

A Study of Chinese Private Financing

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Abstract: *As an important way of financing in China, the position of private financing has been more and more important. But, the private financing also faced a lot of problems in the process of development. This article gives a briefly introduction of private financing, tells about present situation of private financing with focuses on lending to those small and medium-sized enterprises. On this basis, the paper discusses some new trends in the development of private financing and put forward some countermeasures to normalize the development of private financing.*

Keywords: *Private financing, problems, countermeasures*

1. PRIVATE FINANCING

Private financing refers to financial activities between lenders and borrowers; the activities are beyond legal financial institutions. The purpose of private financing is to obtain money by paying agreed interest rates. Private financing often exists in the form of private lending, private bill financing, private securities financing and social fund-raising.

1.1. Private Lending

Private lending is a traditional way of private financing. The main forms of private lending involve mutual aid private lending and usury. Mutual aid private lending borrows less. It is often exists in countryside. The financing subjects are mostly farmers. The relationship between borrowers and lenders is relatively close, generally it is lending among friends. Mutual aid private lending mainly dealt with short-term life need. The borrowers can be expected to repay in the future. The lending is mostly oral agreement without interest or interest rate is low. There is no clear deadline of mutual aid private lending. Usury is the main form of private lending. It is mainly used by individuals and private enterprises in supporting their production circle. Repayment period can be both long and short; interest rates generally refer to financial institutions loans and fluctuate according to different regions, seasons, supply and demand.

1.2. Private Bill Financing

Bank drafts have low risk. VAT invoices and sales contracts are needed by banks in drafts discount business. Drafts discount business is strict, complicate in procedures and extremely low in efficiency. Some Banks do not deal with discount business of small denomination bank acceptance. Holders of small denomination bank acceptance (mostly private enterprises) cannot realize their drafts which influenced their finance recycle. They had to borrow money from private commercial banks with these drafts. Here, tax bills, sale contracts are not needed. They can get cash by providing a bank acceptance query book after introduction of an intermediary. Interest rates are generally negotiable personally, the longer the period, the lower the interest rate.

1.3. Private Securities Financing

In recent years, in addition to private lending, there increased some new kinds of private financing such as certificates of deposit, bonds and real estate. They are mainly used as mortgages and pledge loans. Some lenders will charge a certain interest difference or fees. Securities financing is a popular way in private financing market during these years which made it typical.

1.4. Social Fund-Raising

Due to various reasons, enterprises are difficult to get loans from Banks. When they lack of money, they can raise from work staff. The interest of social fund-raising is generally equal or slightly higher than banks' rate.

2. PRESENT SITUATIONS OF CHINESE PRIVATE FINANCING

2.1. Enterprises Defraud Money from Banks

At present, many small and medium-sized manufacturing companies are unprofitable. They find that private financing has such a high interest than their own business. Cost of private financing is about 2% to 3% per month, while the monthly interest rate is 6% to 8%. There is 4% to 5% of interest rate spreads. That is to say, the annualized yield is about 48% to 60%. If an enterprise lend out money at a rate of 5% to 7%.it will get 3% to 4% of interest profit. We assume that monthly rate do not change during a year, the enterprise's usury has 36%-48% earning a year. They begin to abandon their major business and turn into private financing. Some enterprises even give up their main business, using their empty enterprises as collateral, defrauding a large number of bank loans, lending them to others, in order to obtain profit. This influences normal operation of enterprises and threatens capital market security. A lot of money rushes into market without substantial industry. Private financing chain will be broken down and cause huge loss.

2.2. Underground Private Financing Cause Revenue Loss

The private financing institutions usually pay lump-sum tax. As to those private sectors who have not registered, tax cannot be collected. Some enterprises engage in private financing which is beyond the scope of their licensed business. This is in fact a kind of tax evading.

2.3. Imperfect Law Regulations

Although there are some relevant laws directly regulate private financing in chinese "contract law". There is not a specific law or administrative regulations on the private financing to make a comprehensive system of regulation and adjustment. And compared with the absence of such a law, Chinese private financing is abundant and has increasingly become a dominant social fact. Related legal disputes and social problems increased. In addition, there are many unreasonable and unscientific aspects about private financing in the existing laws.

