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Sustainable Development of New Rural Finance in China

NIE Yong*

School of Finance and Insurance, Guangxi University of Finance and Economics, Nanning 530003, China

Abstract Rural finance is the weakest link in China's financial system. There are still many problems in the traditional rural finance, such as poor business conditions, imperfectly competitive financial markets, and credit information asymmetry; the phenomenon of farmers' loans difficulty has not been fundamentally changed. In order to improve the current situation of rural finance, the state proposes to develop new rural finance and innovate upon rural financial system. The new rural finance has many good development advantages, such as adequate information, flexible operation, and good potential quality of the assets. It is necessary to innovate upon financial products and services, establish the purpose of serving agriculture, countryside and farmers, strengthen the supervision of credit, and improve the financial infrastructure construction, so as to achieve sustainable developments.

Key words New rural finance, Financial support for agriculture, Sustainable development

The development of modern agriculture, increase in the agricultural yield and farmers' income, and the development of rural economy, is inseparable from the support of rural finance. However, the development of traditional rural finance is confronted with some problems, such as high proportion of non-performing loans, low profitability and imperfect market competition of rural finance. In recent years, rural credit cooperatives, as the main force of rural finance, play a huge role in financial support for agriculture. The state transfers the important task of financial support for agriculture to rural credit cooperatives, but in financial support for agriculture, rural credit cooperatives find it difficult to be fully qualified for the task of financial support for agriculture. Consequently, Central Document No. 1 in 2010 highlighted the need to speed up the cultivation of new rural finance, to resolve the status quo of insufficient rural financial support for agriculture. New rural finance, as the complement to the traditional rural finance, plays an increasingly important role. How to achieve sustainable development of new rural finance, so as not to repeat the mistakes of the traditional rural finance, is the problem urgently to be solved at present.

1 The background and theoretical basis for the development of new rural finance

1.1 The background for the development of new rural finance

1.1.1 The active national policy of financial support for agriculture. Central Document No. 1 in the period 2004 –2010 deployed the reform and development of rural finance and posed

clear requirements (Table 1). The state has profoundly understood the importance of rural finance in the development of modern agriculture and building of a new socialist countryside. Solution to issues concerning agriculture, countryside and farmers is also directly or indirectly dependent on the development and support of rural finance. Therefore, the government has put forth the recommendations for nurturing and developing the rural financial institutions for seven consecutive years. Especially in 2010, the government put great emphasis on accelerating the development of new rural financial institutions^[1]. It can be found that the development of new rural finance is in line with the needs of national policy of financial support for agriculture.

1.1.2 Strong demand for agricultural credit. With the development of modern agriculture in China and building of a new socialist countryside, a lot of credit funds are needed for the circulation of commodities in rural areas, construction of rural roads, housing transformation, rural water conservancy building, and purchase of new large agricultural machinery equipments; technological innovation and upgrade, equipment investment in agricultural industrialization leading enterprises also needs long-term credit support provided by rural finance.

At present, the development of "agriculture, countryside and farmers" in China is facing the shortage of capital, that is, the development of "agriculture, countryside and farmers" encounters constraints of funds, making the development of "agriculture, countryside and farmers" fail to get good financial support, and the phenomenon of farmers' difficulty in getting loans quite common. Experts estimate that in the next 15 years, the building of new socialist rural areas will require each farmer to invest about 1 700 – 4 900 yuan on the average; if calculating based on 800 million farmers, the funding gap of new rural construction will be 1 360 billion to 3 920 billion yuan^[1], thereby demonstrating the strong demand for credit.

