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Promoting Inclusive Financial Markets

Working Group on Inclusive Finance in China

Guarantee Funds for Inclusive Finance in China

Peter Situ

China Papers on Inclusiveness No. 3
April 2011

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This publication is supported by the members of the Working Group on Inclusive Finance in China:

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- Incofin IM
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Foreword

This paper has been produced by the Working Group on Inclusive Finance in China. It forms part of a series of publications that seeks to deepen the discussion between regulators, investors and providers of financial services for rural people and the poor in China. The Working Group believes that research-based discussion will help to promote responsible investor behaviour and supportive government policies in the area of inclusive finance.

The Working Group was officially launched on the 14th of October 2010 during the China International Finance Forum in Shanghai. It is an initiative of the German Agency for International Cooperation (GIZ), the Graduate School of the People's Bank of China (PBOC) and the World Microfinance Forum Geneva (WMFG). It is funded by its Partners and Members, a list of whom is provided on the inside front cover of this document.

The Group owes its gratitude to Peter Situ for his diligence and productivity. Our thanks also go to the experts interviewed for the study, who kindly gave their time and provided an important part of the information. Their contributions provided several of the invaluable insights that serve to make this document what it is.

The author's opinions do not necessarily reflect the opinions of individual Partners and Members of the Working Group. While as much effort as possible has been made to be accurate, any errors remaining within the paper remain our responsibility. We hope you enjoy reading this work.

Vidhi Tambiah
CEO
World Microfinance Forum Geneva

Thorsten Giehler
Programme Director Financial Sector Reform Programme
Deutsche Gesellschaft für Internationale Zusammenarbeit

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List of Abbreviations

ADBC	Agricultural Development Bank of China
BOF	Bureau of Finance
CBRC	China Banking Regulatory Commission
CGF	Credit Guarantee Fund
CGTMSE	The Credit Guarantee Trust for Micro & Small Entreprises, India
CNY	Chinese Yuan
DTI	Department of Trade and Industry, UK
FI	Financial Institution
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
IFC	International Finance Corporation
JASME	The Japan Finance Corporation for SMEs
KfW	KfW Bankengruppe
LOW	Laid-Off Worker
MCA	Ministry of Civil Affairs
MGA	Mutual Guarantee Association
MFI	Microfinance Institution
MIIT	Ministry of Industry and Information Technology
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOLSS	Ministry of Labour and Social Security
NDRC	National Development and Reform Commission
NGO	Non-Governmental Organization
PBC	People's Bank of China
PEP PHASE II	The ILO/Japan Inter-Country Project on Strategic Approaches Toward Employment Promotion, Phase II
PRC	People's Republic of China
PSB	Postal Savings Bank
RCC	Rural Credit Cooperative
SAIC	State Administration of Industry and Commerce
SASAC	State Owned Assets Supervision & Administration Commission
SETC	State Economic and Trade Commission
SFLG	Small Firms Loan Guarantee, UK
SIDBI	Small Industries Development Bank of India
SME	Small- and Medium-Sized Enterprise
SOE	State-Owned Enterprise
SORED	The SOE Restructuring and Enterprise Development Project
WF	Women's Federation

Executive Summary

Credit guarantee funds (CGFs) are intended to stimulate formal sector lending to market segments that are considered risky. They either assume part of the risk of individual bank loans or entire portfolios directly, or work through intermediaries such as a microfinance institutions and NGOs.

When it comes to making financial markets more inclusive, CGFs have a mixed record; in many countries their continuity has depended on repeated financial injections. While in some cases this limited success has been due to obstacles in the environment, in many cases it has been due to weaknesses in the design of the funds' structure and the relationship with the lending institutions they support.

CGFs emerged in China in the early 1990s, when the development of private SMEs encountered the bottleneck of difficult credit access. They can be classified into three basic models: policy CGFs, commercial CGFs and mutual CGFs. While policy CGFs focus on disadvantaged groups, commercial and mutual CGFs tend to serve more SMEs with a greater likelihood of success.

In 2009, China's 5,547 registered CGFs together reported net profits of 4.5 billion RMB. These positive results can partly be attributed to the fact that policy CGFs count government subsidies towards income and fail to report on costs directly paid for by the government. Levels of efficiency varied greatly by business model, due to a combination of knowledge deficiencies and contradictory incentives. Compared to successful CGFs in other countries, China's funds have not managed to leverage large volumes of bank loans to disadvantaged groups; this is attributed to the fact that the existing guarantee mechanisms fail to reduce the risks of lending to disadvantaged groups, and a multitude of attractive investment opportunities make banks unwilling to assume any of these risks.

While CGFs have so far been regulated and supervised by a diverse set of government authorities and agencies, there are strong indications that the China Banking Regulatory Commission (CBRC) will soon be mainstreaming all CGFs under a single framework. The government is increasingly interested in international investors' involvement in CGFs' development and growth.

It is recommended that regulators and ministries, possibly with assistance from donors and development finance institutions, define a framework that provides the right balance between market freedom to ensure efficiency and innovation, and the necessary regulation and supervision to ensure responsible conduct and stability. They should consider delegating part of the supervision task to proposed CGF umbrella organizations.

Commercial domestic and foreign investors should work primarily with commercial and mutual CGFs in regions where SMEs are diversified and booming, whereas donors such as GTZ should primarily work with policy CGFs in regions with inefficient markets. Development finance institutions such as IFC and KfW could work with both. All should help to strengthen CGFs' capacity to reach disadvantaged groups in a sustainable manner, through the development of procedures for sharing responsibilities and costs between CGFs and lending institutions, and for reducing the risks of doing business with the disadvantaged. They should bring in more efficient operational procedures and help develop more appropriate loan and guarantee products and methodologies.

Finally, the Postal Savings Bank and GIZ could consider a pilot scheme based on a business alliance between selected PSB branches and local policy CGFs. At the same time, the Agricultural Development Bank of China could leverage the lending capacity of emerging MFIs and RCCs through a pilot of the intermediary guarantee model.

1 Highlights of International Experiences

1.1 Brief Overview

Definition of a guarantee fund. A guarantee fund is a financial instrument that aims to offer additional protection to the formal banking sector against credit defaults; it agrees to meet the loan commitment of a borrower in total or in part, if the latter fails to fulfil the obligations of repayment towards the credit institution.[1] The credit guarantee commonly results from a three-party bonding among the guarantee fund, the credit institution and the guarantee holder or the guaranteed borrower, agreeing on a conditional but irrevocable promise that the guarantee fund will meet the guaranteed borrower's obligations of repayment in case of default, in accordance with the risk sharing agreed between the guarantee fund and the credit institution.

Guarantee funds have been widely used to ease lending to SMEs that are considered as less advantageous in their access to formal credit, as compared to the large enterprises. Nearly 50% of countries worldwide have a credit guarantee system in place. Models vary and they can be classified into different types, depending on the criteria being applied. The common characteristics can be summarized as follows:

a) The Government takes a share in the compensation of losses,
b) The Government is involved in managing and operating the fund,
c) Profit-driven guarantee institutions rarely extend their business coverage to disadvantaged groups.

