financial institutions including rural banks, CBRC drew up the Overall Schedule of New Rural Financial Institutions: 2009-2011, planning to set up 1,294 new rural financial institutions in three years, of which 1,027 rural banks. The CBRC required all offices to clearly know requirements in each phase, implement specific measures, actively promote them, and effectively accomplish the overall goals. As of the end of 2009, there were 148 rural banks.

**Acceleration period (since 2010 on)**

In the catalytic period, the establishment of rural banks and other new rural financial institutions was slow, and was lack of medium and large banks as main sponsor. In order to solve these problems, the CBRC issued Notice on Accelerating the Development of New Rural Financial Institutions Related Issues in April 2010. The notice required all regions to ensure the implementation of the three-year plan. What’s more, a range of policies were develop and adjusted: inked the large and medium sized banks’ participation in the establishment of new rural financial institutions to other market access; linking small and medium banking financial institutions’ establishment of branches to access to initiate new rural financial institutions; main sponsor who clearly owns more than 30 new rural financial institutions can set up a new rural financial holding company. In May, the State Council issued the Opinions on Encouraging and Guiding the Healthy Development of Private Investment, encouraging private capital to participate in the establishment of rural banks.

A series of policies accelerates the development of rural banks. For large banks and joint stock banks, China Construction Bank plans to set up 200 rural banks, cooperating with Spanish Santander Bank in holding company model. Bank of China chooses to set up 400 rural banks, cooperating with Temasek’s Fudengjinkong
Company in joint venture model. China Minsheng Bank and Shanghai Pudong Development Bank are also making plans. Some city commercial banks and rural commercial banks begin to put emphasis on establishment of rural banks, when the regulations on interregional business get tightening. Asset management companies have become a new force, hoping to make up the missing banking license. Meantime, 10 regions are approved to be rural banks pilots. The first rural bank in county-Xiangxi Changhang Rural Bank-opens in Hunan province in December.

As of March 2013, there are 903 opened rural banks, and 108 more are right on the time table. It can be seen that rural banks will emerge quickly in the future.

1.3 Development Prospect of China's Inclusive Financial System Represented by Rural Banks

A. Difficulties and problems

According to regulations, rural banks must be sponsored by a financial institution in the bank industry. An important factor causing the difficulty of launching rural banks is that it's hard to find a main sponsor. By the end of 2012, about 7% of all rural banks in China are sponsored by National Development Bank and the big four banks, 10% by national joint-equity commercial banks, 50% by urban commercial banks, 30% by rural commercial banks (including rural cooperative banks and rural credit cooperatives), 3% by foreign banks. Under current system, rural banks do not have enough attractiveness for most large and medium banks. Urban commercial banks and rural commercial banks are the major force to sponsor rural banks, but their abilities are limited by their capitalization and management.

After a period of initial development, with the gradually development of business and management, practically rural banks are faced with the following difficulties and problems.

The problems of top design

Due to insufficient arrangement of top design and deficiencies of execution, the actual operation of rural banks differs from what is designed by the system, causing various systematic constraints such as unclear policy directions, imperfect risk compensation mechanism, incomplete supporting facilities and unavailable settlement channels.

(1) The objective of serving "farmers, agricultures and rural areas" contradicts the sustainable development of rural banks. The institutional positioning of rural banks,
which is increasing financial supplies, developing financial services and activating financial competition in rural areas, differs from their market positioning of providing financial services for farmers, agricultures and economic development in rural areas. With agriculture being weak industry, farmers being dispersive individuals and vulnerable groups and rural areas being less developed areas, loans provided for three rural issues possess much more risks than industrial and commercial loans and loans for urban areas. In the current case of imperfect risk compensation mechanism, rural banks as independent enterprise legal persons have to shift their loan amount from three rural issues to industry, commerce and urban areas, for the purposes of reducing risks and maintaining sustainable development. As a result of this internal mechanism, loans of rural banks tend to be non-agricultural, big amount and short-term in practice. The difference between the institutional positioning and market positioning of rural banks will inevitably lead to the difficulty in achieving the initial goal of top design.

(2) There is mismatch between the serving objects of rural banks and the regulation of rural banks. From the perspective of industry regulation, due to the purpose of serving three rural issues and the characteristics of quasi-public goods in agricultural finance, rural banks should have enjoyed special support from the policy. But the regulation of rural banks is operated in a way like the management of commercial banks, causing the mismatch between the purpose of setting up a rural bank and its regulation. The policy preference of top design is not clear. When the development of rural banks enters into a popularizing stage, whether the policy prefers encouraging the development or being prudent becomes unclear, which causes inconsistent execution of regulators in various regions and further the difficulty in the development of rural banks. Since 2009, the State Council and the regulation department have actively supported and guided the development of rural banks, showing encouraging policy attitude by introducing a series of policies, such as CBRC's Work Plan For New Financial Institutions In Rural Areas 2009–2011, The State Council's Several Opinions On Encouraging And Guiding The Healthy Development Of Private Investment, CBRC's Notice On Accelerating The Development Of New Financial Institutions In Rural Areas. But in practice, the supporting policies for rural banks have been continuously "modified". The unclear policy preference by top design has impacted and even changed the sponsor's expectation on the development of rural banks, thus reducing the impetus of sponsoring.

(3) Top design lacks supporting policies. Although the government has introduced
some regulations of fiscal supporting and tax reduction, the supporting for rural banks is still insufficient, and there are varieties in the execution of different regions. Firstly, the designs and executions of preferential policies, such as fiscal supporting, tax reduction, interest subsidizing and agricultural re-financing, are imperfect, causing disadvantage to the continuously healthy development of rural banks. The lack of encouraging and guiding forces impacts the enthusiasm and initiative for rural banks to support agriculture, which goes against the forming of financial market competition in rural areas. Secondly, rural banks have difficulty in attracting deposits due to low awareness, and in some areas rural banks are strictly not allowed to get support from the stable agricultural fiscal funds, these limitation of funds source has severely restricting rural banks’ loan amounts to three rural issues. Thirdly, the loss compensation mechanism of loans to three rural issues and small and medium enterprises, as well as the agricultural insurance mechanism, are imperfect. Agricultural loans are vulnerable to risks, easily affected by natural disasters or diseases, which increases the risk levels for rural banks to make agricultural loans.

There is one issue worthy special noting. Due to the inherent characteristics of high risks, high costs and low profits that agricultural economy has, rural banks as bank institutions should enjoy some subsidies and privileges from the government. However, currently the preferential policies have not been effectively executed in some places, mainly in the aspects of income tax and business tax, which have not been as privileged as in the case of credit cooperative. The credit cooperatives in central and western China are temporarily exempted from income tax and those from eastern regions enjoy 50% discount, whereas most rural banks are now imposed a standard income tax rate of 25%. As for business tax, the rate for credit cooperatives is 3%, in contrast with the rate for rural banks being 5%. To guide and support the development of rural banks, we should be neither blindly optimistic nor passively pessimistic, continuously strengthen guiding and supporting, timely introduce related policies and measures, and defuse and release risks in time.

(4) The supporting facilities for top design are insufficient. Due to limitations of size and access, the development of rural banks has incurred some problems that remain unsolved, such as fund settlement and credit system access. Firstly, the channels for fund remittance and transfer are blocked. Funds cannot go directly into the large- and small-amount payment system of the People's Bank of China, missing the convenience brought out by modern payment system. Most of the remittance businesses of rural banks are surrogated by other banks. Secondly, rural banks are
unable to search for the credit situations of their loans. Due to insufficient systematic support, high access threshold and inadequate professionalism, rural banks are difficult to join the anti-money laundering system, check images exchanging system and anti-counterfeit money information capturing system, only to consign searching to the local branch of the People's Bank of China. Thirdly, there are barriers in rural banks' business and institutional access. In one hand, most rural banks are unable to join China UnionPay to independently issue cards, due to reasons such as business systems are not independent, costs like entrance fees are too high, or no networking support for independently issuing cards. In the other hand, rural banks set a high access standard for institutions to join in. The existing rural banks only have one or two branches each, and this narrow coverage of financial services has severely limited institutional structuring and absorbing deposits, impacting business development to a large extent.

**The problems of development**

Rural banks typically have a short history, and some problems in prudent operation and professionalization have revealed, such as weak social credibility, inadequate deposits attracting ability, low quality of employees and imperfect legal-person governance structure.

(1) Low level of social recognition has restricted the sustainable development of rural banks. Compared to traditional financial institutions, rural banks have the disadvantages of low level of social recognition, limited operation scope, few numbers of branches, under-developed locating areas and no guarantees from national credit. These disadvantages of rural banks have resulted in the difficulty of organizing public deposits, the single channels of fund source and insufficient ability of sustainable development. Statistics showed that, almost all rural banks rely on the local governments' public deposits in their deposits business, with public deposits possess about 90% of all deposits and individual and enterprise deposits less than 10% in most cases. However, public deposits as a short-term governmental supporting activity cannot be long-term and sustainable, whereas individual and enterprise deposits are the core of rural banks.

Currently most rural banks are faced with difficulty in raising fund and low growth of liability business. Firstly, rural banks lack enough social recognition. The short history and independent legal-person operation mode leave rural banks with little brand value. Local residents and enterprises are more willing to deposit in big banks and credit cooperatives. Secondly, rural banks are unable to interbank deposit
and withdraw, and therefore difficult to issue the UnionPay cards. As the central bank have not made clear the conditions for rural banks to join the large- and small-amount payment system, currently most rural banks are unable to join in. Meanwhile, subject to their limited funds and out-of-date systems, it's hard for rural banks to join the UnionPay, thus unable to issue cards. Thirdly, the fund sources are limited. Now rural banks are stopped from entering the national interbank lending market, blocked away from the privileged loans such as agricultural re-lending, and are unable to issue and trade financial bonds.

(2) Corporate governance and risk management need improving and strengthening. Scientific and effective corporate governance and internal management are essential for the sustainable development of rural banks, which coincidently are the most difficult problems. First of all, the corporate governance is hardly scientific and effective. The situations that the main sponsors are too big or the participants are too closely related can easily lead to problems, e.g. the regulation system lacks independency, the stimulation and restriction mechanism is imperfect, the risk management system has drawbacks, and the information disclosure mechanism is unsound. Secondly, the institutional structures are difficult to simplify. According to regulations, a rural bank can set up only the board of directors or nothing for a simple and flexible organizational structure, based on its complexity of decision-making management, business size and service characteristics. However, the business sector demand rural banks to build an organizational structure that includes three committees and one dimension based on related rules of the Corporation Law. This causes the situation of "big horse and small carriage", which not only fattens the corporate governance structure and affects the efficiency of decision-making and operation, but also forces rural banks to employ people from the main sponsoring bank as part-time employees, which places more burden on rural banks and increases their relying on the main sponsoring bank in operation and management. Thirdly, restricted by factors such as size, human sources and technology, the internal control and risk management of rural banks are disadvantageous compared to other commercial banks, causing difficulties in managing credit risk, operational risk and market risk. Finally, the innovation ability of rural banks is inadequate. Due to natural conditions and agriculture characteristics, rural financial environment in China has a huge difference with urban financial environment. If rural banks entirely copy the business mode of the main sponsoring bank and do not innovate in their own business modes, then unaccustomed situation will definitely occur. Currently most rural banks have focused
on attracting deposits and expanding credit sizes, do not have enough innovating motivation in operation mode and the products, have a complex streamline and cannot make full use of the advantages of small banks.

(3) The operational mode of credit business and risk management need improving and innovating. The key for rural banks to keep sustainable business development in serving the three rural issues is to control the credit risk. From current situation, three factors have kept the credit risk of rural banks in control in the short term, specifically advantageous economic environment, high quality clients and strict external regulations. But in some periods in the future, situations may change in different degrees. According to the three year plan of China Banking Regulatory Commission, the amount of rural banks in the central and western regions accounts for 62.4% of all, and the economic and financial situations in these regions lag behind those of the regions that have rural banks to some extent, therefore the newly built rural banks are faced with more grim credit environment. From the rural banks themselves, currently they have made some daring innovations in credit guarantee, the products and procedures, and have made beneficial adventures in pre-loan investigation, in-loan check and post-loan management. But there are also a huge amount of rural banks now choose a traditional way of business operating mode, which leads to the de-agriculture phenomenon in customer positioning to some extent, and lack innovations in areas of business scope, credit investigation, mortgage guarantee, post-loan management and interest rate pricing. Rural banks and the current financial institutions in the rural areas are homogeneous competitors to a large extent, but not differential competitors. Besides, as the history of rural banks grows, some temporary unrevealed periodic and industrial problems will reveal step by step. To form more specific small-amount credit operating mode and risk management mechanism is outstandingly important and urgent for rural banks.

(4) The quality of employees needs to be improved. As rural banks are mostly located in counties or small towns with a relatively short history, they have little attractions for financial talents; therefore the problem of talents is a restriction factor for the development of rural banks. Managers of most rural banks come from the main sponsors, but as the human resources of the main sponsors are limited, rural banks generally have the problems of inadequate human resources and too many concurrent posts, which impact the operations of internal control system to a large extent. New employees generally have the disadvantages of inadequate financial industry experience, insufficient business skills, weak endogenous development
ability and bad internal management ability; therefore the deficiency of human resources will severely restrict the development of rural banks in a certain period.

B. Guidance and support

**Accelerate the uniform of development policy preferences and business sustainable development.**

Firstly, the policy preferences should be made clear, and the guidance of policy should be strengthened. After conducting a thorough and rational trade-off between the strategically choices of all participants, the behaviors of market participants should be restrained and regulated by strengthening policy guidance and improving supporting mechanism, in order to reach the goal of top design.

Secondly, policy supporting and business sustainable development should be uniformed. Not only the plans and goals of launching rural banks should be proposed in a prominent way, but also the guidance of rural banks development should be carried out in a variety of areas such as management mechanism, supervision mechanism, policy support, technology support and consensus propaganda. Thus, rural banks can firmly march toward the aim of "to support and serve the three rural issues" in the direction of the policies in one hand, and get profits and maintain business sustainable development in the other hand.

Thirdly, business sustainability of rural banks development should be solved and improved by policy support. For example, to solve the problem of low social recognition and the difficulty of attracting deposits, the allowance for rural banks to set up branches specially for deposits (credit business are not allowed) in the urban areas of the cities will build a channel to transfer urban funds to rural areas and solve the problem of attracting deposits in the short run. For another example, to avoid the risks beyond management abilities brought out by the sponsors launching dispersive rural banks in various areas, and at the same time to satisfy the hope of sponsoring banks to launching rural banks in a sizable and clustering way, the "point-to-point" linkage of rural banks could be changed to "province-to-province" linkage in order to concentrate the development of rural banks.

**Strengthen the external supporting mechanism of top design.**

Firstly, external policy supporting mechanism suitable for the development of rural banks should be built up. Primarily, fiscal and tax policy supporting should be strengthened. We recommend that the forces of fiscal department and regulation
department act together, to introduce some supporting policies in fiscal subsidy and tax preference and extend the policy supporting period, in order to create great social and policy environment to encourage the launching and developing of rural banks. Next, differential regulation policies should be adopted. Based on the quasi-public goods property of rural banks services, policies like differential interest rate, preferential rediscount rate and relatively loose regulation could enhance the funds capabilities of rural banks, increase the return and turnover rate of credit funds and decrease the finance costs and credit risks in rural areas. Then, a multi-dimensional agricultural credit risk protection mechanism should be built up. Finally, local government should give some support. By opening agricultural fiscal deposit account in rural banks, local government can improve the credibility of other clients in rural banks. If possible, some local governments could link their fiscal deposit account to agricultural loans, making the financial institutions that contributed three rural issues get more fund support. Local governments could also offer further support in operating ground, fees subsidies and fiscal deposits, set up local reward fund to award those rural banks that have made great contributions and achieved great performances in supporting agriculture, in order to encourage rural banks invest more in the three rural issues.

Secondly, the technology supporting platform environment should be strengthened. The opening up of settlement system, credit system and business access for rural banks should be accelerated in order to widen the services of rural banks. The People's Bank of China should check rural banks' names and numbers as fast as possible, lower the threshold of entering payment settlement system for rural banks in order to efficiently solve the problem of transfer barrier. The fees for rural banks to join the UnionPay should be decreased in order to encourage card issuing and offer better service for three rural issues. Besides, the central bank should also loosen the conditions for rural banks to directly be connected to the credit management system, in an attempt to strengthen the abilities of managing the credit situations of their customers and the loan risks management.

Thirdly, by setting up industry association, policy focus and support could be gained and a good developing environment could be built. The industry association acts unique roles in communicating information, supporting regulation, integrating functions, promoting innovation and improving services. These roles could strengthen the self-regulation ability of the industry's organizations and promote a normal development of the industry. By ways of periodic training, communicating,
cooperating and collaborating, the rural banks could explore together the innovation mode of agricultural financial services, understand the industry policies in time, improve the knowledge levels of professional teams, express industry needs and reflect market trend. With the platform of industry association, rural banks could strengthen cooperation with other kinds of financial institutions, build up financial risk warning mechanisms and improve financial risk management abilities.

Fourth, the main sponsoring system of rural banks should be adjusted. Currently, whether rural banks can achieve business sustainability should be checked in practice. In this process, private funds can obviously play an important role, but the current regulation system has restricted the ability of private funds. The main sponsoring system of rural banks has directly caused the situations that almost all banks chose to absolutely or even entirely take control over rural banks, which resulted in almost no private funds in rural banks. At the same time, China Banking Regulatory Commission has regulated that microfinance companies could be transformed to rural banks, based on not only a series of conditions, but also the relative regulations of rural banks shareholdings. This is to say, that private funds have to give up their shareholdings to some main sponsors after years of operation, if microfinance companies are transformed to rural banks. This kind of system design, which was based on risk control, has restricted the abilities of private funds in activating and promoting rural financial markets, and restrained the contributions of rural banks as new rural financial institutions in terms of mechanism. From evidence of practice, microfinance companies, brought out by People's Bank of China in 2005, have achieved fast development as they could be entirely managed by private funds, although they could only make loans and had registered capitals 3 to 4 times that of rural banks. Up to August 2013, there are 3600 microfinance companies across the country, among which provinces of inner-Mongolia, Liaoning and Jiangsu are biggest in number. The top 8 provinces accounts for 50% of all microfinance companies nationwide, and have nearly 40 thousand employees. Microfinance companies have a loan balance of 300 billion, which are mainly short-term (accounting for 98%), operational, and individual (accounting for 60%). The main sources of funding for microfinance companies are own funds, which account for 80% and have an amount of 270 billion Yuan up to August of 2013. Financed funds come the second, with an amount of 37 billion and a percentage of 10. Others are profits, accounts receivables and loss provisions. The profit levels of microfinance have increased, with no losses for microfinance companies who last more than one year, and the book profit of
microfinance companies has reached more than 14 billion Yuan up to the end of August.

To accelerate the launching of rural banks, and play a demonstrative role in achieving sustainable development of rural finance, private funds should be sufficiently activated institutionally. Currently, in the regulations of rural banks in Jiangsu and Zhejiang provinces, there are some limitations in the highest shareholding rate of banks, in an attempt to ensure the mechanism advantage of rural banks. As for qualified microfinance companies, the shareholders after transformation should be allowed to include non-bank financial institutions, in order to activate the motivations of private funds as much as possible.

C. Innovations and development

*Insist market operating orientation, and improve core competence.*

Firstly, to insist market operating orientation supported by government, strengthen the target positioning of financial services, bring small bank's advantage into full play, improve social recognition of rural banks and build mis-matching competition. Rural banks should set their main aim to serving the three rural issues, firmly hold the development opportunity in the process of agriculture industrialization and urbanization, build mis-matching competition with traditional agriculture-related financial institutions. Meanwhile, rural banks should bring small bank's advantage into full play; make full use of "soft information" and regional relationship to widen financial services. Strategically, rural banks should divide financial markets according to situations of local economic development, vigorously tap and nurture a group of high-quality customers, and avoid homogeneous competition with other bank institutions.

Secondly, to build simple and effective management structure, and improve streamline levels. In system design, rural banks should obey simplicity and flexibility, emphasis on completing incentive and restriction mechanisms, lower the costs of agency and supervision, and build their corporate governance structures and mechanisms according to the size and operation decision. In development management, the sponsoring bank should take the responsibilities of strategy management and development guidance, take into account both the "soft management" featured in strategy management and culture management and the "hard management" featured in risk management and quantitative index regulation, strengthen support in human resources, knowledge, operation management together,
and enhance the internal management streamline and efficiency of rural banks.

Thirdly, to emphasize on adaptation of the products, improve innovation ability of the products. On the premise of risks under control, financial products and services needed by rural areas should be introduced step by step, including insurance, agency, guarantee, personal money management, information consulting, and bank cards and so on. Rural banks should be encouraged to widen guarantee and mortgage businesses for different customers groups, for example wood property mortgage and warehouse certificate mortgage, adopt new loan mechanism such as "farmers + rural products + banks", "farmers + guarantee companies + banks" "co-guarantee of three families", actively support the development of agriculture industrialization, and achieve win-win of banks and enterprises.

Fourth, to insist on specialize operation, build rural brands. The basic for rural banks to survive and develop is the differential market. Rural banks should satisfy the needs of rural customers using specialized financial products and services through business innovation, vigorously tap and nurture "eating customers" and provide with them deep, careful and good financial services. Nurture a group of high-quality customers who trust the rural banks and have the willingness to communicate with rural banks. At the same time, rural banks and their shareholders should pursue long-term value, and should not watch closely the traditional fields of business banks just for current interests, walking in the dead end of homogeneous development. The specialized and differential operations of rural and small areas should be heavily pursued, and this is also the core and origin of rural banks. Rural banks should spare no attention in the financial services needs of rural and small areas, build brands featured in supporting the rural and small areas by means of strengthening customer dividing and differentiation management, continuously introducing innovation products that highly satisfy market needs and continuously optimizing the business streamlines.