1.1.3 Insufficient supply of agricultural credit. After 1997, due

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* Corresponding author. E-mail: nieyong966@yahoo.com.cn

to the business shrinking of rural policy financial institutions, state-owned commercial banks withdrew from the county-level scope of business, and "credit only, non deposit taking" of postal savings also led to the outflow of rural funds. At the same time, some of the rural financial institutions choose the urban clients but abandon the rural clients, changing the purpose of serving "agriculture, countryside and farmers", so that the existing rural financial institutions' ability to support agriculture is not equal to their ambition. The main formal financial institution that can provide micro-credit services in rural areas at present is rural credit cooperative, which has a de facto monopoly position^[2]. According to the viewpoint of economics, the monopoly will inevitably lead to a decline in efficiency of the service. Statistics show that during the Tenth Five-Year Plan

period, the network and personnel of banking financial institutions in the county decreased by 24% and 14%, respectively; 2 868 towns in China had no financial institution; 2 counties and 8 901 towns had only 1 financial institution; the situation was particularly serious in the western region, where 2 645 towns had no financial institution, accounting for 80% of towns with no financial institution in China^[3]. In terms of rural financial supply, rural credit cooperatives are completely relied upon to support agriculture, which cannot prop up a tottering building. Therefore, it is necessary to reverse the mentality "relying on an only child", and foster the atmosphere of "many children competing each other", to develop new rural financial institutions^[2].

Table 1 The content of Central Document No. 1 on rural finance in the period 2004 – 2010

Year	Main content of Central Document No. 1 on rural finance
2004	Under the premise of strictly supervising and effectively preventing financial risks, encouraging the areas with conditions to attract social capital and foreign capital, actively set up the financial organizations with various kinds of ownership directly providing services for agriculture, countryside and farmers.
2005	The areas with certain conditions can explore the establishment of micro-credit organizations closer to the needs of farmers and rural areas, initiated by natural person or enterprises.
2006	Vigorously cultivating micro-lending organizations initiated by natural person, corporation or association.
2007	Taking the lead to carry out the pilot project of rural financial organizations with various kinds of ownership the poverty-stricken areas.
2008	Actively cultivating micro-credit organizations, encouraging the development of credit loans and guaranteed loans, to solve the problem of insufficient capital sources in some rural credit cooperatives and new rural financial institutions.
2009	Encouraging and supporting the financial institutions to innovate upon rural financial products and financial services, vigorously developing the micro-credit and micro-finance services, to enhance the capacity of rural financial services.
2010	Improving the quality and level of rural financial services, accelerating the development of the village banks, loans companies, rural credit union, and other new financial organizations.

Data source: Annual Central Document No. 1.

1.2 The theoretical basis for the development of new rural finance

1.2.1 Theory of financial deepening. Ronald·I·McKinnon^[4] and Edward·S·Shaw^[5] conduct in-depth exploration of the monetary, financial theories, policies and institutions the developing countries should take. They believe that governments of the developing countries have implemented the policy of excessive intervention or control on finance, so that interest rates can not correctly reflect the characteristics of "capital shortage, supply of funds falls short of demand for funds" in developing countries. At the same time, the nominal interest rate can not really reflect the scarcity of capital, so that real interest rates are often negative. They argue that the state should give up excessive administrative intervention in financial system and financial markets, and expand the scale and capacity of the financial system. Easing financial control aims to develop and regulate new rural finance, diversifying the financial institution system in rural areas, to achieve virtuous competition.

1.2.2 Theory of rural financial market. Traditional rural financial theory suggests that rural residents, especially the poorer classes, have no ability to save; the rural areas face the problem of insufficient funds. Therefore, to enhance agricultural production and alleviate rural poverty, it is necessary to inject policy funds outside the countryside, and establish non-profit specialized financial institutions for the allocation of funds. Since the 1980s, the rural financial market theory has gradually

occupied a dominant position. The theory believes that rural residents, and the poorer classes, have ability to save, and there is no need to inject funds from outside rural areas; low interest rates hinder the people to make deposits in financial institutions, also inhibit financial development. According to the rural financial market theory, market-oriented reform of rural finance is regarded as the key to the development of rural finance, such as accelerating the pace of market-oriented reform of interest rate, and constructing the pilot project of rural micro-finance institutions^[6].

1.2.3 Theory of development economics. Theory of development economics believes that the main factors influencing economic growth include capital input, labor input and management, input of technology, education and other factors. Lewis^[7], Ranis, Fei Jinghan^[8] assert that the agricultural sector of developing countries is able to provide abundant and cheap labor forces for the expansion of the industrial sector; the problem of surplus labor prevails in rural areas.

