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Energy Conservation and Greenhouse Gas Emissions Reduction in

Chinese Township and Village Enterprises – Phase II

Design and Establishment of RCF

# **FINAL REPORT**

FRC/VCChina

November 25, 2003

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## FINAL REPORT

Project Title: Energy Conservation and Greenhouse Gas Emissions Reduction  
in Chinese Township and Village Enterprises – Phase II  
Project Number: EG/CPR/99/G31  
Subcontract Title: Design and Establishment of RCF  
Subcontractor: FRC/VCChina

The Revolving Capital Fund is designed to facilitate access to financing to Chinese TVEs that seek to modernize their production technologies and upgrade the quality of their products while also resulting in significant energy savings. As from December 1, 2002, the subcontractor started to work on the RCF subcontract. With the assistances from the UNIDO, the PMO, the CTA, the ABC and the Hongyuan Company, the subcontractor was able to complete this task.

### **Survey and Interview**

The subcontractor conducted a series of survey and interview activities to further study the possible financial barriers of Chinese TVEs in their efforts upgrading their technologies.

Altogether the subcontractor visited eight TVEs in four provinces and interviewed their management teams as well as staffs of local ABC branches. With the help of the PMO, the subcontractor also organized two forums, one in April and the other during the training session in August, from which the subcontractor also collected useful information and suggestions for the design of the RCF.

From the survey and interview, the subcontractor was able to better understand the current situation and major financial barriers of Chinese TVEs, which was very helpful for the design of the RCF operational structure.

See Attachment One for the survey report and detailed survey plan. The questionnaires, financial statements and other materials collected during the survey and interview have been forwarded to the PMO.

### **Operational Structure of the RCF**

In order to better explore different possible use of the GEF funds, the subcontractor designed two candidate RCF operational structures. On the April 14 forum and the May 20 video conference, the subcontractor had opportunities to discuss the two candidate structures into great details with all the founding parties as well as experts from different departments. After several discussions, all parties agreed that the original RCF structure in which the GEF funds would be used to make entrustment

loans should be adopted.

The RCF is designed as a flexible financing mechanism rather than a traditional fund. The RCF mechanism includes several legal agreements and operational documents which define the relationships between the founding parties and guide the operating parties, the Hongyuan Company and the ABC, in their business operations of the RCF.

The UNDP, the UNIDO, the MOA and the ABC signed the MOU on the Establishment and Operation of the RCF at the end of August, 2003. The MOU defined the funding sources of the RCF and created three facilities for Chinese TVEs, including the entrustment loan facility, the commercial loan facility and the capacity building facility.

The subcontractor also drafted a MOU for the operation of the entrustment loan facility. The MOA, the ABC headquarter and the Hongyuan Company signed this MOU in early September, 2003. This MOU defined the roles of the three parties in the business operation of the entrustment loan facility and set several basic principles in the operation. According to this MOU, the Hongyuan Company and various local branches of the ABC will sign entrustment agreements before the entrustment loans are extended. The subcontractor have drafted a template of such entrustment agreements which has been agreed upon by all concerning parties.

Within the operation structure of the RCF, the ABC is responsible for making commercial loans to the TVEs and also extending entrustment loans according to the terms and conditions set by the Hongyuan Company. The subcontractor helped the ABC headquarter draft a Code of Practice in Operation of TVE Entrustment Loan Business which would guide the local branches of the ABC in their detailed businesses of extending the entrustment loans to Chinese TVEs.

The Hongyuan Company is selected to be responsible for screening and evaluating candidate borrowers and making decisions on terms and conditions of the entrustment loans. The subcontractor developed an Entrustment Loan Assessment and Management Criteria and Procedures to guide the Hongyuan Company in its selection and assessment of the borrower TVEs and management of the entrustment loans.

See Attachment Two through Attachment Six for the above mentioned documents related with the operation structure of the RCF.

#### **Terms of Reference for Transfer and Management of the Entrustment Loan Facility**

As the Hongyuan Company is selected to manage the entrustment loan facility, the subcontractor developed the terms of reference for the Hongyuan Company to refer to

when transferring the GEF funds and conducting the entrustment loan business.

See Attachment Seven for the TOR.

### **Training**

During August 10 to 12, 2003, the subcontractor organized the RCF training at Beijing Fragrant Hill Hotel. The participants included representatives from the eight demonstrating TVEs, local governments, ABC branches at the county and provincial levels, the PMO, the Hongyuan Company, GEF China Office and the CTA. Altogether there were over forty participants in this training session.