Fifth, to manage the development of talents well. The flexible preferential policies of rural banks in areas of salary, wages, welfare and promotion should be made full use of to build studying type banks and promote the sustainable development of the banks.

**Insist on business mode innovation, improve financial sustainability.**

As the developing of world economy and the improving of farmer situations, the world-wide microfinance industry has entered a new development period. Through an empirical survey for the costs and incomes of microfinance in 10 rural banks
Sichuan Province, factors impacting the sustainable development of rural banks are discussed from a view of financial indices. Fundamentally, financial sustainability based on market mechanism demands the operating income of financial institutions to surpass all costs. Therefore, for rural banks in rural areas of China, the core to achieve financial sustainability can be summarized as "improve income and decrease costs".

Firstly, the liability business development of rural banks should be improved by various methods. The key to solve the liquidity risks of rural banks is to improve the liability business development of rural banks. Primarily, rural banks should actively cooperate with local government in advertising to further improve recognition and credibility, and set up branches at the right time to fully absorb funds sources. Meanwhile, the main sponsoring banks should give rural banks enough support in system networking, products offering and brand advertising, solve the technological "mechanical damage" of rural banks in attracting deposits, and improve the social recognition of rural banks. Next, the regulation department should solve without delay the problems of rural banks joining the large- and small-amount payment system and credit information system of the People's Bank of China, joining the UnionPay system, entering into the national interbank lending market, issuing financial bonds, getting agricultural re-loan and the deposit insurance of rural banks, in order to offer support in technology, system and mechanism for rural banks to attract deposits and raising funds. At the same time, the liquidity risk management supporting mechanism should be further completed. The regulation department should guide the main sponsoring banks in policy to build and optimize a liquidity supporting mechanism for rural banks, and improve the asset liquidity of rural banks through businesses such as interbank lending, legal-person account overdraft, bills rediscount and credit asset transfers. Meanwhile, liquidity risk disposition mechanism of local People's Bank of China to rural banks should be built up, to ensure that rural banks could apply to use required reserves or obtain other fund support in case of temporary liquidity shortage.

Secondly, reasonable loan pricing and diversification of incomes are the main methods of improving incomes of rural banks and promoting financial sustainability. In improving incomes, loan pricing is the vital problem. Compare to general commercial banks, a single loan of rural banks has a relatively high cost, therefore the loan pricing method based on cost coverage means loans pricing of rural banks is largely higher than that of general commercial banks. But in early microfinance practices, out of protecting the borrowers, the regulation departments have generally set up an upper bound of interest rate for microfinance, and these restricted interest
rates are largely lower than the costs of small financial institutions, causing the severe inadequacy of microfinance supplies, which is harmful to the borrowers. Although in reality, small financial institutions have overcome the interest rate restriction by means of innovation and methods of charging fees and forced deposits, the loan pricing for small financial institutions have become complex and unclear since, which affects efficiency and goes against the long-term needs of microfinance development. Therefore, from a long-term perspective, to cancel the interest rate restriction to some extent and to make market and clear pricings is an important aspect to achieve sustainable development of rural banks. And in practice, there are many countries in the past period starting changing toward this direction. Diversification of incomes is also a useful method to improve incomes. As the financial service scope widens, incomes other than loan incomes (such as investment incomes, service fees) have increased, which is a good point for the sustainable development of rural banks, although the fractions are not high. Of course, diversification of rural banks incomes are basically related to customers' diversified needs for financial services.

Thirdly, in aspects of decrease costs, to decrease operative costs by scale of economy, and to decrease credit risks and achieve diversified fund sourcing by technology innovation, are important ways to facilitate financial sustainability of rural banks. In practice, high operative costs are the most important factor preventing microfinance from achieving sustainable development. Experience have shown that, the average size of loans, the operative time and the size of small financial institutions are important factors to lower operative costs. The average size of loans and the size index of small financial institutions show the cost cutting brought out by scale of economy, and the operative time shows the effect of "learning while doing" in small financial institutions practice. This also demonstrates that sustainable development can achieve virtuous cycle. Analysis shows that, the asset quality of rural banks is not worse than that of general commercial banks, this attributes to a series of risk releasing methods created in rural banks practice, therefore developing risk managing technique and introducing reasonable incentive mechanism are useful to lower the risks of rural banks and helpful in facilitating the sustainable development.

Fourth, as rural banks uses more commercial funds, to get a reasonable trade-off between increasing the operating size of financial institutions by using commercial funds in large-scale and controlling finance costs effectively, is an inevitable important problem in achieving financial sustainability. In this problem, it's more and more important for rural banks to learn from commercial financial institutions in
finance cost management. From practice, attracting deposits is the main aspect for most small amount financial institutions to get their commercial funds, and in the future absorbing steady funds by interbank lending and bond issuing is an alternative. Of course, because of rural bank's particularity, its development path cannot be entirely equal to that of commercialized financial institution. As rural banks are responsible for more social missions and tasks, in practice rural banks receives uncertain subsidies and donations from governments and other institutions. Some degree of reasonable subsidy has positive effect in forming sustainable development mechanism as well. From the long-term, we should devote ourselves to improving financial self-sufficiency of rural banks, and promote step by step the development and growth of this kind of financial institutions.

References

2. Inclusive Financing: the Practice of Microfinance in China

Abstract: For the purpose of facilitating the achievement of the millennium development goals (MDG)\(^1\) issued by the United Nations, the United Nations put forward a proposal to facilitate all the countries to build inclusive financial sectors around the globe when publishing the blue book of building inclusive financial system in 2006, meaning a financial system that can provide effective and comprehensive services for all social strata and groups (Bai Chengyu, 2006). It also conforms to the evolvement path of the financial services targeting the people with middle and low income in the global context, from microcredit originated in Bangladesh in 1970s, to microfinance thriving in Southeast Asia and Latin America in 1980s and 1990s, and to inclusive finance sweeping around the world after entering the 21st century.

The building of inclusive financial system can solve the long-term mismatch problem between financial supply and financial demand as a whole, which will pay full attention to the poor people at the bottom of the pyramid and reached by microcredit, and will also no longer ignore small and micro enterprises in the middle of social status and served by small and microfinance\(^2\). As Professor Yunus, the laureate of 2006 Nobel Peace Prize once pointed out, to enjoy financial services can be treated as a kind of human rights, allowing all the people with financial demand to access financial services.

Under the advocacy of the United Nations, all the governments and international organizations have taken actions to promote the reform and innovation in the field of finance, and they not only urge existing financial institutions to make product and service innovation, but also encourage the society from all walks of life to participate in the construction of inclusive finance, and enlarge the coverage of financial services and let more people enjoy financial services.

As the world’s largest developing country, China’s economy achieved leapfrog development after the reform and opening up. However, its financial sector was

\(^1\) On September 8, 2000, at the United Nations Summit, 189 member countries jointly signed the millennium declaration of the United Nations, aiming to carry out an action plan to reduce the global poverty in half by 2015 (on the basis of the level of 1990), namely, to eradicate extreme poverty and hunger; to achieve universal primary education; to promote gender equality and empower women; to reduce child mortality; to improve maternal health; to combat HIV/AIDS, malaria and other diseases; to ensure environmental sustainability; global partnership for development, collectively known as the millennium development goals (MDG).

\(^2\) Small and microfinance is more used in China, including two kinds of finance, small finance and microfinance, targeting small and micro enterprises.
facing the problems of insufficient financial supply, financing difficulties of small and micro enterprises and difficulties of farmers in getting loans, which widened the gap between rich and poor, intensified the social contradictions, led to the unbalanced economic development. In order to make up for the blank of financial supply and alleviate the problem of financing difficulties in the rural area, the Chinese government introduced three kinds of new type of rural financial institutions in 2006, namely, village and township banks (VTBs), lending companies, rural mutual credit cooperatives (RMCCs), achieving a major breakthrough in the rural financial policies, which can be regarded as the milestone of the rural financial reform. Especially the establishment of VTBs unlocked the doors to private capital to invest financial institutions, however, VTBs, as a sort of innovation, needs to be constantly explored for development and perfection.

This report firstly introduced the banking system of China, and expounded how China’s banking regulation and supervision evolved and how VTBs arose at the historic moment, and then concretely introduced the regulatory system and methods of VTBs, and took Harbin Bank and Ewenkeqi Baoshang VTB as examples to analyze how VTBs overcame the difficulties in practice to implement the idea of inclusive finance, and finally summarized the problems existed in the development of VTBs and also proposed the corresponding solutions and suggestions. Specific contents are as follows:

This report has a total of six parts including the introduction.

The introduction part mainly depicted the global development of inclusive finance and the corresponding measures taken by the Chinese government.

The first part in the text introduced the architecture of China’s banking system, and elaborated in detail the evolution of China’s banking regulation before and after the reform and opening up, and how to form the current pattern of separate operation and separate supervision, respectively. First of all, it defined the existing banking system of China, consisting of four major parts, namely, the central bank, regulators, self-discipline organizations and banking financial institutions. Among them, the banking financial institutions are divided into policy banks, large commercial banks, small and medium size commercial banks, rural financial institutions, the Postal Savings Bank of China and foreign banks. Secondly, it analyzed the changes of China’s banking regulation before and after the reform and opening up, with the function of the People’s Bank of China (PBC) as the main line, this paper described how the China Securities Regulatory Commission (CSRC), the China Insurance
Regulatory Commission (CIRC), and the China Banking Regulatory Commission (CBRC) were separated from the PBC, forming the financial regulatory system of “one central bank plus three commissions”.

The second part illustrated the establishment background and development situation of VTBs. First of all, the long-term shortage in rural financial supply, the increasing demand of farmers for financial services and the development of microcredit and microfinance prompted the CBRC to carry out the pilot project of three kinds of new type of rural financial institutions. Secondly, it briefly illustrated the overall scale of VTBs and provincial distribution. By the end of 2013, there were 1071 VTBs set up in 31 provinces throughout the country, covering 1,083 counties (cities), which accounts for 57.6% of the total counties (cities).

The third part concluded the regulatory system and methods of the CBRC over VTBs. First of all, it summed up the contents of adjustment and relaxation in the Several Opinions on Adjusting and Easing the Access Policy of Rural Banking Financial Institutions to Better Support the Construction of Socialist New Countryside (the Opinion) published by the CBRC on December 20, 2006, namely, to open access to capital; to lower the registered capital and cancel the limit of working capital; to adjust the qualifications of investors and relax the proportion of shareholding by domestic investors; to ease the condition and scope of business access; to adjust the entry qualifications of directors and senior management personnel; to adjust the power of examination and approval for new corporation organizations or branches; to adopt a concise and flexible corporate governance. Secondly, the Opinion put forward the following four regulatory measures over VTBs: to adhere to the principle of “low threshold, strict supervision”, and the implementation of prudent supervision; to adopt different regulatory measures based on the capital adequacy and asset quality conditions of new rural banking corporation organizations; to guide and supervise the money investment of new banking corporation organizations; to set up service quality evaluation system of supporting agriculture for rural banking financial institutions.

The fourth part shared the cases of Harbin bank and Ewenkeqi Baoshang VTB in practicing the idea of inclusive finance. First of all, it roughly described how Harbin Bank as the main originator ensured the development of VTBs as a whole not to deviate from the original intention and laid a solid foundation for the sustainable growth of all the VTBs. Secondly, it illustrated in detail how EBVTB overcame
difficulties and found financial solutions to meet the needs of local farmers and herdsmen.

The fifth part raised the problems occurred in the development process of VTBs and also provided the solutions and suggestions. First of all, it illustrated the problems from six aspects, namely, single largest shareholder, deviation of market positioning, difficulty in mobilizing savings, lack of financial innovation, lack of human resources, and no enough policy support. Secondly, it also listed six suggestions in response to the above problems, i.e. to broaden the scope of the largest shareholder; to supervise and guide market positioning; to cooperate to find funding sourced; to develop financial innovation mode; to cooperate and optimize human resources; to intensify policy support.

This report finally made a one sentence summary.

**Key words:** Inclusive Finance; Rural Finance; VTB; Banking Regulation

In 2005, United Nation defined 2005 as “the Year of Microcredit” for the purpose of recognizing the contribution of microcredit\(^3\) to global poverty alleviation and the promotion of microcredit operation around the world. United Nation raised the concept of “Inclusive Finance\(^4\)” for the first time in the book of “Building inclusive financial sectors” issued in the same year, which further extends the boundary of microcredit so that comprehensive financial services including microfinance can be reached by a wider range of people instead of the only population at the bottom of the pyramid.

According to the recent statistics of the World Bank, around 2.5 billion people do not have access to formal financial services. In order to ease this situation, national governments, especially the governments of developing countries, under the impetus of Alliance for Financial Inclusion\(^5\) (hereinafter referred to as AFI), are actively

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\(^3\) “Microcredit” in Chinese is translated from a English word, and this word was raised by Professor Yunus who is the founder of Grameen Bank in 1970s (Yunus, 1998), literally microcredit means small amount of loans without collateral provided to the poor population, different from credit products of traditional banks. Grameen Bank has more comprehensive explanation about microcredit, pls refer to the website at http://www.grameen-info.org/index.php?option=com_content&task=view&id=32&Itemid=91

\(^4\) “Puhui Jinrong” is originated from the English phrase “inclusive finance”, Bai Chengyu, Secretary General of China Association of Microfinance, first proposed the Chinese translation of this phrase in 2005, and then Mr. Hu Jintao, former President of China, formally use the concept of inclusive finance (puhui jinrong) at Mexico’s G20 Summit in 2012.

\(^5\) Alliance for Financial Inclusion (AFI) is a member-based international organization comprising central banks and financial regulators of different countries, which was funded by GIZ in 2008 whose former name is GTZ. The mission of AFI is to facilitate the building of inclusive financial
promoting the application and expansion of the concept and practice of inclusive finance, and encouraging all kinds of financial institutions to conduct financial innovation and satisfy various financial needs of different clientele so as to allow financial services to reach a large number of middle and low-end groups. According to the proposal made by AFI at the global policy forum held in Mexico in 2011, most of financial regulatory authorities that participated in the forum signed “Maya Declaration”, aiming at release the potential of 2.5 billion people in the aspects of economic and social development through the building of inclusive financial system. In the same year, The China Banking Regulatory Commission (hereinafter referred to as CBRC) and the People’s Bank of China (hereinafter referred to as PBC) successively joined AFI on behalf of Chinese government in 2011.

In the building of inclusive financial system, “different financial products vary in their business models, so no financial service providers can overcome this challenge to provide all kinds of financial products. Instead, various types of financial service providers should coexist in a financial ecological system to serve the poor people at the bottom of economic pyramid” (World Bank, 2013). To achieve long-term financial support mechanism, we not only need to start from the diversity of suppliers, but also put both sides of supply and demand in a common financial ecosystem. We require full participation and support from all walks of life such as governments, private sectors and social groups, supplemented by the use of technology, to ensure that the people can get, use and benefit from convenient, quick, and sustainable financial services so as to realize the improvement of production and living, to promote the development of real economy and to complete the building of a harmonious society.

The Chinese government has continuously been emphasizing the reform and innovation in rural financial system in its No. 1 documents since 2004, encouraging all kinds of financial institutions to serve agriculture, rural areas and farmers and satisfy the financial needs of the masses of the people, especially the rural population by constantly enriching and completing the system of financial supply. This is also the strenuous effort made by the Chinese government in promoting the building of inclusive financial system. With the shrinking in rural financial supply, as the regulator of banking financial institutions, the CBRC was promoting the reform of rural credit cooperatives (hereinafter referred to as RCCs), meanwhile, it also

system. At the moment, it has members from more than 90 developing countries. For more information, pls refer to the website at http://www.afi-global.org/
launched a pilot project of three kinds of new type of rural financial institutions, namely, village and township banks (hereinafter referred to as VTBs), lending companies, and rural mutual credit cooperatives (hereinafter referred to as RMCCs) in 2006 in six provinces such as Sichuan, Qinghai, Gansu, Inner Mongolia, Jilin, Hubei provinces, attracting private capital to service rural finance together and guiding all sectors of society to focus on rural finance. In 2007, the CBRC expanded its pilot project to 31 provinces and regions.

In three kinds of new type of rural financial institutions, the establishment of VTBs held a dominant position. By the end of 2013, 1071 VTBs were set up across the country, while the number of other two types of rural financial institutions didn’t reach one hundred yet. As a class of new financial institutions specifically targeting rural areas, VTBs has played a positive role in improving the shortage and insufficiency of rural finance, further accelerating the pace of China in building inclusive financial system.

2.1 China’s Banking System and Banking Regulatory Process

For a deeper understanding of how China constructs its inclusive financial system and of the role of VTBs in the process, it is necessary to make a brief introduction about China’s banking system and banking regulatory process.

A. China’s Banking System

The China’s existing banking system consists of four parts, namely, central banks, regulators, self-discipline organizations and banking financial institutions, among which banking financial institutions are divided into policy banks, such as the China Development Bank (hereinafter referred to as CDB), the Export-Import Bank of China (hereinafter referred to as EIBC), the Agricultural Development Bank of China (hereinafter referred to as ADBC); large commercial banks such as Bank of China (hereinafter referred to as BOC), China Construction Bank (hereinafter referred to as CCB), Agricultural Bank of China (hereinafter referred to as ABC), Industrial and Commercial Bank of China (hereinafter referred to as ICBC), Bank of Communications (hereinafter referred to as BOCOM); small and medium size commercial banks, such as the joint-stock commercial banks and city commercial banks; rural financial institutions; the Postal Savings Bank of China (hereinafter referred to as PSBC) and foreign banks as shown in Figure 1.
The PBC is the central bank, and it was established in December 1948. According to the provisions of the Law of the People’s Republic of China on the People’s Bank of China, under the leadership of the State Council, the PBC independently implements monetary policies, and it is also responsible for the issuance and circulation of renminbi, inter-banking market, bond market, foreign exchange market, gold market, foreign exchange reserve and gold reserve, treasury, clearing system and anti-money laundering duties for the purpose of preventing and defusing financial risks and maintaining financial stability.
The CBRC was established in April 2003, and it is in charge of the regulation and supervision for banking and non-banking financial institutions and their business activities across the country. In particular, it is responsible for the establishment, modification, termination of banks; the qualifications of directors and executives; the formulation of prudential management rules; the implementation of off-site supervision and on-site checks; consolidated management; dealing with emergencies; the collection and analysis of national banking statistics; the supervision and management of the China Banking Association (hereinafter referred to as CBA) and the day-to-day management of the board of supervisors for important banking financial institutions etc. In addition, the CBRC also supervises foreign banks and non-banking financial institutions, as shown in the above figure, the non-banking financial institutions includes financial assets management companies, trust companies, enterprise group finance companies, financial leasing companies, auto financial companies and currency brokerage companies.

The CBA was established in May 2000 upon the approval of the PBC and the Ministry of Civil Affairs (hereinafter referred to as MOCA) and it registered with the MOCA as a national non-profit social organization, which is regarded as the self-discipline organization of China’s banking industry. It carries out the self-discipline of the banking industry currently under the leadership of the CBRC. The CBA consists of six committees, namely, the legal working committee, self-discipline working committee, the banking certification committee, the rural cooperative finance working committee, syndicated loans and trade professional committee, and foreign banks working committee.

The basic information of policy banks, large commercial banks and joint-stock banks is as shown in Table 1.

