

Current Situation and Future Prospects for Microfinance in China

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Even though microcredit in China has gone through over 10 years of growth and has achieved remarkable progress, it must not be forgotten that it is still at a nascent stage of development. This paper provides a general picture of the current situation of microcredit in China, and discusses its prospects over the coming 5-10 years.

1 THE 'WHAT IS MEANT BY MICROCREDIT?' CONTROVERSY

It is very important to define what 'microcredit' means when considering its situation in China; and in particular – what size is a 'microloan'? Two opinions currently prevail in the many debates:

- Some argue that a microloan should be defined as not exceeding a predefined **ceiling**, such as a multiple or percentage of a country or region's Gross Domestic Product (GDP) per capita.
- Others think it is best expressed as not exceeding a given **relative value**. For example, a microloan would be any loan smaller than that granted by traditional financial institutions.

Two points must be emphasized:

- The popular opinion that a microloan should generally be equal to or less than GDP per capita of a country or region is often not adhered to in practice. In China, some so-called 'micro' loans amount to several times the country's economy (e.g. 100'000 Yuan, which is 4 times greater than China's GDP per capita of 24'000 Yuan / US\$ 3'000)! Even individual loans amounting to hundreds of thousands – or millions – of Yuan are labeled 'microloans'. For example, the China Banking Regulatory Commission (CBRC) has raised the maximum value of a microloan in coastal areas to 300'000 Yuan, while some people even

categorize small enterprise loans of 5 million Yuan as microloans.

- International good practice guidelines suggest that loans should be considered 'micro' if they serve disadvantaged groups to whom traditional banks are unwilling or unable to provide financial services. This low segment of the credit market includes microenterprises, sole proprietors, and middle to low income people. According to the Consultative Group to Assist the Poor (CGAP), all types of low income households hovering around the poverty line (except the most destitute), should be considered potential microcredit clients.

Here, the author defines microcredit by flexibly using absolute value. So, in general, a loan below 100'000 Yuan is considered a microloan, although different standards can be applied to developed and underdeveloped areas.

2 TYPES OF MICROFINANCE PROVIDERS

2.1 Comparison of microcredit suppliers

Microcredit suppliers in China can be categorized into eleven different types. Tables 1a. and 1b. below summarize the features and performance of these types of suppliers.

Types of microcredit suppliers:

1. Microfinance Institutions (MFIs) established as non-governmental organizations (NGOs) for the public interest;
2. Subsidized microcredit projects for poverty alleviation developed by state-owned banks such as the Agricultural Bank of China (ABC) and the Agricultural Development Bank of China (ADBC);
3. Farmers' microcredit projects implemented by Rural Credit Cooperatives (RCCs);
4. Microcredit projects implemented by Urban Commercial Banks and Guarantee Companies;
5. Credit-only Microcredit Companies (MCCs) – Pilot Project of the People's Bank of China (PBC);
6. Village/Township Banks – Pilot Project of the China Banking Regulatory Commission (CBRC);
7. Rural Mutual Credit Cooperatives (RMCCs) (CBRC Pilot Project);
8. Lending Companies established by commercial banks (CBRC Pilot Project);
9. Subsidized microcredit projects for poverty alleviation implemented by rural financial institutions;
10. Microcredit project implemented by the China Postal Savings Bank (CPSB);
11. Microcredit projects implemented by Commercial Banks.

Table 1a. Comparison of microcredit suppliers – Clients and Products

	Type of Institution	Since	Regions	Target Clients	Traditional Collateral	Average Loan Size	Annual Interest Rate ¹	Savings	Remittances
1.	NGO MFIs	1993	Country-wide	Mid/ low income & poor	No	Several thousands	3-18%	No	No
2.	ABC	1996	Country-wide	Mid/ low income & poor	No	Several thousands	2-3% or zero	No	No
3.	RCCs	1999-2000	Country-wide	All kinds of farming households	No, but yes for large loans	Several thousands – tens of thousands	0.9-2.3 times basic rate	Yes	Yes
4.	Urban Commercial Banks	2002	Urban Areas	Laid-off workers	Guarantee companies	Several thousands - several tens of thousands	Zero or low interest rate	Yes	Yes
5.	MCCs	2005	Country-wide	Citizens & micro/ small Enterprises	Yes	Several thousands - hundred thousands	14-28% but 21% on average	No	No
6.	Village/ Township Banks	2006	Country-wide	Citizens & micro/ small enterprises	Yes	Several thousands - hundred thousands	0.9-2.3 times basic rate	Yes	No
7.	RMCCs	2006	Country-wide	Member farmers & enterprises	No	Several thousands	0.9-2.3 times basis rate	Yes	No
8.	Lending companies	2006	Country-wide	Citizens & micro/ small enterprises	Yes	Several thousands - hundred thousands	0.9-2.3 times basis rate	No	No
9.	Poverty Alleviation Loans	2004	Country-wide	Mid/ low income & poor	No	Several thousands	Less than basic rate	Yes	Yes
10.	CPSB	2006	Country-wide	All kinds of farming households	Pledge or no collateral	Several thousands - hundred thousands	0.9-2.3 times basis rate	Yes	Yes
11.	Commercial Banks	2005	More than 10 regions	Citizens	No	Several tens of thousands	Around 20%	Yes	Yes