During the training, the subcontractor combined training and discussion together. Professor Yulu Chen and lawyer Yunbo Li from FRC, Bo Hu from VCChina, and Dr. Xiaoke Cheng from Renmin Business School made speeches to the participants.

The subcontractor also arranged a forum on the RCF. On the forum, the participating TVEs, the ABC, the subcontractor and the PMO discussed the operation structure and procedures of the RCF into very details, and proposed with valuable suggestions. The subcontractor, the PMO and the CTA made explanations on some questions raised by the participants.

During the training, the headquarter of the ABC also held a forum and asked its local branches from the county and provincial levels to discuss the code of practice in conducting the TVE entrustment loan business. The representatives from local ABC branches also proposed some constructive suggestions.

The subcontractor also developed a plan for further training of the candidate borrowers and staffs of ABC local branches.

See Attachment Eight for the training package, including the training agenda, the training plan, the training minute, and an outline for further training.

### **RCF Further Development Plan**

Since the RCF is designed as a flexible mechanism through which the fund suppliers support Chinese TVEs in their efforts to finance for their technical improvement in order to save energy and reduce GHG emissions, the future development of the RCF relies on continuous fund suppliers and fund demands, and it should make the RCF mechanism a win-win vehicle to obtain both social welfare and economic benefits.

In order to reach sustainable development for the RCF, the subcontractor developed a further development plan for the RCF in consultation with the ABC and the Hongyuan Company. The plan specified the near-term, mid-term and long-term

objectives for the RCF and also planned strategies and activities needed for reach such objectives. It also gave detailed activity plan in the near term.

See Attachment Nine for the RCF further development plan.

## **ATTACHMENTS**

- |                  |  |
|------------------|--|
| Attachment One   | RCF Survey Report  |
| Attachment Two   | MOU on the Establishment and Operation of the RCF                                |
| Attachment Three | MOU on the Operation of the Entrustment Loan Facility                            |
| Attachment Four  | Entrustment Agreement (Template)   |
| Attachment Five  | Code of Practice in Operation of TVE Entrustment Loan Business                   |
| Attachment Six   | Entrustment Loan Assessment and Management Criteria and Procedures               |
| Attachment Seven | Terms and Reference for Transfer and Management of the Entrustment Loan Facility |
| Attachment Eight | RCF Training Package   |
| Attachment Nine  | RCF Further Development Plan   |

**Energy Conservation and GHG Emissions Reduction in Chinese TVEs  
Establishment and Operation of the Revolving Capital Fund**

**SURVEY REPORT**

The purpose of this survey is to better understand Chinese TVEs, especially TVEs in the four pilot industries, of their major obstacles in financing for their efforts in upgrading their technology and equipment. With the help from the PMO and the CTA, the sub-contractor organized a series of surveys and interviews, including visits to TVEs, interviews of banking staffs, and organization of forums.

**Survey and Interview Activities**

On April 14, 2003, "Forum on the Establishment and Operation of the RCF" was held at the MOA and presided by the PMO. The sub-contractor invited experts from the Ministry of Finance, GEF China Secretary Office, China Environment Fund 2002, ICBC East Asia Finance Holding Co., China Energy Investment, People's Court of Beijing, People's Bank of China to attend this forum. The experts analyzed the financing barriers that Chinese TVEs may face and provided many constructive suggestions on the establishment and operation of the RCF.

From July 6, 2003 to July 9, 2003, the sub-contractor went to Shaanxi province together with the PMO, the CTA and the ABC headquarter. The sub-contractor conducted survey on Lingzhao New Building Material, Liucun Brick Making and Redflag New Building Material. These three TVEs were all brick making TVEs. The sub-contractor also interviewed managers of the three TVEs and local ABC staffs.

From July 9, 2003 to July 12, 2003, the sub-contractor went to Zhejiang province together with the PMO, the CTA and the ABC headquarter. The sub-contractor conducted survey on three cement making TVEs, i.e., Suihe Cement Making Company, Three Lion Building Material Group, and Hejiashan Cement Making Company. The sub-contractor also interviewed managers of the three TVEs and local ABC staffs.

From July 21, 2003 to July 22, 2003, the sub-contractor went to Shandong province together with the PMO, the CTA and the ABC headquarter. The sub-contractor conducted survey on Fanlin Cement Making Company and interviewed managers of the company, staffs of local ABC branches and officials of local government environment protection agency.

On July 24, the sub-contractor conducted survey on Beijing Yancun Brick Making

Company together with the PMO and the CTA and interviewed its general manager.