One of the classifications relates to the operational agreement reached between the concerned parties. Three models include the individual guarantee model, the portfolio guarantee model and the intermediary guarantee model:

a) *The individual guarantee model* relates to a direct agreement between the guaranteed borrower, the guarantee fund and the credit institution. The guarantee fund undertakes the borrower screening and it recommends candidate borrowers to the credit institution with a proposed guarantee. The credit institution undertakes its own credit assessment on the applicant and if positive, an agreement will be reached between the guarantee fund and the credit institution regarding the risk sharing and the multiplier rate.[2] The loan is contracted directly between the credit institution and the guaranteed borrower. If the borrower defaults, the guarantee fund is bound to repay the credit institution its guaranteed share of the credit.
b) *The portfolio guarantee model* operates on an arrangement between the guarantee fund and the credit institution to guarantee a specific segment of potential borrowers on the basis of the agreed criteria. The guarantee fund does not interact directly with the borrowers and the credit institution grants guaranteed loans to borrowers who meet with the criteria agreed upon in advance with the guarantee fund.
c) *The intermediary guarantee model* involves an intermediary organisation, which can be an MFI or an NGO authorized to undertake credit operations. This intermediary organization usually works closely with a certain market segment or social group. The guarantee fund guarantees the credit institution a credit line that the intermediary organization uses in its lending to the specified group of borrowers. If the intermediary organization defaults, the guarantee fund repays the credit institution its guaranteed credit line.

Guarantee funds can also be classified according to their business purpose into policy support, mutual guarantee association (MGA) and commercial or corporate guarantee funds. Note that credit guarantee funds that are involved in inclusive finance are mostly of a policy support nature and they are funded by government agencies, the donor community or international NGOs.

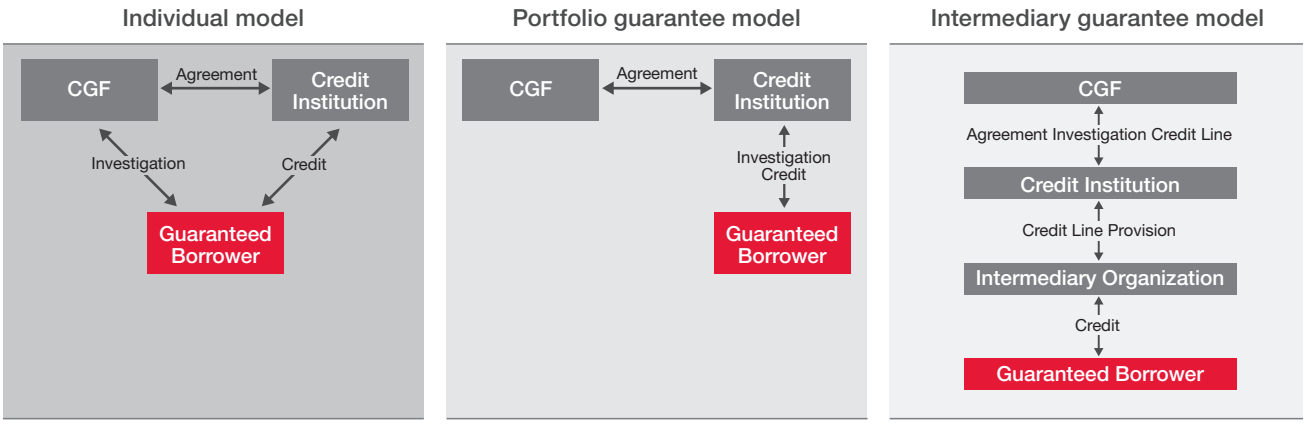
1.2 Examples of Operational Models and Key Lessons Learnt

There seems to be reluctance in openly measuring the sustainability of CGFs. This may be due to the widespread public funding of CGFs. The balance between costs and benefits remains a common challenge among policy and mutual guarantee funds. Commercial CGFs are however able to show signs of profitability, or clear movements towards financial sustainability.

1. *For the sake of simplicity, the words credit guarantee fund and guarantee institution will be used interchangeably without particular distinction in this paper. The terms credit institution, lending institution and financial institution (FI) will also be used interchangeably.*

2. *The multiplier quantifies the relationship between the available or committed guarantee capital and the loan amount leveraged under the guarantee agreement.*

Figure 1: Guarantee relationship of operational models



It is difficult to define best practices, as financial and social objectives may conflict with each other. A few operational practices and lessons learnt that are described below are based on the CGF's effectiveness in improving the target clientele's access to formal credit, and the leverage level that translates the lending bank's confidence in the control of risk. Most CGFs in developed countries may be considered as good performers when using those two criteria, as they generally help SMEs or other disadvantaged groups overcome collateral constraints in the lending bank's credit assessment and achieve a multiplier of 10–20.

Of those functional credit guarantee schemes, the Japanese SME financing experience may be worth mentioning. The Japan Finance Corporation for SMEs (JASME) insures 70%–90% of liability repayments of the cooperating Credit Guarantee Corporations that provide guaranteed loans to the SMEs. This can be viewed as a typical practice of government-backed credit guarantee financing and it operates openly through credit guarantee intermediaries. Germany, Italy, France, Austria and Taiwan tend to adopt a similar set-up to avoid government direct operations in the guarantee business.

The British Small Firms Loan Guarantee (SFLG) is a joint venture between the Department of Trade and Industry (DTI) and a number of approved banks. The loan is screened in two steps, first by the banks and then by the Small Business Service of DTI based on the latter's eligibility criteria. The SFLG guarantees 75% of the loan and charges an estimated 2% commission. This is an example of government direct operation in the credit guarantee business. Government direct operation can be found in the US, Canada and Hong Kong.

In Germany, the Bürgschaftsbanken (Guarantee Banks) have been a proven financial partner for SMEs by issuing guarantees for both loan and mezzanine financing for over 50 years. The equity base of the Bürgschaftsbanken is provided by different representative trade bodies, such as Chambers of Craft, Chambers of Commerce, Industry Federations, Banking Associations and other economic associations. They are to some extent viewed as self-help institutions of the private sector supporting SMEs from all sectors. The Bürgschaftsbanken are known to have the tightest approval procedure among European guarantee schemes, with an assessment by the lender, the guarantee bank and a Board of Industry and Finance experts. SMEs that have been set up with the help of a guarantee from the Bürgschaftsbanken have been proven to be particularly sustainable. This is in large part due to the support offered by the consulting services of the sector trade organisations, which are also shareholders of the guarantee banks. Also, via the project assessment performed by the guarantee banks during the application process, potential weaknesses can be eliminated and necessary corrections undertaken to ensure greater viability of the new business.

Credit guarantee funds that target specific disadvantaged groups have been initiated in a number of developing countries, most commonly through donor and international NGO support. In general, those CGFs operate in the context of inefficient formal banks and an active informal financial sector. There is little evidence for their financial sustainability as they mostly rely on external funding and technical assistance, but their social achievements are widely recognized.