From the current situation of China's rural areas, there are also surplus labor forces, therefore, the labor input plays a tiny role in promoting the growth of China's rural economy. The input of integrated factors, such as institutional innovation and technology development, are inseparable from the support of the capital. American development economist Nurkse^[9] advances the famous theory "vicious cycle of poverty", who believes that in developing countries' money supply, there is a vi-

cious cycle " low – income → low ability to save → low capital formation → low productivity → low output → low income ". The supply constraints of capital hinder the economic growth in developing countries, so in order to break the vicious cycle, it is necessary to increase large-scale investment to accelerate capital formation.

2 The problems in China's traditional rural finance

Relative to the new rural finance, the traditional rural finance mainly includes rural credit cooperatives, rural cooperative banks, the agricultural bank, agricultural development bank and postal savings bank. Rural credit cooperatives and rural cooperative banks transformed from rural credit cooperatives

are the main force of rural finance. Therefore, in order to facilitate research, I choose rural credit cooperatives as the sample, to analyze the main problems faced by the traditional rural finance in financial support for agriculture.

2.1 Large proportion of non-performing loans An important indicator for measuring the level of risk of financial institutions is non-performing loans ratio. According to the statistical caliber of non-performing loans, Table 2 provides the non-performing loans balance and non-performing loans ratio of rural credit cooperatives in the period 2002 – 2010. From the table, we can find that non-performing loans ratio of rural credit cooperatives tends to decline year by year, but non-performing loans ratio is still far higher than that of China's top five commercial banks (Table 3).

Table 2 Non-performing loans in China's rural credit cooperatives in the period 2002 – 2010

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total loans // 10 ⁸ yuan	13 938	16 977	19 238	22 354	26 236	31 321	37 229	4716	5684
non-performing loans // 10 ⁸ yuan	5 147	5 020	4 444	3 308	3 033	2 913	2 941	3490	3183
Proportion // %	36.93	29.57	23.10	14.80	11.56	9.3	7.9	7.4	5.6

Data source: Relevant data from *China Monetary Policy Implementation Report* and *China Financial Yearbook* in the period 2002 – 2010.

Note: (i) The data for 2003 are the data at the end of November; other data are the data at the end of December. (ii) Non-performing loans in the period 2002 – 2006 are based on the caliber of " pass, overdue, idle & bad loans "; non-performing loans in the period 2007 – 2008 are based on the caliber of " five-class classification of loans "; non-performing loans in the period 2009 – 2010 are based on the caliber of " four-class classification of loans ".

Table 3 The basic situation of China's five major commercial banks at the end of September 2010

Unit	Capital adequacy ratio // %	Proportion of non-performing loans // %	Pre-tax profit // 10 ⁸ yuan
Industrial and Commercial Bank of China	11.6	1.15	1663
Bank of China	11.4	2.08	892
China Construction Bank	11.7	1.10	1074
China Bank of Communications	11.6	1.14	1438
Agricultural Bank of China	12.5	1.22	379

Data source: *China Monetary Policy Implementation Report* in the fourth quarter of 2010.

2.2 Low level of profitability In 2004, the rural credit cooperatives in China achieved the first offset balance over the past decade, ending the situation of consecutive losses in the past; the operation and financial situation was improved significantly. In 2004, the net profit reached 10.5 billion yuan, and the net profit rate reached 0.55%. Afterwards, the net profit

and net profit rate tend to increase year after year.

As of the end of 2009, rural credit cooperatives achieved after-tax profit of 22.79 billion yuan. The rural credit cooperatives have been profitable for five consecutive years, but the net profit rate is very low, with low level of profitability.

Table 4 Profitability of China's rural credit cooperatives in the period 2004 – 2008

Year	2004	2005	2006	2007	2008
Total assets // 10 ⁸ yuan	19 238	22 354	26 236	31 321	37 229
Net profit // 10 ⁸ yuan	105	180	280	440	545
Net profit rate // %	0.55	0.81	1.07	1.40	1.46

Data source: Relevant data from *China Monetary Policy Implementation Report* and *China Financial Yearbook* in the period 2004 – 2008.