2.4. Incomplete Lending Procedures

Private financing generally has two contract forms: verbally and written. The lending contract is lack of normative. Once the borrower defaults, the lender will suffer loss. Disputes are easy to be caused. Private financing transactions never pay business tax which not only reduces the national tax but makes financial institutions that pay tax relatively in an unfair situation. The government cannot master the real scale of private financing through taxes.

2.5. Lack of Necessary Government Guidance

In china, service system, credit system and financing guarantee system of small and medium - sized enterprises are imperfect. Risk compensation mechanism of small and medium-sized enterprise has not established. Compared with state-owned companies and large enterprises, small and medium-sized enterprises remain limited in getting loans. In addition, small and medium-sized enterprises in China are difficult to get privilege compared with those foreign enterprises. After financial crisis in 2008, China implemented positive fiscal and monetary policy. But the actual loans flow into small and medium-sized enterprises are less than 20%. The government policy support little on small and medium-sized enterprises. In addition, local governments focus on attracting investment, and give preferential policies to attract capital outside, ignoring the power of local private capital. This led to unnecessary capital flows among counties. Lack of guidance suppressed some private investment and compelled some private investment flow into some prohibited industry.

3. SUGGESTIONS ON PERFECTING CHINESE PRIVATE FINANCING

3.1. Establish and Perfect Relevant Laws, Regulate Private Financing Activities

On the one hand, establish and improve laws and regulations related to the private financing as soon as possible. At the same time, the government should strengthen institutional innovation, creating a good institutional environment for the development of private financing. On the other hand, government should strictly define illegal financing activities, clearly state punishment to illegal financing standards activities. Penalties should be increased to illegal private financing,

conditions of opening private financing institutions should be clearly identified and management on private financing should be strengthened.

3.2. Broaden Investment Channels of Private Fund

Government can issue new bonds to countryside, change current situation that people in countryside cannot buy bonds. Government can also adjust the competitive strategy of insurance, develop investment-oriented insurance product in rural market. Securities market can be guide to permeate to county in order to attract county money. Interest tax imposed by credit cooperatives should be returned to customers, attracting local farmers to saving in credit cooperatives, reducing outflow of county fund through the national banking.

3.3. Strengthen Rural Financial Reform

Government should fully implement rural financial reforms with an emphasis on the reform of rural credit cooperatives. The reformation includes institutional reform of state-owned commercial banks and function adjustment of agricultural development banks. Government should encourage a variety of sources of funds flow into rural financial market. Also, suitable rural financial product innovation should be encouraged. Construction of rural insurance business should be accelerated.

3.4. Scientific Positioning of Private Financing

Government should clearly define legal private financing from and illegal fund raising, actively guide the transparency development of private financing and regulate its compliance management to form a legal management platform.

3.5. Establish Credit Guarantee System of Small and Medium-Sized Companies

Government should provide necessary information, guarantee and human resource services for the development of private financing. By the Usage of "credit system" and "personal credit archives" system in central bank, private financing supply and demand platform can be built. Through information service platform, we can strengthen information disclosure, crack down fraud, and promote objective decision between borrowers and lenders. This can concentrate private fund into economic construction through formal legal channels. At the same time, government should establish and improve credit guarantee system of small and medium-sized enterprises, improve the risk compensation and incentive mechanism of credit guarantee institutions, guide guarantee companies actively serve for the small and medium-sized enterprise. In the process of establishing and perfecting the credit guarantee system, market access conditions should be improved, strict rules should be made to guarantee agencies, guarantees the employees and registered capital. The established credit guarantee system should include independently non-profit, qualified legal representatives led by government which are non-profit mutual complementary guarantee organizations.

3.6. Improve Enterprises' Credit Level

The construction of credit system should be strengthened. Government should guide enterprises to strengthen their own management, standardize finance management and the construction of honest, and enhance the credibility of small and medium-sized enterprise financial information in order to obtain the trust of the financial sectors and investors. Credit veto and release system should also be implemented. As for enterprises that do not keep their words, government should timely list them into "black list", strictly define punishment standard. Managers and accounting staff should be educated in the moral, constraints and faith in order to improve the quality of the small and medium-sized enterprise management and accounting personnel. Government should also try to establish a regional industry association, to form a good operational mechanism of self-regulation and self development.

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