

A Research on Development and Legalization of Non-governmental Financing in Jilin Province

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Abstract

This paper is a research production of a social science research project of Jilin province entitled as Constructing Jilin's Multi-level Investment and Financing System for Industrial Application of High and New Technologies (2009B134). Currently, Jilin is conducting strategies to actively promote independent innovation and industrial application of scientific and technological achievements, to push the adjustment, optimization and upgrading of industrial structure and therefore to promote better and faster development of the economic society all over the province. With finance as the lifeline of high-tech industries' development, it is an effective way to develop non-governmental financing in order to solve the financing difficulties in small-and-medium-sized enterprises relying on science and technology.

Keywords: Non-governmental financing, Small-and-medium-sized enterprises, SWOT analysis, High and new technologies

With the rapid development of China's economy, there is increasingly obvious contradiction in capital supply and demand. In such a situation, with its constantly expanded scale, non-governmental financing has become a significant channel for medium-and-small-sized enterprises and economy related to agriculture, rural areas and farmers to obtain current funds and construction funds. Actually the development of high-tech industries calls for the development of new enterprises as well as mature ones with certain scale and competitiveness, forming an industrial organization structure for medium-and-small-sized enterprises' constant growth and dynamic optimization and playing an important role in maintain these enterprises' competitiveness for a long run. It is hard for these venture enterprises in high-tech industries to effectively obtain capital support from banking system or to realize financing through stocks or bonds. Therefore, Jilin is expected to facilitate its normalization and legalization of non-governmental financing, to perfect its modern financial system, to encourage the development of medium-and-small-sized enterprise relying on science and technology, to promote technological innovation, to relieve employment pressure and to promote social stability.

1. The Definition of Non-governmental Financing

Non-governmental financing refers to financial actions between contributors and borrowers to temporarily transfer capital ownership in the form of non-governmental loan, non-governmental bill financing, non-governmental securities financing and social collection of funds with the intention of earning high interest and achieve capital ownership at the cost of contracted interest out of national legal financial institution. It is beyond regular financial system compared with formal finance. Although it has been approved of by financial supervision institution, it basically falls beyond the category of People's Bank of China's regular financial

activities. Nowadays, there are mainly a variety of non-governmental financing methods.

1.1 Non-governmental Loan

Non-governmental loan refers to the loan between citizens, between citizens and juridical persons and between citizens and other organizations. With both parties' agreement, such a loan is valid. Its interest rate mustn't exceed relevant interest rate laid down by People's Bank of China. Non-governmental loan is a direct financing channel while bank loan is an indirect one. This is an investment channel of non-governmental capital as well as a form of non-governmental financing.

Non-governmental loan is a traditional way of non-governmental financing, including two forms: first comes non-governmental loan in the form of mutual assistance. This form, with its small scale, is quite ordinary in rural areas but has wide breath. Natural persons or farmers are mainly involved in financing actions with their close relations such as between friends and relatives in order to cope with short-term urgent living needs. Second comes usurious loan as a main form of non-governmental loan used for production turnover demands of private enterprises. Such loan varies in period according to financial institutions' interest rate of loan in the same period, regions, seasons and capital supply and demand.

1.2 Securities Financing

In recent years, some other contents such as deposit receipt, bond and real estate have been added in addition to non-governmental loan. These deposit receipts and bonds are mainly employed for loan for mortgage and hypothecated loan. In some cases, certain interest differential or commissions are required. Such a popular method is quite representative in current non-governmental loan.

1.3 Non-governmental Investment

Non-governmental investment, meaning literally investment from people in comparison with national investment and foreign investment, falls into concept distinction in investment source or investment subject. However, this is a category with profound institutional connotation by nature. Non-governmental investment comes from all subjects involved in private economy, including private investment (individuals' investment in production and residence as well as urban and rural privately-owned business' investment in business), private enterprises' investment, private joint-stock enterprises' investment and collective enterprises' investment. In addition to production and circulation, non-governmental financing has spread to tourism, real estate, hospital, school, fundamental construction in which return is given mainly in the form of interest or bonus.