Table 1: Basic Information of Large and Medium Size Banks

<table>
<thead>
<tr>
<th>Types of Institutions</th>
<th>Name of Institutions</th>
<th>Year of Setup</th>
<th>Business Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policy Banks (3)</td>
<td>CDB</td>
<td>1994</td>
<td>Headquartered in Beijing, with 32 branches and four representative offices.</td>
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<tr>
<td></td>
<td>EIBC</td>
<td>1994</td>
<td>Headquartered in Beijing, with 22 commercial branches, one oversea branch in Paris, and</td>
</tr>
<tr>
<td>Bank</td>
<td>Year</td>
<td>Description</td>
<td></td>
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</tr>
<tr>
<td>ADBC</td>
<td>1994</td>
<td>Headquartered in Beijing, with 31 provincial branches, more than 300 secondary branches and more than 1800 business organizations.</td>
<td></td>
</tr>
<tr>
<td>BOCOM</td>
<td>1908</td>
<td>Headquartered in Beijing, with 37 provincial branches and affiliated subsidiaries; 2,701 outlets; one branch in Hong Kong, Macao, Taipei, respectively; 8 branches and one subsidiary bank in 8 countries like the United States, Germany, Japan, South Korea, Singapore, Vietnam, Australia, and Britain, and 12 foreign banking institutions in total.</td>
<td></td>
</tr>
<tr>
<td>BOC</td>
<td>1912</td>
<td>Headquartered in Beijing, offering comprehensive financial services to customers from Mainland China, Hong Kong, Macao, Taiwan, and 37 countries.</td>
<td></td>
</tr>
<tr>
<td>ABC</td>
<td>1951</td>
<td>Headquartered in Beijing, with 32 primary branches, 5 affiliated subsidiaries, 316 secondary branches, 3,479 primary subsidiaries, 19,573 business organizations at the grass-roots level, as well as 55 other institutions. With three</td>
<td></td>
</tr>
<tr>
<td>Joint-Stock Commercial Banks (12)</td>
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</tr>
<tr>
<td>China CITIC Bank</td>
<td>1987</td>
<td>Headquartered in Beijing, with more than 540 branches.</td>
<td></td>
</tr>
<tr>
<td>China Merchants Bank</td>
<td>1987</td>
<td>Headquartered in Shenzhen city of Guangdong province, with 99 branches and 853 subsidiaries, 2 branch-level institutions, 1 representative office, 2,174 self-help banks,</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CCB</th>
<th>1954</th>
<th>Overseas branches and four overseas representative offices; provides comprehensive financial services to more than 350 million customers all over the world.</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICBC</td>
<td>1984</td>
<td>Headquartered in Beijing, with 38 primary branches and 304 secondary branches, 8,835 subsidiaries, 4,402 outlets lower than subsidiaries and professional credit card center at the headquarter.</td>
</tr>
</tbody>
</table>

<p>| ICBC | 1984 | Headquartered in Beijing, through 16,227 domestic enterprises, 203 foreign institutions and more than 1,562 agents and online banking, telephone banking, self-help bank and other distribution channels around the world, provides a wide range of financial products and services for 4.12 million company clients and 259 million individual clients. |</p>
<table>
<thead>
<tr>
<th>Bank Name</th>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shenzhen Development Bank</td>
<td>1987</td>
<td>In 2012, changed its name to Ping An Bank. Headquartered in Shenzhen city of Guangdong province, with 27 branches, 395 outlets, covering about 80% customers of China Ping An.</td>
</tr>
<tr>
<td>Evergrowing Bank</td>
<td>1987</td>
<td>Its predecessor is Yantai Housing Savings Bank, and renamed as Evergrowing Bank in 2003. Headquartered in Yantai city of Shandong province, with 11 branches, 14 secondary branches, and more than 110 branches in total.</td>
</tr>
<tr>
<td>Guangdong Development Bank</td>
<td>1988</td>
<td>Headquartered in Guangzhou city of Guangdong province, with 15 primary branches, 35 secondary branches and 6 affiliated subsidiaries, and equipped with Macau branch and the representative office in Hong Kong, and more than 500 outlets in total.</td>
</tr>
<tr>
<td>Industrial Bank</td>
<td>1988</td>
<td>Headquartered in Fuzhou city of Fujian province, with 54 secondary and 15 affiliated subsidiaries, more than 400 outlets in total.</td>
</tr>
<tr>
<td>Bank Name</td>
<td>Founded</td>
<td>Headquarters</td>
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<tr>
<td>China Everbright Bank</td>
<td>1992</td>
<td>Headquartered in Beijing, with 36 primary branches, and 774 branches.</td>
</tr>
<tr>
<td>Hua Xia Bank</td>
<td>1992</td>
<td>Headquartered in Beijing, with 31 primary branches, 35 secondary branches, 12 remote branches, 487 business outlets; Holding three village and township banks.</td>
</tr>
<tr>
<td>Shanghai Pudong Development Bank</td>
<td>1992</td>
<td>Headquartered in Shanghai, with 38 primary branches, 51 secondary branches, 23 primary subsidiaries, one overseas branch in Hong Kong, and more than 820 branches in total.</td>
</tr>
<tr>
<td>China Zheshang Bank</td>
<td>1993</td>
<td>Headquartered in Hangzhou city of Zhejiang province, with 14 primary branches, 11 secondary branches, 1 affiliated subsidiary in Zhoushan, more than 90 branches in total.</td>
</tr>
<tr>
<td>China Minsheng Bank</td>
<td>1996</td>
<td>Headquartered in Beijing, with 29 primary branches, 30 secondary branches, 11 affiliated subsidiaries, one branch in Hong Kong, and holding 27 villages and township banks.</td>
</tr>
<tr>
<td>China Bohai Bank</td>
<td>2005</td>
<td>Headquartered in Tianjin, with 12 primary branches, 4 secondary branches, and 3 branches in total.</td>
</tr>
</tbody>
</table>
Apart from the above 12 joint-stock banks, small and medium size commercial banks include 144 city commercial banks, which are mostly developed from urban credit cooperatives, and the first city credit cooperatives was established in 1979 in Zhumadian of Henan province.

From the business operation and the covered areas of the above large commercial banks and joint-stock commercial banks, we can see that they mainly serve the customers in the cities, while rural financial institutions specially focusing on agriculture, rural areas and farmers have rural credit cooperatives, rural commercial Banks, rural cooperative Banks, village and township banks as well as rural mutual credit cooperatives.

In addition, the PSBC established in 2007 has 37,000 outlets now, covering most of the villages and towns in more than 2,100 counties, which has become one of the main force providing rural financial services.

The above financial institutions of all kinds have set up a corresponding pyramid to the real economy served by them as shown in Figure 2. Five large commercial banks and three policy banks are on the top serving large state-owned enterprises and carrying out the construction of infrastructure and government designated projects; 12 nation-wide joint-stock banks are in the middle, offering services to medium size enterprises; more down are 144 city commercial banks, providing services for small enterprises; at the base are rural financial institutions and the PSBC targeting micro enterprises, sole proprietorship and farmers. This structure shows the design thought of China for the whole banking system in the process of building inclusive financial system, which is aimed to support real economy, to forge a multi-level, wide-coverage and differentiated financial system, and to truly allow all the individuals and enterprises with financial needs to enjoy high quality financial services so as to boost the continuous growth of the real economy.

Figure 2: Pyramid Graph of Banking System and Real Economy
B. Banking Regulatory Process

Given the special status of banking industry in one country’s economy, establishing and perfecting the banking regulatory system is crucial for the stable operation of the banking system. China’s banking regulation and supervision evolves along with the continuous improvement of the banking system.

The rudiment of China’s banking regulation and supervision is formed with the reform and opening up as its watershed, before the reform and opening up, China employed a unified system of the people’s bank under the planned economic system. In the whole country, there was only one bank, which was regarded as both a central bank and a commercial bank. In the meantime, there was no real sense of regulation and supervision.

And after the reform and opening up, along with the planned economy replaced by the market economy, the financial sector also experienced a dramatic change. In 1983 the State Council issued the Decision on the Dedication of the People’s Bank of China to Exercise the Functions of the Central Bank for the purpose of establishing the position of the PBC as the central bank, separating its functions of a commercial bank and designating them to BOC, CCB, ABC, ICRC and BOCOM that were successively recovered and built. By this way, the PBC only focuses on policy formulation and adjustment at the macro level, and the regulation and supervision of the banking, securities, and insurance industry. This opened the prelude of banking regulation and supervision. During the period, the regulation purpose of the central bank was financial adjustment, regulating and supervising banks according to the
Regulations on the Administration of Banks issued by the State Council in 1986 so as to stabilize financial markets and promote economic growth.

As the industry of securities became mature towards a specialized trend, in August 1992, the State Council decided to set up the securities administration commission and the China Securities Regulatory Commission, splitting the function of regulating and supervising securities from that of the PBC, so that the PBC is mainly responsible for the regulation and supervision of banking, insurance, and trust industry.

To separate the policy and commercial businesses of banks for the purpose of reducing the burden of the banks, in 1994, the Chinese government successively established three policy banks, namely, CDB, EIBC and ADBC. In the same year, all the specialized banks were transformed into state-owned commercial banks.

In 1995, the third session meeting of the 8th National People’s Congress passed the Law of the People’s Republic of China on the People’s Bank of China and the Commercial Bank Law, confirmed the regulatory status of the PBC for banking and insurance in the form of legislation; And then, the PBC promulgated the General Provision of Loans, supervising the risk of banks through systemic regulation and supervision in accordance with the law, and for the first time it put forward to reduce the requirement of non-performing loan for the wholly state-owned commercial banks.

In 1998, the State Council determined to create the insurance supervision and administration commission, being responsible for the supervision of the insurance industry, at this point, the function of the PBC in regulating and supervising the insurance industry was separated, and the main focus of the PBC is on banking regulation and supervision. At the same time, the PBC was undergoing a large-scale internal organization structure adjustment, in order to strengthen the vertical leadership by withdrawing 31 provincial branches while establishing the branches across provinces in nine cities and one business administration department in Beijing and Chongqing, respectively. After the internal structure adjustment, the way of supervision also went through the corresponding changes, and different regulatory requirements were raised depending on different regulatory objects. An effective banking supervision was based on the regulatory thought of combining the domestic and overseas, inside and outside of financial statements, local and foreign currency, and on-site and off-site supervision.
In 2001, China’s entry to the WTO required the gradual opening of banking system to the outside, which put forward severe challenges to the banking regulation. To cope with the challenges and strengthen the banking regulation and supervision, the first session meeting of the 10th National People’s Congress decided that the PBC no longer bears the regulatory functions in 2003 and approved the establishment of the CBRC that is responsible for the supervision and management of banks, financial assets management companies, trust companies and other deposit institutions in accordance with the law, forming a divided financial regulatory system shared among the CBRC, the CSRC and the CIRC with clear division of work and mutual coordination. So far, China’s financial regulation is in the pattern of separate operation and supervision. The PBC only needs to take care of monetary policy, macroeconomic control, while the CBRC, the CSRC and the CIRC are in charge of regulating and supervising banks, securities and insurance, respectively.

Since its establishment of in 2003, the CBRC has been working on building a financial prudential regulation and supervision system at both macro and micro level, guiding banks to develop a practical and applicable system of financial products and services and set up a more effective corporate governance and risk prevention and control system. (Wang Zhaoxing⁶, 2013)

However, the changing of the financial industry and the deep development of financial demand expose banking regulation to new challenges. Market and regulation promote each other. In order to deal with the challenge of a serious shortage of rural financial supply, also in response to the appeal of the United Nations for building inclusive financial system, in 2006, the CBRC initiated a pilot project of three kinds of new type of rural financial institutions to encourage private capital to set up VTBs, lending companies, RMCCs, taking a solid step in the construction of China’s inclusive financial system.

The banking regulatory system of China was started from scratch, and should be constantly reinforced and completed. In addition to the government regulation from the CBRC, we should strengthen self risk control of banks, self-discipline of the CBA as well as the social supervision from the masses of the people, resulting in a form of four-in-one comprehensive regulation so as to achieve effective and efficient regulation.

⁶ Wang Zhaoxing is the vice chairman of the CBRC.
2.2 Setup Background and Business Profile of VTBs

A. Setup Background of VTBs

Since its founding, China adopted the economic policy of requiring agriculture and rural areas to support industry and urban areas, which vigorously facilitated the industrialization process and realized the sustained and rapid growth of the economy, entirely renewing the look of all the big cities across the country, and dramatically raising the living standard of the people. The vast rural areas, however, were engulfed in the economic tide. The scissor gap problem of industrial and agricultural products seriously hindered the social and economic development in rural areas, making it impossible for farmers who occupy 80% of the total population to enjoy economic dividends, thus hovering at the edge of poverty. This contributed to the gap between rich and poor, intensified the social contradictions, which seriously hindered the healthy and sustainable development of China’s economy.

To narrow the income gap between urban and rural areas and change the dual economic structure, the Chinese government started a new economic development measure that allows industry to feed agriculture and urban areas to support rural areas, and formulated the policies conducive to the development of “agriculture, rural areas and farmers” since 2003. But with the revitalization of the rural economy, rural finance is a big bottleneck which restricts the development of the countryside. Since the reform and opening up, the rural financial institutions serving rural areas diverted deposits absorbed from rural areas to urban areas like a water pump for the support of urban construction and urban economy. Meanwhile, the rural financial institutions evacuated from the villages and towns, leading to the shortage situation of the rural financial supply for a long time. To analyze its main reason, besides the national macro policy guidance, it is because financial institutions narrowly thought that lending to farmers has high risk and cost. In 1990s, the Rural Development Institute of the Chinese Academy of Social Sciences (hereinafter referred to as CASS) introduced the concept and practice of “microcredit” targeting rural poor populations from Grameen Bank in Bangladesh. The over ten-year operation of pilot projects run by nongovernmental organizations has verified the effectiveness of the innovative loan methodology in cracking the borrowing problem of farmers, at the same time, they have also showed the integrity of farmers with high repayment rates to traditional financial institutions, which laid a certain civil foundation for the pilot project of
microcredit companies\textsuperscript{7} of the PBC in 2005 and the pilot project of three kinds of new type of rural financial institutions of the CBRC in 2006.

With the development of rural economy, the farmers’ demand for financial services, especially for loans becomes increasingly urgent, which is characterized as diversified, small amount and seasonal demand. This requires financial institutions to meet their needs through innovative products and services so as to promote the increase of their production and realize the sustainable development of rural economy.

In view of unitary rural financial supplier as well as outstanding bad debts problem, financial scholars and practitioners have been calling for the introduction of diversified financial service providers for many years in order to activate the vitality of rural financial institutions through the “catfish effect”, forming a multi-level financial service system.

Therefore, under this background, through the moment of that Grameen Bank and its founder, Professor Yunus, were awarded the 2006 Nobel Peace Prize for recognizing the contribution of microcredit to global poverty alleviation, the CBRC promulgated the \textit{Several Opinions on Adjusting and Easing the Access Policy of Rural Banking Financial Institutions to Better Support the Construction of Socialist New Countryside} (hereinafter referred to as the Opinion) on December 20, 2006, which achieved a major breakthrough in the rural financial policies and is regarded as the milestone of the rural financial reform. It was the first time for China’s financial door to open to private capital, industrial capital, and foreign banks, leading the capital from all walks of life to solidify the base of the financial system.

\textbf{B. Business Profile of VTBs}

VTBs refer to banking financial institutions providing financial services to local farmers, agriculture and rural economic development, which are located in rural areas, funded by domestic or overseas financial institutions, domestic non-financial institutions enterprise legal persons or domestic natural persons and approved by the CBRC in accordance with relevant laws and regulations.

VTBs are allowed to absorb public savings, to issue short-term, medium-term and long-term loans, to deal with domestic settlement, bill acceptance and discount, and to engage in interbank lending and bank card business, and to issue, cash and underwrite government bonds as an agent, and to agent receipt and payment funds and

\textsuperscript{7} The existence of microcredit companies promotes the building of inclusive financial system, but since they are not included into formal financial institutions, there will be no more discussion on microcredit companies.
insurance business as well as conduct other businesses approved by the CBRC. In accordance with the relevant provisions of the State, VTBs can also agent the businesses of policy banks, commercial banks and insurance companies, securities companies and other financial institutions.

The quantity of VTBs has begun to take shape from the beginning of the pilot project to the present with more reasonable distribution, and VTBs have gradually improved their operation and management and made their service innovation more characteristic, turning into the new forces of serving “agriculture, rural areas and farmers” as well as small and micro enterprises. By the end of 2013, there were 1071 VTBs set up in 31 provinces throughout the country, covering 1,083 counties (cities), which accounts for 57.6% of the total counties (cities). Figure 3 shows the distribution of VTBs in the provinces.

Figure 3: Distribution Graph of VTBs

![Distribution Graph of VTBs in Provinces and Cities](image)

In the environment of enormous rural financial demand versus scarce rural financial supply, VTBs as a new type of rural financial service provider, has huge market space. After VTBs get the great support of national policy, as long as they target the right market and make product and service innovation, they can realize sustainable development in the case of risk control. Meanwhile, along with the continuous improvement of the rural financial system and the steady growth of the agricultural economy, VTBs will inevitably play a more and more important role in
rural economy, but also create a condition for building inclusive financial system in China.

2.3 Regulation and Supervision System and Methods of VTBs

In order to solve financing problems faced by farmers and encourage financial institutions to service to agriculture, rural areas and farmers, the CBRC published *Several Opinions on Adjusting and Easing the Access Policy of Rural Banking Financial Institutions to Better Support the Construction of Socialist New Countryside* on December 20, 2006. *The Opinion* indicates that the CBRC will run pilot projects of three kinds of new type banking financial institutions including VTBs, RMCCs and lending companies in the central and western regions in our country, among which VTBs are the major rural financial institutions. The first batch of pilot provinces includes Inner Mongolia, Jilin, Hubei, Sichuan, Qinghai and Gansu. In the second half of 2007, the experiment of VTBs was extended from six pilot provinces to 31 provinces. By the end of 2013, the whole country witnessed the opening of 1071 VTBs.

In *the Opinion*, the specific contents of adjustment and relaxation are as follows:

a. To open access to capital. To actively support and guide domestic and foreign banking capital, industrial capital and private capital to invest in rural areas and set up VTBs.

b. To lower the registered capital and cancel the limit of working capital. For the VTBs set up in the county (city), the registered capital shall not be less than RMB 3 million yuan; for those set up in the countryside (town), the registered capital shall not be less than RMB 1 million yuan.

c. To adjust the qualifications of investors and relax the proportion of shareholding by domestic investors. Domestic enterprise legal persons shall have good credit record, profitable operation for the past year, net assets accounting for over 10% of the total assets after the annual distribution (based on consolidated financial statements) and capital from legitimate sources. The establishment of a VTB should be initiated, and there should have more than one (including one) domestic banking financial institutions as the originator. Among them, the shareholding percentage of a single domestic banking financial institution shall not be less than 20%, the aggregate shareholding percentage of a single natural person, a single other non-banking enterprise legal person and its affiliated party shall not be more than 10%. Any unit or individual owns more than 5% of total shares of any VTB, which
should be approved by regulators in advance.

d. To ease the condition and scope of business access. Under the premise of cost estimation and risk control, to actively support rural banking financial institutions to operate all kinds of banking businesses and provide standardized bank products and services. To encourage and assist rural banking financial institutions to deliver financial innovative products and services in accordance with the reasonable requirement of local customers. The specific business access for rural banking corporation organization should be treated differently and adjusted to local conditions, and be examined and approved according to the off-site supervision and on-site inspection results of local regulators.

e. To adjust the entry qualifications of directors and senior management personnel. The directors of VTBs should have knowledge, experience and ability adapted to designated position, and the chairman of the board of directors and senior managers should have working experience in the banking industry for more than five years, or in the related economic sector for more than 8 years (including working in the banking industry for more than two years), and have a college or above degree (including college).

f. To adjust the power of examination and approval for new corporation organizations or branches. The establishment of the above banking corporation organizations within the adjustment scope of the access policy is divided into two stages, preparation and commencement. The application for preparation should be handled by the CBRC sub office, and examined and decided by the CBRC branch; the application for business commencement should be handled, examined and determined by the CBRC sub office. The establishment of banking corporation organizations taken place in the rural areas administrated by provincial capital cities should be handled, examined and decided by the CBRC branch.

g. To adopt a concise and flexible corporate governance. New or restructured VTBs can only set up the board of directors, which will exercise the function of supervising senior management. The board of directors may set up zero or few special committees, and establish a corresponding specialized management team or position if it is necessary. For the small-scale VTBs, the chairman of the board of directors may concurrently hold the position of president.

In addition to the stricter provisions for originators and shareholding proportion, the above other provisions offer convenience for private capital to set up VTBs, and push toward the multi-level development of rural financial supply so as to meet the
financial needs of rural areas.

The Opinion also puts forward the following four regulations:

a. To adhere to the principle of “low threshold, strict supervision”, and the implementation of prudent supervision. To strengthen the sustained and dynamic supervision for new rural banking corporation organizations in terms of capital adequacy, asset loss reserve ratios, non-performing assets ratio and the credit concentration of a single group client. New rural banking corporation organizations must perform prudent and formal asset classification system, at any point, the capital adequacy ratio shall not be less than 8%, and the asset loss reserve ratio shall not be less than 100%, and internal control, loan concentration and liquidity should strictly meet the requirements of prudent regulation and supervision. VTBs shall not provide loans for the shareholders and their affiliated parties.

b. To adopt different regulatory measures based on the capital adequacy and asset quality conditions of new rural banking corporation organizations. Firstly, for those with a capital adequacy ratio more than 8% and non-performing assets ratio below 5%, regulators can appropriately reduce the frequency or range for the on-site inspection, and support their healthy development. Secondly, for those with a capital adequacy ratio lower than 8% and non-performing assets ratio more than 4%, regulators should in due time urge them to improve capital adequacy ratio within a deadline, and increase the intensity of off-site supervision and on-site inspection, and take actions to limit speed of assets growth, purchase of fixed assets, distribution of dividends and other income, increase of branches, and introduction of a new business, and to require them to reduce the scale of risk assets and urge it to rectify within a time limit. Thirdly, for those cannot meet rectification requirements within the time limit but their capital adequacy ratio fell to 4% and their non-performing assets ratio is above 15%, regulators should in due time take actions to instruct them to adjust senior management, close all businesses, conduct restructuring and adopt other measures within a deadline. Fourthly, for those still cannot effectively achieve restructuring within prescribed time limit, and their capital adequacy ratio dropped below 2%, regulators should take over or revoke them or let them go bankruptcy at right time.

c. To guide and supervise the money investment of new banking corporation organizations. To encourage other new banking financial institutions in rural areas to use the funds absorbed from the local as much as possible for the local people under the premise of local inclusion and commercial sustainability. For those do satisfy the local rural financial demand, they can utilize their surplus funds to purchase financial
bonds issued by the ADBC or finance “agriculture, rural areas and farmers” through other legal channels.

d. To set up service quality evaluation system of supporting agriculture for rural banking financial institutions. Firstly, rural banking financial institutions shall formulate credit policy to meet demands of local farmers and rural economy for financial services, and design a clear service target and ensure their loan businesses to reach certain regions and population in combination with the actual situation of local economic and social development. Secondly, banking financial institutions should actively carry out institutional innovation, build a positive incentive constraint mechanism, establish a practical loan management system suitable for “agriculture, rural areas and farmers”, and cultivate credit culture compatible to the construction of socialist new countryside according to the characteristics of loan businesses in rural areas. Thirdly, regulators should establish service quality evaluation system of supporting agriculture for rural banking financial institutions, and will take the results as important contents to make comprehensive appraisal, administrative licensing, and senior management role evaluation of institutions, so as to promote steady and safe operations of rural banking financial institutions and meet the effective financial demand in rural areas.

Regarding loan products, the CBRC requires VTBs to insist on the principle of small and scattered, improve loan coverage, prevent excessive loan concentration. Specific provisions show that the loan balance to the same borrower shall not exceed 5% of net capital; for a single group of corporate clients, the credit balance shall not exceed 10% of the net capital. Regulatory policy will ensure VTBs to aim at low-end customers with loan demand in rural areas.