¹ Calculated on a declining balance.

Table 1b. Comparison of microcredit suppliers - Performance

	Type of Institution	Number of Active Clients	Gender of Clients	Value of Loans Disbursed in Yuan	Portfolio Quality	Ability to Achieve Sustainability
1.	NGO MFIs	150 thousand	No limitation or mainly female	Over one billion	Uneven	A few can
2.	ABC	No information	Mainly male	Several tens of billion	Poor in general	Cannot
3.	RCCs	70 million	Mainly male	Several hundred billion	Uneven	Uneven
4.	Urban Commercial Banks	Several hundred thousand	Mainly male	Nearly ten billion	Uneven	Cannot
5.	MCCs	Several thousand	Mainly male	Several hundred million	Good	Yes
6.	Village/Township Banks	Several thousand	Mainly male	2-3 hundred million	Good in general	Good tendency
7.	RMCCs	Several thousand	Mainly male	Several million	Good in general	Cannot
8.	Lending companies	Several thousand	Mainly male	Several million	No information	No information
9.	Poverty Alleviation Loans	Several ten thousand	Mainly male	No figure	Mostly good	Relying on subsidy
10.	CPSB	Several thousand	Mainly male	Tens of billions and hundreds million respectively	Good in general	Good tendency
11.	Commercial Banks	No information	Mainly male	Several billion	Good	Yes

Note: The information in tables 1a and 1b. was extracted from relevant documents and sources, and summarized by the author.

2.2 Microcredit Suppliers with Potential for Sustainability

China requires sustainable financial service providers in order to offer financial services demanded by disadvantaged groups in the long run. The following institutions and projects engaged in microcredit operations are potentially sustainable²:

- Rural Credit Cooperatives, Rural Commercial Banks and Rural Cooperative Banks
- Agricultural Bank of China branches
- China Postal Savings Bank branches
- Shareholding Commercial Banks
- Micro Credit Companies
- Village/Township Banks
- Unregistered private Rural Mutual Credit Cooperatives
- Social Organizations or NGO MFIs

² More information on these institutions is provided in a paper entitled "The Current Supply of Microfinance in China", prepared by the author for the WMFG workshop in China in February 2008, see www.microfinanceforum.org

Foreign-funded institutions are beginning to enter the field by setting up Village/Township Banks and MCCs, as well as some microcredit projects, but progress is slow.

3 MICROCREDIT'S FUTURE PROSPECTS

Here are some views on the future of the business operations of different kinds of microcredit institutions:

3.1 Rural Credit Cooperatives

Rural Credit Cooperatives (RCCs) are the primary financial institutions giving microcredit in rural areas, along with Rural Commercial Banks and Rural Cooperative Banks. RCCs have issued 90% of the ca. 1.4 trillion Yuan total outstanding farming household loans across the country, and have approximately 370 billion Yuan of outstanding microcredit and group loans. It is estimated they serve over 70 million – possibly 90 million – farming households, accounting for about 30% of overall farming households in the country.

However, the data on these loans collected by the author from different sources varies greatly. In particular, the discrepancy in statistics is significant in terms of the loan size that farming households obtain.

Due to RCCs' high operational costs, high credit risk, overloaded credit officers, and caps on interest rates they are allowed to charge (0.9-2.3 times the basic rate), their microcredit operations are generally loss-making. For instance, an RCC in Jiangxi Province is famous for its microcredit business, but were this accounted for separately, it would show an annual deficit of several million Yuan. A virtuous spiral of expansion has been further marred by poor asset quality and the limited management capacity of many RCCs across the country.