2.3 Imperfect market competition When analyzing the financial institutions, Goldsmith^[10] points out that the market concentration degree of financial institutions can reflect the level of financial development. After 1997, rural credit cooperatives became the main force of rural finance, nearly monopolizing most of the rural financial business.

Table 4 shows that the rural credit cooperatives' proportion of putting money on the rural credit markets increases year by year, from 80% in 2002 to 95 % in 2009; rural credit coopera-

tives are in a monopoly position in rural credit market.

2.4 Serious credit information asymmetry American economist George Akerlof and Joseph Stiglitz conducted theoretical study on the asymmetric information market in the 1970s. In economics and contract theory, information asymmetry deals with the study of decisions in transactions where one party has more or better information than the other. This creates an imbalance of power in transactions which can sometimes cause the transactions to go awry, a kind of market fail-

ure in the worst case. Examples of this problem are adverse selection, moral hazard, and information monopoly. Most commonly, information asymmetries are studied in the context of principal-agent problems.

From the current actual situation, the credit rating is determined by the loan officer based on the borrower's identity, status and wealth when rural credit cooperatives offer loans, but such way can not effectively assess the borrower's real credit status. The serious asymmetry of information grasped by rural financial institutions and borrowers also easily leads to high

non-performing loans of financial institutions in rural areas. It can be also found from Table 2 that at present, non-performing loans of rural credit cooperatives are high, and the agricultural bank is also in face of some problems, such as poor asset quality, and low capital adequacy ratio. At the same time, rural financial institutions, especially rural credit cooperatives, lack sufficient monitoring and control on the risks in the ordinary business activities, making the development of rural credit cooperatives face great security risks, thereby affecting continuous operation ability of rural financial institutions.

Table 5 Agricultural loans of rural credit cooperatives in the period 2002 – 2009

Year	Agricultural loans balance of the national financial institutions //10 ⁸ yuan	Agricultural loans balance of rural credit cooperatives //10 ⁸ yuan	Proportion of agricultural loans of rural credit cooperatives //%
2002	6 884.58	5 507.66	80.00
2003	8 411.3	7 056.38	83.89
2004	9 843.11	8 455.70	85.90
2005	11 529.93	10 071.00	87.35
2006	13 208.19	12 105.00	91.65
2007	15 429.31	14 407.66	93.38
2008	17 628.82	16 923.67	96.00
2009	21 622.53	19 460.28	95.00

Data source: Relevant data from *China Monetary Policy Implementation Report* and *China Financial Yearbook* in the period 2002 – 2009.

3 Development advantages of the new rural finance

3.1 Good quality of the assets Through the survey of new rural financial institutions in Gansu Province and Shanxi Province, Shen Jie and Ma Jiujié^[11] find that due to the strict control of the loan risk level, the new rural financial institutions in the two provinces achieve a good level of profitability. For example, RS micro-credit company and LW credit union achieve 100% recovery of principal and interest. Although RX and HT rural banks have non-performing loans, the non-performing loan ratio is far below 1%.

The relevant researches also show that the new rural financial institutions do not assume the business of state policy, and have no burden of non-performing assets. Therefore, as long as the new rural financial institutions actively innovate upon the financial products and services and vigorously develop the micro-credit for farmers in accordance with the principles of "strict supervision" on credit and farmers' demand for small and medium-size loans, the asset quality will be better than that of the traditional rural financial institutions, and the profiting potential will be stronger.

3.2 Flexible operation and management The network of new rural financial institutions is distributed widely. In terms of operation, it can flexibly subdivide the credit market, design targeted services, and provide a variety of products, in accordance with the individual needs of "agriculture, countryside and farmers", to promote differentiated and diversified development of financial services.

Even if there is phenomenon of poor management in new rural financial institutions, they are likely to be taken over by other types of capital because of the relatively small scale of operation, or according to the competition in the market, they can timely adjust strategies, and improve their own various

functions, achieving flexibility in the operation and management.