The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in India is an example of an inclusive credit guarantee scheme without pressure from external initiatives. The CGTMSE was launched by the Indian Ministry of Micro, Small and Medium Enterprises and the Small Industries Development Bank of India (SIDBI) in order to make collateral-free credit available to the micro- and small-enterprise sector. Subject to a maximum loan ceiling, the extent of the guarantee covers up to an average of 75% of the total portfolio, but 85% of the micro-enterprise portfolio, and 80% of portfolio held by women entrepreneurs.

The failure of several credit guarantee schemes in the 1980s has led to a number of lessons learnt, which can be summarized as follows:

a) Government funding should not be accompanied by strong and direct interference in CGF management and operation,
b) Full coverage of default and lack of a risk sharing mechanism with the credit institution leads to moral hazard and opportunistic lending,
c) Weak governance creates ambiguity between CGFs' financial and social objectives, and under-qualified management staff encumbers the achievement of operational efficiency,
d) Limited scale and heavy overhead leads to poor cost efficiency and unsustainable operations,
e) Prudential regulation and supervision should be in place to guide CGF institutional and market development.

Another important challenge, for CGFs that seek to promote inclusive finance, is to pursue and achieve sustainability without losing sight of the target of disadvantaged groups.

2 Spectrum of CGFs in China

2.1 Brief History, Current Status and Legal Framework

Brief history. Credit guarantee funds emerged in China in the early 1990s, when the development of private SMEs encountered the bottleneck of difficult credit access. In 1992, SME umbrella associations in Chongqing, Shanghai and Guangdong successfully lobbied their local governments to obtain policy and financial support for establishing their own mutual guarantee funds.[3] This marked the beginning of CGFs and its mainstreaming in support to SMEs in China. It took the country about 10 years to pilot different options of the model. Three models prevail: the policy CGF, the mutual CGF and the commercial CGF. For nearly 20 years, the Government has strongly supported policy intervention through established CGFs. The creation of CGFs in China was intended to support the segment of SMEs that was disadvantaged in terms of credit access and funding structure compared to large state-owned enterprises (SOEs). This policy predilection was further incorporated into the operational functions of established SME CGFs in order to inclusively target other financially disadvantaged groups, such as laid-off workers and the unemployed, start-up microenterprises, women entrepreneurs and rural SMEs.

3. *Inspired by the EU mutual guarantee association (MGA), in which guarantee holders or beneficiaries are all members of a trade association. The members contribute to to a fund that offers a guarantee.*

Snapshot of performance. As of end 2009, 5,547 CGFs were recorded with CNY 338.9 billion as registered capital providing credit guarantees to 370,000 SMEs amounting to CNY 1,079.6 billion.[4] CGF credit guarantee service covered 7.5% of the banks' total SME credit portfolio in the country in 2009 and 21.4% of the new disbursements during the period.

In 2009, the 5,547 CGFs recorded total revenues of CNY 18 billion, a net profit of CNY 4.45 billion, and a tax contribution of CNY 1.64 billion. 5,938 claims were recorded for a total amount of CNY 2.98 billion, or 0.27% of the annual coverage. The actual claimed amount was reduced to CNY 520 million after recovery, or 0.05% of the annual coverage only.

However, mixed results keep being reported, with problems of deviation of main business scope, as well as uneven risk management and internal control. CBRC analysis indicates an average effective multiplier rate of 2.6 only among CGFs in 2010, which is far from the 8 to 10 multiplier reported by the CGFs themselves. Meanwhile, overall profitability is largely the consequence of the good results achieved by the commercial and mutual CGFs; policy CGFs tend to operate at a loss and substantially live on government subsidies.

Table 1: Snapshot of SME CGF Operations in China, 2009

Year 2009, in CNY	
# of CGFs	5,547
Registered capital	338.9 billion
SME guarantee holders	370,000
Guaranteed SME credit portfolio	1,079.6 billion
Sales revenues	18 billion
Tax contribution	1.64 billion
Number of claims	5,938
Amount claimed	2.98 billion
Losses	520 million
Net profits	4.45 billion

Foreign involvement. In addition to the ILO's and DFID's TA projects in support of inclusive CGFs described further below, a number of foreign financial corporations have invested in the credit guarantee business in China. Singapore-based Temasek registered its Fullerton Investment & Credit Guarantee Co. Ltd. in 2008 in Nanjing. It operates in the SME credit guarantee sector, building business alliances with local branches of the Bank of China. Fullerton charges an average 3% commission and it has reportedly become profitable after two years of operations.

Another significant example of foreign investment is the case of Zhenzhen Credit Orienwise Group which is known as the first comprehensive non-governmental corporation in the business of guarantees, investment and consulting. The Group has attracted investments worth USD 100 million from a number of foreign investors, including ADB, Carlyle, Citigroup and GE. The Group's credit guarantee branch extends its cover to SMEs and banks in the Pearls River Delta region.

Increasing Government interest in involving foreign investors in the commercial credit guarantee business has been reported recently. The NDRC has taken the lead in preparing the establishment of a foreign capital funded SME guarantee company. Preparatory work has involved both domestic and international stakeholders, such as ADB, IFC, KKR China, and a number of domestic guarantee companies and FIs. Preparations for company establishment have entered the implementation phase. A number of domestic FIs, private enterprises and local governments have expressed their interest in investing in or cooperating with the future company. ADB and IFC have reportedly expressed their intention to invest at an early stage. JP Morgan Chase has also reportedly been invited to invest USD300 million in this new guarantee company. A business plan seems to have been submitted and is under appraisal by NDRC and other major stakeholders.

Milestones in the development of the legal framework. "The 'PRC Guarantee Law' approved in 1995 forms the core legal basis for the guarantee sector in China. However, it does not put emphasis on the regulating of guarantee institutions."[5] Until recently, policies and guidelines issued by different ministries surrounding the development of CGFs "have related mostly to policy CGFs and their scope for application tends to be limited and partial."[6] **Table 2** on Page 36 summarises the key regulatory documents constituting the CGF policy framework.

Note that in accordance with the central government agencies' circulars and guidelines, local governments have mostly issued their own more detailed guidelines regarding guaranteed lending to SMEs or CGF operations. Similarly, regarding the targeting of disadvantaged groups such as LOWs and rural women entrepreneurs, instructions are jointly issued by the central leading agencies in charge of such social groups, and the related financial or banking regulators such as MOF, CBRC and PBC. Examples can be cited for the case of the *Circular on Further Promoting Guaranteed Microcredit to LOWs*, and the *Circular on Improving the Policy on Finance-Subsidized Guaranteed Microcredit in Support of Women Entrepreneurship and Employment*. The first circular was issued jointly by PBC, MOF and MOLSS in order to instruct the SME CGFs to extend their operational coverage to LOWs, the second by MOF, MOLSS, PBC and the All China Women Federation.