In 2007, the CBRC has successively issued the Interim Provisions of VTBs’ Administration, Guideline for Establishment, Examination and Approval Work of VTBs and Notice on Pilot Work of Adjusting and Easing the Access Policy of Rural Banking Financial Institutions to further clarify the opening conditions and concrete steps of setting up VTBs, at the same time, the scope of the pilot was released so as to encourage the establishment of VTBs across the country.

In order to promote the development of VTBs, the Chinese government gradually lowers access threshold of VTBs, by adopting the principle of low threshold, strict supervision. In September 2009, the State Council issued the Several Opinions on Further Promoting the Development of Small and Medium Size Enterprises, clearly put forward to speed up the study of measures to encourage private capital to
participate in establishing VTBs, lending companies, and joint-stock financial institutions; support and standardize the development of microcredit companies, and encourage conditional microcredit companies to be transferred to VTBs.

In May 2012, the CBRC introduced the Implementation Opinion on Encouraging and Guiding Private Capital into Banking Industry, supporting private enterprises to participate in the establishment or capital increase of VTBs. It will reduce the minimum shareholding percentage of the main originator of VTBs from 20% to 15%, and clearly indicates that after VTBs achieve their sustainable development, the main originator can adjust the shareholding proportion with other shareholders in accordance with the principle of being conducive to expand their characteristic financial services, to prevent against financial risk, and to perfect their corporate governance.

These regulatory policy of VTBs is helpful to arouse the enthusiasm of private capital to set up VTBs, certainly, for the regulation of VTBs, it should be improved based on the challenges and problems encountered by most of VTBs in the process of operation, allowing VTBs to really serve rural finance and driving other banks to jointly build an inclusive financial system of providing financial services for the whole society.

2.4 Cases of VTBs in Financial Inclusive Business Innovation

Among those several hundreds of main originators of VTBs, Harbin Bank and Baoshang Bank have set up the largest number of VTBs with good performance, respectively. They formed more than 20 VTBs all over the country. Harbin Bank and Baoshang Bank were city commercial banks before city commercial banks were allowed to operate cross regions and after then they were approved by the CBRC to become national commercial bank. Harbin Bank and Baoshang Bank started to open branches in each place, given the low barriers to entry of VTBs, and the service target of VTBs is consistent with the market positioning of the two banks, plus to get the support of the government, Harbin Bank and Baoshang Bank devoted themselves into the establishment of VTBs. Harbin Bank and Baoshang Bank are the pioneer domestic banks advocating for inclusive financial concept, and they have done a lot of work in expanding the coverage. The following is the brief introduction of how Harbin Bank practice the concept of inclusive finance in the process of the preparation and management of VTBs and of how one Ewenkeqi Baoshang VTB (hereinafter referred to as EBVTB) invested by Baoshang Bank makes specific
innovation in realizing inclusive finance, respectively.

**A. Harbin Bank’s Practice in Financial Inclusion**

**Introduction of Basic Information**

Since Harbin Bank established the first VTB—Bayan Rongxing VTB on January 6, 2009, Harbin Bank has totally set up 24 VTBs in Heilongjiang province, Gansu province, Beijing, Shenzhen, Chongqing, Hainan province and other places, managed 18 subsidiaries and 42 institutions in total by the end of 2013. All the VTBs set their fundamental purpose as promoting and practicing the operation concept of “inclusive finance and harmonious wealth”, and supporting “agriculture, rural areas and farmers” and serving small and micro enterprises. All of them embrace the characteristics of microfinance and provide inclusive financial services to local residents, sole proprietorship and small and micro enterprises, and play an active role in economic construction of each county in order to fulfill their social responsibilities.

It is notable that in 2009, Harbin Bank responded quickly to the State’s policy appeal of supporting regional economic development in the western regions, and adapted to the CBRC’s policy guidance of encouraging financial institutions to set up VTBs in the western areas by taking a lead in establishing a second VTB of Harbin Bank—Huining Huishi VTB in Huining of Gansu province that is a state-designated poverty-stricken county, making Harbin Bank to be the first financial institution that set up a VTB in the western state-designated poverty-stricken counties. Up to now, among 24 VTBs established by Harbin Bank, 6 VTBs are located in the state-designated poverty-stricken counties, namely, Huining Huishi VTB, Yanshou Rongxing VTB, Baiquan Rongxing VTB, Huachuan Rongxing VTB, Hainan Baoting Rongxing VTB and Chongqing Wulong Rongxing VTB.

By the end of 2013, the 24 VTBs totally served more than 30,000 households, disbursed loans of RMB 8.2 billion yuan with the non-performing loan ratio of only 0.18%. The VTBs established by Harbin Bank can enjoy healthy growth, and the key reason lies in their unique corporate governance structure built by Harbin Bank, as well as a series of innovation in management ideas.

At the same time, the information technology system independently developed by Harbin Bank also laid the foundation of advanced science and technology for the sustainable development of VTBs. At present, the information technology systems of VTBs have full independence from the parent banking system, and they have enriched and perfected the means of payment and settlement. Those 24 VTBs all have realized
independent issue of bank cards and online banking system, being the leader among domestic VTBs in terms of science and technology.

**Practice in Financial Inclusion**

a. Unique Corporate Governance

As the originator of VTBs, Harbin Bank innovates the management mode of VTBs in China, by setting up the board bureau of VTBs under the board of directors consisting of five departments including integrated security, institutional development, risk management, operational support, and planning and finance departments, which represents Harbin bank to support and serve the development of VTBs, to establish a set of independent system in line with the growth of VTBs, unique business model, profit model and risk control model, and to push forward the building of infrastructure, team, brand and cultural for VTBs.

In terms of equity structure, Harbin Bank adheres to provide no less than 60% of total funds, in order to facilitate the overall control of the development direction and risk control of VTBs and serve the local economy and local people and small and micro customers.

b. Management Ideas from Innovation in Practice

How to make VTBs themselves achieve their sustainable development while practice the concept of “inclusive finance and harmonious wealth” in a real sense? The VTBs board bureau of Harbin Bank has gradually formed the advanced management ideas with the characteristic of Harbin Bank and will lead VTBs down the road of high starting point, the connotative and sustainable development after several years of innovation practice.

Positioning Management of “Four Adherences”. To adhere to the localization; adhere to downscaling and carry out micro business; adhere to the characteristics of microfinance; adhere to service to agriculture, rural areas and farmers as well as small and micro enterprises. Based on this, not to pursue too fast growth speed, or high profits, instead, sincerely rooted in the local to serve the people and small and micro customers. The practice has proved that such positioning management and “two no pursuits” has a great assistance in promoting the local reputation of VTBs set up by Harbin Bank.

Value-driven Management of “Combination of Two Performances”. What cannot be avoided is that VTBs has the characteristics of “duality hybrids”, firstly,
they are for-profit following commercialized operation; secondly, they have public welfare offering social services. Therefore, the VTBs board bureau of Harbin Bank has been heavily promoting that all the VTBs must embrace the values of considering social performance and responsibilities in the pursuit of financial performance. The fact has showed that the value-driven management of “combination of two performances” is particularly important in the development of the VTBs with “inclusive finance” as their own duties.

Management Based on Ideas of “Being Permanent Customers and Running Lifelong Banks”. Customers are the life resource of a bank, so it is crucial to develop the trust relationship of “lifelong company and growing together” between banks and customers. Based on the competition environment, customer characteristics, and growth needs of VTBs as well as the economic development characteristics of the regions where VTBs are located, in the past two years, the VTBs board bureau of Harbin Bank has constantly intensified the new concept of “being permanent customers and running lifelong banks”, and advocated that VTBs should not only provide better-off services but also offer timely assistance for customers, and should not prefer rich than poor, instead, should help alleviate poverty and achieve common wealth. The implementation of this new idea makes “inclusive finance” really embedded and applied in the actual operation of VTBs.

c. Good Brand Influence

Adhering to the development concept of “inclusive finance and harmonious wealth” created by Harbin Bank, with the new thinking, new model and new pattern, 24 VTBs not only realized their own healthy and sustainable development, but also won the recognitions from all levels of governments, regulatory departments and the market and received the praise from the general public. Several VTBs successively obtained more than 10 awards, including the nomination award of “Best Social Performance” delivered by China Banking Association (Citi Group) Microentrepreneurship Awards, the award of “Chinese Microfinance Institutions with Best Social Responsibility”, and the title of “National Excellent Village and Township Bank" and so on, greatly improving the social image and brand awareness of VTBs as corporate citizens.
The EBVTB started to operate in April 2009 with four branches and 160 employees, which is regarded as the first VTB stationed in minority autonomous county and also the first VTB in Hulunbeier. The EBVTB is located on the baerhu prairie at the west foot of Greater Khingan Mountains, which is in the northern part of the motherland, with high latitude (49.14 degrees of north latitude) and cold winter (minus 40-50°C), where is sparsely populated with backward economy. Over the past five years, the EBVTB has continuously made efforts to build its own inclusive finance culture in practice, adhering to the business positioning of “small bank, large stage, being a good bank with the trust of herdsmen” and carrying the operation philosophy of “Tolerance is Big and Business wins the World” based on the position of “grass-roots”, and it vigorously supports the construction of three animal husbandries, and explores new financial service model that meets the needs of herdsmen, and promotes animal husbandry prosperity, and guides the herdsmen to become rich, and achieves inclusive finance and practices social responsibility with the vision of being the best credit institution for animal husbandry in China.

**Practice in Financial Inclusion**

EBVTB continues to practice the concept of inclusive finance in the pastoral area from two aspects: breadth and depth, and main innovations include product innovation, service innovation, institutional innovation, and other aspects.

a. Efforts to enlarge the service scope and constantly expand the breadth of inclusive finance

(a) To design rational distribution of outlets and form the radiation network in the pastoral area at the grass-roots level

The autonomous Banner of Ewenke Minority has the land with a total area of 19,000 square kilometers, governing 3 towns, 1 district, 1 township, 5 Sumus and 44 Gazhas (administrative villages) with the outstanding feature of “vast but sparsely populated, lack of finance”. When designing the location of outlets, the EBVTB considered the cost of setup, sustainable operation and other problems, at the same time, focused on the problem of filling the gaps of financial services in the pastoral area, so that it established its outlets in the towns and townships where have relative

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8 Inner Mongolia autonomous region has counties, banners, autonomous counties, and autonomous banners. And a county is divided into town, township, minority town, sumu and minority sumu. Sumu is from Mongolian language, meaning administrative institutions between county and village. In Inner Mongolia autonomous region, in general, township refers to industrial zone, town refers to agricultural area, and sumu refers to pastoral region.
shortage of financial services such as bayantuohai town, dayan town, yimin town and so on, forming a radiation network in the pastoral area at the grass-roots level (Gazha) to narrow the service radius in the pastoral area and provide more convenient and efficient financial services for the pastoral area at the grass-roots level.

(b) To perfect the system of financial products and expand the scope of the services group

At its inception, the EBVTB had its loan products mainly for workers and individual housing mortgage, and its service target was limited to employees and individual business men with more fixed assets. In early 2011, the EBVTB launched a series of loan products named “Three Auspicious Treasures” for farmers and herdsmen, including the animal husbandry, herdsmen and the economic cooperation organization of herdsmen into its service customers, which effectively supported the development of the economy of “three animal husbandries”.

By the end of February, 2014, the EBVTB disbursed 2,321 loans with the accumulated value of RMB 218.81 million yuan in terms of the series of loan products named “Three Auspicious Treasures”; the value and number of the loan balance reached RMB 125.9 million yuan and 1,879, respectively; the average single loan size was RMB 94,300 yuan.

(c) To introduce “unsecured” small and micro enterprise loan model and break the traditional ideas about small and micro enterprise loans in the pastoral area

The local financial institutions in the autonomous Banner of Ewenke Minority require individual business men to provide adequate real estate mortgage like houses when issuing small and micro enterprise loans. Nevertheless, limited by the level of economic development, very few local small and micro enterprises have housing mortgage with sufficient value, and in the eyes of local small and micro enterprises, it is very difficult to get loans from banking financial institutions. According to this situation, in order to vigorously support the development of small and micro enterprises and further push forward the concept of inclusive finance, the EBVTB begun to run microfinance project on July 26, 2012, and imported “unsecured” small and micro enterprise loan model, and introduced one loan product named “Tala© Microcredit” applicable to small and micro enterprises in the pastoral area, which allowed it to be the first local financial institution dealing with “unsecured” small and micro enterprise loan to fill the gaps of microcredit in the pastoral area.

By the end of February 2014, the EBVTB disbursed 998 loans with the

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9 Tala is Mongolian language, meaning prairie.
accumulated value of RMB 175.48 million yuan in terms of the loan product named “Tala Microcredit”; the value and number of the loan balance reached RMB 96.2 million and 759, respectively; the average single loan size was RMB 175,800 yuan.

(d) To meet financial demands of female customers and facilitate women empowerment

The EBVTB has paid attention to cultivate women customers in the pastoral area, and support their development in the business operation. In 2013, the small and micro enterprise finance department of the EBVTB again introduced a special loan product named “Tala Beauty Loan” to support women entrepreneurship in the pastoral area. By the end of February 2014, the EBVTB has 4931 stock loans, among them there were 1383 women loan customers, accounting for 28.05%, indicating a gradual increase in the ratio of female financial consumers. Meanwhile, when married customers apply for loans at the EBVTB, it will require the signatures from the spouse, which would also help to empower women and improve women’s rights of participation, voice and decision-making in their families.

b. Efforts to approach the reality of pastoral areas and continuously excavate the depth of inclusive finance

(a) To develop a guarantee system in the pastoral area and solve the difficulties of herdsmen in acquiring loan guarantees

The series of loan products named “Three Auspicious Treasures” for farmers and herdsmen were adjusted to local conditions and tailored for the pastoral area and cooperative organizations according to the characteristics of economy and the rules of production and living in the pastoral area, by adopting various guarantee measures like employees’ guarantee, the mortgage of contracted management right of pasture, and mutual risk fund of farmers and herdsmen, to solve the problem of local herdsmen’s difficulties in offering mortgages or guarantees and improve the financial guarantee system of pastoral areas.

(b) To serve low-end market in the pastoral area and introduce group guarantee loans for herdsmen

In the process of development, the EBVTB gradually found that the series of loan products named “Three Auspicious Treasures” for farmers and herdsmen mainly met the funding needs of those relatively rich herdsmen with middle or upper economic condition in the pastoral area, but they still could not fully adapt to the characteristics of the production and business operation of low-end market with poor economic condition in the pastoral area. As a result, in early 2014 the EBVTB
launched “Huri Pasture”--herdsmen group guarantee loan, meaning “it moistens the prairie land like a timely rain”, and it was merged with the original “Three Auspicious Treasures” to become a series of loan products named “Four Auspicious Treasures” for farmers and herdsmen. The introduction of herdsmen group guarantee loan named “Huri Pasture” allowed low-en herdsmen customers with smaller pastoral area and without a guarantor to find a loan financing guarantee measure suitable for their own situation, which further excavated the depth of inclusive finance in the process of practice.

(c) To reduce the herdsmen financing costs and set up mobile service point in the pastoral area

Loan customers in the pastoral area at the grass-roots level often spend higher costs in terms of “travel, accommodation, and food” when handling loan business due to the influence of far distance, road closure by snowing and other reasons. Thus, in order to satisfy customers’ demand for loans in the pastoral area and also save herdsmen’s financing costs, the EBVTB set up mobile service points in the pastoral area at the grass-roots level from this year. Generally each site has 2 employees, and each period is 3-5 working days. They offered on-site loan consulting and loan application as well as other services to the people in the pastoral area, which received a warm welcome by the local herdsmen, substantially reducing the costs of the herdsmen for loans indeed.

(d) To design characteristic repayment mechanism suitable for production and living routine in the pastoral area

The production cycle of animal husbandry is usually around 3 years, and the collection of production money by herdsmen is also relatively concentrated, generally in Spring and Autumn every year. At the same time, owing to far distance and inconvenient traffic in the pastoral area, the monthly repayment schedule is difficult to follow. Therefore, in accordance with the actual production cycle and seasonal regularity, the EBVTB designed a three-year loan term and an unique repayment schedule especially for herdsmen loans, by adopting the quarterly interest payment and allowing them to repay the principal and interest in the agreed way such as repaying the principle once or twice each year, which lowers the number of repayment for herdsmen and also saves the repayment costs, at the same time, enables herdsmen to make full use of the loan fund for animal husbandry production and management so as to improve the efficiency of the use of loans.

(e) To establish an independent loan examination and management mechanism
and completely eradicate the phenomenon of “eat, take, block, request”

The financing cost of herdsmen is relatively high thanks to the particularity of the social and economic environment. Moreover, loans for herdsmen are riskier and difficult to handle, leading to the problem of “eat, take, block, request” taken place in some financial institutions, which increases the cost of loans for herdsmen. As a result, in order to strictly regulate the behavior of loan officers and completely eradicate the phenomenon of “eat, take, block, request”, the EBVTB has established an independent post-loan management center, responsible for handling customer complaints and undertaking loan inspections after delivery. Once such a problem is found and confirmed, it will be handled in a strict way, safeguarding the rights and interests of the herdsmen for loans and curbing the bad behavior of loan officers.

(f) To produce bilingual version of files with Mongolian and Chinese languages and Mandarin and offer special financial services

The major minorities in the pastoral area of the autonomous Banner of Ewenke Minority include the Mongolian, Ewenke, Daur among others, and the main language is Mongolian so that many herdsmen loan customers are not proficient in mandarin, and even cannot recognize Chinese characters accurately. As for this situation, the EBVTB designed a bilingual version of files with Chinese and Mongolian languages, providing characteristic financial services for herdsmen and ensuring the information right of herdsmen for loans.

(g) To adapt to the production and living routines in the pastoral area and implement targeted promotion model

Herdsmen have special production schedule due to the influence of the production model of traditional animal husbandry. Besides, the communication condition is not developed in the local animal husbandry area, and the information transfer mode is relatively single, thus, most of herdsmen receive external information by the way of listening to the radio. As a result, the EBVTB promotes its various businesses through the local Mongolian radio during the breakfast time of herdsmen (around 6:00 a.m. in the morning) and the evening weather forecast period (around 6:50 p.m. in the evening), according to the production habits in the pastoral area, allowing the local herdsmen to get its financial service information in time.

(h) To elect a typical model household and guide herdsmen to accumulate good credit

The history development and economic situation of animal husbandry areas determines the financial understanding and ideas of the people in the pastoral area,
and there is a big mistake for most of the herdsmen to know financial institutions and loan financing. They simply think loans of financial institutions belongs to the national policy so that it doesn’t matter whether to repay the loans, and they don’t pay enough attention to the benefits brought by the accumulation of credit. Hence, based on this actual situation, the EBVTB selected the customers with “strong strength and good credit” as typical model households in each Sumu and GaZha within the jurisdiction area, delivered a plaque of “Customers with Integrity” to each household, and gave them the corresponding favorable loan conditions, so as to guide the herdsmen to follow standard management and accumulate good credit, and gradually build a correct concept about finance among the herdsmen groups.

(i) To attach great importance to the expansion and coverage of non-financial services and popularize knowledge of finance

During the period of relatively leisure in the production and smaller demand for funds in the pastoral area, the EBVTB organizes on-the-ground promotional activities in towns, townships, Sumus and Gazhas on an irregular basis, with the main contents of “credit product introduction”, “consulting on money management of herdsmen”, “financial consumer protection”. Meanwhile, the EBVTB attaches great importance to financial consumer protection, and requires its staff to keep strict confidentiality for customer data and information, and make reasonable evaluation of a customer, guide the customer to make rational financing, and avoid excessive debt.

The above two specific cases not only illustrate from the perspective of macro strategy how Harbin Bank as the main originator ensured the development of VTBs as a whole not to deviate from the original intention and laid a solid foundation for the sustainable growth of all the VTBs through the top-level design, but also describe from the perspective of micro tactics how EBVTB overcame various difficulties and found financial solutions to meet the needs of local farmers and herdsmen, and practiced the concept of inclusive finance in its specific operation, playing a leading role in the process of the construction of VTBs.

2.5 Development Problems and Solutions and Suggestions

A. Development Problems

Single Largest Shareholder

According to the provisions of the Opinion, the investors of VTBs can be domestic or overseas financial institutions, domestic non-financial institutions
enterprise legal persons or domestic natural persons, but the largest shareholder must be a banking financial institution, and its stake shall not be less than 20% of the total amount of a VTB’s equity, later on this ratio was changed to 15%. However, the provision of requiring a banking financial institution to be the major originator hasn’t been loosened. Furthermore, the major originator usually holds more than 50% of shares for the absolute holding position, which put off the enthusiasm of non-financial institutions enterprise legal persons or natural persons in taking shares of VTBs in the process of concrete preparation of establishing VTBs.

In addition, the establishment of VTBs is designed to introduce new ideas and mechanisms to serve vast farmers, while although traditional financial institutions have obvious advantages in terms of financial strength and system structure, their inherent opinions will go against the innovation of VTBs and the injection of new vitality.