There is little scope for growth of RCCs' microcredit business in the near future without an adjustment of the relevant policies and regulations (as a matter of fact, RCCs' microcredit business has shrunk in some places). New measures would be needed to make RCCs' microcredit business sustainable.

3.2 Agricultural Bank of China branches

In the late 1990s, the Agricultural Bank of China (ABC) launched subsidized microcredit for poverty alleviation. For various reasons, including poor asset quality, after 2000, these projects were almost suspended nationally. Very few projects continued in some regions of Yunnan Province with the support and collaboration of local governments.

Nevertheless, over the past two years ABC changed its operational focus from targeting urban areas to simultaneously covering and developing urban and rural financial markets. Moreover, it has started to consider the development of rural microfinance as an important business area for further exploration. Its efforts here are guided by two projects, 'Serving Agriculture and Farmers Countrywide' and 'Commercializing Operations'. As a result, it is quite likely that ABC will become a significant force in rural microfinance. It is believed that in 3 years time the business of ABC's Department for Rural, Agricultural and Farmer Finance will cover 97% of state-designated and 90% of province-designated poor counties, and eventually 30% of all rural areas (*First Finance Daily*, August 15, 2008).

ABC issued a 'Jinhui Farming Benefit Card', with farmer microcredit as its core product, to alleviate farmers' difficulties in getting loans. This card offers services including subsidy payments, deposits, microloans and remittances. By thoroughly exploiting the potential of current outlets and personnel, as well as widely using electronic channels such as online banking, telephone and mobile banks, mobile POS-devices and ATMs, ABC strives to better serve millions of farmers against relatively low transaction costs (Li Zhenjiang, *China Urban and Rural Finance*, August 14, 2008).

ABC aims to issue 5 million Farming Benefit Cards by the end of 2008, and to make this an exclusive product that eventually serves 250 million farmers across the country. And in 3 years, 30% of farming households nationwide should benefit from these loans.

However, at the majority of branches, the Farming Benefit Card and microfinance services have been developing slowly – leaving a wide gap between their objectives and actual performance. Reasons include inaccurate understanding of the cards' meaning, market positioning, and core function, as well as insufficient attention given to this work.

From the author's perspective, this powerful reform demonstrates ABC's desire to change its mindset, and make full use of modern technology, such as mobile banking, to solve farmers' difficulties borrowing. It is likely that the greatest challenge will be how to avoid borrowers' moral hazard and guarantee normal loan collection, so that historical mistakes can be effectively prevented.

3.3 China Postal Savings Bank branches

In terms of its deposits, CPSB ranks as the 5th largest bank in China, and its 37'000 branches make it the country's largest urban and rural network. It therefore has great potential to cover unbanked rural areas and become a distinctive retail bank.

Since its 2006 pledge, CPSB has piloted its microcredit business in vast rural areas, achieving preliminary results. Based on its assumption that it will be able to capture 2% of the market, CPSB believes that by the end of 2010 it will have disbursed 30 billion Yuan in microloans to farmers and 100 billion Yuan in rural microloans. In addition, it plans to gradually develop other financial services like microinsurance. It predicts that within three years, the balance of its loans below 100'000 Yuan will amount to 80 billion Yuan, and within five years the balance of its loans below 1 million Yuan will reach 600 billion. By that time, these loans will account for 30% of all outstanding loans. CPSB may also decide to provide wholesale funds for retail MFIs with good operational performance.

The challenges to CPSB's future development include a lack of talent, relevant experience, and risk control capability in operating financial business. Other problems include unsound accounting methods, an incomplete risk management framework, and flaws in internal control mechanisms (*Wealth.863171.com*, 24 November 2007).

3.4 Shareholding Commercial Banks

Most shareholding commercial banks have not paid microcredit much attention. However, some have progressed remarkably in exploiting urban and rural microcredit businesses. Twelve urban & rural commercial banks have joined pilot projects initiated by the China Development Bank (CDB) and the World Bank in 2005, including Taizhou and Baotou commercial banks. Harbin Bank is also engaging in microfinance, under internal pressure to reform.

The twelve pilot banks in collaboration with CDB have spent about 40'000 loans worth 2.7 billion

with an average loan size of 70'000 Yuan. They enjoy high profitability, high growth, and their portfolio has less than 1% overdue by more than 30 days.