An inter-ministerial joint council was established in 2009 in search of prudential supervision for CGFs. The council is headed by the CBRC and composed of other related agencies such as NDRC, MIIT, MOF, MOFCOM, PBC, SAIC and Legislative Affairs of the State Council. In 2010, *Interim Measures on Administering Financial Guarantee Companies* were released to redefine market entry conditions for guarantee companies, and regulate the latter's business scope. While those interim measures were issued for regulating the corporate conduct of the commercial guarantee companies, they are seen as applicable to the mutual CGFs also. An ongoing survey on the development and performance of CGFs launched by CBRC suggests that systematic prudential supervision is on the regulators' agenda.

4. *Based on reports and speeches of senior officials of the Ministry of Industry and Information Technology in December 2009.*

5. *Wang Tiejun, 28 financing Models for SMEs in China, 2006.*
6. *Ibidem.*

Table 2: Key Laws and Regulatory Guidelines of the CGF Policy Framework

Laws and regulations	Effectiveness	Milestones
PRC Law on Credit Guarantees (Congress)	June 1995	Core basis of the CGF legal framework
Policy Guidance on Encouraging and Supporting SME Development	October 1998	Official promotion of policy CGFs targeting SMEs
Guidance on Piloting a SME Credit Guarantee System (SETC)	September 1999	Policy guidance for SME CGF model piloting and guarantee focus on banks' short-term loans for SMEs
PRC Law Promoting SMEs	2002	Governments' roles in establishing local SME CGFs
Decision on Reforming the Investment System (State Council)	July 2004	Diversified investments and business scope for CGFs
Notions on Supporting and Facilitating the Development of Private and Non-State Sector (State Council)	February 2005	Opening up for private investments in CGFs
Guidance for Banks Lending to Small Enterprises (PBC and CBRC)	July 2005	Policy support in favour of eased access to bank loans for SMEs
Circular on Strengthening Employment and Re-Employment (Guo Fa #36, 2005)	November 2005	Viewed as instrumental to the SME CGF's inclusive targeting for the disadvantaged groups of LOWs and the unemployed
Guidance on Strengthening the SME Credit Guarantee System (NDRC, MOF, PBC & Tax Bureau)	2006	Preferential policies in business tax exemption; base premium rate set at 50% of bank base rate, with a band of 30–50%
Notions on Further Promoting SME Development (State Council)	Sept. 2009	Funding of CGFs from central and local finances, corporate investments and non-governmental sources
Notions on Strengthening the SME Credit Guarantee System (MIIT)	May 2010	Promoting SME credits re-guarantees. Emphasis on SME credit re-guarantee funds at the provincial level
Interim Measures on Administering Financial Guarantee Companies	2010	Prudential supervision and regulation on institutional conduct of commercial CGFs

2.2 Organizational Models

CGFs can be classified by business scope into three categories in China: policy CGFs, mutual CGFs and commercial CGFs. They are registered under the organizational forms of company, public institution[7] (*Shi Ye Dan Wei*) or social organization.[8]

The Chinese guarantee system is largely inspired by the Japanese experience; its development was built on the "SOE Restructuring and Enterprise Development Project (SOERED)" and the "ILO/Japan Inter-Country Project on Strategic Approaches toward Employment Promotion, Phase II," respectively piloted by DFID and ILO in China during the early 2000s. Policy and mutual CGFs could be seen as the result of replication from SORED and PEP Phase II.

Policy guarantee institutions are the leading model of the current CGF system, at least in terms of number of operating institutions. They are the policy institutions directly supported by the government to assist SME development. Policy guarantee institutions are mostly registered as independent legal persons, under the organizational forms of company, public institution (*Shiye Danwei*) or social organization. They operate openly for non-profit purposes under the government's direct supervision as non-financial institutions.

Policy guarantee institutions have mainly been funded by government budget allocations or state-owned assets attribution. Local departments and agencies under MOFCOM, MOF and state-owned banks are the primary financial contributors to the policy CGFs.

Policy guarantee institutions primarily target local existing SMEs, especially those that are in the stages of middle or later growth and maturity. While the service is gradually being expanded to private SMEs, state-owned SMEs under the local government's direct support programme constitute the core segment. Start-up micro and small enterprises are not targeted and former SOE LOWs who have registered a small venture remain a very insignificant part both in terms of number and portfolio.

Mutual guarantee institutions have been created by industrial and sector stakeholders in response to difficult credit access from the banking sector. They are mostly registered as independent legal persons under the forms of public institution (*Shiye Danwei*) or social organization for non-profit purposes, with their business scope limited to member SMEs under special agreement with the local government.

Mutual guarantee institutions are mainly funded by contributions from local industrial and commercial federations, private enterprise umbrella associations, SME membership and local governments.

Mutual CGFs tend to be self-governed and disciplined with conscious risk management. They focus exclusively on providing SME credit guarantees to their members. Portfolio diversification is assured by sector allocation among members; guarantees for progressively larger loans to repeat borrower are considered the primary way of ensuring steady growth and performance.

7. *Roughly translated as "institutional unit" defined in the regulations as "social service organizations, established for the purposes of social welfare by state agencies or other organizations, funded from state resources and undertaking activities such as education, science and technology, culture, health, etc."*
8. *Social organization means voluntary group formed by Chinese citizens in order to realize a shared objective, according to their rules, and to develop non-profit making activities. All groups other than state organs may join social organizations as institutional members (Regulations for Registration and Management of Social Organizations, PRC State Council Order #250).*

Commercial guarantee institutions were created in the 1990s with public investments, as an alternative to the prevailing policy CGF model. They are mostly registered as independent legal persons under the organizational form of company, and operate openly for profit. Commercial CGFs are mainly funded by government or para-governmental investments, state-owned assets attribution and investments from the state-owned and private corporate sector.

Commercial CGFs' business scope tends to be more diversified according to their institutional market positioning, usually covering SME credit guarantees, asset valuation and management services that are closely related to the guarantee business. Commercial guarantee institutions target successful local SMEs, especially those that are in need of medium-term growth and short-term working capital.

Re-guarantees have started to take shape from 2008, with several re-guarantee companies established in the economically better-off regions where the commercial guarantee sector performs well. Re-guarantee companies receive considerable backing from public funding. The Government has recently showed interest in further developing the re-guarantee sector and is considering foreign investments in this regard.

2.3 Linkage with Governments and Other Financial Intermediaries

If government direct funding has been steadily increased since the beginning of CGF development in China, its weight in CGF finances and the total guarantee capital has been reduced, thanks to the increasing participation of non-state investors. However, government involvement remains very much present, either through direct and indirect investments in guarantee institutions from governments of different levels, or through the latter's *de facto* regulatory functions, which to some extent control CGFs' business scope and management orientation.

Table 3: Comparison of Government Financing Between 2004 and 2009

	2009	2004
Total CGFs recorded	5,547	2,188
Number of government-financed CGFs	1,501	2,188
Percentage of CGFs supported by gov. financing	27%	100%
Total guarantee fund capital in CNY	338.9 billion	66.7 billion
Government contributed portfolio in amount in CNY	86.6 billion	19.3 billion
Government contributed portfolio in percentage	25.5%	29%

The NDRC is responsible for policy formulation, national planning, development and approval of new programmes including those related to CGF development. It took the lead in overall CGF development with its department of SMEs, which was spun off to be currently placed under MIIT.