3.3 Independent operation decision-making At the end of 2006, CBRC (China Banking Regulatory Commission) issued *Several Opinions on Adjusting and Relaxing the Access Policy of Banking Financial Institutions in Rural Areas to Better Support the New Socialist Countryside Construction*, and guided all kinds of capital to invest in rural areas to establish rural banks, loan companies, rural credit unions and other new rural financial institutions, in accordance with the principle of "low threshold and strict supervision".

In accordance with the regulations of the CBRC, these new rural financial institutions are the first-level "legal person" bodies, providing institutional security for the independent realization of operating decision-making. It not only invests them with characteristics of short decision-making chain and high efficiency of decision-making, but also strongly restricts the managers, in order to prevent the imbalance of power, conducive to the steady development and growth of new rural financial institutions.

3.4 Adequate credit information Credit information asymmetry is an important reason for the high non-performing loans of financial institutions in rural areas. In the agricultural credit market, as against the borrowers, financial institutions obviously grasp less information, and the borrowers are fully aware of their willingness and ability to repay. Relative to the traditional rural financial institutions, the new rural financial institutions' employees are usually very familiar with the local market, and they have a direct or indirect contact with loan customers, with lesser extent of information asymmetry and strong risk identification ability, which makes the new rural financial institutions have greater room for safe profit margin than the big banks in the loans to farmers or small and medium-sized enterprises.

4 Policy recommendations for new rural finance to achieve sustainable development

Both the theory community and practitioners are positive about the development of new rural finance. Development advantages and national policies have laid solid foundation and depicted broad prospects for sustainable development of new rural finance. *The Overall Work Arrangement of New Rural Financial Institutions* from 2009 to 2011 formulated by the CBRC, has been endorsed by the State Council, and the new rural financial institutions will receive further policy support in the next three years. China will establish 1 300 more new rural financial institutions, of which there are 1027 rural banks, 106 loan companies and rural credit unions^[3]. As the platform for the supply of various types of capital and demand for "agriculture, countryside and farmers" funds, new rural finance will play a positive role in lifting the predicament of financing for "agriculture, countryside and farmers".

4.1 Innovating upon financial products and services In order to achieve sustainable development, new rural finance should have its own core competitiveness and have characteristic products and services as support, otherwise there is no difference between it and other rural financial institutions. Therefore, the key of emphasizing personalized service is to create features, such as innovating upon loan guarantee mode, implementing the guarantee of toll collection right and income right, the forest right mortgage, chattel mortgage, using stock rights, management rights, land contractual rights, housing use right, order, warehouse receipts, raw materials or finished products for hypothecated loans, and implementing "second guarantor" system for the corporate loans; implementing contiguous lending system, tied guarantee system and so on for personal loans. It is necessary to draw on the characteristics of "the right place" and "the right person", to build the marketing services team. We can establish the first-level marketing services team, and long-term market development mechanism of "second-level marketing" integrating office duty staff, office staff and client managers, to create powerful marketing service team, and build new financial marketing service system with strong competitiveness.

4.2 Establishing the purpose of serving agriculture, countryside and farmers New rural finance emerges based on "agriculture, countryside and farmers", and its foundation also lies in "agriculture, countryside and farmers". Deviating from the direction of serving "agriculture, countryside and farmers" is unreasonable. Therefore, the new rural finance should firmly establish the goal of serving "agriculture, countryside and farmers", and preventing deviation from the goal of serving "agriculture, countryside and farmers" due to the pursuit of high profits. The form of loans should be focused on micro-credit, and the use of the loans should be focused on the development of agricultural products and breeding. It is necessary to take into account the strength and risk factors, and township enterprises is still not suitable as the lending object of the new rural finance. The new rural finance can not leave the basis of "stabilizing county", can not be divorced from the actual situa-

tion of "taking actions that suit local circumstances", and can not blindly expand the size to give loans beyond the scope. As to the surplus funds that indeed have met the local needs for rural funds, according to the relevant policies and regulations of CBRC, these funds can be used for the purchase of financial bonds issued by the agricultural development bank, or providing financial services for "agriculture, countryside and farmers", through other legal channels. The new rural finance should take the county as unit; place emphasis on the principle of making up for the rural financial market gap; focus on the remote poor rural areas where the network distribution of rural credit cooperatives is not in place and service strength is weak; strengthen rural financial services.