**Deviation of Market Positioning**

*The Opinion* clearly pointed out that the purpose of carrying out the pilot project of VTBs is to solve the problems of low branch coverage of banking financial institutions in the rural area, insufficient financial supply, and inadequate market competition, especially settle the issue of the difficulty of rural credit cooperatives (hereinafter referred to as RCCs) in supporting “agriculture, rural areas and farmers” in less developed areas. Thus the purpose of setting up VTBs is to make up for the gaps of rural finance by combining VTBs and RCCs to meet the production and consumption demand of customers in the rural area for loans, and use financial services to promote the development of rural economy, and offer down-to-earth services to agriculture, rural areas and farmers. The main business of VTBs focuses on savings and loans, and most of them determine the level of interest rates when pricing their products, not based on their respective business cost and expected risk. Many VTBs refer to the interest rate of local RCCs for pricing. Moreover, they offer similar products and services as RCCs, leading to the situation of homogeneous competition with RCCs. If the market segment of VTBs overlaps with that of RCCs, they are unable to compete with RCCs, and also cannot create a benign interaction with RCCs, resulting in a negative impact on the development of rural finance. In addition, some VTBs located their branches in the economically developed city and serve corporate customers with strong profitability in order to pursue profits, which completely deviate from the target market positioning of VTBs so that they cannot play a role in filling the gaps of rural finance.
**Difficulty in Mobilizing Savings**

The problem of difficulties in keeping savings and borrowing loans make most of poor people in developing countries puzzled at the same time, whereas in China’s rural financial market, the demand of the people for savings can be basically satisfied by the PSBC and RCCs through their extensive network. As for the difficult problem of loans, the Chinese government plans to ease the situation through introducing more service providers. The pilot project of VTBs opened up a new channel to solve the problem of rural finance. Furthermore, as a primary legal person, VTBs have the characteristics of short decision-making chain and high decision-making efficiency in terms of loan products delivery as compared with the traditional commercial banks, which enables them to make a quick response to demand for loans, enhancing the competitiveness of VTBs in rural areas and making them get a lot of customers in a short period of time.

In contrast with large demand for loans, VTBs encounter difficulties in mobilizing savings. The main reasons are divided in the following three aspects:

a. As mentioned earlier, in China’s rural areas, the basic demand for savings can be met, and when choosing financial institutions to deposit, the people mainly consider safety, but as for VTBs as emerging rural financial institutions, the general public have no much understanding about it so that there is no enough trust. As a result, the people are not willing to put their money in VTBs.

b. As the commercial banks continue to introduce innovative financial products as well as a large number of convenient businesses, on the contrary, due to the small scale and late entry, VTBs still focus on traditional deposit and lending business and offer few intermediary business. Furthermore, except the VTBs invested by Harbin Bank, a lot of VTBs haven’t opened online banking, mobile banking or other business, which hampers the enthusiasm of farmers about opening an account for savings at the VTBs.

c. Since the VTBs are not connected to the settlement system of the PBC, they are unable to conduct long-distance transaction and settlement business, which cannot satisfy the demand of a large number of migrant farmers for remittance service; And the VTBs have small-scale of registered capital, so they cannot afford the membership fee of up to RMB 3 million yuan to join Unionpay and they are unable to use Unionpay, which have reduced the attraction of VTBs to collect deposits.

**Lack of Financial Innovation**
As the main originator of VTBs, commercial banks have rich experience in serving urban customers. However, because of different economic development level between urban and rural areas, the demand of the farmers significantly differs from that of urban customers. Therefore, VTBs will not only lose the power of innovation, but also make it unable to meet the diverse financial needs of farmers through transplanting the business model and products and services suitable for the cities. VTBs should innovate in financial products according to the characteristics of rural credit, such as the issuance of microcredit, the promotion of group guarantee among farmers, the development of financial products to satisfy the seasonal needs, etc.

**Lack of Human Resources**

In *the Interim Provisions of VTBs’ Administration*, it clearly stipulates that the chairman of the board of directors and senior managers of VTBs should have working experience in the banking industry for more than five years, or in the related economic sector for more than 8 years (including working in the banking industry for more than two years), and have a college or above degree (including college). As compared to commercial banks, VTBs have small scale and limited financial strength. For the new graduates, the VTBs at their start-up stage are unable to show the development prospect. Thus, the VTBs are unable to find or keep the talents, resulting in lack of human resources.

**No Enough Policy Support**

As a new type of rural financial institutions, the VTBs receive their mission given by the CBRC to serve agriculture, rural areas and farmers, while in view of a series of challenges faced by the VTBs, the CBRC should give more preferential policies, and help them overcome those difficulties so as to provide sustainable financial services for farmers, agriculture and rural areas. Since the VTBs conduct deposit business, they are required to make the deposit reserve as other banks, but there is no specific provision about the legal deposit reserve ratio for VTBs in the existing policies. Therefore, at present the common practice is that the VTBs make the deposit reserve referring to 15% of legal deposit reserve ratio for RCCs, which brings a huge burden to VTBs.

In addition, in order to support the development of VTBs, the regulator should give tax preferential policies to VTBs. But in fact VTBs haven’t got the same policy support as RCCs. For instance, RCCs only pay 3% of business tax while VTBs give 5%, and for income tax, RCCs can be exempted or be levied half while VTBs have to
pay the full amount. These policies make it difficult for the VTBs at the start-up stage to conduct business, make profit, and support long-term services to agriculture, rural areas and farmers.

The above problems become the main cause of slowing down the establishment of VTBs. Actually, the CBRC has also issued some policies, such as lowering the stake of the main originator from 20% to 15%, the purpose is to promote the sustainable development of VTBs, and make VTBs give full play to the role of service to agriculture, rural areas and farmers.

B. Solutions and Suggestions

In the seven years since the launch of pilot project of VTBs, even though the above six issues occurred, in general, the operation of VTBs as a whole still maintained at a state of steady growth, and there were no business failures. However, with the constant innovation of financial industry and the increasing competition of banking sector, the CBRC should adopt the following six measures to strengthen the market position and strategic importance of VTBs, and ensure them not to deviate from their mission of serving agriculture, rural areas and farmers, and perfect rural financial system, and make a strong basis for the construction of an inclusive financial system.

To broaden the scope of the largest shareholder

The provisions of the CBRC’s policy stipulate that the largest shareholder of a VTB must be a banking financial institution, and its stake is reduced from no less than 20% of the total amount of a VTB’s equity to 15%. But in practice, the major originator usually holds more than 50% of shares for its controlling position. Thus it changes VTBs into its branches in a disguised form, making VTBs lose their advantage of being a primary legal person and also violating the design purpose of the pilot project. Therefore, the suggestion is to limit the stake of the largest shareholder, and properly increase that of private capital, and allow private capital to use equipment, technology and site as equity investment in VTBs, so as to improve the participation of private capital, and guarantee its voice. For those VTBs with mature conditions, it can be considered to gradually widen the scope of VTBs’ largest shareholders, and allow non-banking financial institutions to become the biggest shareholder. Given the current trend of mixed management in financial sector, it should also permit insurance institutions, securities institutions and other qualified
legal person units to be the holding party of VTBs, in order to realize diversified operation of VTBs.

**To supervise and guide market positioning**

In the presence of VTBs deviating from their target market positioning, the CBRC should conduct a thorough investigation into a purpose of establishment when examining and approving the preparation of VTBs, to ensure its consistency with policy objectives. After the approval, the originator and senior management of VTBs should receive training regarding mission and governance structure of VTBs, being guided to understand the historical mission of VTBs from the perspective of the overall strategy, grasp the direction of VTBs and always adhere to the concept of service to agriculture, rural areas and farmers.

In addition to training and guidance, the CBRC should also make some policies to ensure that the target of VTBs will not move away from agriculture, rural areas and farmers, for example, the proportion of microcredit loans issued by VTBs should not be less than 60% of its new loans, and that of loans supporting small and micro enterprises in rural area should not be less than 20% of its new loans, to monitor the flow of credit funds.

The CBRC should also reinforce the risk control over the VTBs, especially the supervision of their capital adequacy ratio, in order to avoid the liquidity risk resulted from blindly lending of the management personnel in pursuit of profits.

**To cooperate to find funding sources**

In regard to the difficult problem of VTBs in taking deposit, the CBRC should guide the VTBs to rely on their originators to establish modern payment and settlement system, actively promote bank card business so as to bring convenience to the depositors of the VTBs to handle the settlement and remittance business. Besides, it should also allow the VTBs to agent the bank card business of other commercial banks so as to solve the current problem that the VTBs cannot conduct bank card business since they cannot afford the membership fee of Unionpay, which will strengthen the attraction of VTBs and allow them to get more depositors.

In addition to the source of savings, the CBRC should encourage large commercial banks to provide “wholesale” funds to the VTBs as inter-banking funds or low-interest loans, in order to solve the funds shortage problem of VTBs.

**To develop financial innovation mode**
The VTBs should adjust measures to local conditions when designing the products and services so as to serve agriculture, rural areas and farmers in an innovative way. The VTBs should develop financial products with local characteristics according to the actual local circumstances. For example, Ewenkeqi Baoshang VTB developed the product named “Four Auspicious Treasures” specifically for herdsmen, to meet the needs of herdsmen for loan products. Furthermore, the EBVTB also sets up mobile banking outlets according to the scattered and remote characteristics of herdsmen’s residence, allowing herdsmen to enjoy convenient financial services.

The VTBs should give full play to the advantage of being a primary legal person, shorten the approval chain and improve the efficiency of examination and approval in the process of loan approval, so as to deliver loans to customers in a relatively short time. The VTBs should change the practice of traditional commercial banks that wait for clients to knock the door, instead, they should take the initiative to send loan officers out to the fields to conduct market research and marketing loan products, and make the loan officers go deep among the masses, and understand the demand of farmers for loans, and their repayment willingness and capacity, and establish credit rating files to reduce the risk of loans. In the aspect of risk prevention, VTBs accept flexible ways of physical security, such as housing mortgage, forest right mortgage and so on. For those farmers who are unable to provide physical security, the VTBs can offer them group guarantee loans or unsecured credit loans based on the analysis of their family property and cash flow as well as their credit ratings. In terms of repayment mode, the VTBs can take a revolving loan mode of giving credit line once but disbursing in batches. In addition to the savings and loans business, the VTBs should enhance the intermediary business service, to provide more financial management products for customers and make them enjoy more affordable and convenient financial services.

At the same time, the government should guide originators to set up their VTBs in the areas where RCCs and other financial institutions have lower distribution density through subsidies or other ways, so as to fill the financial gaps in these areas.

To cooperate and optimize human resources

The problem that the VTBs cannot find or keep the talents has seriously hindered the development of VTBs. It should properly relax the employment conditions for the top management, according to the reality, and allow VTBs to employ some retirees from commercial banks, RCCs and other financial institutions.
For the recruitment of employees at the grass-roots level, especially loan officers, the standard can be reduced. They can hire some personnel with college degrees but familiar and in love with rural areas, and enhance the level of their business through training, and create personal development space in order to attract and retain good employees.

In terms of personnel training, the VTBs can cooperate with large commercial banks to use their rich business experience and complete training courses to guide the business of the VTBs, and train the staff of VTBs, and strengthen the financial professional knowledge learning, and help them to be familiar with related policies and regulations as well as business operation process, and finally improve the business quality of VTBs’ employees. Such cooperation requires the policy support from the regulator. Otherwise large commercial banks won’t actively cooperate with the VTBs.

To intensify policy support

In order to better help the VTBs to achieve sustainable development, the government should give preferential policies to the VTBs in terms of three aspects, namely, loan interest rates, tax, and legal deposit reserve rate. Firstly, the government should moderately relax the limitation of loan interest rates, allowing the VTBs to set the price for loan products based on their own operating costs, risk level, and profit margin, and leaving them enough profits to support long-term development. In the market with full competition, the loan interest rate will gradually return back to a reasonable level; Secondly, the government should give tax incentives to the VTBs, such as reduced income tax and business tax same as for RCCs, which can mitigate the tax burden of the VTBs and enhance their profitability; At the end, the government should require the VTBs to make deposit reserve according to the minimum ratio so that the VTBs have more funds used for lending, serving the farmers, agriculture and countryside and letting more people benefit from financial services.

To sum up, if the government can help the VTBs to solve these problems, the VTBs will release the huge potential, and complete rural financial system together with RCCs and PSBC and other financial institutions, building an inclusive financial system in China that allows everyone to access financial services.
References

3. Inclusive Finance: The Practice of Taizhou-based Bank

Abstract: This paper mainly outlines the general development of the bank, the development and characteristics of inclusive finance, the achievements and future development direction of TZB and shares the successful experience of the bank to practice the Small and Micro Enterprises (SME) services and financial services in rural areas in the past 26 years.

Since the establishment, the bank has always been committed to meet the SME’s demand and urgent financial needs in the rural areas and to create equal financing opportunities for the vulnerable groups. While developing its culture of efficient execution, innovation ability, risk management ability, training ability and accumulating its experience in the field of SME’s financial services, the bank focused on a market segment not served by other financial institutions represented by the brand motto of “simple, convenient, and efficient”. The bank focused on a community bank business characterized by the slogan “making friends with clients” and integrated into the local communities. This helped to establish reputational and client proximity advantages, which successfully resolved the technical difficulties of financing SME and helped to accumulate the practical experience for other Chinese commercial banks in improving financial inclusion.

Key words: Financial Inclusion; 小额 () Small Loan; Energy Efficiency Loan; Market orientation

3.1 Introduction of Bank of Taizhou

Bank of Taizhou(TZB) is located in the city of Taizhou, which part of the region which is considered the birthplace of Chinese private economy. The city of Taizhou is located at the coast of Zhejiang Province and at southern edge of Yangtze River Delta economic circle. The population of Taizhou city is six million and the GDP is 315.33 billion RMB (51.72 billion USD, 2013). Since the reform and opening-up of the Chinese Economy, a “Taizhou phenomenon” has appeared which mainly features “Private economy leading the way with the local government supporting”. The proportion of private economy in the total GDP is 97%. Moreover, the city of Taizhou is the cradle of the Chinese joint-stock type company mode. As an important
manufacturing base in the Yangtze River Delta region, Taizhou City has six pillar industries: auto & automotive accessories, pharmaceutical and chemical industry, household electric appliances, plastic mold, sewing equipment, and ship manufacturing.

The development of the financial industry in Taizhou City has been symbiotic with the booming private economy for a long time. Three local city commercial banks were established and developed step in step with ups and downs of the private economy. Bank of Taizhou is the largest and leading one of these three local banks. The self reinforcing circle of economic and financial sector development promoted the healthy and rapid development of the city commercial banks. In view of good financial sector environment of Taizhou City, the Zhejiang provincial government in 2013 decided to establish a Small and Micro Businesses Financial Service Innovation Experimental Zone in Taizhou City. This provided unprecedented opportunities for the local city commercial banks. At the end of 2013, the deposits and loan of the financial institutions amounted 521.97 billion RMB (85.61 billion USD) and 445.41 billion RMB (73.06 billion USD) respectively.

The Bank of Taizhou was originally founded as Yinzuo Financial Service Corporative which was established in 1988. Under the strong guidance of local government and regulators, in 2002 the bank became the first city commercial bank formed strictly following market economic principles (named Taizhou City Commercial Bank). In context with the start of its trans regional development the bank changed its name to Bank of Taizhou in 2010. At present, the registered capital of the bank is 1.8 billion RMB (295.23 million USD). In 2008 China PingAn and China Merchants Bank became shareholders of the bank and are strategic partners. Since its establishment the bank has always maintained its financial characteristics of inclusive finance, focused on service for SME and rural areas and adhered to the credit policy and flexible management mechanism of “small amount”, “wide coverage”, “short term” and “high efficiency”, encouraged innovation and effective management and realized the market economy style management. At the end

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1 When Taizhou Commercial Bank was founded, it had a registered capital of 300 million RMB(49.21 million USD). Government share was 5%. That made it the first city commercial bank in China that did not have a controlling government share. When Taizhou City Commercial Bank was formed the original Yinzuo Financial Serve Cooperative was merged with 7 other credit corporative. That meant to take over 3.510 billion RMB (575.70 million USD) bad assets. The non performing rate rose from 0.91% to 13.10%, but later the bank dealt with the bad asset without spending any penny from government. The NPL rate was reduced back to 1% with in 5 years. Since then, even during the financial global crisis, Bank of Taizhou's NPL rate has never exceed 1% any more.
of 2013, the bank had over six thousand employees and more than 1 million clients. Six branches are located in Zhoushan, Wenzhou, Hangzhou, Ningbo, Jinhua and Huzhou City. These branches and the main office in Taizhou have a total of 74 sub-branches (including 17 SME specialized branches). Moreover, the bank established 7 village banks in Shunyi, Beijing Municipality; Yubei and Qianjiang, Chongqing Municipality; Futian, Shenzhen Special Economic Zone; Ganzhou, Jiangxi Province; Sanmen, Zhejiang Province, and Jingning, Zhejiang Province. The bank has a total of 126 branches which includes 39 branches of village banks. The total asset\(^2\) at the end of 2013 were 87.48 billion RMB (14.35 billion USD), with a growth of 25% to the previous year. The total deposits stood at 73.70 billion RMB (12.09 billion USD), with a growth of 27.26%. The loans stood at 53.29 billion RMB (8.74 billion USD), with a growth of 21.94%.

Under the complex and changing macro economic situation, TZB performed well in 2013 and continued to maintain the distinct characteristics of financial inclusion services. The average loan amount was 487,500 RMB (80,000 USD). Small loans below 5 million RMB (820,000 USD) accounted for a total loan of 99.32% of the number of loans and for 82.56% of the total outstanding amount.

\(^2\) Numbers in this paper are consolidated figures for Bank of Taizhou and controlled village banks.
Small loans of up to 1 million RMB (_164,000 USD_) accounted for 90.99% of all loans and for 44.60% of outstanding amount. TZB lending practice considers the lack of available bankable assets for SME. Therefore, mortgage loans accounted only for 10% while the majority of loans were credit loans and loans backed with personal guarantees only. The data above also shows the unswerving market orientation of focusing on SME.

Bank of Taizhou’s development has proven that medium and small sized banks can achieve commercially sustainable success, develop steadily and control risks by focusing on financial inclusion and SME service. Taking the international financial crisis in China in 2008 as an example, the bank adhered to increase credit to SME. However, a loan growth of 28.70% in 2008 did not resulted in a high growth in risk, and the non-performing loan ratio was 0.44%. The net profit of the bank was 580 million RMB (95.13 million USD_), accompanying with a rate of return on assets of 2.71% and a rate of return on capital of 41.78%. In recent years, the bank's loans continued to increase with a growth of about 20% while the non-performing loan ratio was always below 0.5%. In 2013, the non-performing loan ratio of the bank was 0.41%. The net profit of the bank was 1.82 billion RMB (299 million USD_), with a growth of 18.70% year on year. The bank has maintained a stable high profitability though the years and while focusing on SME financial service.

The long-time financial inclusion practices of Bank of Taizhou obtained the recognition and affirmation from all sectors of society and professional institutions. McKinsey & Company described that the Bank of Taizhou has a suitable market positioning and its community bank mode of being friend with clients is its core competitive advantage differing from the SME’s service mode of other banks. Internationale Projekt Consult GmbH (IPC) evaluated Bank of Taizhou as one of the best among their cooperating banks and they truly believed that the integration of Chinese and Western Micro Lending Technology could create even more equal opportunities for small clients accessing to loans from formal financial institutions. The British journal of "The Banker" ranked Bank of Taizhou in 589th among the world's top 1000 banks in 2013. Furthermore, the bank also had been fully affirmed by the Chinese government and China Banking Regulatory Commission (CBRC) and received a number of awards. The bank was the only one achieving a award of “small business financial services advanced unit” from CBRC for 5 consecutive years and was assessed as “the best MSME service bank”. These and other awards from national and province level are significant in the Chinese context and signify the banks good
3.2 Introduction of implementation of financial inclusion

During the long development process, the bank summed up a simple truth that "Smaller banks can only services small business clients and their business should focus on small clients". Mr. Chen Xiaojun, the chairman and founder of the bank, vividly explained with a metaphor that each city has luxurious as well as budget hotels corresponding to different needs and groups of guests. It is the same for financial markets where different institutions serve different segments of the market. We are the “small, budget hotel” in banking sector which specially serves SME, individual businesses and rural entrepreneurs.

The bank adopts the business strategy of firmly insisting on the market positioning towards SME. Its core clients’ loan is between 20,000 RMB (3,280 USD) and 5 million RMB (820,000 USD). Adhering to the small client financing needs is its route of survival and development road in fierce competition.

A. Xiao Ben (小本®) Small Loan: Creating equal financing opportunities for vulnerable group

Starting in 2005, Bank of Taizhou cooperated with the World Bank and China Development Bank and introduced advanced European microfinance technology provided by IPC GmbH, and successfully carried out the localization transformation of the technology. In this context the bank launched a characteristic loan product called “Xiao Ben Small Loan” which aimed to serve SME, individual businesses, commercial households and farmers. It is a loan focused on supporting small business and is the first exclusive registered trademark in the field of SME’s credit services in China. Compared with the traditional credit products, "Xiao Ben Small Loan" has 3 distinct characteristics:

First, no threshold. This product is designed for the loan amounted between 2,000 RMB (330 USD) and 1 million RMB (164,000 USD). The bank believes that as long as a business operator has willingness and ability to work he can be profitable and they should enjoy the equal opportunity of financing. Through practical investigation, the bank supports a big number of clients even those with a bad financial/business condition but with strong desire to improve their situation through diligent work.

Second, no obstacle. Bank of Taizhou fully lowers the requirements for
guarantees. There is no requirement for clients to provide any collateral nor any strong, qualified guarantor, which improve the loan accessibility for SME. Typically, small business clients especially low-income people lack bankable collateral and qualified guarantors. “Xiao ben Small Loan” primarily focuses the borrower's income through their own business activity as the source of repayment. The bank adopts a method called “superficial guarantee”. Loans are guaranteed by the clients’ relatives, while clients of good conditions can get loan without any guarantee at all. Therefore, the low-income people can truly benefit from “Xiao Ben Small Loan”.