1.4 Non-governmental Discount on Notes

Non-governmental discount on notes refers to note holders fulfilling transactions with their undue notes (mainly bank acceptance) in order to circulate necessary funds. Non-governmental note market is the circulation market existing among non-banking institutions, which is named secret note market. In such an invisible market, transactions are fulfilled through private negotiation among private enterprises. The seller and the buyer contact each other according to the information of supply and demand when they need to have transactions. Due to its simple process without those sophisticated checkup procedures adopted by banks, it has huge room for profit in reality.

Because of the low risk coefficient of bank draft and strict requirements, sophisticated procedures required when banks dealing with discount and even some banks' refusal to give discount to small acceptance bills, some small bills usually held by private enterprises cannot be cashed in, hence influencing their circulation in funds. As a result, holders prefer to realize their financing in those large-scale private businesses where no tax receipt or purchase-and-sale contract is required. An inter-mediator's reference and enquiry about acceptance bills are enough for a person with a draft to get cash from the borrower. The interest rate can be negotiated. Generally, the longer the loan period is, the lower the interest rate is. Meanwhile, the interest rate is directly influenced by the discount interest rate adopted by financial institutions. The loan period, influenced by the expiration of receipts, normally lasts for about 4 months.

1.5 Fund Raising inside Enterprises

Many medium-and-small-sized private enterprises and private industrial and commercial units draw funds directly from people in the form of deposit, collecting money from staff, joint shareholding management and drawing shares from other areas. Due to reasons in all aspects, it is hard for these enterprises to get loan from banks or credit cooperatives. With insufficient current funds, they have to collect funds among their staff, in which the interest rate is equal to or slightly higher than the interest rate for loan in the same period.

2. The Formation and Development System of Jilin's Non-governmental Financing

2.1 Demand Being an Important Element for Non-governmental Financing's Initial Formation

With fixed financial demands, when some demands have been fulfilled by formal financial supply, other demands have to turn to non-governmental financial market. The specific process is shown in Figure 1: when the supply at formal financial market (S_1) exceeds or is equal to request for social funds (R), it means that request for funds can be fulfilled by formal financial market, non-governmental financing will not exist; but when S_1 is not enough to fulfill R , the $R-S_1$ part has to be fulfilled by the supply from non-governmental financing market (S_2), hence promoting the formation of non-governmental financing.

In late 1990s, state-owned commercial banks conducted their intensity strategy by orientating their market to large-scale enterprises or key industries and enterprises, hence forming insufficient loan support for those medium-and-small-sized enterprises as well as rural areas. Such insufficiency provides an opportunity for the development of non-governmental financing. For example, Jilin's prosperously developing private economy has offered survival and development opportunities for non-governmental financing since it cannot obtain sufficient funds from formal financial system. Currently, China has no financial institutional arrangement for financial services for medium-and-small enterprise as well as other private economic subjects. Formal financial institutions have to treat large-scale enterprises as their major clients because they have to follow fixed requirements for loans and their consideration on reducing costs for loan transaction and achieving maximized loan profit. Especially with more profound reform in state-owned commercial banks, medium-and-small-sized enterprises have to rely more on non-governmental financing which fills up the thin spots in formal financial services.

2.2 Supply being a Decisive Element for Constant and Rapid Development of Non-governmental Financing

With private economy's rapid development, the importance of the supply element gets exposed and eventually grows into a decisive element. Jilin has increasingly prosperous private economy including a large number of medium-and-small-sized enterprises and a large proportion in economy, being one of the distinguishing features of regional economy. However, during its development of regional economy, financial oppression also exists inevitably. To a large degree, economic development is restricted by the failure of traditional financial system to effectively encourage social savings and investment. Here financial oppression refers to some phenomena existing in developing countries such as excessive financial restraints, limits in interest rate, loan quota and monotonous financial capital due to insufficiently exerted market system. To be more specific, the financial market is underdeveloped with a poor variety of financial commodities and citizens' preference for savings. In addition, citizens have insufficient investment channels. For example, those in places below the county level can hardly have access to national debt, stock or other financial commodities such as financial derivatives and futures. Then as a result, they turn to non-governmental financing instead of formal financial fields. From the perspective of supply from non-governmental financing, Jilin's increasingly prosperous non-governmental financing should be attributed to expanding individual wealth which has come to the source of this kind of financing. In such a situation, the supply element is a decisive element for the constant and rapid development of non-governmental financing.

