

Research on the Sustainable Development of China's Village Banks

—Analysis Based on Financial Sustainable Development Theory

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Abstract

The sustainable development of village banks concerns the effect of rural financial incremental reform, and the sustainable supply of rural finance concerns the sustainable development of the economy of the whole rural area. Based on the financial sustainable development theory, this paper seized the key point of financial efficiency, analyzed the factors that affected the sustainable development of village banks from the three aspects of demand and supplied matching degree, rural capital use efficiency and management performances of village banks, and proposed the solutions to the sustainable development of village banks based on the analysis of the three aspects.

Keywords

Village Banks, Financial Sustainable Development Theory, Sustainable Development, Efficiency

1. Proposition of the Problem

With the deepening of China's overall reform, some achievements were also made in the reform of financial system. As an important part of the whole financial system, rural finance has been at the forefront of reform and innovation in recent years. For a long time, the phenomenon of "financial exclusion" was very common in China's rural finance, and rural finance was gradually forgotten in the corner. Urban commercial banks repelled to set up branches in rural areas or even evacuated from rural areas gradually, which seriously restricted the development of rural economy. Since 2007, the successive establishments of new rural financial institutions represented by village banks showed that the rural financial incremental reform was activated formally. Since then, the stock reform and incremental reform of rural financial system collaborate with each other and func-

tion together. Village banks refer to banking financial institutions approved by CBRC (China Banking Regulatory Commission) according to relevant laws and regulations, and funded by domestic or foreign financial institutions, domestic non-financial enterprises and domestic natural persons, which are set in rural areas to provide financial services for local farmers, agriculture and economic development of rural areas. With the right emergence of village banks, rural finance is no longer forgotten, and the financial repelling phenomenon is alleviated. The village banks relieved the contradiction of increasing demand of capital and insufficient supply of finance in rural areas, effectively filled the gap of rural financial services, and strengthened the financial support for rural areas.

Since the first village banks were set in six first pilot provinces in March 2007, they sprang up and developed very fast. Sichuan Yilong Huimin Village Bank, China's first village bank, was officially established and opened on March 1st, 2007 in Jincheng, Yilong. After ten years of development, village banks have covered 31 provinces including 1083 counties (cities), accounting for 57.6% of the total counties (cities). As shown in **Table 1**, since 2007, the number of villages and towns bank of China is growing. By the end of 2016, totally 1519 village banks have been established in China. The piloting of village banks increased the financial supply for central and western rural areas, satisfied the capital demand of local farmers and small-and-medium-sized enterprises, activated the rural financial market, preliminarily achieved the goal of importing urban capital into rural areas, maintaining rural capital and activating rural financial market, and laid a basis for attracting more capital. On CBRC's press conference held in March 2017, CBRC summarized the effect of village banks in the past ten years, and affirmed the important role that village banks played in stabilizing the county territory, supporting rural and small enterprises, and enhancing the economic and social development of rural areas.

However, regardless of the booming of village banks, there are also some problems. For example, "supporting rural" remains in name only, which deviated from the satisfaction of small load demand of farmers and market positioning of serving local small-and-medium-sized enterprises, not following the principle of setting down at barren areas of financial services [1]. These problems also caused a lot of trouble for its own sustainable development, such as deviation from the tenet of "agriculture, rural areas and farmers", lack of follow-up funds, and difficult in risk control, etc. As the most important part of three new rural

Table 1. Number of village banks approved for opening from 2007 to 2016.

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
No. of village banks	19	91	148	349	726	876	1071	1152	1311	1519
Annual growth rate	-	378.95%	62.64%	135.81%	108.02%	20.66%	22.26%	7.56%	13.80%	15.87%

Notes: The data was originated from the yearly reports of CBRC (2007-2016), Annual growth rate= (No. of this year – No. of last year)/No. of last year. In the year of 2006, there is no village bank in China, so 2007's Annual growth rate is non-existent.

financial institutions, the sustainable development of village banks has direct influence on the success of three pilot financial institutions [2] [3].