In 2005, Baotou Commercial Bank explicitly defined medium, small and micro-enterprises as core clientele. It defined micro- and small enterprise loans as those ranging from 3'000 to 3 million Yuan per client. By July 2008, it had issued 13'429 loans to micro- and small enterprises for a total value of 2'623 billion Yuan, and the total loan portfolio outstanding was 1.48 billion Yuan. Of these, 8'062 loans were outstanding with 7'311 micro-entrepreneurs for a total value of 0.574 billion Yuan. The overdue rate among these microloans was below 2%.

Baotou Commercial Bank's 5-year development goal is to make its portfolio of micro and small loans reach at least 30 billion Yuan, resulting in earnings that comprise over 1/3 of the bank's total profit. Of this portfolio, 12 billion Yuan should be for loans with an average value of 100'000 and a maximum value of 500'000 Yuan.

Projecting itself as a microfinance bank, Harbin Bank promotes the concept of inclusive finance and harmonious wealth. By June 2008, it has granted loans worth approximately 30.4 billion Yuan. Urban-rural microcredit (including small enterprise loans) account for 33% of total credit assets and 50% of overall earnings. This includes farmer loans with a maximum loan size of 100'000 and average loan size of 20'000 Yuan, and 213'000 outstanding farmer loans at 5'374 billion Yuan. Its portfolio yields 6.74%, with a non-performing loan rate of 0.51%.

Harbin Bank aims to become a first-class microfinance bank within 3-5 years in China, and world-class in 5-10. It estimates its microcredit portfolio will reach 15.7 billion in 5 years and 29.4 billion Yuan in 10, accounting for respectively 50% and 70% of total loans outstanding. This microcredit can be divided into three types: over 50% of loans are less than 100'000; about 2% are 100'000-500'000; and about 45% are 500'000-5 million Yuan.

Table 2. Projections of Microcredit Disbursed by Harbin Bank Unit: Yuan

Year	Products	Accumulative Loans Disbursed		Loans Outstanding	
		Number	Amount	Number	Amount
2013	Farming Loan	1,356,500	33.9 billion	301,400	7.5 billion
	Microcredit	31,400	3.1 billion	22,400	1.6 billion
	Individual Business Loan	11,300	10.2 billion	2,200	2 billion
	Micro Guarantee Loan	19,600	0.4 billion	7,900	0.2 billion
	Small Enterprise Loan	8,500	22 billion	1,700	4.4 billion
Total		1,427,300	69.6 billion	335,600	15.7 billion
2018	Farming Loan	2,910,600	72.8 billion	529,200	13.2 billion
	Microcredit	58,800	5.9 billion	42,000	2.9 billion
	Individual Business Loan	45,700	41.2 billion	4,600	4.1 billion
	Micro Guarantee Loan	73,500	1.5 billion	14,700	0.3 billion
	Small Enterprise Loan	33,900	88.2 billion	3,400	8.8 billion
Total		3,122,500	209.5 billion	593,900	29.4 billion

Notes:

- ≤100,000 Yuan: consists of 90% of total farming loans, microcredit, micro guarantee loans.
- 100,000-500,000 Yuan: consists of 10% microcredit.
- 0.5-5 million Yuan: consists of overall individual business and small enterprise loans.

Source of data: Harbin Bank

To summarize, the microcredit operations of shareholding commercial banks can be categorized into two kinds:

- The first reflects the situation in which the majority find themselves in: so far they have not paid enough attention to their microcredit operations and need to reconfirm their willingness to engage in microcredit, and develop relevant skills – before they can expand their operations on a large scale.
- The second is represented by leading pioneers such as Baotou Commercial Bank, Taizhou Commercial Bank and Harbin Bank. With their continuous exploration and expansion, they must keep their minds alert and learn from experience. They have to improve their operational and management capacities to prevent the risk of running too fast. Issues pertaining to the quality of personnel, mechanisms of internal control and the

establishment of outlets should be settled before they grow their microcredit operations.

3.5 Credit-only Microcredit Companies

In 2008, after the PBC and CBRC issued *Guidelines on the Establishment of a Microcredit Company* (CBRC 2008, File 23), many provinces had great enthusiasm for setting up MCCs. Available information indicates that over a dozen provinces, including 5 pilot provinces designated by PBC in 2005, have facilitated the establishment of private commercial MCCs with a good momentum for growth. For example, so far over 10 MCCs have been established in Ningxia Province with a total capital of more than 2 billion Yuan. And Jiangsu Province has a plan to launch dozens of MCCs with a total projected capital of 80 billion Yuan next year.