The MOF acts as the state financier and it carries out its functions of budget allocation and overall financial management related to policy CGF. Its functions are assumed by its vertical structure of departments and bureaux of finance at provincial, prefecture and county levels.

The PBC and the CBRC act as regulatory agencies in the financial sector and they support the piloting of innovative financial services in the country, undertaking steps in gradually formulating a prudential supervisory framework.

Different ministries and agencies take the lead in sponsoring the creation of policy CGFs for the specific social groups under their patronage. Presently, MOFCOM, MOLSS and WF are involved in the development of CGFs that target SMEs, laid-off workers, and women entrepreneurs. The structures of SAIC and MCA act at different administrative levels for CGF registration.

CGFs primarily work with local banks under partnerships sponsored by local governments. Typical agreement of cooperation lasts for 1–3 years renewable. Involvement of national banks tends to be very limited, mainly due to their lack of interest in marginal market segments and the rigidity of their highly centralized decision-making structure.

Regulatory framework. Until April 2003, China's financial sector was headed by the Central Bank, the People's Bank of China (PBC). Under the direction of the State Council, PBC's task has been limited to the formulation and implementation of monetary policies to maintain the stability of the currency and to promote economic growth. The banking supervision function of PBC was handed over officially to a new banking regulatory body: the China Banking Regulatory Commission (CBRC). The paramount goal of this landmark reform was to improve the efficiency of bank supervision.

PBC has been instrumental in many innovations related to the financial sector, which are being tested on a pilot scale. Based on the established capacities in banking research and management training that it inherited from the time before the split with CBRC, PBC continues to be involved as sponsor, facilitator or researcher in areas related to FI innovation, regulation and supervision.

CBRC is expected to introduce innovations in the areas of regulatory methodology, systems and technologies to modernize financial supervision and to render it more professional. CBRC has established a number of supervision departments for banking institutions of different categories; its department of commercial guarantee business takes the lead in regulating and supervising the commercial CGFs.

Note that in principle, CGFs of all types should be subject to the regulatory and supervisory authority of the CBRC. Presently, CBRC tends to exercise its functions more on the commercial CGFs and policy and mutual CGFs primarily report to their sponsoring ministries or local governments. There is however strong indication that CGFs of all types will undergo a process of registration or even relicensing before being mainstreamed under the formal regulatory framework of CBRC.

2.4 Disadvantaged Market Segments and Their Financing Needs

In this paper, disadvantaged market segments or groups mean the social groups of people that are vulnerable or marginalized in the formal financial market. They include farmers, urban laid-off workers and the unemployed, women and especially rural women, rural and urban micro-entrepreneurs, school graduates from poor families and other socio-economically vulnerable population segments. Little is known about their financing needs in the fields of income-generation and entrepreneurship.

Credit institutions advance a number of primary reasons for their reluctance to extend credit to the disadvantaged groups, which can be summarized as:

a) Poor cost-efficiency for small-scale lending to marginalized segments,
b) Asymmetric information on the applicants,
c) High risk perception,
d) Lack of material collateral whose value is recognizable by lenders.

In simplistic terms, financing needs can be classified into four areas by stages of entrepreneurship or income generation, as demonstrated in **Table 4**.

Table 4: Financing Needs by Causes

	Stages of entrepreneurship development and needs for financing			
Financing causes	**Start-up**	**Growth**	**Maturity**	**Decline**
Seasonable sales peaks	Low	High	Medium	Low
Long term sales growth	Medium	High	High	Low
Inventory turnover slowdown	High	High	Medium	High
Receivables collection slowdown	High	Medium	Medium	Medium
Fixed asset replacement	Low	Low	High	Medium
Expansion of fixed assets	Low	High	High	Low
Expenditures for other assets	High	Low	Low	Low
Restructuring liabilities	Low	Low	Low	High
New market penetration	High	High	Medium	Low
Innovation financing	Medium	Medium	High	High
Access to new tech and know-how	Medium	Low	High	Low
Unprofitable or marginally profitable operations	Medium	Low	Low	High
Dividend payments or return of owner's capital	Low	Low	Medium	High
Extraordinary or unexpected expenses	High	High	Medium	Medium

3 Management, Operations and Performance of CGFs Visited

This section provides an assessment of five CGFs visited in March 2011, and serves primarily to get a more in-depth understanding of some of the issues surrounding CGFs. The selection of CGFs is based on the possibility to arrange visits within a limited time frame. In principle, three CGFs in Xinjiang were visited to help understand the state of operations under the strong leadership of local governments, a CGF in Guangxi under the dynamics of the local bureau of finance, and a CGF in Tianjin as a successful replication from donor-assisted projects and in good collaboration with local banking institutions.

The selection of CGFs does not permit generalized conclusions. CGFs in different cities are operating under specific circumstances with various degrees of policy intervention and market efficiency. Among the five CGFs visited in Xinjiang, Tianjin and Guangxi, only one should be classified as a genuine corporate CGF with well defined commercial orientation; the other four belong to the category of policy CGFs. Operational efficiency and institutional dynamics vary, sensibly depending on the political will of the local government or the sponsoring agency. There is no ready-to-replicate case in this snapshot assessment; some findings are however indicative for future support and development in inclusive finance in China.

3.1 Institutional Set-Up and Linkage with Government

Four CGFs were registered with the local bureau of SAIC as independent legal persons under the form of public institution, while Longzhou CGF in Guangxi was set up by county government circular and it is considered part of the local BOF. In three registered CGFs, a board of directors was appointed by the local government, representing different interest groups such as the local bureaux of finance, industry and information technology, commerce, or state-owned assets supervision and administration commission (SASAC). The board's main functions included hiring and overseeing the general manager, reporting to shareholders or sponsor stakeholders, formulating institutional policies and strategic development plans, approving the annual budget and work plan submitted by the management, and approving changes in funding structure and sources. Most of the board members had senior management experience. Among the three registered CGFs with a board, only one had an executive committee set up by the board to work more closely with the management; others relied on the board's president to provide regular guidance between the intervals of board meetings with the general manager. The exception was Fukang CGF in Xinjiang, which was incorporated with 100% capital from eight private investors, who themselves constituted the board that hired the management staff. The status of independent legal person does not seem to automatically lead to basic institutional governance and self-sufficiency. Except Fukang CGF which is fully funded by private capital, the other four CGFs, registered or not, operate in a way similar to any other government bureau—following the top-down social political guidance from their sponsoring agencies.

It is worth mentioning that the policy CGFs visited appear to be replication of the models introduced by the SORED and PEP Phase II pilots. However, their lineal affinity with the government tends to be higher than their reference models, which somehow succeeded in gaining some managerial and operational autonomy at the end of the piloting phase.