The research on the sustainable development of village banks has just rolled out, which mainly focuses on the policy opinion research and theoretical basis research of setting up village banks. Of them, the representative researches of policy opinions include: based on the system level, Small loans for the rural poverty class is the blank field for rural financial services, and village banks should develop the blank business of the poverty class [4]; It also analyzed from the policy perspective, stating that village banks not only need the policy support in tax deduction and exemption, deposit reserve ratio, and loan risk subsidies, but also need to avoid their dependency on policy support which will have negative effect on the diversified and competitive development of village banks [5]. The theoretical researches on village banks are mainly theoretical basis researches to set up village banks. Most of scholars believed that theory of financial deepening, endogenous theory of financial growth, and development economics theory provided the theoretic basis to set up village banks. Few scholars will use theories to analyze and study the sustainable development of village banks. Financial sustainable development refers to continuous adjustment of financial systems and financial mechanisms with economic development, which is to reasonably and effectively mobilize and allocate financial resources, improve financial efficiency and realize a long-term effective running and stable development of economy and finance [6] [7]. This paper is dedicated to using financial sustainable development theories to analyze the problems existed in the village bank development that may restrict the sustainable development of the village banks, such as mismatching supply and demand of rural finance, low efficiency of using rural finance and poor operating efficiency of village banks, so that to find out proper solutions to help the sustainable development of village banks [8].

2. Analyze with Financial Sustainable Development Theory

There are a lot of case studies on a single village bank or on village banks in a single area. However, seldom of them analyzed the overall development of over 1000 village banks existed. Based on the overall analysis and study on China's village banks, this paper conducted a concentrated and in-depth research on the most crucial problem of the sustainable development of village banks [9]; current domestic papers that summarized and concluded the development process and practical problems of village banks are more like investigation reports. Seldom of them conducted in-depth researches by combining with specific theories. This paper is designed to analyze the efficiency of rural finance by combining financial sustainable development theory, aiming to proceed an in-depth research on the theoretical causes of the problems.

The paper studied the efficiency of rural finance based on the financial sustainable development theory. This theory was proposed by Professor Bai Qinxian, who first raised financial resources theory after nearly 20 years of study. Then, based on the financial resources theory, he creatively applied the idea of

sustainable development into the financial field, and finally formed the financial sustainable development theory. He said that finance is a scarce resource, which is also the most basic strategic resource for a country. Different from other resources, financial resource is featured with strategic, vulnerable, summative, social and hierarchical characteristics. As a resource, finance also faces the problem of efficiency of resource allocation. Sustainable development refers to the development that can satisfy the development demand of modern society and will not harm the demand of the descendants. Efficiency means to use the social resources to satisfy the desire and need of human beings in the most effective way. Hence, sustainable development is essentially an issue of efficiency, and efficiency is the premise and guarantee of sustainable development. In the financial domain, the sustainable development means a high use efficiency of capital. In the following part, this paper first analyzed the supply and demand contradiction existed in rural finance from the perspective of supply and demand in economics. Then, taking village banks as the example, it analyzed the insufficient capability in shielding against risks of the village banks due to the high loan-to-deposit ratio; after that, from the perspective of capital use efficiency, the paper analyzed the problem of low efficiency of capital use in rural areas. At last, the paper discussed the management efficiency of village banks which represented new rural financial institutions.

2.1. Mismatching Supply and Demand of Rural Finance

As of the matching degree of supply and demand, the supply and demand of rural finance are seriously mismatching. When the supply and demand in economics is applied to rural finance field, demand refers to the capital requirement of farmers with payment ability under interest rate or known as the loan amount; supply refers to the funds that farmers are willing to and can deposit in bank under a certain interest rate or known as the deposit amount. Similar to the demand of general commodities in economics, the demand and supply here are also affected by various factors, such as the price of currency, preferences of farmers, income of farmers, prices of complements or substitutes, expectation of future prices and policy factors, etc.

The circulation of contractual right of land can promote the appropriate scale management of land, the rapid development of rural private economy, the rapid development of industrialized operation of agriculture, and the fast advancement of urban-rural integration, etc. In recent years, the new changes in the rural areas have enhanced the financial demands of farmers with more new changes, such as the expanding of occurrence rate and scale of debit and credit, the increasing proportion of loans used for production, and the increasing demand for formal finance, etc. Insufficient supporting financial supply mainly manifests in the single and monopolistic rural financial supply system formed by policy banks, commercial banks, cooperative financial institutions and informal financial institutions, as well as in the lack of deposit capacity of farmers due to distrust or insufficient economic ability. The lack of financial supply will un-

doubtedly restrict the sustainable development rural economy.