## Major Findings

During the surveys and interviews, the sub-contractor mainly learned the TVEs' general development environments, their understanding of the energy-saving technical upgrades, their major financial barriers and the commercial banks' understanding of the barriers. See annex one for the detailed survey and interview plan.

The following are major findings based on the analysis of the survey and interview, the experts' opinions on the April 14 forum, and other researches the sub-contractor did before.

**The overall technologies and equipments of Chinese TVEs are less developed and can not meet the requirements of energy saving and environment protection.**

Actually the eight TVEs in the survey and interview are from cement making and brick making industries. Among the four cement making TVEs, three Zhejiang TVEs have both vertical and rotary kilns, and the Shandong TVE has only vertical kilns. According to China Building Material Research Institute, currently, most provinces in China have not fully stopped the construction of new vertical kilns. From the nation-wide perspective, most cement making TVEs do not have rotary kilns, and the cement produced from vertical kilns takes about 75 percent of the total production.<sup>1</sup> From the perspective of energy consumption, the overall technology of Chinese TVEs lacks much behind that of foreign companies (see Table 1 below).

**Table 1 Comparison of compound technical indicators in cement making industry<sup>2</sup>**

Item	Unit	Foreign>7000t/d	Domestic 2000t/d
Heat consumption	KJ/kg	2885	3178
Power consumption (P,11525)	kwh/t, 340m <sup>2</sup> /kg	90	110
Production efficiency	t/man • year	>8000	<2400
Kiln operation percentage	%	>95	<85
Dust emissions	Mg/Nm <sup>3</sup>	<50	<100
NO <sub>x</sub> emissions	ppm	<400	n.a.

<sup>1</sup> See China Securities Markets Research Center, 2003 Investment Analysis Report: Cement Making Industry, page 6.

<sup>2</sup> See Tianjin Cement Industry Institute, Capitalization Tendency, 2002.

In the brick making industry, most TVEs are small businesses and their technologies are out-of-dated (see Table 2).

**Table 2 Basic information of four brick making TVEs**

	Lingzhao	Redflag	Liucun	Yancun
Registered capital	\$100,000	\$80,000	\$110,000	\$120,000
Production type	Labor intensive	Labor intensive	Labor intensive	Labor intensive
No. of employees	140	240	150	350
Production per capita	\$1,786	\$1,458	n.a	\$5,300
Profits per capita	\$357	\$156	n.a	\$1,071

Source: survey and interview conducted by the sub-contractor.

**Chinese TVEs have some understanding of the significance of energy saving and environment protection.**

Among the eight TVEs which attended the survey, all of them set high priority for technical upgrading toward energy saving and environment protection. Some of the TVEs have already upgraded their technologies in past years, and some others have plans to adopt upgrading in the near future (see Table 3).

**Table 3 Technical upgrading of the eight TVEs**

TVE	Upgraded in the past	Plan to upgrade in two years
Lingzhao	n.a.	n.a.
Redflag	√	√
Liucun	×	√
Yancun	√	√
Fanlin	n.a.	√
Suihe	√	n.a.
Three lion	√	√
Hejiashan	√	√

Source: survey and interview conducted by the sub-contractor.

When were asked why they attached such importance to technical upgrades, the four brick making TVEs said they saw the technical upgrades as a way to lower costs of raw materials and improve products quality. However, to a large extent, the four cement making TVEs took measures to upgrade their technology just to comply with government regulations. Currently, almost all provinces of China have set explicit timetable to restrict or even abandon use of new vertical kilns. In Zhejiang province, for example, all companies including TVEs are not allowed to invest in new vertical kilns.

When were asked about the implications of technical upgrades, five out of eight TVEs emphasized on both social and financial benefits, and the other three only emphasized on social benefits. This indicates that while some TVEs have understood the significance of technical upgrades, more successful demonstrations are still needed.

### **Most TVEs have financial barriers in their efforts of technical upgrades.**

During the interviews, most TVEs said they had financial barriers in their efforts of technical upgrades. Of the eight participating TVEs, Shandong Fanlin was able to use the credit line of its parent company Conglin Group and therefore had no difficulty in its financing, and Beijing Yancun had successfully received financing from the ABC Beijing branch with the guarantee of the local government. All the others had some problems with their financing plans.

Based on the survey and interview and other information sources, the sub-contractor finds that Chinese TVEs as a whole mainly have the following four financial barriers.

(1) Unclear property rights. Most Chinese TVEs are collectively owned enterprises. Although the TVEs are in a process toward privatization, in general, the problem of unclear property rights has created huge financial obstacles for them. Commercial banks are generally reluctant to make loans to collectively owned enterprises because they will have difficulties in recovering the principal in case of non-performing loan. Therefore, collectively owned TVEs can hardly get bank loans without government guarantees.