2.3 Value-seeking Nature of Capital Propelling Non-governmental Financing's Development

Value seeking is the basic nature of capital. From the perspective of the investor, profit is their fundamental drive for their investment in whichever industry or enterprise. Along with strengthened comprehensive economic strength of Jilin Province, citizens have got rapid increase in income. Meanwhile, rapid economic development and improved investment environment give citizens high expectations about maintaining and increasing the value of their idle funds and therefore turn to new investment methods as well as expand their channels of income. In direct financing, the higher the degree of information opacity is, the higher risk compensation fund suppliers will require when offering funds, hence leading to medium-and-small-sized enterprises' capital cost much higher than that of large ones. Such high cost is only affordable for those medium-and-small-sized enterprises with high profit as well as high risk, in which some high-tech ones are included. It is high profit and financing request that endow non-governmental financing with its spontaneous stimulation system. In addition, private credit reduces financing cost and its interest rate varies according to capital supply and demand, the borrower's economic strength, credit, the risk of credit agencies. Overall, non-governmental financing has expanded investment channels and encouraged the development of non-governmental investment. Thus, value seeking serves as a propelling force for non-governmental financing's development.

3. SWOT Analysis Model for Jilin's Non-governmental Financing Development

SWOT analysis refers to a kind of situation analysis. In such analysis, internal strength and weakness as well as external opportunity and threat are listed according to relevant surveys, are arranged in matrix form and then analyzed with the idea of systematic analysis, hence producing a series of conclusions which are generally quite decisive. With the SWOT method, we conducted a model analysis on Jilin's non-governmental financing development so that we could precisely find out those factors influencing Jilin's non-governmental financing and put forward some countermeasures.

4. Countermeasure for the Development of Jilin's Non-governmental Financing

4.1 Laying down Special Local Regulations on Non-governmental Financing to Standardize Non-governmental Financing

In China's legal system, there are no special laws and regulations about non-governmental financing, making it hard to standardize non-governmental actions. In this situation, it is necessary for Jilin government to establish Regulations on Jilin's Non-governmental Financing fit for relevant development to set up a legal and standardized business platform for non-governmental financing, to guide legal non-governmental financing as well as to exert its make-up role. Regulations on Jilin's Non-governmental Financing should clarify how to define non-governmental financing, how to affirm institutions, how to standardize interest rate policies, capital flow guidance, non-governmental financing transaction methods as well as essential elements for contracts, how to prevent risks and some other specific issues.

4.2 Enhancing Supervision and Standardizing Monitor on Non-governmental Financing

Financial supervision departments should cooperate with local government to establish non-governmental financing monitor system. First is to establish long-lasting supervision system, forming a monitor system jointly supervised by government, People's Bank of China, China Banking Regulatory Commission and Industrial and Commercial Bureau. In addition, illegal financing such as usurious loan as well as illegal private banks should be punished to purify non-governmental financing market. Financial supervisory board is expected to take financial supervision duties and to standardize non-governmental loan. Strict management regulations should be established to enhance supervision on those spontaneous organizational financial activities and to specially monitor those institutions drawing public deposit to avoid financial disturbance harming social peace. Besides, usurers grabbing huge profits in others' trouble should be cracked down in order to maintain social stability. Second is to establish monitoring information system. Banking supervisory departments should keep a close eye on the trend of non-governmental financing's development, regularly investigate non-governmental financing, conduct precautions on loan risks. Local People's Bank, China Banking Regulatory Commission, National Development and Reform Commission and Statistical Bureau should regularly conduct investigations and statistics, timely monitor the total volume, interest rate, capital source and application of non-governmental financing in the relevant region, expose information and give warnings about risks at the proper time and enhance non-governmental financing subjects' legal sense, risk awareness and self-protective ability.