3.2 Partnership with Financial Intermediaries

All the CGFs visited cooperate with the local commercial banks or RCC network only. The latter were instructed to be involved in such cooperation by the local governments, which are more able to execute administrative pressure on the local FIs than the national banks. Agreements usually stipulate obligations and duties of the CGF and the FI, but commonly with cost and risk taking are placed one-sidedly on the shoulders of the CGF, with some examples as follows:

a) The CGF is mainly responsible for operations related to the guarantee and for monitoring and collection of the loans, while the FI's responsibility is mainly limited to credit disbursement and legal procedures of the loan;

b) The CGF *de facto* assumes the full risk of losses, even where clauses mention operational loss sharing of 20–30% by the FI;

c) The CGF needs to undertake all the steps of credit screening and investigation. The FI also undertakes a parallel or follow-up investigation and the loan approval is subject to the FI's independent decision.

d) The CGF undertakes all the efforts and assumes all the costs of loan monitoring and collection after disbursement; the FI's action is limited to procedural or legal notification to the borrowers;

e) If overdues persist over a certain period of time, the FI will proceed to claiming the guarantee from the CGF; it can directly deduct the claimed overdue amount from the CGF deposit in its branch.

A couple of FIs show moderate interest in institutional marketing for guaranteed loans to disadvantaged groups; all of them give priority to avoiding the acceptance of operational costs and associated risks in their cooperation with local CGFs. Most of the cooperating banks were reported to reduce their portfolio under the guarantee framework to a symbolic level, as soon as the CGFs tried to share some risk responsibility from their originally set 100% coverage. Cooperating FIs also face an issue of opportunity cost when their funds are used in policy lending to disadvantaged segments. As long as other market segments with higher profitability are not saturated, there is no business incentive to lend to segments that are perceived to be of higher risk and that are less known. It does not matter how high the interest subsidies are, because they would never compensate for the possible losses of loan capital in the case of default. In all the areas visited, CGF-guaranteed lending represents less than 1% of the cooperating FIs' overall portfolio. There is no evidence of developing tailor-made loan and guarantee products in line with financing needs and risk patterns of the target groups.

3.3 Guarantee Mechanism

All the CGFs visited have adopted the operational mechanism of individual guarantee. Direct agreement is reached between the guaranteed borrower, the CGF and the FI. After creditworthiness screening, the CGF recommends the candidate borrower to the FI with a proposed guarantee scheme, of which the overall framework has been agreed upon under the patronage of the local government. The FI undertakes its own credit assessment and if positive, the loan is contracted to the guaranteed borrower under the FI's normal lending terms and in conformity with the agreed risk sharing and multiplier rate between the CGF and the FI.

Occasionally, the FI proposes to the CGF some candidate borrowers whose first sources of repayment are acceptable but whose second and third sources of repayments are unknown to the FI. This is reported by Tianjin SME CGF Centre, which is among the first CGFs established in the 1990s and which has built a long-term cooperation with several FIs.

At a certain point, there was an intention to negotiate a portfolio guarantee in Tianjin, but cooperating banks expressed their reluctance. Both banks and the CGF seem to have had a lack of technical know-how on how to undertake in-depth and substantive negotiations in this regard.

3.4 Targeting and Eligibility

Except in the case of Fukang CGF in Xinjiang, which targets well-established SMEs, the CGFs visited and their cooperating FIs had usually reached agreement on a specific target group, such as LOWs, the unemployed or rural women entrepreneurs. The four policy CGFs visited reported that over 70% of their total portfolio had been granted to the agreed target groups, in terms of amount and number of loans disbursed. Clarifications and field observations found some variation but overall, the targeting issue had been addressed. The remaining minority percentage related mostly to local SMEs in the growth phase.

Formal business registration appears to be one of the conditions of eligibility. This makes the portfolio coverage of informal micro-enterprises very sporadic, if not non-existent. Start-up micro-entrepreneurs of former LOWs or urban and rural women are reported to constitute less than 5% of the overall portfolio for all the five CGFs visited, regardless of their business registration status.

3.5 Access by Disadvantaged Market Segments

Data reported by the four policy CGFs do not indicate conclusive trends in the area of increasing disadvantaged groups' access to financial services. They indicate however that policy CGFs' contribution to increased access remains insignificant. CGFs with a large portfolio such as Tianjin's expose a minority percentage of its total portfolio to the supposedly prime target group. The small scale CGFs show a high percentage of exposure but are very insignificant in terms of the number of guaranteed loans disbursed. CGFs pay a lot of attention to targeting in their communications in order to access government programme funding, but actual market penetration and growth show that implementation remains questionable (**Table 5**).

Table 5: Disadvantaged Groups' Share in Guaranteed Lending

Average outstanding portfolio, 2010, in CNY	Fukang MCGF, Xinjiang	Hutubi CGF, Xinjiang	Manasi Honye CGF Co. Ltd, Xinjiang	Tianjin SME CGF Centre, Tianjin	Longzhou MCGF Centre, Guangxi
Outstanding loan amounts guaranteed	47,000,000	2,100,000	12,200,000	730,000,000	250,000
# of guaranteed loans outstanding	18	81	251	2,500	28
Disadvantaged segment % share in amount	0%	70%	80%	15%	100%
Disadvantaged segment % share in number of loans	0%	80%	70%	3%	100%

Table 6: Selected Performance Indicators of Visited CGFs

2010, in CNY	Fukang MCGF, Xinjiang	Hutubi CGF, Xinjiang	Manasi Honye CGF Co. Ltd, Xinjiang	Tianjin SME CGF Centre, Tianjin	Longzhou MCGF Centre, Guangxi
Average performing assets	19,500,000	2,100,000	2,000,000	100,000,000	580,000
Average loan size guaranteed	2,611,000	25,900	48,000	292,000	8,900
Fee rate reported	2.0–4.0%	2.0%	1.0–2.0%	1.98%	0%
Financial income	1,300,000	42,000	33,000	8,000,000	6,000
Adjusted operating expenses including salaries	500,000	67,000	28,500	5,038,400	82,400
Amounts guaranteed	47,000,000	2,100,000	12,200,000	730,000,000	250,000
# of guaranteed loans disbursed	18	81	251	2500	28
# of CGF active officers	6	5	5	12	7
Reported multiplier	2.0	5.0	6.0	8.0	1.0
Multiplier	2.4	1.0	6.1	7.3	0.4
Risk sharing	100%	100%	100%	100%	100%
Claim rate	0%	0%	1%	1%	6.5%
Loan loss provision in place	Non	Yes	Non	Yes	Non
Operating efficiency					
Operating cost ratio	2.50%	2.91%	1.43%	4.99%	13.29%
Cost per unit of money guaranteed	1.06%	3.19%	0.23%	0.69%	32.96%
Cost per loan guaranteed	27,778	827	114	2,015	2,943
# of loans guaranteed per active CGF officer	3.00	16.20	50.20	208.33	4.00
Portfolio per active CGF officer	7,833,333	420,000	2,440,000	60,833,333	35,714
Overall financial performance					
Return on average performing assets	6.67%	2.00%	1.65%	8.00%	1.03%
Financial self-sufficiency	260.00%	62.69%	115.79%	158.78%	7.28%

There is no evidence of tailor-made loan products from the cooperating FIs in order to better target the disadvantaged groups under the guarantee scheme. On the contrary, CGF procedures appear more like an enlarged copy of the government guidelines, with little managerial and operational details built on the financial aspects of a normal guarantee fund.