(2) Collateral barrier. TVEs usually have difficulties in provide commercial banks with qualified collaterals because of their small sizes and low percentage of fixed assets. This problem is more prominent in brick making industry where most TVEs' registered capital is less than one million RMB and many fixed assets are rented. For example, the land, houses and machines of Lingzhao New Building Material were all rented.

(3) Barriers from commercial banks. During the commercialization of major Chinese banks, the banks put more and more emphasis on profits generation and risk

management. Now all domestic large commercial banks have established complicated authorization system in extending loans. In the ABC, for example, the county level branches which are most familiar with the situation of TVEs do not have the rights to extend fixed asset loan or technical upgrades loan to its clients but can only extend small working capital loans. They will have to report loan applications to the upper level branches for approval. It will take much time to complete the appraisal process.

(4) Financial costs. According to current regulations, in extending loans to TVEs, commercial banks can charge 20% more over the standard interest rate, and credit unions can charge 50% more. In applying for loans, the TVEs also need to pay various of fees. And many TVEs will have to pay about 3% of the loan as service fee to the local government of guarantee company to have their support in providing loan guarantee. High financial costs affect the profitability of the TVEs which in turn makes financing more difficult. For example, the financial costs of Zhejiang Three Lion in recent years were as high as about 10 million RMB which took almost all of its operational profits (see Table 4).

**Table 4 Major financial indicators of Three Lion**

In millions of RMB

Year	2000	2001	2002
Profits from Sales	5805.0	10,591.8	12,597.1
Financial Costs	14,371.8	13,489.7	9,970.9
Operating Profits	-8,566.8	-2,897.9	2,626.2

Source: financial statements of Three Lion, in various years.

**The commercial banks are cautious in making loans to TVEs.**

The survey and interview shows that many ABC local branches do not fully understand the significance of technical upgrades. Many of the interviewees believed that such upgrades were not bankable and they were not very interested in such projects.

Currently, corporate lending staffs in the ABC have good command on management and corporate finance, but they are lack of knowledge about energy saving and environment protection.

When were asked to point out main financial barriers of Chinese TVEs, three factors were most often cited.

- low credit rating and lack of qualified human resources
- historical non-performing loans in TVEs
- low profitability

## **Conclusions and Suggestions**

Several conclusions can be drawn from the survey and interview.

(1) Current industrial development policies adopted by Chinese government are in the right direction and have positive influence on energy saving and environment protection.

(2) Chinese TVEs have some understanding of the significance of energy saving technical upgrades, but more work still need to be done.

(3) Domestic commercial banks are generally cautious in making loans to TVEs.

(4) Major financial barriers of Chinese TVEs are unclear property rights, low credit rating, lack of qualified guarantee, high financing costs, etc.

The survey and interview suggests that measures need to be taken in the establishment and operation of the RCF. Such measures include:

(1) Train the TVEs as well as local commercial banks. For the TVEs, the training should focus on improve their management quality, and for the banks, the training should focus on improving their knowledge about energy saving and environment protection.

(2) Several successful demonstrating projects should be made ready so as to help more TVEs and banks better understand the economic benefits of energy saving technical upgrades.

(3) The RCF should play a key role in eliminating financial barriers of Chinese TVEs. In the short term, the RCF help create several demonstrating projects and spread their experiences to more TVEs. In the long run, the RCF should be able to absorb more funds from various sources to better support the TVEs in their efforts of technical upgrades.

Annex:

Annex One Survey and Interview Plan

**Energy Conservation and GHG Emissions Reduction in Chinese TVEs  
Revolving Capital Fund**

**SURVEY AND INTERVIEW PLAN**

**Places of Survey and Interview**

Shannxi, Zhejiang, Shandong, Beijing

**Time of Survey and Interview**

July, 2003

**Targeted Interviewees**

Management team from TVEs and loan managers from commercial banks

**Objectives**

1. To study the overall development conditions of Chinese TVEs, including infrastructure, technical equipment, government policy, managerial levels, etc.
2. To identify key barriers for Chinese TVEs to access financial sources.
3. To identify key problems for commercial banks in making loans to Chinese TVEs.

