

Research on Countermeasures for Sustainable Development of Small Loan Companies in China

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Abstract

In recent years, financing difficulty has become one of the problems which constrain the development of three issues (related to agriculture, rural areas and farmers) and MSE (Micro and Small Enterprises) in China. The creation of small loan companies has satisfied the needs of financing for SME (Small and Medium Enterprises) and individuals to some extent and has brought vitality for marginalized rural finance. However, it has only been a relatively short period since the small loan companies started up with immature operation model; many problems arise in the development process of small loan companies. The paper starts from exploration of existing problems during the development process and proposes some countermeasures for these problems so as to create fine external environment, enhance their internal constructions as well and ensure sustainable and prudent development of small loan companies.

Key words: Small loan companies; Problems; Sustainable development; Countermeasures

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INTRODUCTION

In recent years, it is still difficult for farmers to obtain the loan, with great financing gap for rural finance to go and rural financial system to be improved, despite furthering of rural financial reform in China and great achievements in increase of farmers' income, construction of agricultural infrastructure and development of rural economy. Moreover, financing difficulty—one of the problems which constrain MSE in China has not been virtually solved. In order to deal with the financing predicament for MSE, improve the rural financial market, standardize the non-governmental loan, the small loan companies come into being at the proper time. However, with the slower pace of development in recent years, and the inclining trend of the whole, the problems that small loan companies encounter have become increasingly obvious and it is of crucial importance to study the problem of sustainable development.

1. STATUS-QUO OF DEVELOPMENT OF THE SMALL LOAN COMPANIES IN CHINA

In China, small loan companies were founded under the lead of People's Bank of China as a pilot project in 2005. Financial management organizations, such as PBC (People's Bank of China) and CBRC (China Banking Regulatory Commission) have jointly issued "Guidance on Pilot of Small Loan Company" in 2008, in which relevant provisions on corporation nature, the resource and operation of capital, establishment conditions, the supervision, etc have been stipulated, and the pilot of small loan companies throughout the country raised. Thereafter, every province issued relevant detailed rules for implementation and management regulations successively according to their conditions and small loan companies have entered the phase of pilot since then. Under the support of government policies, small loan companies developed rapidly like mushrooms, expanded

continuously, and have become a crucial force for new finance. Since 2005, Chinese government has started pilot of commercial small loan companies and Chinese small loan companies have made tremendous progress in numbers of institutions, scale of loan, number of employees and paid-in capital, etc.

According to Report on Statistics of Small Loan Companies in 2014 issued by People's Bank, there are 8,791 small loan companies altogether in China, with 109,948 employees, paid-in capital of 828.306 billion RMB, balance of loan 942 billion RMB and newly increased loan of 122.8 billion RMB (Zhu, 2015). On the whole, the small loan companies are developing very fast. However, there are still striking differences in the number of institutions, balance of loans and paid-in capital, with imbalance in different regions. As for the number of institutions, Jiangsu Province, Liaoning Province and Hebei Province top the list, accounting for 19.45% of the total with the number of 631, 600 and 479 respectively; there are merely 12 in the province with relatively fewer institutions, taking up 0.14 %. Regarding balance of loans, Jiangsu Province, Zhejiang Province and Chongqing City hold a relatively large portion, making up 29.73% of the whole with the amount of 114.666 billion RMB, 91.061 billion RMB and 74.313 billion RMB respectively (Zhang, 2014); while the Tibet Autonomous Region, Hainan Province and Qinghai Province have relatively little balance of loans, accounting for 1.02% of the whole with the amount of 0.482 billion RMB, 3.838 billion RMB and 5.268 RMB respectively. Concerning paid-in capital, Jiangsu Province, Zhejiang Province, and Sichuan Province constitute a relatively large portion, making up 26.82% of whole nation with the amount reaching 92.991 billion RMB, 70.899 billion RMB and 58.231 billion RMB respectively; in contrast, the Tibet Autonomous Region, Hainan Province and Qinghai Province hold a relatively small portion, accounting for 1.10% of the whole, with the amount of 0.801 billion RMB, 3.450 billion RMB and 4.907 billion RMB.

2. PROBLEMS IN THE DEVELOPMENT OF SMALL LOAN COMPANIES IN CHINA

2.1 Indistinct Market Positioning and High Operating Cost

Recently, Chinese small loan companies mainly deal with the loan service, which belongs to financial service. Since what small loan companies do fall into financial services, they should certainly enjoy the same favorable treatments as the commercial banks. However, small loan companies are merely regarded as ordinary commercial enterprises in accordance with current relevant laws and regulations in China, consequently, they could hardly enjoy the same treatment as the financial enterprises on several aspects such as external financing, taxation, etc. resulting in much higher operating cost compared with ordinary financial enterprises.

2.2 Stringent Control of Interest Rate Compresses the Profit Margin of the Small Loan Companies

At present, Chinese small loan companies mainly work on loan services, with the majority of revenue coming from the interest of loans issued. Under the control of government, the interest rate level of the small loan companies falls into 0.9 to 4 times of the base interest rate of Central Bank of China, which reveals government's stringent interest rate control policy has immediate impact on the operation and revenues of the small loan companies and compresses the profit margin as well.