4.3 Strengthening the strict supervision of financial risks

In the operating development, rural financial institutions are beset by serious risk problems^[12]. If without strict supervision on the risk, the rural financial institution is more likely to develop into the second rural foundation in history. When researching the credit risk faced by the village bank, Zhang Yan^[1] find that the credit risk faced by the village bank is concentrated, and it is difficult to be spread and transferred; credit risk prevention capacity and resistance level are very poor.

Therefore, how to control risks is the key to sustainable development of new rural finance. The new rural finance has some particularities, such as specific service objects, small scale of operation and poor anti-risk ability. Therefore, the financial risk control mode can not copy the experience of domestic and foreign commercial banks, and can not their practices even if the risk control mechanism of rural credit cooperatives is unsound. Consequently, financial risk control of new rural finance must comply with the operating law and characteristics of China's rural economy and rural finance, to meet the requirements of the healthy development of the rural economy and rural finance and adapt to their own sustainable development needs, such as taking the development mode of Grameen Bank, implementing micro-credit system, establishing the guarantee mechanism with financial poverty-alleviation discount capital as guarantee fund, adopting the group lending strategy, and strengthening the supervision of credit risk.

4.4 Striving for more fiscal and monetary policy support

When the producers or consumers use the mode that can not be directly reflected in the market to influence others' production or consumption activities, there are externalities^[14]. The externality favorable to those who are affected is called positive externality, also the external economy. When the external economy exists, the private marginal output ratio is not equal to the social marginal output ratio, which will lead to inefficient resource allocation.

The main benefits of rural finance include improvement in the social credit environment, optimization of the industrial structure of agriculture, increase in farmers' income, and decrease in the poor rural population^[15]. These products can not be exchanged in the market, but these products are also free of charge or shared by society with low cost, thus rural finance has obvious external economy. Therefore, the government

should give a series of preferential financial and fiscal policies for new rural finance, including some fiscal policy incentives and supporting measures.

4.5 Improving the supporting infrastructure construction of new rural finance

At present, the supporting infrastructure building refers to opening the new rural financial settlement, credit, and financial trading system as soon as possible, in order to reduce the operating costs of the new rural finance, and promote the business development of the village bank. As to the concrete operation, we can establish a shared platform model, and can also further improve the efficient use of existing platforms. At the same time, the new rural finance can try the use of innovative sales and service channels in rural areas, expand the point of contact with customers, and abate the impact arising from the shortage of network.

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teachers' further study and exchange; invite business managers and marketing directors as the visiting professors to lecture for the students; encourage university teachers to participate in marketing practice; organize teachers to go to enterprises for the collection of cases and accumulation of practical experience; encourage teachers to participate in the establishment of marketing business when the teaching is not affected, or to do a part-time job in the business in leisure time, which can not only help arrange students' practice, but also complement fresh cases for the teaching content to make up for flaws in the traditional teaching materials, and enhance the students' practical ability.

3.3.4 Encouraging students to participate in all kinds of marketing practices of agricultural products. It is necessary to encourage the students to participate in various kinds of marketing competition, marketing program design, marketing planning, questionnaire contest, and marketing simulation practice. For the extra work of teachers in participating in guidance and evaluating the students' marketing practice activities, it is regarded as the same teaching load. The colleges can rely on the Agricultural Committee and other agriculture-related enterprises and institutions, to jointly build marketing practice base, and establish the operational mechanism integrating production, learning and research. Students can provide planning and consulting services for enterprises, par-

ticipating in the operation of business market survey, market expansion and advertising planning. It is necessary to arrange students to participate in social research and survey activities, to shorten the time and psychological distance for the students to adapt to the job.

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