**Questionnaire for TVEs**

1. Overall Information

- (1) size of registered capital
- (2) nature of the TVE (privately owned collectively owned state owned) and capital structure (whether or not registered as a corporation)
- (3) organization structure (main departments)
- (4) personnel structure (number of employees, educational background of employees and age structure of employees)

2. Business Information

- (5) main business
- (6) revenue, profit (or loss), and market share in the past three years

3. Technologies and Equipments Updates Information

- (7) the up to date size of the investments on such updates
- (8) capital planned to be invested in such updates in the future three years
- (9) the needed technologies and equipments mainly come from domestic market  
international market
- (10) according to past experiences, whether or not such updates are bankable

#### 4. Financial Information

- (11) asset/liability ratio
- (12) ratio of assets which can be accepted as mortgage to total assets
- (13) loan history in the past three years

#### 5. Financial Barriers

- (14) the main financial barriers are:
  - poor financial performance
  - poor credit rating
  - lack of qualified guarantee
  - lack of sufficient credit line
  - strict loan criteria and complicated loan procedure
  - high financing cost
  - other (specify)

### **Questions for Commercial Banks**

1. Understanding of social and economic implications of energy efficiency and GHG emission reduction projects (whether or not necessary, whether or not bankable)
2. Knowledge Base of Employees (educational background, knowledge about energy saving and GHG emission reduction technologies and markets, knowledge about management and accounting)
3. Key barriers for Chinese TVEs to get loans (from commercial bank's view)

**MEMORANDUM OF UNDERSTANDING**  
**ON THE ESTABLISHMENT AND OPERATION OF**  
**THE REVOLVING CAPITAL FUND**

“Energy Conservation and Greenhouse Gas (GHG) Emissions Reduction in Chinese Township and Village Enterprises (TVEs) – Phase II” is a project funded by the Global Environment Facility (GEF). The United Nations Development Programme (UNDP) is the implementing agency for the project. The project is executed by the United Nations Industrial Development Organization (UNIDO) in cooperation with the Chinese Ministry of Agriculture (MOA). The project aims to promote Chinese TVEs to adopt advanced technologies to improve their energy efficiency and reduce GHG emissions. According to the project document, all parties agree to establish a Revolving Capital Fund (RCF) to help the Chinese TVEs remove financial barriers in their efforts to implement technical improvement. In order to make the RCF function well according to the project document and relevant Chinese laws and regulations, the concerned parties agree to establish the RCF as a financing mechanism and have reached the following understanding.

**1. Funding Sources for the RCF**

The RCF financing mechanism consists of one million US dollars from GEF/UNDP through UNIDO, two million US dollars (in Chinese RMB equivalent) from the Agricultural Bank of China (ABC), and one million US dollars (in Chinese RMB equivalent) from the Chinese MOA.

All parties agree that in future the RCF financing mechanism can receive funds from sources other than the founding parties.

**2. The Entrustment Loan Facility**

UNIDO will transfer the one million US dollars from GEF/UNDP to Hongyuan Energy and Environmental Protection Company, Ltd. (formerly PTPMC). In turn, Hongyuan will entrust the funds to ABC to make loans to the qualified TVEs.

**3. The Commercial Loan Facility**

ABC will make no less than two million US dollars (in Chinese RMB equivalent) commercial loans to TVEs in support of technical improvement for the purpose of

energy conservation and GHG emissions reduction. The commercial loan appraisal, disbursement, and management procedures will be solely decided by ABC according to relevant laws and regulations.

#### **4. The Capacity Building Facility**

MOA will provide no less than one million US dollars (in Chinese RMB equivalent) to help TVEs in capacity building with regard to removing financial barriers. MOA will act by itself or through its local agencies to provide capacity building. This will include training, equipment, and technology support.

#### **5. Other Business**

Detailed procedures regarding the operation of the RCF will be agreed to by the parties concerned.

MOA

Authorized Representative:

Signature:

Date:

ABC

Authorized Representative:

Signature:

Date:

UNIDO

Authorized Representative:

Signature:

Date:

UNDP

Authorized Representative:

Signature:

Date:

## **MEMORANDUM OF UNDERSTANDING ON THE OPERATION OF THE ENTRUSTMENT LOAN FACILITY**

The TVE entrustment loan is an important part of the project entitled “Energy Conservation and GHG Emissions Reduction in Chinese TVEs” sponsored by UNDP/GEF. It aims to help to eliminate financial barriers for Chinese TVEs in their efforts to improve their technology and thus improve their energy efficiencies. According to the project documents and related Chinese law and regulations, the Chinese government has agreed that Beijing Hongyuan Energy and Environmental Protection Co., Ltd (the former PTPMC) is designated as the managing body and principal of the TVE entrustment loan and the Agricultural Bank of China (ABC) provides the banking services. In order to better implement the business, all the related parties have reached the following common understanding.