The major problem of village banks is the strong demand for loans with difficult absorption of deposits, which caused a high loan-to-deposit ratio for many-village banks and resulted in circulating risks [10] [11]. At last, China's supervision department set the loan-to-deposit ratio of 75% as the red line. Viewing from bank's earnings, the higher the loan-to-deposit ratio, the better. This is because more deposits mean more interests to be paid, and will cause higher costs and less profits, showing a poor profitability of the bank. However, from the perspective of bank's resisting risks, the loan-to-deposit ratio should not be too high. Because the bank should deal with daily cash withdrawals and clearings. Excessive loan-to-deposit ratio will cause shortage of the capital and lead to payment crisis of the bank.

As shown in **Table 2**, before 2010, the loan-to-deposit ratio was kept within the red line of 75% and the risk was relatively low; from 2011 to 2014, the loan-to-deposit ratio of China's village banks started to step out of the red line given by supervision department, indicating a poorer capability of village banks in resisting risks. Hence, the village banks were expected to improve their capability of resisting risks and maintain the loan-to-deposit ratio in the red line. According to the latest data uncovered by CBRC in 2016, the liquidity ratio is 77.1%, which is approaching the red line of 75%, showing that the village banks are paying more and more attention to the improvement of their ability in resisting risks.

2.2. Low use Efficiency of Rural Capital

In the aspect of capital use efficiency, the rural capital use efficiency is relatively low, and the capital cannot be used effectively. Efficiency means to effectively use social resources to satisfy the desire and demands of human beings. Hence, efficiency is a dynamic concept changing with different reference standards. With the development of society and technology, different reference standards will have a higher requirement on efficiency. Capital use efficiency is one of the indicators to evaluate the effect of capital use. The two main indicators are the efficiency and sufficiency. Efficiency refers to the effect after use of capital, which

Table 2. Deposit balance and loan balance of village banks from 2007-2016 (unit: 100 million RMB).

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Deposit balance	10.16	64.6	269	—	1697	3055	4632	5808	7480	9106.4
Loan balance	5.72	34.2	181	596	1305	2347	3628	4862	5880	7021
Loan-to-deposit ratio	56.3%	52.9%	67.3%	—	76.9%	76.8%	78.3%	83.7%	78.6%	77.1%

Notes: The data was originated from the yearly reports of CBRC (2007-2016); loan-to-deposit ratio = loan/deposit; the data of deposit balance of 2016 is lacking, which is estimated according to the liquidity and loan balance.

describes the output concept; sufficiency refers to the degree of use, which describes the input concept.

Generally, compared with urban areas, rural areas have a low use efficiency. Most of farmers invest limited capital in low-earning crops. These crops have a high natural risk and the yielding is mostly determined by natural factors. For high-earning economic crops, farmers are afraid to have a try due to factors of insufficient fund, lack of technology and poor sales, and keep planting the traditional crops. Hence, the efficiency of capital use is very bad; most of farmers lack long-term investment plans, or are unable to get large loans from banks due to limited collaterals. Even if they get small loans sometimes, the money is used to satisfy the consumption demand. Consumption demand refers to the demand and desire of consumers on the consumer products in the form of goods and services. These consumer demands are mostly life consumption demands, which are featured with one-off consumption, and the use of capital will end when the consuming behavior ends. Hence, the lifetime of the capital use is short and the efficiency of the capital is not fully played. However, most of farmers have a flat productive financing demand. According to the investigation on 102 farmers in Jinshan district, Qingpu district and Chongming county on the outskirts of Shanghai, the farmers are lack of productive financing demand, and only 9.8% of the investigators are lack of capital constantly and raised funds [12].