Third, the simple service. As all a client needs to do is to tell his/her account manager that he/she wants a loan, the bank will deal with all process steps for the client. This can achieve a high efficiency. Repeat clients are can get loans paid to their accounts within minutes and new clients will receive a within two days. Bank of Taizhou pays attention to long-term relationship and development of clients. Therefore, there is no excessive reaction to the short term volatility of their operation. There is no doubt that small client's are prone to volatility and risks, but there are a number of factors which can influence small client’s sustainability of operation. The bank pays attention to clients actual operation situation and more attention to client's ability. It will continue to support well qualified clients who are temporarily engaged in a serious loss.

At the end of 2013, the balance of “Xiao Ben Small Loan” amounted 6.52 billion RMB (1.07 billion USD), cumulative amount since the products launch was 31.82 billion RMB (5.22 billion USD) of loans disbursed. More than 260,000 clients were supported by “Xiao Ben Small Loan”. The average loan amount is 110,000 RMB (18,000 USD). 60% of clients obtained their first bank loans at all from the Bank of Taizhou, and the loans created and supported almost 800,000 jobs for the locally.

The Bank constantly improves the features of “Xiao Ben Small Loan”. By virtue of “Xiao Ben Small Loan”, the bank forms a standardized, replicable, commercially sustainable micro-finance business model and creates equal opportunities for vulnerable groups’ access to bank loans. It results in more people from vulnerable groups, who were not able to get bank loans in the past, to start their own businesses. By their demonstration effect, more people desire to escape poverty by their diligent work. The bank explores a sustainable method of providing financial assistance to low-income people which is suitable to Chinese conditions and achieves considerable social and economic benefits. It is recognized by experts that the bank established the “China Small Loan Mode” in the field of international micro-finance and poverty
alleviation, and made a unique and significant contribution to the financial inclusion and harmonious finance.

**B. Energy Efficiency Loan: Supporting SMEs’ energy efficiency, transformation and upgrading.**

In 2011, Bank of Taizhou cooperated with the Climate Financing Innovation Facility (CFIF) from the United Nations Environment Programme (UNEP). On 28\textsuperscript{th} November, the bank formally launched a product called “SME Energy Efficiency Loan” after the training and guidance of 3 times by 3 experts from the Frankfurt School of Finance & Management. The bank adjusted the technology to SME field which originally is only applicable to large enterprises. Through “SME Energy Efficiency Loan”, the bank lends to SME at preferential interest rates in order to motivate them to carry out technological transformation and production process improvement. Its main features are as follows:

*Set up green threshold, help SME to improve energy consumption efficiency*

Many Chinese enterprises are facing with transformation and upgrade pressures resulting from environmental degradation. Many SMEs are related with high energy consumption. Their production process is backward and they are engaged in industries of high pollution and high energy consumption. However, they are still in the stage of growth with small scale and lack of capital and can’t afford to update to energy-saving equipment and production processes. Also there is a lack of awareness and motivation for SME to transform technology.

“SME Energy Efficiency Loan” of the bank is applicable for energy-saving investment of SME, which emphasizes the loan to be used in updating energy-saving equipment and improving production process to achieve energy efficiency. The loan amount is between 50,000 RMB (8,200 USD) and 5 million RMB (820,000 USD), and lasts for a period of up to 3 years. The repayment method of the product is flexible designed according to the clients’ actual operational situation. The product attracts SME and motivates them to update their technology with preferential interest rates.

*Evaluate the effect of energy efficiency, and visually display economic benefits created for clients*

The bank simplifies the complex energy efficiency evaluation to two indicators,
namely energy efficiency increase and carbon emission savings. Through the loan investigation and the energy assessment, specialists of the bank investigate enterprises’ usage of energy in their production process and form the energy assessment report. By comparing power consumption and the total amount of CO₂ emission correlation, SME can easily find out that the energy efficiency investment can bring direct electricity expenditure savings and benefit both the company and the society. Therefore, the motivation of technical transformation for SME can be effectively enhanced.

Through the assessment, the bank can effectively know the real loan use. According to the analysis of input and output, the bank can determine the loan payback period which enables the enterprises to use the loan in a right application. What’s more, the bank can be flexibly determine the payback period according to the useful life of enterprises’ fixed assets, the investment recovery period and regard the added value as a major source of credit repayment. It can considerably reduce clients’ pressure of credit payment This credit analysis method and management mode can also provide a feasible way for the medium and long term loans management in the field of SME.

At the end of 2013, the cumulative amount of “Energy Efficiency Loan” was 107.8 million RMB (17.68 million USD). The “SME Energy Efficiency Loan” was expected to save electricity of 34.83 million kwh per year. Moreover, it reduced 26.3 thousand tons of CO₂ emission per year, which is equivalent to one day absorption amount of 5.3 million trees. In the aspects of environmental protection, the bank indirectly planted a enormous forest of trees and well performed its societal responsibility. In 2013, the bank officially became one of the 6 Chinese members of UNEP FI(United nations Environment Programme Financial Initiative)

C. Xingnong Card: Provide “group purchase” loans to farmers

“Xingnong Card” is an exclusive product for farmers launched by the Bank of Taizhou. There is no need for the farmers to provide any collateral or guarantor, and each household can receive credit loans with a limit from 50,000 RMB (8,200 USD) to 300,000 RMB (49,200 USD ). It is “group purchase” loan to farmers, let farmers enjoy the convenience and benefits of bank loans. Another main feature of “Xingnong Card” is providing one-stop on location service to clients. The only requirement for clients is going to the branch to sign the contract and loan officers will provide a on location service to deal with the rest.

The product has benefited 2,449 farmers since it was launched in 2013 and gave
them the opportunity to improve their economic situation. The bank lent 180 million RMB (29.5 million USD) to clients in rural places and villages.

D. Mutual Guarantee Fund: resolve financing difficulty and guarantee difficulty of SME in groups

“Mutual Guarantee Fund” is a special loan product of solving SME’s financing and guarantees difficulty launched by the Bank of Taizhou. This product mainly is for groups of SME in the same industry and same spot of the production chain. Each client contributes 15%-20% of their own loan limit to compose the guarantee fund and the bank lends without collateral guarantees.

Its core is allowing banks to take the lead for the loan clients to build up the guarantee risk protective walls and finally solve the financing and guarantee difficulty of SME. Clients of “Mutual Guarantee Fund” loans only bear limited mutual joint liability and the maximum loss of them is losing the guarantee fund they had paid. It can prevent the bankruptcy of good condition companies resulting from individual guarantee chain problems.

In 2013, the Bank of Taizhou had established 9 “Mutual Guarantee Fund” projects and disbursed loan to 336 SMEs for a total amount of 203.34 million RMB (33.35 million USD).

E. Poverty Alleviation and Business Startups Fund: Lend for free

The “Poverty Alleviation and Business Startups Fund” is a pure welfare fund cooperatively launched by the Bank of Taizhou, Zhejiang Charity Federation and Taizhou Office of China Banking Regulatory Commission. The fund is professionally operated by the bank with its advanced credit technology, and lends to local impoverished people completely free of cost. It is aimed especially at poor and young startup entrepreneurs. Recipients only need to pay back the principal, and can receive the support in business management and industry information sharing which are provided by the bank.

At the end of 2013, the bank lent to 166 entrepreneurs for their business startups for an amount of 3.44 million RMB (564,000 USD). The “Poverty Alleviation and Business Startups Fund” helped a group of poor and was recognized by more and more people. In order to assist more entrepreneurs, the bank focused on cooperation, and actively established a connection with local government departments, local Disabled Association, Poverty Alleviation Office, College Pioneer Zone and other public institutions, which laid a good foundation for future promotion of “Poverty
Alleviation and Business Startups Fund”.

3.3 Features of financing inclusion and its achievement

Bank of Taizhou's freedom of decision from public influence is very clear since it was founded. On corporate governance, the banks’ advantage of short decision chain and quick response is in accordance with small businesses' feature of "small ship turns quick". The management completely follows market economic principles, truly acting" market-oriented, client-centered". TZB gradually clarifies the commercial mode of "community bank" as “friends with clients”. The accurate commercial mode creates the special financial service, also brings up the model for Chinese medium and small commercial banks in improving financial inclusiveness.

A. Formation and development of financial inclusion

Market orientation: complementary service, serving a different market than big banks, make up service gap proactively

At its inception, due to small size, Bank of Taizhou had no choice but chose the private business owners who were unable to get financial services from bank as the target client. However, the more cooperation with them, the more TZB found it is a segment rather worthy of attention. At the same time, it is suitable for small financial organizations like TZB to serve. Small business client, private owned business owners and agricultural clients have become TZB's firm market strategy option. With the "simple, convenient, fast" service and innovative credit technology for SME, TZB made a distinct service offering from other banks and supported many generations of small businesses to grow up.

The "client definition" proposed by TZB's chairman Mr. Chen Xiaojun considered “People who have labor skill and are willing to work are good client for us." As practiced for 26 years,SME individual’s higher risk does not mean the whole group has a higher risk,. instead, some SME have strong concept of credit and high repayment motivation.

China's urbanization and industrialization has hastened a huge number of land-lost farmers and individual entrepreneurs who are eager to have simple financial services provided to them. Objectively, since they do not have enough communication experience with banks, some client even extremely believe they will not get the sincere and equal service from banks. But for small businesses, capital is precious as
blood, they are unable to solve the demand in the early days of start-up because of the high rate and instable social financing. Since the credit record in bank is a key factor in the access to gain formal financial service, the willingness to maintain good credit record of this group is stronger.

Bank of Taizhou has always held the idea that SMEs in China have a big potential and it keeps on keeping SME as its market orientation. On client selection, TZB has always held the simple idea of "improving financial inclusiveness", which has promoted SME' development strongly and helped weak entrepreneurs to succeed, also inspired local start-up atmosphere, promoted social stability effectively, lightened up good future for people who are willing to work, achieved its unique social and economic value. Many enterprises with hundreds of millions of output now were TZB's client back then. At that time, it was hard to gain loan from other banks for them as they did not have financial reports, the first small loan of a few thousand RMB from TZB contributed to their development.

**Service concept: To be "convenience store" of financial service**

Small business entrepreneurs usually get up early and work late, they are also in charge of accounting and are their own cashier. They go to bank to do transactions by themselves. This put forward the direct requirement towards bank's service. Experience of growing up with SMEs enables the bank to know more about small business. TZB always regards client's feeling on service as the standard to evaluate its own work. According to SMEs' demand, TZB set up the service system, integrated back office management, simplified the process and product function and built the "simple, convenient, fast" financial service brand which is suitable for small business.

TZB provides clients with convenient financial service 365 days a year and 12 hours per day. Moreover, all branches of TZB open at weekends and holidays adapting to the client's timetable.

80% branches of TZB are in towns and villages that have few financial service spots. TZB has been exploring to set up new style small outlets which are located near client's place and factory. The banks aims to be closer to client and becomes the "convenience store" of financial service.

Bank of Taizhou is the first bank to start integrated front desk service among

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3 At the time when Bank of Taizhou was just founded, the local informal market financing interest is as much as 2.5% a month.
local banks and thus can offer "one stop" service. It has plenty of teller windows and established queue monitoring mechanism to ensure that people in the queue are never more than 4. The bank tied client's feedback machine with core system\(^4\) so that all management staff can know about client's evaluation of service, and then try to make the best front desk service. What's more, TZB established a standardized time-limited service mechanism to limit transaction period to the second.

Bank of Taizhou puts more emphasis on the "small innovation" such as night service, exchange small notes into big, special front desk window for small notes counting, equipping front desk windows with correction glasses for clients use, mobile bank and others. These kind of innovation is done quickly and has high flexibility, which usually has high efficiency with less work.

To weather the hardship with SMEs, TZB took the lead in adopting the "zero fee bank" policy and thus further displays its social responsibility actively. The policy launched under the motto "free service, better service" Canceled kinds of 42 fees to make banking for SME simple and cost transparent. Except for credit card use, all others transactions charge no fee, especially taking away cost burden from small transactions typical for small business. The national Xinhua News Agency and other Chinese official media picked up the initiative. Right now this beneficial policy is still continuing.

Based on doing good financial service, Bank of Taizhou also paid attention to the service on popularizing financial knowledge. The bank's staff went to communities, villages to serve people at home. By doing this, not only can people see and understand financial knowledge, but also they can use it and get benefit. TZB established long term relationships with nearby residents relying on the advantage of outlet proximity to the residential areas. It extended activities, offered entrepreneurs sustainable financial services improved the financial service coverage, which also gained more clients for itself, achieved "all win" situation, and explored a new route for city commercial banks in serving community and village.

**Risk management: crack the technology bottleneck of SME financing**

Out of all staff of TZB, 40% are account managers. They do not stay in office at work time, but go to markets, factories, communities and villages to communicate with clients on location, with aim of keeping close relationship with clients. They do

\(^4\) Client has right to assess the front desk service every time a transaction is made. In Bank of Taizhou, all front desk windows equipped with a "satisfaction assessment machine".
not wait in the office for clients to come, but take initiative to know and satisfy clients demands. Their business mode is labor intensive, which is seldom seen among financial institutions.\textsuperscript{5} Through the “making friends with clients” policy, the bank can understand SME clients’ credit demand while effectively solving the problem of information asymmetry, which is one of the core problems in SME lending business. The daily information accumulation and frequent communication is also core competitiveness of the bank.

After many years operation, Bank of Taizhou summarizes credit technology to 16 Chinese characters, "Pay on-site investigation, See and touch, Bank makes financial statements, Cross checking." Based on this philosophy the bank lets professional staff make all kinds of financial statements (balance sheet, profit and loss statement) for clients, instead of asking for it. The bank helps to clarify SME's unclear financial situation, with all levels of approvers' cross checking, information accuracy checking and combined with the motto to "rely on three things but not the other three" (Do not rely on official statements but on the original record, Do not rely on collateral but on the repayment ability, Do not rely on company management but the family management). The bank has a 2% tolerate ratio for non performing loans in order to motivate account managers be able and dare to disburse loan to SMEs. In order to improve SME loan approval efficiency, the bank has set up strict monitor system and completed authority management mechanism, delegating approval authority to first line, so that 84% of all loans are approved at sub branch level, while 99% are approved at branch level.

On the basis of having solved the problem of information asymmetry between bank and SME, the bank innovated more credit products. It rolled out products such as Mutual Guarantee Fund, Energy Efficiency Loan. The whole bank only has about 10% collateral loans while credit loans and guarantee loans take the biggest share. This is a big difference with big banks; it designed SME specialized service process, so that the SME client can enjoy good service provided by front desk and account managers. Account managers provide consultancy service and introduce products face to face, which can satisfy clients comprehensive demands and help them to solve the financing difficulty once and for all.

A typical testimony from a person who has experienced TZBs service says, "My Account manager from Bank of Taizhou helps clients to refill gas, take care of kids and even helps to introduce boyfriend/girlfriend" The Account managers record how

\textsuperscript{5} Currently, in Bank of Taizhou, an account manager manage about 124 clients on average.
many noodles a noodle shop can sell, count the chickens on a farm. They even know more about clients business status and cash flow than the clients themselves. They prepare everything ready for a loan even before client speaks out."

Bank of Taizhou also applies and adapts its credit technology to each region where it has an outlet. After 4 years practice, the reality shows that the bank achieves preliminary success in cross regional development. The village banks initiated by the bank are affirmed by governments and awarded as local "benchmark bank". Which proves that it’s SME credit lending technology is feasible, can be applied to other places.

**Staff team: Willing to and good at serving SME**

Most of SMEs have office, processing plant, and storage place all in one location. The boss works together with the employees. Which means it is not enough for bank employees to have complete and strong professional knowledge, but also should forget about their formal clean dress. They visit clients a lot and can be pleased to stay with SME owners, so that they can really understand clients demand and client will like them. On the other hand, this also means that TZB cannot recruit qualified staff from outside, but needs to train staff by itself.

Staff recruitment. The bank's policy is to recruit from nearby, and from typical local industries not just people with financial education. When choosing outlets' location, the bank makes good plan for staff recruitment, and designs employees criteria that adapted to SME clients; it has effective recruitment from target industries, communities, and commercial areas. 99% of staff is cultivated internally. The bank hardly recruits staff from other local banks.

Staff cultivation. The bank has founded a college called "Bank of Taizhou Yinzuo Financial Training College". It introduces international advanced training concept, develops courses by each business line, sets up high density, efficiency, and standardized training system and designs scientific, reasonable qualification test. It can train freshly graduated young people to be independent front desk teller within 3 months and to be a skilled loan officer who can independently process loans, within 6 months of training. It guarantees a strong human resource for business development.

For internal competition, the bank holds the value of "fair, just and transparent". In order to build a level playing field, the bank follows a rule of "not hiring any close relative of managers” and of “everyone is equal", "let suitable person do right work". It sets up complete performance based evaluation system and drafts career path for all
staff. Oriented by performance, the bank forms an open, fair and competitive staffing mechanism. It assesses staff by their competency, encourages to promote talent and provides an equal opportunity platform for staff to realize their value. This also allows to find out outstanding staff. It keeps on using effective and practical talent criteria, pays high attention to key position staff and the performance based salary system is inclined to key positions.

**Enterprise culture: Strong sense of risk awareness, and high efficiency on implementation**

Bank of Taizhou manages enterprise with strict attitude and forms a strict and high efficiency enterprise culture. The emphasis of the credit culture is "no corruption, honesty, high efficiency", and the risk concept of "good credit assets is the basis of survival of the bank" is now deep in every staff's heart. The bank forms an atmosphere that everyone maintains credit asset security as the supreme value. In the environment that Bank of Taizhou is in, its way of asking people to repay overdue loan which is "never giving up", makes the public all knows its reputation of "cannot owe TZB any overdue debt". All these are the root of the bank's risk control, the cherished characteristic TZB has built up in so many years.

Another feature of TZBs corporate culture is represented by the slogan: “We need the result, instead of the endless excuses and complaints.” The bank is oriented on results, which encourages every employee to pay attention to their final target at all times and make all efforts to fulfill their duties. Through setting up the strict system, the bank clarified the code of conduct, smoothed the internal management mechanism, which made the management intention can be understood better and the management level and ability can be improved even more. By forming a high efficiency enterprise culture, the banks development is secured.

As part of the national financial reform movement, all banks lower down their market orientation to SMEs in the recent years. The market competition is more and more fierce, which pushes financial institutions to improve their service quality for SME. The promotion of interest rate liberalization makes the financial institutions deepen their thinking on sustainable development. Through strict market study and a detailed business development plan the bank distributes business target to every first line staff. It set up comprehensive budget management system and implements detailed control on cost to spend every penny on serving SME.

**B. Share the achievements of Inclusive Finance with peers**
Through 26 years of operation, Bank of Taizhou always practices the concept of Inclusive Finance and successfully realizes the commercially sustainable business model. This effectively breaks the financing bottleneck of SMEs, especially low-income earners. Bank of Taizhou shares its own experiences with peers through multiple channels to jointly promote the steady development of the financial industry.

**Share credit experience of Inclusive Finance**

The success of Bank of Taizhou serving SMEs with great concentration, answers the questions Inclusive Finance are facing from 3 aspects: what can be done, what is worth doing, what we can do, and effectively eliminates the concerns of the peers on the risks of financial services for SMEs, thus promotes the deeper development of Inclusive Finance.

a. what can be done: SMEs have a strong concept of credit

People used to think SMEs, especially migrant population, lack the concept of credit due to low cost of default. But seen through the practice of Bank of Taizhou, SMEs have strong concept of credit. Financial services for SMEs can be done.

b. what is worth doing: Commercially sustainable development for micro-finance service is possible

The successful commercial mode Bank of Taizhou achieved in serving the SMEs and disadvantaged groups proves that SMEs financial service is well worth doing and will have great impact.

SMEs have low management cost and high rate of return. Since loan amount is small, interest can be completely covered by the business profit. The problem of high cost and high risk can be solved through commercial market path, letting income to cover cost and risk, thus commercial sustainability can be achieved.

c. What we can do: SMEs loan risks can be fully controlled

The risk of single SMEs loan is certainly high. This is directly related with their characteristics of small total assets, low resistance to risk and the lack of collateral. But the honest, hardworking SMEs are creditworthy. Loan risks can be well controlled through transformation of banks' internal credit processes. More importantly, SMEs loans follow the principle of risk diversification. Since loans are disbursed to multiple enterprises and industries, the risk of a single enterprise or industry won't pose a serious threat to a bank. Not blindly pursuing zero risk, controlling average loan amount, covering wide range area, by doing all these, risks are diversified and increasing number of clients get benefit. The excellent credit asset
quality Bank of Taizhou kept for a long time fully proves that the risks of SMEs loans are controllable as long as there are suitable management system and business mode.

**Share the social effects of Finance Inclusion**

The practice of Bank of Taizhou on Finance Inclusion poses considerable change for financial ecological environment.

In terms of creating employment and entrepreneurial opportunities: After getting financing, SMEs expand plants, purchase equipments, increase inventory. Employment is created through those activities. It is estimated that on average each loan will create two or more jobs. At the same time, improvement of the financing environment and the demonstration effect of SMEs owners have good entrepreneurship demonstration effect, thus forms a virtuous circle.

In terms of suppressing illegal financing: If formal financial institutions cannot effectively replace private financing, private financing will grow intensely. Large scale, unregulated private financing would seriously harm the healthy development of the economy and even endanger social stability. Bank of Taizhou orderly guides the financing needs of the disadvantaged group through regulated financial supply, which safeguards the security of the local finance market.

In terms of guiding the peer competition: Bank of Taizhou focuses on serving the start-up clients who don’t have credit experience, which enhances the integrity of financial services in the market segments and generates the "catfish effect", solves the difficulties of SMEs on getting financing. For sure, clients are the upmost beneficiaries of competition in the financial sector.

**Share the service channels for Finance inclusion**

Allocation of financial resources by supporting the rural areas with funds from cities is effectively solved. Traditionally, the funds of city commercial banks come from and go to urban areas. The SME mode business is mainly in the rural area. This mode is like a green passage to channel urban funds to rural areas. In Bank of Taizhou, above 94% of the SMEs loans are disbursed to the rural areas. The funds are basically supplied by its deposits.

