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A Probe Into the Sustainable Development of Petty Loan Companies

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Abstract

The petty loan companies in China have been in good performance since taken the pilot demonstration, which effectively relieves the rural funds and financing difficulties of SMEs. However, the petty loan companies in the business development also face many problems, such as the unreasonable legal status, the limited sources of funding, the heavy tax burden, high cost, and operational risks, and so on. These issues will be restricted to the sustainable development of petty loan companies. This thesis is in-depth analysis of the problems of petty loan companies in terms of sustainable development, and puts forward suggestions to promote the sustainable development of petty loan companies.

Key words: Petty loan company; New type of rural financial institution; Sustainable development

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The appearance of petty loan company is just for solving the issues of agriculture, farmer and rural areas and financing difficulties of SMEs. It is a new type of rural financial institution, no deposit from the public, invested by natural

person, business entity and other social organizations dealing with petty loan business. It's called Limited Liability Company or joint stock limited partnership in the service of SMEs, low-income individuals and households, similar to the international microfinance or microcredit institutions. In October 2005 the five provinces of Shanxi, Shaanxi, Sichuan, Guizhou, Inner Mongolia in China were selected to set up the first commercial pilot petty loan companies by People's Bank of China and Banking Regulatory Commission and then it is asked to perform the commercial interest rates in order to provide loans for farmers and SMEs continually. In May 2008, the Banking Regulatory Commission and People's Bank jointly issued a “guidance on petty loan company pilot work” comprehensively promoting the petty loan companies' pilot project in 31 provinces of China. According to the latest statistics released by the People's Bank of China, by the end of December 2011, there were 4282 petty loan companies in China, the loan balance of 391.5 billion Yuan, an annual new increase of 193.5 billion Yuan in total. From the petty loan companies' pilot work, we know that the overall operation is in good condition now and the effect of “supporting agriculture and protecting small companies” is obvious, which has obtained the good economic and social benefits. However, with the continuous progress of the pilot work, the various difficulties and problems faced by the small loan companies in the business development is also prominent. These difficulties and problems that exist in the development will restrict the sustainable development of petty loan companies.

1. THE PROBLEMS OF PETTY LOAN COMPANIES IN SUSTAINABLE DEVELOPMENT

To sum up, the difficulties and problems of petty loan companies in the development are mainly embodied in the following aspects:

1.1 Legal Status Needs to Be Improved

From the perspective of legal laws and regulations, China's current development of microfinance organizations is still in the exploratory pilot phase, not yet having a legal framework to define their legal status. In May 2008 Banking Regulatory Commission and the People's Bank of China jointly issued the "guidance on petty loan company pilot work" (hereinafter called "guidance") positioning the petty loan companies as the enterprise legal person, not making clear of its financial properties. It determines that the petty loan companies are not financial institutions without financial license, only operating financial products in accordance with the Companies Law. Also from the perspective of petty loan companies' business model and scope, we know that they are engaged in small lending and financing activities and their essence is carrying out financial services in the name of the company, actually causing a series of problems during the operation, which impedes the further development of petty loan companies. One of the most prominent problems is unable to obtain subsidies. In 2009, Ministry of Finance issued the provisions of "on the implementation of new financial institutions Oriented Subsidies": The Banking Regulatory Commission approves the establishment of three new-types of rural financial institutions, including village banks, loan companies and rural fund cooperatives, while whoever reaches regulatory requirements and achieves the year-on-year loan balance growth may receive subsidies by the previous year's 2% of loan balance from the central government during 2009 and 2011. Since the petty loan company has not been included in the scope of "new financial institutions", thus it is unable to obtain the subsidy.

1.2 The Upper Limit of Interest Rate

Many developing countries set restrictions on interest rates for microfinance institutions. According to Helms and Reille's (in 2004) research, there are about 40 developing countries with the upper limit of interest rate, and its purpose is to maintain a normal operation of the financial institutions on one hand, on the other hand to ensure that the clients of microfinance institutions (mostly the poor) to obtain loans at lower interest rates in order to reduce the repayment pressures. In China, in accordance with the provisions of the "guidance": according to the principles of market-oriented business, the petty loan companies liberalize the interest rate, but not exceeding the upper limit of the judiciary provisions, which shall not exceed the bank lending rate four times. The upper limit of interest rate will cause a portion of petty loan companies' unsustainable survival and they are unable to make ends meet. Just for lacking money, some SMEs and farmers have to turn to private lending (usury), which increases their repayment costs.