### **1. Fund Sources of the TVE Entrustment Loan**

The TVE entrustment loan program has a fund of equivalent with one million US dollars. Hongyuan is responsible for supplying the fund.

### **2. Several Basic Principles in the TVE Entrustment Loan Business**

Hongyuan and the ABC agree that both parties will comply with the following principles in the TVE entrustment loan business.

- (1) According to the commercial banking act of China and Chinese banking regulation, the ABC as an agency and services provider can only deliver services of making, supervising and assisting drawing back the entrustment loan. The ABC will not assume any kind of loan risks.
- (2) Any single TVE entrustment loan shall not exceed 200,000 US dollars.
- (3) Hongyuan agrees that it will not charge any interests for the TVE entrustment loan, but only charge some management fees, and the fee rate will not exceed 50 percent of the interest rate charged by commercial banks during the same period.
- (4) The Ministry of Agriculture will act as the supervisory body of the operation of the TVE entrustment loan business.

### 3. The Management of TVE Entrustment Loan Business

The local branches of the ABC will be responsible for providing banking services to the TVE entrustment loan program. In order to better manage the operation of the program, the ABC headquarter will issue a code of practice in doing the TVE entrustment loan business to guide its local branches. And the ABC headquarter will also be responsible for coordinating the relationship between Hongyuan and its local branches.

According to a regulation issued by the People’s Bank of China, currently Hongyuan needs to sign entrustment agreements with the ABC branches respectively. The ABC headquarter and Hongyuan will work together for a template agreement. The rate of the service fee charged by the ABC local branches will be set in the entrustment agreements.

### 4. The Fund Management of the TVE Entrustment Loan

Hongyuan will open an special account with the ABC headquarter and deposit the fund of one million US dollars into the account.

After the loan application is approved by Hongyuan, Hongyuan shall arrange the fund transfer from the special account to the borrower through the ABC local branches.

The local branches of the ABC will transfer the management fee paid by the borrowers less the service fee to the current account of Hongyuan. And the principal repaid by the borrowers will be transferred directly back to the special account.

### 5. Other Matters

In case the related regulation changes in the future, the operation and management of the TVE entrustment loan program might need to change as well. However, any such change must be approved by the MOA, Hongyuan and the ABC.

Other issues concerning the TVE entrustment loan program will be resolved by all three parties through mutual consultation.

MOA	Hongyuan	ABC
Name	Name	Name
Signature	Signature	Signature
Date	Date	Date

## ENTRUSTMENT AGREEMENT

(Template)

This agreement is signed between  
Beijing Hongyuan Energy and Environmental Protection Co., Ltd (hereinafter referred to as “Hongyuan”)  
and  
The \_\_\_\_\_ Branch of Agricultural Bank of China (hereinafter referred to as “the ABC”)

Hongyuan entrusts the ABC to make loans to the borrowers designated by Hongyuan, and the ABC agrees to do the business. According to related law and regulation of People’s Republic of China, both parties have reached the following agreements on the business of TVE entrustment loan.

Article One Hongyuan entrusts the ABC to make loan of RMB \_\_\_\_\_ yuan and helps to collect the loans back according to the procedures of the entrustment loan.

Article Two Hongyuan should open a special account with the ABC headquarter and deposit funds of RMB \_\_\_\_\_ yuan within \_\_\_ days since this agreement comes into effect. The entrustment loan can not exceed the amount deposited by Hongyuan.

Article Three The borrower qualification, the amounts, the types of loans, the duration, the interest rates, and grace period and the repayment methods of the entrustment loans should all be decided by Hongyuan. And Hongyuan should fill in an Entrustment Loan Notification Form.

Article Four After this agreement comes into effect, when Hongyuan decides to make an entrustment loan to a borrower, it should deliver the Entrustment Loan Notification Form to the ABC. The ABC should check the items listed in the Entrustment Loan Notification Form for their compliance with this agreement and then make the entrustment loan according to the Entrustment Loan Notification Form.

Article Five The ABC should sign an Entrustment Loan Contract with the borrow before making the loan and should send a copy of the contract to Hongyuan within \_\_\_ working days since the Entrustment Loan Contract comes into effect.

Article Six If the borrower can not repay the entrustment loan, Hongyuan can not ask the ABC to pay any part or full of the entrustment loan. If the entrustment loan

suffers a loss, the ABC will not assume any responsibility of reimbursement.