Success of entrepreneurship depends on two factors: opportunities and funds. Entrepreneurial opportunities can be obtained by the entrepreneurs through their own efforts, but funds are difficult to get without access to banks. The bank quickly meets the funding need of small business, provides a stable and reliable source of
funds for entrepreneurs, effectively solves the difficulties of landless farmers in the process of urbanization and achieves a smooth transition from farmers to urban residents, from agricultural to non-agricultural industries. It realizes effective support for agricultural industry transformation and development, which plays a very important role in the maintenance of social stability.

3.4 Challenges and future directions

A. Medium and small size banks will face more fierce challenges

*The impact of interest rate liberalization*: Compared with big banks, medium and small size banks generally have shorter history, weaker client base, narrower business scope, larger proportion of net interest income in business income. So interest rate liberalization, deposit interest rate in particular, will produce a significant margin squeeze on medium and small size banks, which have put forward higher requirements on pricing power, risk management capabilities and integrated management capabilities of medium and small size banks. These banks should get prepared early, and to meet the interest rate liberalization through SME target market positioning, business management capabilities improvement, internal adjustment and external cooperation. The deposit insurance system, which will be introduced in connection with the interest rate liberalization, will pose negative effect on medium and small size banks' deposit gathering. The probability of losing deposits will be high because of the compensation limit set by the deposit insurance. Similarly, the "Bankruptcy Act for banking financial institutions" is not conductive for enhancing the credibility and creditworthiness of medium and small size banks.

*Increasingly fierce competition in the "Age of big asset management"*: Currently in China, although commercial banks are regulated by asset liability ratio, the competition for liabilities which mainly consists of deposits will continue to exist. Liability management is still the focus of most banks, small banks in particular. With the gradual relaxation of policy on the asset management business scale of non-banking financial institutions, a wild war has started. Commercial banks, trust companies, securities companies, funds, insurance asset management companies all get involved. The big asset management time has come. High net value clients will be the focus of financial institutions. Non-banking financial institutions, Securities institutions and fund companies, etc., will vigorously develop so called “wealth management business”. They have a distinct advantage over medium and small commercial banks on the configuration of equity assets. Higher rate of return of their
products may attract high net value clients, which will pose serious challenges to wealth management and deposit business of city commercial banks.

**Impact of uncertain macro economy is far-reaching:** At present, economic situation at home and abroad is very complex. The macroeconomic data at the beginning of the year shows greater downward trend of the economy. First, business difficulties for SMEs exist. They face the risk of failure and bankruptcy. Thus banks' loan risk is more difficult to manage; Second, in order to win market share, competition among banks will be more intense, which will increase the operating cost of banks and higher pressure on revenue; Third, moral hazard is hard to control. Bank employees are also social beings. Under tough economic environment, various types of conflicts may outbreak, involving various influence.

**B. unswervingly fulfill our corporate mission**

Mission statement of TZB is: “To change China’s financial market by giving small business access to top quality financial services.” Under the guidance of its mission, Bank of Taizhou is market-oriented and client-centric, practicing its service culture: Simple, convenient, efficient. It creates future for the employees, creates value for shareholders, provides fair financing opportunities for small businesses, fulfills social responsibility, sets up first-class financial service standard and builds a green, respected and trustworthy bank.

**C."Transformation and a new undertaking", achieve take-off again**

In the future, Bank of Taizhou will continue to push forward the development of social credit concept, promote the construction of local credit culture, improve local financial development and competition environment. It will be committed to the pursuit of a comprehensive development, risk prevention, reform and innovation, to establish a highly responsible financial institution, to make itself a quality bank with fast growth, low risk, and high profitability. It will be committed to creating equal opportunities for SMEs which could not get financial services from banks before. It will provide personalized financial services for clients; help the economy disadvantaged groups to improve their living conditions, to promote the economic development of poor areas in China. It will be committed to encourage and support employees to initiate and participate in social welfare and environmental protection activities; it will be grateful for the society, actively create equal access to service, and strive to contribute to the community. Bank of Taizhou is not pursuing short-term growth. It is dedicated to achieve sustainable development. It pays great attention to
the protection of the natural environment, to the harmonious development of the society, to the harmonious coexistence with the nature. It fights for an overall sustainable development with the society, economy and nature.

In February 2012, Bank of Taizhou launched a strategy consulting project in cooperation with renowned international strategy consulting firm, to look for the path for successful market positioning of SMEs, the path of improving standardized management and the path of achieving other management innovations. By implementing "market-leading performance, winning business and management and control model, a strong team and cohesion, national market influence," the bank wants to build itself a leading inter-regional micro-finance service expert in 5 years, and the leading bank for micro-finance nationwide in 10 years.

"Community banks" mode as the goal, to achieve differentiated, characteristic, and professional management

The bank will deepen its "community bank" service mode in the coming 3 years; get sustainable access to client information by using its popularity and geographic advantages, advocating making friends with clients, and providing convenient, considerate financial service for clients. It will make its SMEs financial service better and more specialized. On the basis of keeping its own financial service mode, “Community bank" mode brings Bank of Taizhou a new idea for community marketing--“ to be friends with clients" . This new mode effectively solves the problems brought by the inter-regional development. The bank will stick to its market positioning of SMEs, and achieve differentiated, characteristic, and professional operation. Through the strategy of covering the un-served part of market and avoiding competition with the strong, to provide convenient, considerate financial service for clients, and to improve client satisfaction and loyalty; to expand the market by giving full play to its "simple, convenient, efficient" service, by actively providing funds to the surrounding merchants and villages, by offering products like "SME loans", "energy efficiency loans", "xing nong card"," mutual fund" etc..

Create a SME specialized institution both internally and externally through the process of “5 transformations”

On the basis of passing on its traditions, Bank of Taizhou will continuously carry out “5 transformations”. Transformation 1: open and proactive corporate culture. To improve the happiness of employees, middle and senior managers set good examples
and actively improve themselves to create a corporate culture of respecting and caring for employees. Transformation 2: Wholesale marketing and precise marketing: achieve a breakthrough in business development through further strengthening “community bank” business mode, enhancing business planning capacity, raising wholesale marketing efficiency. Transformation 3: risk control under the support of systems and tools. To provide a steady base for business development and calmly deal with risk through building a comprehensive risk management system, exploring new technologies and methods for comprehensive risk management. Transformation 4: organization of lean headquarter and capable branches. Create a management and control mode of lean headquarter and capable branches, and improve the productivity of sub-branches. Transformation 5: system improvement and strengthening motivation and guidance for employees. Carry forward the value of “fair, just and transparent”, optimize the performance management, talent identification and growth mechanism.

"Participating in the public welfare", to build a respected, trustworthy bank

While doing good financial services for SMEs, as part of fulfilling social responsibilities, Bank of Taizhou will promote and facilitate public welfare activities independent, pure, and without any marketing purpose. The Bank calls all employees to actively join the team of volunteers, asks its branches and employees to put some time every month on carrying out public welfare activities including cultural and sports activity, helping the old and the impaired, participating in environmental protection activities and fund raising for natural disasters relief. The bank will earnestly perform its social responsibility as an outstanding company.

By looking back, Bank of Taizhou has always been a responsible corporate citizen who actively fulfilled social responsibilities, and carried out activities such as "environmental protection activities", "poverty relief and innovation fund" for the disadvantaged group, "TZB Cup" Youth Entrepreneurship contest, preferential policies of reducing clients' cost; "resting chairs in the corner"6. In the future, the bank will be engaged in social welfare activities as usual. As what it says in its mission statement, the bank strives to become a green, respected and trustworthy bank.

Conclusion: Bank of Taizhou, inherently, has a more flexible and efficient

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6 In high-rise buildings which don't have elevators, portable seats are set up at the corners of corridor in higher floors, the aged can stop for a rest
decision-making mechanism, a business mode more suitable for SMEs, and a firmer risk control mechanism. With enlightened guidance of governments and regulatory authorities at all levels, the bank strikes its root in micro-finance service market, firmly grasps the quality growth environment and opportunities, and maximizes the efficiency of private capital serving the local economy by means of well-leveraged government power.

Bank of Taizhou is in the period of transformation while the old strategic core still applies, but in the future development, in order to further practice Financial Inclusion, it must adhere to SMEs positioning, unswervingly promote the "community bank" business mode of making friends with clients, maintain "simple, convenient, efficient" service, adhere to high execution and coordination among all levels, provide quality, efficient financial services to small clients, pursue wholesale marketing and ensure high quality risk control level through standardized management, so as to maintain a successful replication of SME financial service in inter-regional development and to contribute more to Financial Inclusion in a much wider range.
4. The practice of Jiangxi Credit Community Loans

Abstract: China’s economic entities such as small and medium-sized enterprises (SMEs), individual business, industrial enterprises, planting and breeding specialized households, regional industrial clusters have been effective strength that promote economic growth, increase financial income, and solve difficult employment problems in recent years.

These economic entities, however, cannot joint up with modern financial service standards and conditions because of effects on asymmetric information problems, such as low organization degree, lacking guarantee and standardized internal management that lead to outstanding loan problems, becoming the weak link of financial support and bottleneck of economic development.

Rural credit cooperatives or other medium and small banks establish credit communities by organizing credit projects’ stakeholders in some areas, forming credit operating mechanism of risk-sharing and revenue sharing. In addition, it has solved loan problems on economic weak links and puts forward an idea for financial institutions about asymmetric information.

This paper introduces the main types and operation steps of Jiangxi credit community loans, and put forward the ideas of promoting community credit loans.

Key words: Inclusive Finance; Jiangxi rural credit cooperatives; credit community loans

4.1 Contradictions on jointing up between weak economy and modern finance

The reason that economic entities, such as small and medium-sized enterprises(SMEs), individual business, industrial enterprises, planting and breeding specialized households, regional industrial clusters in China, become the weak link of financial supports is that there exist difficulties and contradictions between weak economic entities and modern financial services. Its main features are:

A. Contradictions between lack of collaterals in weak economic entities and strict collateral conditions of modern finance universally

Because of smaller scale, fewer assets, lack of standardized financial management, economic entities such as small and medium-sized enterprises(SMEs),
individual business, planting and breeding specialized households are not only
difficult to determine the first source of repayment (operating efficiency), but also
have common collateral problems, which cannot joint up with modern financial
requirements. For instance, it is hard to establish property rights, determine asset
value, safekeeping items, and difficult for mortgage registration, as well as mortgage
liquidation.

According to Jiangxi Rural Credit Cooperatives Union’s sampling survey, a
majority of entities lack collaterals to obtain financial credit support, including about
65% small and medium-sized enterprises (SMEs), 78% individual business, 56%
industrial enterprises, 83% rural planting and breeding specialized households, 92%
peasant household, resulting in lower loan availability.

Modern financial enterprises, operating third-party funds, and gaining profit
depending on risk management, firstly must follow the principle of prudential
management, which means they should establish valid repayment guarantee and risk
compensation mechanism when providing financial services for economic entities,
especially credit support. And one of the important measures is requirement on
adequate and effective collaterals for supported subjects to make risk controllable.

This is one of the most important reasons that it is hard for weak economic
entities, including small and medium-sized enterprises (SMEs), individual business,
industrial enterprises, regional industrial clusters to get loans.

B. Contradictions between difficult information acquisition in weak
economic entities and requirement on comprehensive information management
of modern finance

There obviously exist weak qualities such as management dispersion, smaller
scale, lower management, unstable operation, larger revenue fluctuation in economic
entities, including small and medium-sized enterprises (SMEs), individual business,
planting and breeding specialized households. They lack formal financial and
statistical reports, credit rating and credit registries, as well as information disclosure
mechanism, internal governance structure, modern enterprise management system.

Modern financial enterprises must fully grasp the true situation about operation
condition, management, cash flow of financial service objects based on
comprehensive information when providing financial services, so that they can
forecast, analyze, and supervise different potential risks, and timely take valid
measures.

Although these weak economic entities can get operating rules of financial
institutions easily, it is hard for financial institutions to obtain real, adequate, full, valid and dynamic operating information from weak economic entities, leading to serious asymmetric information problems, and this is also an important reason for financial insufficient supply to weak economic entities at present.

C. Contradictions between low organization degree, high cost for financial services in weak economic entities and pursuit for scale benefits and lower management cost of modern finance

Business activities of weak economic entities’ business activities such as small and medium-sized enterprises (SMEs), individual business, planting and breeding specialized households, have universal characteristics of smaller scale, dispersion, larger quantity, especially lower scale and organization, so that they cannot joint up with modern financial pursuit of scale management and scale benefit.

And this feature determines that financial enterprises should pay for higher operation cost for managing the same amount income-bearing assets from weak economic entities, in turn, weak economic entities also pay higher cost for financial services.

And weak economic entities mainly deal with weak industry, focusing on agriculture, and their earnings are more fluctuate; These subjects are vulnerable groups, which not only want to get comprehensive top quality financial services, but also wish the financial support to be low cost, which means that they should be in industrial profit margins, as well as in available cost. And this is also one of the important problems for butt joint between modern finance and weak economy.

D. Contradictions between more risky factors, difficult integrity constraints in weak economic entities and financial risk prevention, risk diversification of modern finance

The endowments and features of weak economic entities such as small and medium-sized enterprises (SMEs), individual business, planting and breeding specialized households determine that they always face risky factors from different aspects during management process, especially market risk.

According to concerned files, about 20% small and medium-sized enterprises (SMEs) close and shut down for suffering from market risk every year. Furthermore, a large variety of individual business, industrial enterprises fail in business every year, even costing large loss for market condition change.

Meanwhile, it is hard to make credit status, and constrain dishonesty for
economic entities, especially weak economic entities, due to lack of social credit environment, shortage of credit resources, as well as imperfect credit system construction of individuals and businesses.

As modern financial enterprises that manage risk, they should always guarantee assets’ security, liquidity and benefit in order to make various risks in acceptable range and keep to minimum, which needs preventing and diversifying different management risks, as well as striving for growth opportunities.

Although above mentioned problems and contradictions on jointing up with modern finance exist in weak economic entities, they have vigorously become the important growth points in our national economy and main force to solve employment problems. Weak economic entities such as agriculture, small and medium-sized enterprises(SMEs), individual business have large quantities of informal finance during vigorous development due to lack of modern financial support, which shows the general benefit and growth about these economic entities, and reveals banks’ fund application and revenue opportunity.

And modern banks need analyzing customers’ characteristics seriously, coming out from traditional normal credit risk management, fully exploring and taking advantage of credit sources about credit programs, making up shortage of collateral and asymmetric information, when facing exuberant financial demand and potential benefit opportunity. So that they can finally find the mechanism for valid management and risk dispersion, filling up gaps between difficulty in loans and being difficult to loan, achieving positive interaction.

Various regions are exploring thorough credit community lending patterns just about the link of credits, and wish to solve problems of jointing up between weak economy and modern finance through forming credit risk dispersion mechanism of risk-sharing and revenue sharing, which actually put forwards an idea for financial enterprises, not only obtaining valid development opportunities, but also effectively managing and diversifying risk.

4.2 Main types and operating sequences on credit community lending patterns about Jiangxi rural credit cooperatives

Rural credit cooperatives spread around the whole province in 1952 based on credit cooperatives’ experimental units in 1951 organized by Jiangxi People’s Bank. Thereafter, Jiangxi rural credit cooperatives have undergone periods of cooperatives, People’s Commune, the Great Cultural Revolution and Reform and Opening.
As one of experimental units, Jiangxi rural credit cooperatives participated in trial basis on deepening rural credit cooperatives in 2003. Particularly, the whole province’s rural credit cooperatives(rural commercial banks) persist in the aim to “creating value for customer, making profit for shareholders, creating future for employees, producing wealth for society”, stick to market orientation of “based on county domain, serving ‘Agriculture, Rural Areas and Farmers’”, and promote the management concept—“credit as the essence, cooperation and win-win”, make efforts to practice three great historical missions—“promoting standardization, enhancing competitiveness, and making new contributions”, exert to crack historical problems of heavy historical burden, low asset quality, poor personnel quality, backward business methods and weak management foundation; strive to create the brand on the main banks serving county, retail banks based on community, grameen banks favored by peasants; resulting in its own business sound and fast development while improving contributions to “Agriculture, Rural Areas and Farmers” and regional economic society. And it has been the local banking institutions which possess the most branches, the largest business scale, the most extensive customer resources, playing an effective role in practicing the main force on inclusive finance, becoming the own bank of Jiangxi people, as well as the most important financial finger that implements national supporting agricultural policy and the development strategy of party committee and provincial government in whole province since establishment of Associated Press on 26th, May, 2004.

Currently, there are 88 common members in rural credit cooperatives(rural commercial banks) in the whole province, including 16 rural commercial banks, 6 rural cooperative banks and 66 rural credit cooperatives, covering every city(county, district), and about 2600 branches spread around every village and town. Furthermore, 50 thousand automatic equipments have implemented rural financial service available in the whole province, and about 2600 staff serve at urban and rural customers widespread in the whole province.

Jiangxi rural credit cooperatives have eliminated villages and towns with blank financial services since 2011 in order to practice inclusive finance, and play the main force on supporting agriculture, truly making rural and urban residents enjoy the basic financial services widespread, and push out credit modes such as credit community loan during the practice on inclusive finance.

A. the main types of credit community lending patterns

After foundation of Jiangxi Rural Credit Cooperatives Union, it drew on the
experience actively such as Tianjin rural cooperative banks, and started standard pilots in Qingyuan and Yujiang. The model has been promoted for the whole rural credit cooperatives through the whole province based on the experience in 2007, which has gotten preliminary results. There have been 50 county credit unions(cooperative banks) launching 78 kinds of credit community lending patterns, crediting up to 11.8 billion yuan, granting the loan of 15.2 billion yuan totally, supporting 2713 small and medium-sized enterprises(SMEs) and industrial enterprises, and the recovery of principal and interest of maturity loans is above 98% on average.

The rural credit cooperatives strength the interactive cooperation with the local government, agriculture-related departments, professional associations and guarantee corporations at present, insisting on the belief of credit as the essence and cooperation and win-win, and fully disinter credit resources of intermediary organizations and professional associations, link all loan beneficiaries, and establish the credit community of risk-sharing and revenue sharing, build new credit mode of credit cooperation and professional cooperation, finally getting out of a way on rural financial development based on use of information resources comprehensively, finding the alternative mechanism for small and medium-sized enterprises' loan collaterals. Currently, the credit community lending patterns that rural credit cooperatives mainly put forward are as follows:

**Credit community to SMEs, especially on industrial clusters**

Guarantee funds that are composed by credit communities’ leading, commerce’s specific organization, and corporations’ participation have characteristics of closed, non-profit and self-service, and they are stored in rural credit communities. After risk evaluation on corporations, credit communities will enlarge certain credit multiples based on corporations’ guarantee fund, such as 5-8 multiples, then amplifying every company’s investment capacity.

The certain guarantee fund that each company pays means that they bear joint guarantee responsibility for other corporations actually. Corporations establish an anti-guarantee mechanism in turn with guarantee fund in order to prevent risks.

It not only solves enterprises’ investment problems, but also problems involving market price, technology, material procurement, commercial negotiation and so on, finally improving organization degree in large extent, and making powerful guarantee on scatter small enterprises to extended market.
Credit community around agricultural industrialization leading enterprises

During the development process on agricultural industrialization, various regions have developed the industrial management model about lots of “one product and one village” specialized division, leading corporations connected with bases, and bases linked with farmers, and some are in the form of cooperatives and professional associations connecting farmers, solving technology problems, market problems, risk prevention problems that scatter farmers will come up with on certain industry.

Meanwhile, the government often puts forward many policies in order to encourage and aid agricultural industrialization leading enterprises, policies include guarantee, discount and tax reduction and so on. Credit cooperatives participate in to organize credit communities with all beneficiaries through government support policy and different organizations in the development process of agricultural industrialization.

The government will bear some risk compensation in this mechanism, and leading enterprises will provide cash flow guarantee, farmers form guarantee fund, finally solving capital demand problems and risk prevention problems when scatter farmers develop large industries or certain specialized industries.

Credit communities on corporations about transportation and construction

Individual business households and private enterprises buy cars for transportation; buy construction machineries to be engaged in engineering, once investment and redemption by yearly, then uncertain risks come out.

It can solve problems of capital investment and risk guarantee by organizing them to form credit communities through certain way. For instance, setting up transportation associations by means of transportation organizations, and the transportation households pay little fund, finally forming a closed and non-profit guarantee fund to store into credit communities, the credit communities provide 5-8 multiples loans, then the transportation households can buy a 100 thousand car with only 20 thousand yuan, so they can provide anti-guarantee for guarantee enterprises and automobile associations with the car.

Automobile transportation associations solve risk dispersion problems on transporters’ honesty and other aspects with powerful management through administrative powers on operation certificates.
And insurance companies are also brought into the credit community, once traffic accidents, road accidents and goods loss happen, the insurance company should claim, refund credit community lending patterns preferentially. Large investment industries such as constructions can take this measure.

**Credit communities on individual commercial enterprises**

Organizations of individual business households, private associations(chamber of commerce), Industrial and Commerce Administration, market management committees and credit cooperatives as one credit community, can not only solve problems of asymmetric information during credit cooperative loans, but also help loan management with individual business households, realizing valid collateral.

The management right on commercials actually is a contractual relationship between market management committees and individual business households, and it is hard to possess mortgage effects without market management committees’ coordination, and credit cooperatives cannot play an active role. So it is necessary to bring them in, providing confirmation and guarantee business households’ collaterals.

Meanwhile, it can also connect close business households to form guarantee fund, constituting powerful guarantee to solve fund deficiency problems.