4.3 Facilitating Marketization of Interest Rate and Harmonizing Price Difference between Formal Financing and Non-governmental Financing

Because the interest rate adopted by formal financial departments is distorted due to governmental control and deviates from the proper interest rate. Capital's value-seeking nature distracts non-governmental capital from formal financial flow and wrong price guidance tends to create unreasonable flow of capital, disturbing macro-control of the authority. Interest rate, as the price of financial commodities, is the most vigorous element of the whole financial system and financial market as well as the core of the market. The marketization of interest rate enables supply and demand at market to play a decisive role to the largest degree in the formation process of interest rate. Therefore, it is quite vital to facilitate marketization of interest rate and to harmonize the price difference between formal financing and non-governmental financing.

4.4 Innovating Financing System and Expanding Investment Field

Government departments should conduct proper guidance, effectively improve investment environment, facilitate the development of capital market, encourage and guide direct investment of non-governmental capital and promote the diversification of investment subjects. Favorable environment can be created for non-governmental financing by deepening the reform in financial system and encouraging a variety of financial innovation. Here financial innovation refers to the innovation in financial tools, technologies and institutions as well as that in financial system and financial liberalization. Since traditional loan management has hindered financing at bank, breakthroughs have to be made in financial tools and technologies.

4.5 Establishing Service system of Non-governmental Financing and Optimizing the Environment for Non-governmental Investment and Financing

Jilin government should include its effort in promoting and guiding non-governmental investment and financing in its local economic and social development plan, offer non-governmental investment with more loose policies and more effective support, establish and perfect its organization system of non-governmental investment and financing, encourage to establish some self-discipline organizations such as chamber of commerce and guild, develop agencies offering non-governmental investors and financiers with services in polity, law, accounting, technology, management and market information and help them to establish standardized property order, accounting rule and rule on staff training.

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Table 1. SWOT analysis model for Jilin's non-governmental financing development

Internal factor external factor countermeasure	<u>Internal strength (S)</u> 1. simple and flexible process 2. diversified methods	<u>Internal weakness (W)</u> 1. blind expansion in scale 2. increasing interest rate
<u>External opportunity (O)</u> 1. Rapidly developing private economy and great demands for capital 2. Residents' limited investment channels and increasing idle private funds	<u>Strength+opportunity (SO)</u> Creating non-governmental financing organizations in different forms and supplying financing and credit agency services	<u>Weakness+opportunity (WO)</u> Innovating financial products, expanding service space, supporting medium and small enterprises and individual's legal financing in addition to formal loan institutions
<u>External threat (T)</u> 1. Lacking in legal support and restraint for non-governmental financing 2. No government's strict supervision system	<u>Strength+ Threat (ST)</u> Establishing and perfecting laws and regulations to standardize non-governmental financing	<u>Weakness+threat (WT)</u> Government enhancing its monitor on non-governmental financing organizations and actions

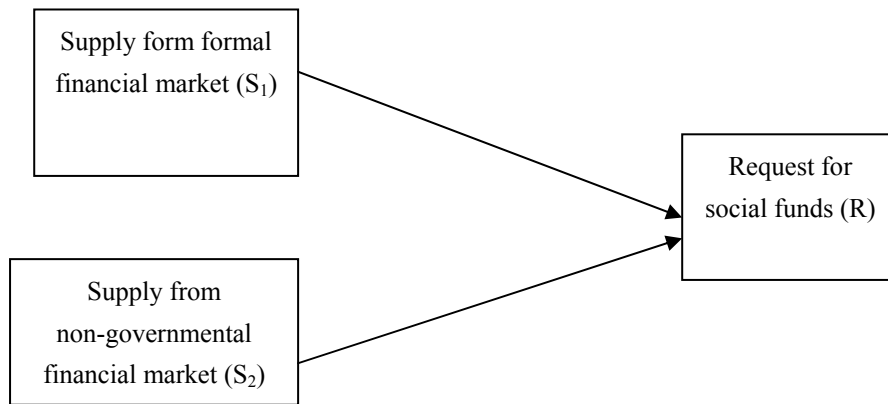


Figure 1. Supply-and-Demand Relations between Formal Finance and Non-governmental Finance