MCCs show they could be one of the microcredit providers with the fastest growth in the coming 2-3

years in China. They should pay attention to vigorous promotion and risk prevention; key causes for concern appear to be operational risk and moral hazard.

3.6 Village/Township Banks

Since 2007, no less than 70 Village/Township Banks (VTB) have been set up. Performance varies. The target clients, operational philosophy and methodology of VTBs resemble those of RCCs, but very few VTBs are keen to deliver loans as small as several thousand or tens of thousand Yuan. At county level, VTB assets are lower than RCCs'. Because they have been operating for a short time, it is difficult for VTBs to mobilize savings. At present, VTBs enjoy the advantage of greater flexibility than RCCs in the interest rates they are allowed to charge (4 times the basic interest rate). However, they are disadvantaged by an unclear tax policy, whose implementation varies across counties. Besides, VTBs cannot obtain on-lending funds from the central bank. Like RCCs, VTBs need creativity to improve *inter alia* their philosophy, operational methods, product design, and incentives.

HSBC has so far established 3 VTBs, and is preparing to launch more. It would like CBRC to allow it to set up a parent organization where the administration and management of VTBs operating in different counties could be centralized, in order to reduce operational costs through scale economies. It is not clear yet whether such a pilot system can be implemented.

3.7 Rural Mutual Credit Cooperatives

Since CBRC announced its pilot reform programme for Rural Mutual Credit Cooperatives (RMCCs) in 2007, only 9 RMCCs have been established. This is low, especially in comparison with the nearly 30 Village/Township Banks registered in the same period. Just like the unregistered rural (community) mutual credit cooperatives established before 2007, registered RMCCs experience unbalanced development with uneven performance. There are several explanations. On the one hand, as a consequence of lessons learnt with past rural cooperative foundations, local governments have generally shown no interest in setting up RMCCs – some even objected. On the other, CBRC's requirements with respect to prudential supervision

and institutionalized operation make RMCCs operational costs unbearable.

Besides these external factors, RMCC sustainability would require at least the moderate development of a local market economy, community cohesion, the ability to raise funds by selling shares to members, at least one respectable person capable of handling issues fairly, mechanisms and a capacity for mass democracy, relatively sound operational and financial management systems, and suitable external supervision... Therefore, one concludes there is no prospect for RMCCs to achieve relatively fast, extensive, healthy and sustainable development in the near future. But passion and potential exists for further development, were government policies to become more favourable. Then, risks would probably mainly lie in poor, unsustainable operations, illegal deposit mobilization and fundraising, and disruption of the financial order.

3.8 Social Organizations or NGO MFIs

The most significant function of these institutions is to serve middle to low income and poor clients, which other financial institutions are unwilling or unable to serve. Some RMCCs fit into this category. Until now, the central government has not promulgated any specific policy or regulation for this type of credit-only organization, even though it has clearly indicated its support for the development of microfinance institutions of various types in its 'Number-One Documents'.

One could consider three possible methods for regulating these organizations, depending on their stage of development:

1. Allowing their existence
2. Requiring them to submit data
3. Registering them

For each regulation method, different requirements, policies, incentives, disincentives and exit mechanisms could be adopted.

There are several options for these organizations to develop:

- Continuing as an NGO but becoming healthier and stronger
- Transforming into an MCC
- Transforming into a Village/Township Bank
- Developing microcredit business in cooperation with commercial banks
- Becoming a shareholding microfinance company operating across counties
- Transforming into an RMCC, etc.

All options rely on the existence of supportive external policies, motivation and capability, and the willingness, collaboration and management of relevant partner organizations. Their absence risks greatly that transformation will fail and asset quality will decline.

Social organizations and NGO MFIs are unlikely to reach significant scale, unless favourable policy changes are made. If they can successfully become well-managed MCCs or even banks (after going through a long and painful process), they will ultimately enjoy rapid expansion and growth; especially those in provinces where they are allowed to develop businesses across counties and prefecture-level cities. However, if they attach more value to commercialization than to serving mid/low income and poor clients, they risk marginalizing disadvantaged groups even further.

Since NGO MFI services mostly cover remote underdeveloped or sparsely populated areas, it is worth exploring whether they can take advantage of technologies like mobile banking, POS-devices and computerized MIS systems at low cost and large scale.