Article Seven Hongyuan can ask the borrowers to supply with security interest against the entrustment loans. The method of the security interest should be checked by Hongyuan and should be made clear in the Entrustment Loan Notification Form.

Article Eight If the borrower can not repay the entrustment loan according to the Entrustment Loan Contract, the ABC could charge the borrower with an interest fine. The ABC could reserve 50 percent of the interest fine and transfer the remaining to Hongyuan's account.

Article Nine The ABC should pay interests at a monthly rate of \_\_ percent for the balance of the special account of Hongyuan. The ABC should transfer the interests or management fees paid by the borrowers to Hongyuan's account within \_\_ working days.

Hongyuan shall pay a service fee which is 0.3 percent of the entrustment loan to the ABC. The charge of the service fee will be according to the following:

Article Ten Within \_\_ working days after the ABC collects the entrustment loan back from the borrower, it should remit the money to the special account of PTPMC with the headquarter of the ABC.

Article Eleven Any changes to the repayment of the entrustment loans should be agreed in written by Hongyuan, the ABC and the borrower.

Article Twelve After the entrustment loan is collected, Hongyuan can use it on another new entrustment loan project.

Article Thirteen This agreement can not be changed without written agreement of both Hongyuan and the ABC.

Article Fourteen Defaults

1. If Hongyuan fails to deposit the fund to the special account with the headquarter of the ABC according to Article Two of this agreement, or fails to supply with necessary materials according to Articles Three and Four of this agreement, the ABC can refuse to make the entrustment loan.
2. If the ABC fails to make the entrustment loan according to the Entrustment Loan Notification Form, Hongyuan can draw part of full fund from the special account and the ABC should compensate any losses caused by its default.
3. If the ABC agrees the borrower to change the repayment method without written permission of Hongyuan, Hongyuan can ask the ABC to collect the entrustment loan according to the original repayment method.

Article Fifteen Other Issues

Article Sixteen Disputes Resolution

Any dispute with regard to the execution of this agreement should be resolved through mutual consultation. Failure of mutual consultation can lead to a lawsuit on the court.

Article Seventeen For any issues that are not specified in this agreement, both parties agree to act according to the laws and regulations of the People's Republic of China.

Article Eighteen This agreement will come into effect upon signatures of legal representatives or their authorized representatives of both Hongyuan and the ABC.

Article Nineteen The Entrustment Loan Notification Form and the materials provided by Hongyuan should be regarded as appendixes of this agreement.

Article Twenty This agreement has two formal copies, and each party shall have one copy.

Hongyuan

ABC

Name

Name

Signature

Signature

Date

Date

## **CODE OF PRACTICE IN OPERATION OF TVE ENTRUSTMENT LOAN BUSINESS**

### **Chapter One General Rules**

1.1 This code of practice has been formulated, in accordance with existing Chinese laws, the agreement and memorandum made and entered into by and between the concerned parties, to govern the extension and management of the TVE entrustment loan to finance Chinese township and village enterprises (the “TVEs”) in energy conservation and GHG emissions reduction which shall consequently facilitate the operation of the Project entitled “GEF/UNDP Energy Conservation and Reduction in GHG Emission” (“the Project”).

1.2 The TVE entrustment loan is funded by the GEF and managed by Beijing Hongyuan Energy and Environmental Protection Co., Ltd (PTPMC). It aims to help Chinese TVEs to improve their energy efficiency and reduce their green house gas emissions through its use as loans.

1.3 The ABC as an agency and services provider can only deliver services of making, supervising and assisting drawing back the entrustment loan. The ABC will not assume any kind of loan risks. The qualification of the borrowers, the loan size, the loan usage, the duration, and the rate of the management fee will all be determined solely by the PTPMC.

1.4 The local branches of the ABC need to first be approved by the ABC headquarter and sign an entrustment agreement with the PTPMC according to this code of practice.

1.5 The local branches of the ABC needs to file this business with local branches of the People’s Bank of China of the same region.

1.6 Any TVE who wants to apply for the TVE entrustment loan must supply valid security interest for the loan. The ABC can reject the applications without valid security interest.

1.7 The applicant of the TVE entrustment loan can also apply for a commercial loan to the ABC local branches.

## **Chapter Two Eligible Applicants and Loan Requirements**

2.1 Eligible applicants are the TVEs which are registered in the People's Republic of China.

2.2 The TVEs that intend to borrow the TVE entrustment loan shall meet the requirements of the ABC and the PTPMC.

2.3 A TVE that files an application for the TVE entrustment loan shall submit the documents and materials to the ABC according to the requirements of the ABC and the PTPMC.