2.3. Poor Overall Management Performance of Village Banks

With respect to the management efficiency, some of the village banks started to make profit after years of rapid development. The analysis of the Forward-looking Industry Research Institute on the data of listed banks showed that many village banks of the listed banks have a good profit status and promising development prospect. According to the investigation data, 16 village banks of CCB (China Construction Bank) have realized a net profit of 24 million RMB in 2011; the village banks of ABC (The Agricultural Bank of China) in Hubei, Neimenggu, Shaanxi and Anhui also realized the net profits of 4,859,200 RMB, 3,960,000 RMB, 1,745,100 RMB and 4,591,300 RMB, respectively; 13 village banks of SPDB (Shanghai Pudong Development Bank) have realized a pre-tax accounting profit of 193 million RMB by the end of 2011; the profit rate of the village banks set by CMBC (China Minsheng Banking Corp., Ltd) also developed very fast. By the end of 2011, the 18 village banks of CMBC have realized a total net profit after tax of 190 million RMB, and an average net profit after tax of 10.55 million RMB of each bank.

In general, however, village banks have a high loan-to-deposit ratio and lack of liquidity, and their profitability is still much lower than that of commercial banks. From the perspective of bank profitability, the deposit being higher than loan means a high cost and less profit, and a poor profitability of the bank. Similarly, as shown in **Table 2**, the loan-to-deposit ratio is maintained under 1, which indicated that the loan balance is smaller than deposit balance and the profitability of the bank is very poor. To study how to improve the management

efficiency, we should analyze and understand related factors that affect the management efficiency, and work out the weaknesses or causes of the low efficiency. The factors that affect the management efficiency mainly include external factors and internal factors. Externally, the low profitability and management efficiency of village banks are concerned with the rural financial environment. Even the profitability of RCC (Rural Credit Cooperative) and PSBC (Postal Savings Bank of China) who have taken root in rural areas and have been leaders of rural financial market for many years is also much lower than that of common commercial banks, let alone the college banks who just stepped in and have no basis in rural areas; internally, the employees of village banks are mostly local non-bank professionals who have low professional skills and poor service consciousness; in addition, the products of the village banks are less innovative, and no personalized services can be carried out without supporting of featured products.

3. Countermeasures and Suggestions for the Sustainable Development of Village Banks

According to the analysis based on financial sustainable development theory, the real factor that affects the sustainable development of village banks can be concluded by one word, efficiency, which is manifested in three aspects: supply and demand mismatching; low capital use rate; poor management efficiency. Therefore, it is urgent to develop proper countermeasures to stimulate the sustainable development of village banks.

3.1. Matching Supply and Demand to the Maximum

The sustainable development of village banks is heavily relying on the sustainable development of rural economy. Village banks should be aware of their market positions, try to find market vacancies, dislocate operations, cooperate with formal financial organizations, and avoid frontal competition with them. The aim of village banks should be striving to satisfy the increasing credit demand of farmers and small and micro businesses; based on policy advantages, implement related supporting polices for village banks, further loosen the interest rate control on village banks, carry out pilot interest rate marketization of village banks, include village banks into the national payments and settlement system and deposit insurance system, prevent the vicious cycle of relying on policies when making up the blank of rural finance, develop characteristic products, and form core competitiveness.

Although village banks are set up by CBRC according to relevant laws and regulations, they are a new comer compared with RCC and PSBC, featured with low credibility and unknown security to farmers. Hence, the absorption of deposits is one of the common challenge to village banks. To solve this, village banks should make huge efforts to publicize the national policy and demonstrate that they are formal financial institutions supported by People's Bank of China and CBRC to establish their legitimate status in the rural areas. In addition, village

banks can raise their credibility by improving their services, and innovate their credit technologies such as to innovate loan collaterals allowing farmers to use land management rights, forest properties and water-surfaces contractual management rights as collaterals for the loan, thus to provide farmers with practical financial services to absorb more deposits.

3.2. Constantly Improve Capital Use Efficiency

The improvement of capital use efficiency can be started from efficiency and sufficiency. In the aspect of efficiency, village banks can give preferential policies to the productive financing loans of farmers, and improve the output efficiency of capital. For one-off consumption loans with low output efficiency, the bank should try to confirm customer's repayment ability according to their source of income before making loans. The premise of on-time repayment of loan and interests is that the loan is effectively used and has generated economic effects. For example, village banks can make response to China's "three rural" (agriculture, rural areas and farmers) subsidies call, give interest preferences and subsidies for farmers who purchased large agricultural machinery with loans from the bank, popularize the application of agricultural technologies, and promote large-scale machinery operation of farmland. With respect to the sufficiency, village banks should stick to the market positioning of supporting rural and small enterprises, provide loans mainly to village enterprises and small and micro businesses, deepen the degree of capital use, and improve the input efficiency of capital.