3.6 Operational and Financial Performance

Due to the incompleteness of data, only data of 2010 are used to provide a snapshot of performance of the CGFs visited. Nevertheless, it should be noted that all five reported a stable state of performance over the last three years, with little fluctuation in trends.

Operating efficiency. The operating cost ratio[9] does not really reflect true efficiency, as CGFs do not account for some expenses such as office overhead and travel spending, which are partly absorbed by the government sponsoring bureau. Some CGFs visited reported an operating cost ratio ranging between 6–8%, sometimes higher than the return ratio. This reflects the general situation of heavy office overhead and operational spending due to the fact that CGFs cover the full costs of loan appraisal, monitoring and recovery. This should coincide with an improved operating cost ratio on the side of the financial institution.

Operating efficiency is low by any available standards, indicating that current CGF management has little notion of managing the CGF. In Hutubi county of Xinjiang and Longzhou county of Guangxi, cooperating FIs tend to be most concerned about their transaction costs and reducing their involvement in all stages of loan operation and management.

9. *Operating expenses/CGF average performing assets.*

This leads directly to an increase in operating expenses on the side of the CGF, which translates into a large denominator that eliminates any gains in financial income.

Efficiency expressed in cost per unit of money guaranteed and disbursed[10] is not comparable to any available benchmark; cost per loan guaranteed[11] is definitely high except for the CGF in Hamasi county of Xinjiang. Staff productivity expressed in number of loans per active CGF officer[12] does not appear high by any standards, ranging from the pathetic 3 to the insufficient 208.

CGFs in Fukang county of Xinjiang and in Tianjin show some signs of operational viability through their ratio of portfolio per active CGF officer,[13] while the others remain vulnerable with a portfolio that generates insufficient revenue to compensate for the costs of staff.

Overall financial performance. The return on performing assets[14] of Fukang CGF in Xinjiang and Tianjin CGF Centre shows a reasonable rate close to the median rate of 7-8% among policy CGFs of five years or older. The remaining three CGFs show a return that is significantly lower; this is mainly due to their relatively small portfolio and low fee rates.

Figures for financial self-sufficiency[15] suggest that three of the five CGFs are able to cover their assumed costs of operations plus their financial expenses and loan loss provisions with internally generated income.

10. *Operating cost/Total amount disbursed.*
11. *Operating cost/# of loans made.*
12. *# of loans guaranteed and disbursed/# of CGF active officers.*
13. *Total amount disbursed/# of CGF active officers.*
14. *Financial income/CGF average performing assets.*
15. *Financial income/(financial and operating costs + loss provision).*

3.7 Summary of Key Findings

Credit access for disadvantaged groups may not necessarily be improved through established policy CGFs, even though these are supported by strong political will and public funding. The snapshot given through the basic ratios described above may not tell exactly how well the CGFs visited perform, it however raises some red flags regarding the lack of knowledge and competence in financial and operational management among CGFs. All the CGFs visited rely on narrative records and reports; they showed some difficulties in adequately reporting their performance over a specific period of time and in the form of financial statements. In addition, liquidity management does not seem to have caught CGF managers' attention and there is no evidence of maintaining an adequate level of liquidity in relationship with the operational inflows and outflows. Portfolio growth strategy tends to rely heavily on governments' new fund injections.

4 Conclusions and Recommendations

Conclusions

Credit Guarantee Funds (CGFs) are a popular instrument for promoting inclusive finance in developing countries. While some are successful in increasing access to credit, numerous CGFs struggle to achieve sustainability. Lessons learnt revolve around the need for good governance and for sound sharing of responsibilities and risk between the fund and the credit institution.

Credit guarantee funds emerged in China in the early 1990s, and there are currently 5,547 registered CGFs. The Chinese guarantee system has been largely inspired by the Japanese experience. Its development was consistently supported by the Government; it was built on ILO and DFID pilot projects and supported by other donor agencies.

CGFs in China can be classified into 3 models: policy CGFs, mutual CGFs and commercial CGFs. Policy CGFs are the leading model; they are characterised by a strong government presence in both funding and administration. While all CGFs combined report an overall profit, this is mainly the result of the profits achieved by mutual and commercial CGFs; most policy CGFs operate at a loss and survive as a result of government subsidies.

The creation of CGFs was meant to support disadvantaged SMEs. Policy CGFs have a focus on disadvantaged groups such as laid-off workers and women entrepreneurs. While commercial and mutual CGFs are more profit-driven, some of them have shown a movement toward disadvantaged groups based on corporate social responsibility. However, all CGFs have struggled to serve disadvantaged groups effectively, because they lack the know-how to develop tailor-made products for the prime target groups.

Agreements between Chinese CGFs and credit institutions generally involve some sharing of costs and risks. An assessment of five CGFs in the field suggests that CGF costs are relatively high due to mediocre efficiency, particularly among policy CGFs. It also suggests that in practice CGFs often assume all loan losses.

Despite the low risk of loan loss involved, Chinese CGFs are not leveraging large volumes of loans to disadvantaged SMEs. The effective multiplier, which is considerably less than the reported multiplier, is much lower than in other countries. This may be partly due to the fact that credit institutions do not consider lending to disadvantaged groups attractive, even when supported by a guarantee. Opportunity costs are high in the presence of the attractive market opportunities that are the consequence of economic growth.

The NDRC is responsible for CGF national policy formulation, planning, development and approval of new programs. The MOF acts as the state financier, and different ministries and agencies take the lead in sponsoring the creation of policy CGFs for the specific social groups under their patronage. Presently CBRC exercises its functions mostly on commercial CGFs and policy and mutual CGFs primarily report to their sponsoring ministries or local governments. There is however strong indication that CGFs of all types will be mainstreamed under the formal regulatory framework of CBRC.

A number of foreign investors have invested in commercial CGFs in China, and the Government is increasingly interested in international involvement in their development and growth. A good example is the recent work on the development of a foreign capital funded SME guarantee company under the leadership of NDRC.

Recommendations

Recommendation 1: Regulatory environment. In view of the expansion in the number and size of CGFs in China, regulators should cautiously define a framework that fosters healthy growth with sound risk control. The regulation of for-profit CGFs should not focus on a high entry threshold, but rather create a competitive environment for sustainable growth. Non-profit CGFs should be regulated similarly to policy banks under a specific framework. However, while government intervention may be necessary to overcome market imperfections, care should be taken to minimize market distortion. For example, subsidies to end-users should be avoided.

Recommendation 2: Umbrella federations. The fast growth of CGFs poses challenges for effective supervision by the heavily centralized state authorities. The establishment of provincial federations of CGFs could help to ease the pressure on local state supervisors. The government could delegate some supervisory tasks, such as those involving on-site supervision of internal controls, to these federations.