4 CHINA'S GOVERNMENT POLICIES AND REGULATIONS ON MICROCREDIT

4.1 Features of the evolution of government policies and regulations

4.1.1 Policies and regulations lag, but are gaining momentum

China's development of microcredit policies and regulations started late; it is about 20 years behind early movers. The process of slow, gradual liberalization was followed by regression, until 2006

and 2007 brought accelerated policy and regulation formulation. These must now be further improved.

The process through which the development of policies and regulations on microcredit has gone reflects a steady progression from:

- Disagreement or a 'wait-and-see' attitude, to
- Acknowledgment of microcredit's effective role in reaching poor households, to
- Support for pilot microcredit projects and a confirmation of the function of microcredit in upholding rural development, to
- Requirements by central government that MFIs with diversified ownership structures be established, to
- Central government's confirmation that microcredit is an integral part of the rural financial system – which needs active cultivation and development -- and proactive promotion of relevant regulatory departments and further improvement of regulations.

4.1.2 Government has focused more on commercial microcredit and less on microcredit for the public interest

Microcredit laws and regulations that have been issued until now only relate to formal commercial banks and new types of financial institutions. There are no regulatory documents for public-interest microcredit operations or institutions, which by their nature focus on poverty alleviation. Despite such an environment, public-interest MFIs have been able to develop and sustain themselves. This is mainly due to imperfect policy linkages between central and local government, as well as the vitality of organizations themselves.

4.2 Improvements in Relevant Policies and Regulations for Further Discussion

4.2.1 Relax the territorial limitation on Village/Township Bank and MCC operations

Village/Township Banks and MCCs are only allowed to operate within the counties in which they are located. This causes a lack of incentive for growth and expansion. This needs to be adjusted. For example, when they reach certain standards

after 2-3 years of normal operations, they could be allowed to expand to adjacent areas.

4.2.2 Relax the limitation on sources of funding and leverage for credit-only MCCs

Under existing regulations, a credit-only MCC can only mobilize wholesale loans worth up to 0.5 times its registered capital from two banking institutions. This overly-conservative policy needs to be adjusted. For instance, permitted leverage could be enlarged step-by-step from 0.5 to 4 times, or even more, depending on circumstances.

4.2.3 Relax the requirements for commercial bank shareholding in Village/Township Banks

In a Village/Township Bank, a commercial bank must be the largest shareholder. Given insufficient resources for supervision and regulation, this provision seems suitable for a while. Nevertheless, with the establishment of more Village/Township Banks, it would be reasonable to consider its relaxation. Indeed, under certain conditions commercial banks could be required to take only a minority stake or no stake at all.

4.2.4 Relax the cap on interest rates for RCCs and ABC

RCCs and ABC face an interest rate cap of 0.9 to 2.3 times the basic rate. This is unfair, since other organizations engaging in microcredit can charge 4 times the basic rate. Besides, it is unreasonable, since this means they cannot generate enough revenue to cover their costs (see, for instance, Wu Yuan RCC of Jiangxi province and Beijing Rural Commercial Bank). RCCs and ABC should be allowed to charge interest more in line with competitors.

4.2.5 Relax regulations for RMCCs, in particular at village level

RMCCs that are set up under the CBRC's pilot project require significant investments in security and personnel, while being subject to prudential regulations. All this unnecessarily increases costs. Besides, prudential regulations are difficult to enforce, given regulatory authorities' limited resources and capacities. Without additional

support, such requirements hinder RMCC growth, making them unable to survive or develop sustainably. In addition, the theory that RMCCs set up in accordance with CBRC regulations can finance themselves from commercial banks hasn't verified in practice so far. Therefore, the author recommends that regulatory authorities apply only non-prudential regulation and supervision to RMCCs. Their transparency and integrity should be assured through a public reporting system. Furthermore, regulatory authorities should establish policies that allow RMCCs to raise necessary funds for their operations.

4.2.6 Issue policies and regulations for public-interest MFIs that pursue sustainability

Public-interest MFIs, defined as those MFIs that have an average loan balance per client of less than 50'000 Yuan, are currently unregulated in China. Generally speaking, existing commercial financial institutions engaged in microcredit do not reach low income and poor farming households. Therefore, public-interest MFIs that pursue sustainability deserve an appropriate legal status, and funds and favourable policies to strengthen their quality and capacities. At the same time, the government should facilitate domestic and international investment in these MFIs.