The typical example of Yunus microfinance bank is the Grameen bank which is operated in a complete market commercial mode and realized a rolling development through a good corporate management. The Grameen bank has a good asset quality, whose repayment rate is as high as 98.89%, which ranks the first of all the banks in the world; Yunus helps poor people shake off poverty and obtain high profit with dignity, and continues to make loans to more poor people and realizes a double-win.

Not only developing countries and areas are suggested to learn from the Grameen mode, developed countries such as the United States, Canada, France and Norway are also imitating the mode. China's village banks can also learn from the successful experience of the Grameen bank, and loan more money to the poor. Same amount of money has a higher satisfaction degree for poorer people, and the output of the invested money will take effect faster. At present, in response to the national policy, village banks have put forward the loan policy of less than 50,000 RMB at a low interest for poverty family who possesses poverty evidences. This policy can be seen as a good start of learning from foreign experience. However, the banks should also prevent further deviation of capital input caused by unfair and private identification of poverty family. This deviation will aggravate the gap of wealth because the families that should not be regarded as poverty family are provided with poverty family loans.

Today, the economy of China's villages has already broken through the scope of traditional planting, breeding and handicraft industry, and started to per-

meate industry, construction, transportation, and services, etc. Meanwhile, cultural production methods are also experiencing in-depth changes, the operating modes as agriculture industrialization, rural industry cluster, and “company plus farmer” are promoted. Hence, rural economy is being developed both in depth and width, and village banks also showed up in such a background. The use efficiency of capital is definitely higher than that of traditional agriculture.

3.3. Improve Internal Factors and Increase Management Efficiency

Capital will not enter rural financial market if the market has no profit space. A growing profit space is the basis for the development of village banks. The only way of realizing a sustainable development village banks is to keep innovating, accumulate credits and innovate credit products, and avoid the homogeneity of credit products; innovate intermediate products and services; innovate guarantee system; innovate systems and modes; establish excellent cooperate culture; pay attention to the expanding of the scale; learn from experience and lessons during the development; maintain the vitality and vigour of village banks. Li Dongwei also expressed that the sustainable development of village banks relies on the support of featured products to form characteristic management and improve their core competitiveness. It showed that further researches are required to effectively improve labor capital, develop targeted products and businesses, form unique service channels, and cultivate the core competitiveness of village banks [13].

The village banks can learn from the successful experience of Yunus’s Grameen bank small loans mode, stick to the market positioning of supporting rural and small enterprises, constantly improve micro-credit products and services according to the characteristics of rural economic and financial development status and farmer’s financial demands, positively explore and innovate new modes that are suitable for small enterprises and “three rural” low-end customers, improve their operating and management level through micro financial businesses and innovation of rural financial products and services, so that to satisfy the diversified financial demands of farmers and small and micro businesses. In addition, the village banks can develop personalized products according to local conditions, such as to provide agent services of selling funds, bond funds, financial products, insurance, as well as paying water and electricity. These intermediate businesses not only can help increase rural savings and improve the popularity of village banks, but also can optimize the management structure, improve the profit level and solidify the previous development basis of the village banks.

4. Conclusion

After ten years of development, China’s village banks have helped in the rural financial development to some extent, eliminated the embarrassing situation of blank rural finance, got the village finance out of the forgotten corner, and pro-

moted the reform and development of the rural economy. However, the problems of village banks also showed up gradually, which restricted the sustainable development village banks to some extent. This paper proposed to take efficiency as the starting point and focused on the matching degree of demand and supply, efficiency of using rural capital and operating efficiency of village banks, so that to gradually improve the financial environment of rural areas, cultivate rural market and customers for village banks, and clear the obstacles for the sustainable development of village banks. Due to various limitations, the research in this paper still faces the following problems: The research only started from the above three aspects, which are hard to essentially improve the practical running efficiency of rural capital. Indeed, the sustainable development of village banks should comply with the market operating law. But it is also very important to get sustainable financial support from the government in the beginning. When China's financial market becomes more mature gradually, village banks can surely realize their sustainable development by themselves.

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