Recommendation 3: TA for regulatory framework. Ministries struggle to find the right balance between market freedom to ensure efficiency and innovation, and the necessary regulation and supervision to ensure stability. Donor agencies with experience in policy dialogue with the Government could provide assistance in the development of a friendly but prudent regulatory framework for CGFs. Policy dialogue is most effective when combined with and based on support to CGF field experiments at the operational level.

Recommendation 4: Commercial investors. Commercial investors, especially domestic and foreign financial institutions in search of new market opportunities, should work in regions where SME development is diversified and booming. They should work with local lending institutions under a framework that not only shares and reduces costs, but also shares and controls risks. Requests for government support should not focus on funding but rather on stable and healthy policies fostering market competitiveness. Investors should endeavour to serve disadvantaged groups through good market segmentation and the development of tailor-made products.

Recommendation 5: Donors. Donors should work primarily with policy CGFs that embed some objectives of social development groups and commercial and mutual CGFs that

Table 7: Possible Approaches for Supporting the Development of the Credit Guarantee System in China

CGF	Guarantee Policy	Commercial	Mutual	Re-guarantee Policy and commercial
Who	- Policy SME CGFs - Local governments	- Non-state CGFs - Local governments	- Mutual CGFs and local SME associations	- Local re-guarantee companies - Local government
Where	- Tianjin - Shanghai - Anhui - Jilin - Fujian - Shenzhen	- Tianjin - Hainan - Guangdong - Shanghai - Qingdao - Shenzhen	- Sichuan - Guangdong - Shandong - Shenzhen	- Changchun - Beijing - Shenzhen - Guangdong - Shanghai - Jiangsu - Shaanxi
Why	- Steady financial and policy support from local government - Disadvantaged groups identified and supported - Continued cooperation with local banks - Fairly reasonable performance of CGFs - CGF leadership in search of innovation and breakthrough with regard to the bottleneck of development - Possibility of restructuring the organizational form and strengthening governance	- Booming SME sector - Foreign SMEs' target areas with increasing operations - Local banks targeting SME lending - Existence of CGFs of different organizational forms and commercial CGF takes good share of the guarantee market - Commercial CGFs in search of better financial sufficiency and operational efficiency - Commercial CGFs flexible in funding structure - Commercial CGFs looking for innovations - Commercial CGFs looking for diversified funding and investments	- Booming SME sector - Diversified industries formed and pillared by SMEs - Existence of mutual CGFs working with SME associations - Possibility of forming cross-sector mutual CGFs - Local government support - Mutual CGF's interest in innovative products for members	- Booming SME sector - Functional CGFs of different natures widespread - Local government strong interest in and support for re-guarantee structure
How	- Guarantee credit line - Loans	- Equity participation - Mezzanine financing - Loans	- Mezzanine financing - Loans	- Equity participation - Mezzanine financing

show some corporate social responsibility. Their assistance should emphasize the development of an operational model that combines a focus on inclusive finance with financial sustainability. This should involve effective sharing of costs and risks, more efficient managerial and operational procedures, and tailor-made guarantee and loan products. Options for the piloting of this model include the re-engineering of a registered policy CGF, or the creation of an operational module that can be integrated into any kind of CGF.

Recommendation 6: IFC. IFC has worked closely with local banks and the SME community in a number of cities in China and it has proven experience in capacity building for SME financing, on the side of supply as well as demand. It should continue to support improved access to credit for SMES, and to foster a sound credit culture in the business community. Its further technical assistance should consider the development of better banking products and lending techniques for disadvantaged segments of the market.

Recommendation 7: KfW and GIZ. KfW and GIZ have supported a number of initiatives related to inclusive finance in China. They both have built a reliable reputation for technical assistance to financial institutions and a continuous partnership with government agencies of different levels. KfW and GIZ should continue to bring international best practices on techniques for inclusive finance and contribute their knowledge of credit guarantees.

Recommendation 8: Cooperation with Postal Savings Bank (PSB). German technical assistance has successfully helped restructure the Postal Savings Network in China. It is worth building on this institutional partnership and considering a pilot scheme based on a business alliance between selected PSB branches and local policy CGFs.

Recommendation 9: Option for the Agricultural Development Bank of China (ADBC). The Agricultural Development Bank of China has shown increased interest in inclusive finance. There may be an opportunity to leverage the lending capacity of emerging MFIs and RCCs at the grassroots level through a pilot of the intermediary guarantee model.

Possible approaches. The interests of different stakeholders in supporting the development of CGFs in China may vary. Policy CGFs were created to help reach the Government's goal of supporting disadvantaged group policy. Support to those CGFs would need to help them move up to an acceptable level of operational efficiency and financial self-sufficiency. Commercial and mutual CGFs currently mostly target market segments of a higher socio-economic level, but in a competitive market environment they should become the mainstream. The following table provides some indications of possible approaches for stakeholders that wish to support the different types of CGFs. ■

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Experts Interviewed/Consulted

In alphabetical order

Mr. Bian Qingliang, Manager of Small Enterprise Lending, Tianjin Binhai Rural Commercial Bank

Ms. Duan, County Bureau of Finance, Manasi County, Xinjiang

Mr. Ermat, County Bureau of Labour and Social Security in charge of Manasi Hongye Credit Guarantee Fund Co. Ltd., Manasi County, Xinjiang

Ms. Feng Xue, President, Women's Federation, Longzhou County, Guangxi

Mr. Gao, County Bureau of Labour and Social Security, Hutubi County, Xinjiang

Mr. Lai Jinchang, Access to Finance Business Line in China, Chengdu Office, International Finance Corporation (IFC)

Ms. Li Li, President of County Women Federation, Manasi County, Xinjiang

Mr. Li Zhengxuan, Director, County Bureau of Finance in charge of Longzhou Microcredit Guarantee Fund Centre, Longzhou County, Guangxi

Ms. Linda Li Ren, Beijing Office, International Finance Corporation (IFC)

Mr. Liu Bidong, President of Fukang Microcredit Guarantee Co. Ltd., Fukang City, Xinjiang

Mr. Qian Ying, Lead Regional Cooperation Specialist, East Asia Department, Asian Development Bank (ADB)

Mr. Shi Fanghua, Deputy Division Chief, Tianjin Department of Finance

Ms. Song Qingling, President of County Women Federation, Hutubi County, Xinjiang

Ms. Sun, Duying, County Bureau of Finance, in charge of the Hutubi Credit Guarantee Fund, Hutubi County, Xinjiang

Mr. Wang, Director, County RCCU, Manasi County, Xinjiang

Mr. Wang Jun, Lead Financial Sector Specialist and FPD Sector Coordinator of China, The World Bank

Ms. Wang Ying, Financial Sector Specialist, The World Bank Beijing Office

Mr. Yang Dongxiang, Director, Tianjin SME Credit Guarantee Centre

Ms. Zhao Li, County governor, Longzhou County, Guangxi

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