4.2.7 Issue the planned Money Lenders' Ordinance

The Money Lenders' Ordinance legalises informal non-depository credit practices. It effectively strengthens the positive impact of informal financial practices, and mitigates their negative impact. The Money Lenders' Ordinance should be issued. However, before it is, management and sanctioning policies and measures should be put in place to prevent illegal fundraising.

4.2.8 Open the market to foreign capital and technology.

Although there is some experience with foreign capital and technology, distinct rules and regulations are unavailable. An open market can play an important role in introducing technology, management and talent, promoting competition and increasing supply, as well as in pushing forward the development of the microfinance

market. At the same time, however, an open market can lead to foreign capital and technology displacing domestic investors and microfinance operators, resulting in foreign institutions taking a large market share. In the near future, the latter risk is insignificant. A more realistic risk is that foreign institutions will be unable to adapt to their surroundings and achieve successful localization. Or, they will be unwilling to serve the truly low.

International investors can be divided into 3 categories:

1. Commercial and social investment funds or donors targeting the middle or high segment of the microfinance market. They are advantaged in integrating capital, technology, management and talent and achieving economies of scale. Some played an important role developing microfinance operations in the former Soviet Union and Eastern European, with success. In collaboration with actors such as IPC and the World Bank, the CDB has introduced international technology and capital and then conducted experiments in more than 10 shareholding commercial banks, resulting in delightful achievement. This model could be further tested in more regions, and improved policies could be based on the pilot's effectiveness.

2. International investors focusing on the mid to low segment of the microfinance market, such as Grameen Trust (GT), ASA and ACCION International. GT has cooperated with the RCC Union of Hainan Province by providing technical assistance, and has a plan for further cooperation with domestic institutions, to set up MCCs through the method of 'build, operate and transfer' (the so-called BOT model). Local governments and international microfinance networks and providers should find more efficient ways of working together, so as to provide faster proof of what works and what doesn't.

3. Commercial microfinance players such as HSBC, Standard Chartered and Microcred that have set up Village/Township Banks and MCCs. The geographical limitation on Village/Township Banks and MCCs, while conducive to risk control from the regulators' perspective, restricts domestic and international investment, because it affects investment cost and profit margins; it should be relaxed.

4.2.9 Build supporting infrastructure at the meso level

Besides this strategy of creating a diversified set of retail microcredit agencies, China needs to develop the infrastructure required to support their healthy development: including wholesale funds, credit bureaus, external auditing companies, rating agencies, consulting companies, training agencies, and guilds/associations or networks.

4.2.10 Publish a systematic and complete set of documents for the purpose of promoting microfinance development

Based on the discussion above, it is recommended that policies or regulations (such as *Guidelines for the Support of Microfinance Development*) or other temporary provisions be published, in order to encourage the healthy, rapid, growth of microfinance. These should include specific rules for various types of institutions engaged in microfinance. After a period of implementation – in which different practices are tested and institutions given a chance to reach a certain level of maturity – such provisions could be reformulated and turned into law. A rush to make regulations and laws will restrict innovation and end up giving the industry a wrong direction. The publication of rules and regulations that support microfinance development in China will allow all domestic and international investors and stakeholders interested in microfinance to obtain a clear and complete picture of China's government policies on microfinance. This will improve investment efficiency in microfinance, and ultimately benefit the healthy growth of microfinance business in China.

4.2.11 Define the role of government in directly providing credit services

On the one hand, government's inclination to directly participate or intervene in providing financial services by itself in line with best practices, generally achieves good results. On the other, under formidable pressure from society and its own precepts, government continues to support unredeemable and inefficient subsidised loans, which makes projects difficult to sustain, while distorting the market. In the presence of such unfair competition, commercialized microfinance projects cannot survive. The government should carefully consider what role it wants to play in creating an

enabling environment and directly facilitating the provision of credit services.

4.2.12 Strengthen the communication and coordination between different administrative departments that support microcredit.

One of the decisive factors for microcredit growth is the support and encouragement of government

policies and regulations. In China, the relevant government departments include at least the PBC, CBRC, Ministry of Finance (MOF), Poverty Alleviation Offices, the State Administration of Taxation (SAT), and local governments at all levels. These should reinforce their communication, reach consensus, and take consistent steps to promote the healthy, orderly and large-scale development of microcredit organizations.

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