**Credit communities on government-sponsored utility industries**

The increasing financial revenue, land leasing revenue and common industry income all can be repayment sources in the future, such as repairing roads, building squares, funning waterworks and building other facilities.

But the finance cannot provide straightforward guarantee for banks, it can apply for loans with the pledge of management rights if the common industry that government build is profit-oriented, and the future cash flow is guaranteed.

The finance can establish an enterprise operation and non-profit guarantee company with part of finance when it involves some non-profit public welfare. The finance continues to put revenue into Guarantee Company, and it provides guarantee for government public welfare in turn, persists in enterprise operation, finally the financial enterprise can provide loans for it.

Establishing a corporational control mechanism between capital sources and use of investment company or guarantee corporations controlled by the government, will make the responsibilities clear with relative corporations, the government and banks.

Establishment of the actual community has solved a series of complicated
problems on government short-term capital demand with long-term payment
guarantee, but the repayment guarantee cannot meet loan conditions.

B. operation steps about credit community lending patterns

Different credit community loan models are such credit service modes, which always start by related parties( the government, industry associations, commercial associations, rural credit cooperatives etc.) of credit activities, as a link to credit, organizing scatter economic entities such as industrial business households, SMEs to be credit counter-guarantee communities with characteristics of equal responsibilities and rights, joint guarantee revenue sharing, risk-sharing, then the rural credit cooperatives loan to single member of the organization, the credit joint guarantee body or guarantee corporations guarantee for the loan, members undertake the responsibility and supervise between each other.

Specific operation steps are included as follow:

Launching survey and investigation. Launching a comprehensive survey among all scatter economic organizations such as industrial business households, industrial clusters and so on. Rural credit cooperatives, professional associations and community government filter industrial operations households, forming intention groups to establish credit communities.

Interactive discussion with beneficiaries. It is necessary to interact with the government, professional associations, agencies, and industrial business households against industrial characteristics, recommending, negotiating, and establishing credit communities.

Establishing joint guaranty bodies and determining credit community members. Rural credit cooperatives, the government, associations, and agencies should guide, coordinate with industrial operation households to form joint guaranty body, consisting of above 5 industrial operation households generally.

Industrial operation households should submit written applications to join in joint guaranty body with voluntary portfolios, and elect credit community principal democratically.

Then, every member signs ‘the counter-guarantee commitment on credit community industrial operation households ‘, and each industrial operation household joins in one joint guarantee body. Rural credit cooperatives, the government, industrial associations, the agency, industrial operation households should negotiate fully and fairly to determine credit community members.

Credit community members signing the agreement. Credit community members
should negotiate the commitment contents fully and fairly. After consistent negotiation, the members sign the credit community commitment.

**Paying joint guaranty funds.** Credit community industrial operation households open fund account in cooperatives, and pay certain funds that each household should not be lower than 125% of own line of credit. Some credit communities also introduce guarantee corporations in order to improve risk management and diversified capacity, and the credit community members will take anti-guarantee (without assessment of registration) for the guarantee corporations by the means of assets.

**Approving lines of credit and deadline.** Credit community members check assets for joint guaranty body of industrial operation households, and fill in the asset checking list on credit community industrial operation households (introducing guarantee corporations’ anti-guarantee asset checking list on credit community industrial operation households), approve lines of credit according to the assessed credit rating, which are 5-8 multiples of joint guaranty funds in general, and sign credit agreement with yearly dynamic adjustment. The credit terms are 1-2 years generally, less than 3 years, according to industrial operation households’ production and business cycle.

**Granting a loan.** The operation households can go to credit communities to make loans according to credit agreement and related documents. They should sign the maximum amount guarantee contract before applying for loans. If guarantee corporations are introduced, the joint guaranty enterprises and guarantee corporations should sign anti-guarantee contracts, and the associated press of citizen and county also need to sign anti-guarantee asset management and risk treatment commitment with guarantee corporations.

**Sharing and disposal of credit risk.** Dividing risk levels into individual risk, local risk, and general risk and so on according to adverse proportion of credit community industrial operation households’ loans. And handling risks as follows due to risk levels: implementing mutual assistance between industrial operation households, credit cooperatives deducting joint guaranty funds (guarantee funds) contributed by joint guaranty bodies, dealing with risky assets of industrial operation households (anti-guarantee assets), and implementing joint guarantee responsibilities of other industrial operation households.

4.3 The role and revelation on credit community lending patterns

**A. Roles on credit community lending patterns**
The credit community loan models effectively crack series of problems on lack of collaterals, high cost for financial services, and asymmetric information, management and risk dispersion of SMEs, industrial operation households and so on. And it shows a valid method of jointing up between financial supply and demand, reveals a new idea on not only meeting the abnormal financial demand in weak economy, but also realizing valid risk prevention and risk dispersion, resulting credit as the essence, cooperation and win-win.

Firstly, cracking problems on lack of collaterals in weak economic entities, and finding a way of meeting abnormal financial demand in weak economy.

The core of credit community lending patterns is at the guarantee on credit resources without collaterals or with less collateral requirements, which effectively crack problems on universal lack of collaterals in weak economic entities such as SMEs, individual business households, industrial operation households, planting and breeding specialized households, regional industrial clusters.

For instance, in 2004, Qingyuan joint guaranty in Ji’an started credit community lending patterns on trade square households based on the condition that although there exist large quantities of scatter households’ rental shops, lack of collaterals universally in the trade squares, they have huge capital demand and fine management benefits. The community loans at the basis of Ji’an trade squares, as a link to individual and private associates, build credit households assessment team composed of rural credit cooperatives, individual and private association directors, assess households’ credit level, approve the lines of credit about trade squares one by one, and approve credit loans which can be used cyclically.

By the end of 2007, Qingyuan joint guaranty body provides 1.2 billion yuan credit community lending patterns for households, supporting about 800 merchant stations for their business management, solving households’ loan problems effectively, achieving leapfrog development of business squares; and finally makes the tax amount yearly increase by 248% from 2.24 million yuan in 2003 to 7.8 million yuan in 2007, which becomes the key program in national glorious career.

Some credit communities also introduce guarantee corporations that guarantee community corporations’ loans, in turn, the communities will provide anti-guarantee for guarantee corporations at the basis of machines, equipments and workshops. This mechanism solves loan problems of community corporations for lacking valid collaterals. The micro-components industry in Yujiang establishes three guarantee service corporations which are closed, non-profit, and self-service. They provide
guaranty for three credit communities along with 25 companies, and the 25 enterprises provide anti-guarantee with workshops and production line valued at 68.92 million yuan, improving risk control ability.

Since November, 2005, this county joint guaranty loan 43.62 million yuan for the 25 micro-components corporations, and the cumulative distribution is up to 67.84 million yuan. The loan principle and interest collection ratio is 100%, which effectively resolves the problem on shortage of micro-components enterprises’ capital, and contributes to rapid and healthy development. By the end of 2007, the 25 micro-components enterprises achieve 1.1 billion yuan sales revenue, as well as 19 million yuan taxation, absorbing 4100 employees such as migrant and laid-off workers.

Secondly, resolving informal collaterals of weak economic entities, and finding a valid credit guarantee mechanism of jointing guaranty with each other, and with mutual restraints.

The rural credit cooperatives loaned to farmers, composed of 5-10 farmers jointing guaranty, but this practice did not have any mutual restraints for the relatives always provided guaranty, and there was no property guarantee. Once risks happened, and the guarantors did not admit each other, lots of loans finally became frauds.

But this credit community lending patterns have resolved problems on formal joint up mechanism, which means that the same industrial common beneficiaries consist of one joint guaranty, and members of joint guaranty provide guarantee for their personal interests, forming an anti-guarantee mechanism.

And this mode structures guarantee funds of closed operation, non-profit, self -services, making it more assured. Moreover, it provides a powerful cash flow controllable condition through related beneficiaries.

The Jiangxi HUANGSHANGHUANG Group (abbreviation of HUANGSHANGHUANG) develops duck base in Nanchang. The enterprise, farmers and credit cooperatives sign credit community loan agreement, and credit cooperatives provide newly-hatched duckling, feed loans for farmers. When ducks grow up, farmers will sell them to the Huang, and the Huang pays for farmers. As the accounts of Huang and farmers both are in rural credit cooperatives, the revenue must repays loans first, which provides favorable conditions for cash flow conditions.

Thirdly, resolving contradictions on asymmetric information on modern finance and weak economic entities, finding a way to prevent and diversify financial risks effectively by use of different credit resources.
The model of credit community lending patterns combines government departments, industrial associations, community enterprises, guarantee corporations with related beneficiaries of credit projects, and they sign agreements with clear responsibilities and rights, take the advantage of related beneficiaries to gather information and supervise effectively, bridging the gap between financial enterprises and economic entities for information communications, resolving asymmetric problems effectively.

Yujiang joint guaranty cannot get risk assessment information through financial analysis according to different scales, family internal management, informal accounts, and the risk control lacks valid information supports. While these corporations are not familiar with banks’ loan procedures and requirements, resulting asymmetric information problems between banks and enterprises.

It not only helps rural credit cooperatives grasp enterprises’ conditions comprehensively, but also makes companies know credit cooperatives’ loan procedure and requirements through the community members fully play active role in supervision, such as the local government, micro-components associations, guarantee corporations and industrial and commercial and tax authorities.

Fourthly, resolving problems on high threshold, high costs, and poor integrity constraints when weak economies get financial services, and finding a way for interactive development between finance and economy, as well as improving organization of decentralized economy.

Credit communities make enterprises to be a overall credit, undertake joint-up guarantee responsibilities with each other, improving the honesty binding significantly, loan to enterprises uniformly and make dynamic adjustments. The enterprises can use the loans anytime, not need paying timely in the lines of credit and credit deadlines. When enterprises grow bigger and stronger, they also can apply for increasing credit, which is beneficial for enterprises based on market changes, catching opportunities timely, and reducing finance costs effectively.

Anti-guaranty assets do not need mortgage registration, reducing the registration fees. The credit community lending patterns implement preferential rates and pay back deposit and loan spreads, reducing customers’ interest cost. The enterprises choose to purchase materials jointly, get preferential price through team purchasing or bidding, reducing management cost effectively, improving organization degree on scatter economies. Rural credit cooperatives reduce credit risks and fight for more qualified customers and development chances through credit community lending.
patterns.

The cumulative loan of Yujiang joint guaranty is up to 71.34 million yuan during three years’ credit community lending patterns, and the loan balance is 36.43 million yuan, saving 1.1 million yuan financing cost and absorbing about 36 million yuan deposit. The Pengze joint guaranty launched the aquaculture credit community, and purchased fish feed and drugs with bidding, then the price on fish feed reduced from 2300 yuan per ton to 2040 yuan per ton, which saved 1.3 million yuan for community members.

The shellfish processing credit community loan is launched by Duchang joint guaranty, and 216 operation households constitute 19 credit communities, which make 14.88 million cumulative loan. The principle and interest recovery is above 98% on average, achieving 40 million yuan sale revenue, and every household gets 560 thousand yuan pure profit. This mode boosts the shellfish industry development, becoming national cultivation base of freshwater pearls and shellfish processing base.

B. Revelation on credit community lending patterns

The essence of credit community lending patterns is that financial enterprises excavate related beneficiaries about credit programs, and establish a risk-sharing and revenue sharing mechanism according to the projects which is risky and not easy to manage with benefits and debt-servicing capacity, solving problems on risk management and diversification, and revealing a new way on rural financial innovation by use of credit resources comprehensively

The revelations are as follows:

Firstly, the credit community actually is such a mode that banks excavate the valid demand among the economic society actively, and they make passive risk management into initiative risk prevention, not missing any good credit chance that can control risks.

The inherent thinking when many financial enterprises provided credit services at past is judging whether the project is risky. If it is so, they would avoid the project.

The thinking to grant credit community lending patterns is not to judge whether the project is risky, but the benefit, and whether it has the feature of principle and interest repayments, then consider where the risk point is, as well as how to diversify risks, mitigate risks, finally making it to be a qualified loan project.

This involves the issue that one financial enterprise changes management concept, making passive risk prevention into initiative risk management, catching every chance for valid development during active management process.
Secondly, excavating related credit resources fully is the essential requirement on consisting credit communities. And this requires knowing stakeholders in credit activities and catching the interest relationship in credit projects.

Generally, the related links (such suppliers or sellers, customers) in enterprises’ value chains, members that have common interest demand in the same industry, intermediary service agencies, customer groups, project benefited communities and the government, all may be owners of credit resources.

Therefore, it is the industrial clusters that exist in industrial parks, commerce parks, one county and one product zones are natural areas that structure credit communities.

Because the same industry is favorable to form common interest and demand, therefore it is beneficial to develop credit communities. Simultaneously, the developing rural professional cooperatives and agricultural industry leading enterprises in rural economy and county economy are the most important resources that constitute credit communities.

As these corporations and organizations have constituted certain organizational production mode, the financial enterprises participate in it with the platform organized by enterprises and institutes, so they can solve the risk management and asymmetric information problems on scatter industrial households and individual loans.

Thirdly, valid credit demand is the premise of credit communities, while establishing mechanism to diversify and mitigate risks is the key to constitute credit communities. Regardless of SMEs or individual business households, they all need valid credit demand. And the investment is rewardable, which has the ability of paying principle and interest, and is the premise to form credit communities.

After finding good projects, it is the important condition that whether the economic entities can overcome asymmetric information problems and find a collateral alternative mechanism.

The key point is to find a risk-sharing mechanism about related beneficiaries. The credit investigation and loan management can be introduced to strength cash flow management, eliminate asymmetric information risks, or establish certain mutual insurance mechanism to diversify risks, reduce risks with establishment of loss compensation mechanism, prevent credit risks by establishing moral constraint relations and so on.

Fourthly, grasping interest relations among interest stakeholders constituted by beneficiaries in credit activities, and achieving interactive benefits are the lifeline to
maintain credit communities. The key point to sign credit community agreement is to establish the revenue sharing and risk-sharing mechanism between beneficiaries in credit activities, making them realize risk sharing under the premise of revenue sharing.

Therefore, subjects should understand the interest mechanism about related beneficiaries seriously, and set mutual restraint clauses, form interactive cooperative agreements and ensure its implementation.

Moreover, it is not the better, the stronger the guarantee conditions of the credit community lending patterns are, and it should be temperate. We always think that the better, the stronger the guarantee conditions, the higher the loan interest rates, the fewer the guarantee multiples are. In addition to guarantee, the enterprises should provide management help and information assurance, making the interest impute to financial institutions and enterprises, but such credit communities are unsustainable.

As an enterprise managing risks, financial enterprises should undertake some risks. If the guarantee conditions increase artificially, it means that related beneficiaries should increase costs, benefits will be lower, and such credit communities are easy to be broken down in intense market competition.

So it is necessary to put conditions that constitute credit communities into financial market competition, and it is good to make it stronger and better, valuable to spread with moderate conditions.

4.4 The thinking to spread credit community lending patterns

The practical experience of Jiangxi rural credit cooperatives launching credit community lending patterns recently provides some ideas to spread credit community loan mode.

A. Studying customers’ demand and fostering credit communities

All kinds of industrial operation households and SMEs are basic components of credit communities. With economic development and deeper market competition, the demand on financial products and services of industrial operation households and SMEs present diversified. Therefore, it is necessary to study customers’ demand deeply in order to develop credit community loan, as well as making adjustments timely according to the demand.

Specifically, we should analyze industrial clusters and customers’ capital demand according to local industrial structures, and study the current and potential financial
demand, analyze industrial characteristics, development prospects, risk conditions, as well as customers’ management benefit, credit conditions, financial strength, capital demand, finding the high quality customers and important client base, and constituting credit communities.

It is important to make the government, industrial (commercial) associations and other institutions to take active participants into credit communities. The government can exert leading role, and the industrial (commercial) associations can negotiate, manage, and achieve self-discipline, making determination that the government and industrial (commercial) associations contribute enterprises to be stronger and bigger into motivation to constitute the credit community.

Under the condition of lacking collaterals, making the common appreciation that the SMEs and industrial operation households wish for financial supports into active actions to constitute credit joint guaranty body initiatively. So the interactive condition that the government and industrial (commercial) associations lead, industrial management households participate in the combination, rural credit cooperatives provide credit support will form, finally fostering different credit communities.

B. Regulating business operation and evaluating credits scientifically

In the process of spreading credit community lending patterns, it is necessary to make the rating, credit and other specific operations fit customers’ demand, scientific and standard.

Assessment on credit rating involves rating agencies composed of credit communities, they will take customers’ first repayments ability, credit conditions that the account managers get as important basis, and approve lines of credit, deadline scientifically according to credit ratings, total assets, managing benefit, operation scale, solvency, prospects, production and business cycle, cash flow speed, capital demand and other factors of corporations and industrial operation households, while the credit conditions should not only fit capital demand of corporations and industrial operation households, but also control risks effectively.

Meanwhile, it is necessary to use interest rate lever to make industrial operation households or corporations honest. The loan rate to credit community members can be lower against the same level loan rate, and should be made dynamic adjustments during the credit period according to principle and interest repayment conditions of industrial operation households. The joint-fund spreads return mechanism can be taken into consideration about qualified customers, which pay back appropriate return
or spread subsidies according to the spread between joint fund that customers pay and loans, making customers beneficiary.

C. Grasping risky points and assigning risk prevention responsibilities

During the process of credit community formation and the whole business, it is easy to cause moral hazard, operation risk, credit risk among internal staffs if members’ access conditions are not considered, and the contract is not complete, responsibilities and rights between joint bodies are not clear, bankers’ responsibilities are not implemented, especially the credit rating, loan’s approval, management after loan, and non-performing loans’ management cannot get good management and supervision.

Therefore, financial enterprises should assign responsibilities according to potential risk points during the process of launching credit community lending patterns, regulate operations in each link, and prevent different risks effectively.

Firstly, clearing responsibilities and rights of the credit communities. The agreement should make conditions of credit community members’ participation, daily economic activities, quitting and every member’s rights and responsibilities clear, resulting in equal responsibilities and rights, trusting each other, revenue sharing, and risk sharing.

Credit community members’ daily economic activities should be supervised consciously and fit the agreement. And the quitting of credit community members should accomplish responsibilities of paying back financial enterprises’ loans and other agreements. Regulation on entry and exit mechanism of credit communities assure the quality of credit communities and contribute to sustainable development of credit community lending patterns.

Secondly, fulfilling responsibility on management after loan. Bankers’ customer managers should grasp customers’ conditions on use of credit capital, production management, economic benefit and so on, collecting customers’ financial and non-financial information from different aspects, do well on collection work before loan maturity, ensuring to withdraw loans’ principle and interest timely. When finding credit risks, they should take active measures in time, and prevent, resolve it as quick as possible.

The person should be strictly responsible for breaching his responsibility during links to organizing credit communities, carrying out credit ratings, issuing loan, and loan after management, which results in loan risks simultaneously.

Thirdly, improving risk recovering mechanism. Credit community industrial
operation households should open guarantee fund account in financial enterprises, and
corporations’ credit ability, credit records, industrial characteristics, offering loans to
customers within 4-8 multiples of guarantee fund generally.

The risk of credit community loans should be divided into different levels according to induce proportion of credit community lending patterns, and establishing corresponding risk diversification resolution mechanism. When risks happen, the disposal of the order should be based on sequences of customers’ mutual assistance, rural credit cooperatives deducting guarantee fund that the joint guaranty has paid, handling risky customers’ assets, calling to account other members’ joint responsibilities.

D. Establishing interactive platform of cooperation, and completing policy-supporting mechanism

The credit community lending patterns involve credit resources of the government, relevant departments, intermediary organizations, industrial associations, guarantee institutions, financial enterprises and so on. Therefore, it is necessary to unify the understanding, enhance cooperation, and establish sustainable development environment and operating mechanism.

Firstly, fostering cooperative economic organizations such as professional association will lay the foundation of forming credit communities. It is permissible to guide enterprises that are engaged in deep processing agricultural products, highly processed products and agricultural marketing service into organizing professional associations or industrial associations, to set professional guarantee fund by the help of associations, finally forming credit communities and industrial cluster guarantee mechanism.

Secondly, formulating relevant supportive policy to financial enterprises that launch community loans. The government and relevant departments should formulate supportive policies for credit community lending patterns’ risk compensation, and make the investment that is used to support industry development into the guarantee fund that the corporations constitute credit communities, and get banks’ loan, then compensating potential risk loss. The authorities also can carry out preferential policies of tax reduction, financial support for financial enterprises that grant community loans to rural credit cooperatives, making weak economic entities such as peasants, SMEs get sustainable benefits.

Thirdly, encouraging the development of all guarantee institutions. It is good to
encourage the competitive private enterprises to organize new guarantee institutions, and implement marketable cooperation, and offer guarantee for farmers.

It is good to avoid credit risk by establishing complete agricultural credit insurance mechanism, carrying out political agricultural insurance supports combined with commercial agriculture insurance, and executing political premium subsidies for weak economic entities that participate into planting and breeding insurances. Setting up the platform among insurance companies, weak economic entities and financial enterprises, encouraging the insurance company to develop insurance products that fit weak economic entities’ demand, will make credit community members participate in personal insurance and property insurance as soon as possible, and confirm beneficiaries to be financial enterprises, leading the loan to households to get certain risk compensation who suffer from market risk and credit risk caused by natural disasters.

Fourthly, completing factor markets, and forming loan collateral mechanism of weak economic entities such as SMEs. Simplifying the registration that asset such as enterprises’ workshops, and equipments are to be used in loan collateral, and lowering relevant fees, reducing transaction cost of customers and financial enterprises. Currently, it is urgent to establish rural property right registration system, grant house ownership certificate based on clarity of property rights, build and complete the mechanism of rural house assessment, collateral, circulation, resolving weak economic entities’(farmers, industrial operation households, etc) problems on capital shortage and lack of invalid collaterals during the production organization process.