1.3 The Limit of Funding Source

Major sources of funding for petty loan companies are from shareholders' capital, donated funds, as well as from no more than two banking financial institutions' injection, but not from internal or external investors, absorption or disguised deposits from the public. The balance of injection from the banking financial institutions may not exceed 50% of its net capital. Enterprise funds are running blood, however, only loan but no deposit, together with the limit of registered capital is restricted to petty loan companies' lending scale, existing innate weakness. In the face of farmers, SMEs and individual proprietor's strong demand for loans, petty loan companies are always in the condition of no money to loan. Therefore, under the current policy circumstance, these petty loan companies only play a trifling role in solving their financing problems.

1.4 The Heavy Tax Burden

As petty loan companies don't belong to financial enterprises, so the same as the general companies, they must pay 25% of corporate income tax, 5% of the turnover tax, sales tax, as well as 5 ‰ of the stamp duty. The income tax of general financial institutions is levied in accordance with the difference between deposit and lending rates, while the total loan interest levy is imposed on the petty loan companies. In addition, the loan terms of petty loan companies are generally shorter than any other financial institutions and the speed of cash flow is relatively fast, therefore the petty loan companies need to pay more turnover tax.

1.5 High Cost and Big Risk

Firstly, only loan but no deposit — this kind of features of Small loan companies lead to the limitations of financial leverage and relatively high business costs of the equity investment. In addition, the small loan companies are defined as "non-financial institutions", which makes them borrow money only in the identity of the industrial and commercial enterprises, and can not do market financing among the inter-banks. "Guidance" stipulates loan interest rate can not be less 0.9 times than the current benchmark interest rate of banks, which will inevitably lead to petty loan companies' financing costs much higher than that of general financial institutions. Moreover, followed by the principle of "small and scattered loan", petty loan companies must pay a higher management fee than any other commercial banks on the same amount of loans, because of the number of each loan is small. Secondly, petty loan companies engage in loan business and naturally they need to know their clients' credit information. However, the People's Bank of China's credit system has not yet been open to those small loan companies, and also a large number of clients' information that they own can not be indexed in this system, which greatly increases the small loan companies' risk of information asymmetric.

1.6 The Problems of the “Interim Provisions”

On June 18, 2009, the Banking Regulatory Commission issued a “transforming petty loan companies into rural banks interim provisions” (hereinafter called “Interim Provisions”), which clearly stipulates the petty loan company can be transformed into a village bank. But there are two problems. One is the high transformation threshold. “Interim Provisions” decrees that the proportion of the agricultural loan balance of the lately four quarters of petty loan company to the overall loan balance cannot be lower than 60%. Most of the petty loan companies are generally more difficult to achieve this goal. The other is the problem of ownership structure and corporate governance. “Interim Provisions” decrees that village banks must be operated by banking financial institutions holding or wholly-owned business. The funds of small loan company mainly come from private capital, which means that in the current regulations of ownership structure, if it is transformed, the original shareholders need to vacate the petty loan company’s control power and total equity, which is likely to make petty loans company give up transformation.

2. SUGGESTIONS ON HOW TO PROMOTE THE SUSTAINABLE DEVELOPMENT OF PETTY LOAN COMPANIES.

“Sustainable development” is a new concept in the 1980s with extensive discussions on the global environment and development issues. Here it is referred to self-reliance of institutions. The sustainable development of petty loan company is a rural financial innovation in the new era, for the purpose of “poverty alleviation” and the service for “agriculture, farmer and rural area”, helping the vulnerable financial groups to obtain funds and at the time realizing its own survival and development in a long term.

At present, the petty loan industry in China is facing an important opportunity during the “12th Five-Year” of deepening financial system reform, increasing the investment of agriculture, farmer and rural area, as well as accelerating regional industrial transition and upgrading. So it is necessary to take active measures to clarify the petty loan company’s legal status, to improve the managerial mechanism, to enhance the policy supporting, which actually promotes the sustainable development of the petty loan company.

2.1 Clarify the Legal Status of Petty Loan Companies

According to the regional background and development characteristics of petty loan companies, national authorities should clarify their legal status as soon as possible and formulate the related loan law which

determines the business procedures and standards to promote them into a healthy and orderly development. In the process of promoting the pilot company, the local government can firstly make laws and regulations for the petty loan company, which can support and manage them. Meanwhile, access system, regulatory framework, accounting financial system, internal management system, and exit mechanism should also be sorted out and specified. When the small petty loan companies are on the business, all the local governments and relevant departments may refer them to the new rural financial organizations, so that the petty loan companies can enjoy the same treatment as other rural financial institutions to provide legal protection for their sustainable development

2.2 Specify the Petty Loan Companies’ Behavior

2.2.1 Promote Corporate Governance and Intensify Business Innovation

Complied with the relevant provisions of the “company law”, the petty loan companies need to establish a sound corporate governance structure, to strengthen system and capital constraints, to establish an effective information disclosure mechanism, thus ensuring them in a legitimate, stable and well running. At the same time, on the premise of the manageable risk, the petty loan companies should be encouraged to promote the business innovation actively, to carry out the transfer of assets appropriately, to handle bill discount, to do business loans and financing guarantee business, which eventually improves profitability. Also they need to cooperate with the banks and insurance companies that are in advantage of customer resource and technology in order to expand business channels.