2.3 Fund Source in Difficult Circumstance

The constraint of fund source has long been the problem which cannot be solved by the small loan companies alone. At present, Chinese small loan companies carry out the operation model of "loan only and no deposit" in accordance with the relevant policy. Equity fund makes up the majority fund of the small loan companies, with the external financing from the channels such as bank financing, trust capital increase and donation, etc. With the restricted financing channels and lack of follow-up fund, some of the small loan companies have to carry out illegal operation and break through the original bottom line. For example, when there is a client having high demand, some companies will adopt the illegal method through attracting social funds, which will increase the operation risk and constrain the follow-up development of the small loan companies (Zhang, 2014).

2.4 Loopholes in Supervision

The supervision regulations targeted at the small loan companies mainly cover the relevant documents issued by CBRC (China Banking Regulatory Commission) and PBC (People's Bank of China), etc. and relevant administration methods stipulated by the local government with relatively low level in legal system, which fails to meet the standard of administrative regulations or laws, therefore, it is impossible to impose punishment on small loan companies, resulting in ineffectiveness of punishment (Liu & Xu, 2014). Moreover, the local governments which are responsible for supervision of the small loan companies fail to work out the unified relevant supervision regulations and specifications; general supervision will be conducted based on the former regulation and according to the actual development requirement of small companies, which results in striking differences in supervision of small loan companies. Since there are too many regulations for small loan companies issued by different departments, it is inevitable to have multiple managements in daily supervision for small loan companies. The supervision mode results in a series of problems, such as shirking responsibilities, obscure specification of responsibilities duties, different supervision standard, all leading to poor supervision for small loan companies.

2.5 Shortage of Talents and Operation in Risk

Small loan companies fall into rising industry in China. Since they are lately founded with relatively short period of development and poor performance, most small loan companies find it impossible to recruit professional financial technicians. Meanwhile, there are fewer relevant education and training institutions for small loan organizations, which is the immediate cause for short supply and deficient reservation of professionals and talents in most small loan companies in China.

At the present stage, the operation of small loan companies have not been virtually standardized with good and poor management intermingled. Some companies regard “profit” as their sole objective, providing speculation service with high risk which is inclined to result in operation risk, besides loan service. Some companies are not only confronted with external risk, but also internal control risk. Most companies are lacking in professionals, which leads to inaccuracy in verification and process control of loan service and increases the internal operation risk. Since most clients of small loan companies could not provide collateral or limited collateral, small loan usually adopts guarantee of warrantor. If the client fails to repay the loan when it is due, the small loan companies will require warrantor to perform the duty of repayment. If the warrantor could not afford to repay the loan for the debtor, it is very difficult for small loan companies to collect the loan, thus causing uncollectible debt or bad debt in reality.

2.6 Low Recognition from Society

The promotion of small loan companies is a relatively effective way to activate non-governmental fund. The official small loan companies can issue a loan based on legal operation and compliance with regulations, which is essentially distinct from traditional loan of usury and some illegal private loans in society. Nevertheless, some people are inclined to mix up the unofficial loan organizations which preach “unsecured loan” and “speedy loan” and official loan companies. The unofficial loan organizations usually claim 6% monthly interest rate when issuing the loan and resort to violence in case of violation of the contract, which put the personal security of the clients alone and their family under threat. Meanwhile, some outlaws carry out the fraud practice under the disguise of “speedy loan” and “unsecured loan”, swindling “deposit” or relevant “procedure fee”. These phenomena do harm to the social image of the official small loan companies and decrease their social recognition of the public.

3. THE COUNTERMEASURES TO PROMOTE SUSTAINABLE DEVELOPMENT OF SMALL LOAN COMPANIES

3.1 Strengthening the Government Support

The sustainable development of small loan companies

relies on support from government. The government should first of all support small loan companies from legalizing them, confirming that they belong to micro and small financial institutions and they are entitled to enjoy the financial preferences like rural or small financial institutions. Meanwhile, since the clients the small loan companies serve are less-privileged group, such as micro and small enterprises or farmers, and there is great operating risk, the government should grant certain amount of subsidy for risk.

3.2 Adjusting Interest Rate in a Rational Way

The small loan companies demand stable support for interest rate and the liberalization of interest rate in China has played a definite role for development of small loan companies. Internationally, economy is not the sole target, while the government values the social value of the small loan companies. There are two factors to take into consideration before determining interest rate of the small loan companies. From the perspective of the client, the interest rate should ensure that the debtors would increase their income and improve their living conditions. As for small loan companies, it will ensure their sustainable development and steady expansion, so as to provide contingency fund for the neediest people in the society. With the consideration of the two factors mentioned above, the interest rate of the petty loan will be regarded as the real sustainable interest rate. In the international petty loan market, sustainable interest rate usually maintains approximately 40%. In Bengal, the origin of petty loan, the interest rate has been approximately 20%, since they have the relatively mature credit market and wide spread of small loan companies. In Mexico, the market interest rate was once above 60%, with the large small loan companies coming in to being, the interest rate becomes declining. In China, PBC (People’s Bank of China) and CBRC (China Banking Regulatory Commission) confine interest rate within four times of the base interest rate of Central Bank of China. The stipulation accords to judiciary interpretation of usurious loans, with great restraint of moral, rather than market (Wang, 2013). In accordance with current conditions in China and suggestions from relevant academia, the interest rate level of petty loan can be determined between 25% and 30%.