2.2.2 Guide the Loan Correctly

Those petty loan companies whose loans are unreasonable and even contrary to the national macro-control policies should strengthen window guidance. Meanwhile, they should be urged to adhere to the notion of “serving the agriculture, farmer, rural areas and SMEs”, to adhere to the market orientation of “small customers, small organizations, small loans,” and provide small loans for the individual businesses, farmers, rural enterprises, small enterprises whose loans are not covered by banks with the effort of fully understanding the towns, streets, the professional markets and small customers.

2.2.3 Strengthen Internal Controls and Improve the Risk Prevention Capability

Guide the petty loan companies to improve the existing internal control system on the management of funds, provisions for risks, risk compensation, and improve the risk prevention

2.3 Assist Petty Loan Company With Moderate Supporting Policies

At present, the petty loan company’s profit margin is relatively narrow, while self-survival and development

ability is relatively limited. In order to promote the healthy development of petty loan companies, government and relevant departments should continue to support them in policy, so that the petty loan companies may play a more important role in supporting the “agriculture, farmer and rural areas” and servicing the SMEs.

2.3.1 Formulate Fiscal and Tax Preferential Policies

Strengthen the communication and coordination of the local financial departments, the Inland Revenue Department, the People’s Bank and banking regulatory departments, in order to give a certain inclination of the petty loan companies on tax policy. For example, the petty loan companies should be given full tax exemption or reduction of taxation at the beginning, and when they develop into the normal track, they are given tax preferential policies for those who are in the condition of good operating, a sound internal control system, excellent risk prevention measures, and the outstanding annual assessment, with reference to three new types of rural financial institutions, such as credit cooperatives and rural banks, loan companies, rural fund cooperatives.

2.3.2 Set up Risk Guarantee Fund of Petty Loan

Recommend that the risk guarantee fund of petty loan should be set up by the finance departments, and they have the right to guarantee the loans for the “agriculture, farmer and rural areas” and SMEs from the petty loan companies. At the same time, if there are non-performing loans, the petty loan companies can be given a certain percentage of compensation after audited and identified by the management departments that have been done well in the loan before the review, post-loan management and claiming, and also the loans belong to the type of “supporting agriculture and protecting small”.

2.4 Broaden the Financing Channels for Petty Loan Companies

Firstly, in order to encourage petty loan companies actively expand financing channels, those petty loan companies can be allowed to increase their investments who have achieved the effectiveness of servicing the “agriculture, farmer and rural areas” and SMEs, also for that in good internal control system. So they may increase their investments according to regulations half a year earlier than that of the previous. Secondly, making use of the government funds, rural development funds, the state policy banks and wholesale loans establish the petty

loan funds. The petty loan company is entrusted to make loans that increase its funding sources. Thirdly, open up the financial markets and allow the outstanding petty loan companies to enter the interbank markets to issue notes and bonds financing. Finally, when the conditions of the operation, supervision and related supporting policies are mature, the petty loan companies are permitted to absorb the deposits from the specific groups, including the absorption of government organizations and social groups by poverty or specific project funds.

2.5 Encourage the Petty Loan Company’s Business Innovation, Transformation and Upgrading

To achieve the sustainable development of petty loan companies, at present there are three development directions to choose. First, on the basis of the professional position of petty loan company, they need to make efforts to expand or derive a new financial service. When the conditions are ripe, it is necessary for them to establish the inter-regional petty loan holding groups. The second choice is to transform and upgrade into a rural bank. The third one is to develop into a professional loan companies which can absorb large amounts of deposits with reference to the foreign models. In view of most of the institutions are still in the small-scale and initial stage, while upgrading to the village bank’s policy is still brewing, so the first direction will be the most secure choice for the majority of petty loan companies. Absolutely, it also needs the government and regulators to achieve breakthrough and innovation in the policy, in order to give petty loan companies more extension space of non-lending business. Then they will have strong self-survival and sustainable development capacities. Therefore, in the long run, the village banks will become the ultimate direction of petty loan companies.

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