3.3 Figuring out Shortage of Fund Through Multiple Channels

To begin with, the financial institutions should increase the financing proportion for small loan companies by appropriately altering the original stipulation of financial policy that the small loan companies can apply for the borrowed funds from no more than “two” financial institutions to “more” institutions; by appropriately increasing financing leverage rate. The original stipulation that the borrowed fund balance should not reach over 50% of the net capital will also be adjusted appropriately. For example, the financing proportion of the small loan

companies can be increased year by year according to the credit ratings, with the 50% financing proportion in the first year, 100% the second year and 150% the third year (Wang, 2013). Secondly, some small loan companies with good performance and high control of risk can be endowed with inter-bank lending service, which can be carried out among the small loan companies within the same industry, and between small loan companies and the banks as well. Thirdly, multiple level financial institutions will jointly raise fund for small-loan fund. Small loan fund provides the raised fund to small loan companies so as to solve the demand of the clients. Finally, the cooperation between small loan companies and the foreign investment organizations should be enhanced. Many foreign investment organizations are keen on Chinese small loan companies but it is very difficult for small loan companies to bring in foreign investment. Therefore, reasonable methods to introduce foreign investment should be found out to increase the financing channel for small loan companies.

3.4 Improving Supervision System

Firstly, the supervision system for Chinese small loan companies should be improved. The supervision regulations for Chinese small loan companies are still in incomplete state and the current regulations and documents should be summed up and sorted into systematic law system; the relevant regulations on market operation risk should also be stipulated so as to realize sustainable development of small loan companies. Secondly, the supervision subject should be clarified to avoid multiple supervisions. Thirdly, associations for small loan organizations should be established to strengthen self-discipline, which will play a crucial role to motivate internal supervision and promote good development of small loan companies. CMCA (China Micro-credit Companies Association) will provide service for clients of small loan companies, and build up a bridge between small companies and government as well so that the small loan companies will win great support from government and the association will assist government to supervise small loan companies. Government can also hire relevant intermediary to approve and evaluate the business of small loan companies and provide some suggestions. The involvement of intermediary will be of significance for the small loan companies to provide real financial conditions and improve management structure of the company. Meanwhile, the non-governmental power should be made use of to motivate the supervision from the society. Consequently, the illegal or foul act in the small loan companies will be actively reported by the public and the supervision power of the society will be positively motivated.

3.5 Increasing Capacity of Risk Control

From the perspective of lowering the credit risk, the

small loan companies should comprehensively and further investigate the facts about the debtor, which not only cover the manufacture, operation and performance, but also behaviors and personalities, social relationship, economic dispute, and the repay of the loan in the past. The companies with good conditions can have access to the credit reference system of People's Bank of China.

In the routine work, small loan companies can constantly enhance the awareness of risk prevention and improve the risk screening ability of the staff by various methods, such as organizing training and lectures on risk supervision periodically; sending employees to visit and learn from the companies of the same kind in the financially developed areas with advanced management mode and operation principle.

3.6 Enhancing Social Image of Small Loan Companies

The government and the news media should publicize the legal identity and social status of the official small loan companies to the public in various ways, enhance the distinction between small loan companies and unofficial loan organization and rectify the reputation for small loan companies so as to increase their social recognition. On the other hand, the government will intensify the penalty for illegal companies, impose stringent penalty on illegal acts, such as fund-raising, collecting loans through violence, granting usury, etc. to enhance their social image. The small loan companies will also promote their social image by persistently specifying and regulating the order of the industry, establishing service and supervision system and adopting credit ratings, etc.

CONCLUSION

The emergence of Chinese small loan companies is a beneficial supplement to Chinese financial services field. To a certain extent, it covers the gap of financial services that our traditional financial institutions offer to three rural issues and the healthy, stable and promote the harmonious development of our society. However, with the slower pace of development in recent years, and the inclining trend of the whole, the problems that small loan companies encounter have become increasingly obvious. Internal problems are mainly lack of source of funds, lack of professional talents, product innovation, risk control risk more, etc.; Market orientation are the main external problems is not clear, the heavy taxes and fees, lack of legal protection, congenital regulation difficult problems. The author Suggestions to small loans company future development direction, which insists on "small, scattered," mode of operation, under the guidance of policy, continue to strengthen the "three rural" economic and micro, small and medium enterprises financing service, truly become a "facilitator" financial reform and the role of "financial credit supplement".

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