## **Chapter Three Loan Procedure**

3.1 The applicant TVEs need to first apply for the TVE entrustment loan to the local branches of the ABC and supply with the documents and materials designated in Article 2.3 in this code of practice. The local branches of the ABC shall deliver the application to the PTPMC in a timely manner. The PTPMC needs to finish its assessment within 25 working days and inform the ABC of its final decision.

3.2 Any single TVE entrustment loan shall not exceed 200,000 US dollars.

3.3 For those applications approved by the PTPMC, the local branches of the ABC is responsible for loan disbursement.

## **Chapter Four Terms and Conditions and the collection of the TVE Entrustment Loan**

4.1 The PTPMC does not charge an interest on the TVE entrustment loan. However, the PTPMC could charge a management fee. The fee rate shall not exceed 50 percent of the interest charged by commercial banks during the same period.

4.2 The ABC should assist the PTPMC to collect the TVE entrustment loan.

## **Chapter Five Management of the TVE Entrustment Loan**

5.1 The local branches of the ABC shall supervise the borrower on whether or not the borrower has any violation from the loan usage.

5.2 The borrower may submit financial statements and other documents according to the loan contract from time to time to the ABC. The ABC shall deliver the statements and documents to the PTPMC in a timely manner.

5.3 The risk management of the TVE entrustment loan is the sole responsibility of the PTPMC. However, the ABC may offer possible helps and facilities.

5.4 The ABC shall collect the principal of the TVE entrustment loan according to the schedule designated in the loan contract, and transfer the fund back to the special account with its headquarter.

5.5 In any event of the default by the borrower, the ABC shall inform the PTPMC in a timely manner.

## **Chapter Six Miscellaneous**

6.1 This code of practice should be interpreted by the head office of the Agricultural Bank of China.

6.2 This code of practice should come into effect upon its promulgation.

## **THE ENTRUSTMENT LOAN ASSESSMENT AND MANAGEMENT CRITERIA AND PROCEDURES**

The loan assessment procedures should be followed by the Hongyuan Energy and Environmental Protection Co., Ltd (formerly PTPMC). In conducting the assessment, Hongyuan needs to first clarify whether or not the applicant TVE meets the basic requirements for the TVE entrustment loan. And then, Hongyuan needs to complete the preliminary test. There are several removal standards, and if the applicant TVE meets any one of the standards, Hongyuan can just reject its application. For those who passes the preliminary test, Hongyuan needs to conduct detailed due diligence, to evaluate the applicant TVE from its industrial, market, technological, managerial, financial and legal aspects. The conclusion from the due diligence is of great importance for Hongyuan to make its final decision. However, Hongyuan still needs to consider the opinions of PIC and ABC to finally decide whether or not to make the loan and terms and conditions of the loan.

### **I. Basic Requirements to Qualify the Application of the TVE Entrustment Loan**

Any Chinese TVE who wants to apply for the TVE entrustment loan must meet ALL the following basic requirements:

- (1) The applicant's businesses must comply with Chinese law and regulation, and are in accordance with the national industrial development plan.
- (2) The applicant has steady revenue and good credit record, and have the capability to repay the loan in time.
- (3) The applicant should have opened an account with the Agricultural Bank of China, and is willing to accept ABC's monitoring.
- (4) The applicant has the Loan Card issued by People's Bank of China and an

Organizational Code issued by the Quality and Technical Supervision authority.

(5) The applicant has a valid business license issued by local SAIC.

## **II. Preliminary Test Criteria**

During the preliminary test, if the applicant is found to meet ANY of the following removal standards, Hongyuan can just simply reject its loan application. The removal standards are:

- (1) The applicant is not a township and village enterprise.
- (2) The applicant does not belong to any one sector of brick manufacture, cement production, metal casting and coking.
- (3) The purpose of the loan application is not for a technical improvement for energy conservation and GHG emission reduction.
- (4) The applicant does not have a feasibility study report for its technical improvement project.
- (5) The management of the applicant is disordered, and the applicant does not have a financial record or taxation record.
- (6) The applicant's average asset-liability ratio in the last three years is higher than 85%, and the net owner's equity is negative.
- (7) The applicant's credit rating is lower than BBB.

The Hongyuan Company should finish the preliminary evaluation within five working days since it receives the loan application, and decide whether or not it accepts the loan application according to the above basic requirements and preliminary test criteria. Hongyuan needs to notify its decision to the applicants and related ABC local branches.

For those applications accepted by Hongyuan, it should conduct due diligence within twenty-five working days upon its receive of the applications, and decide whether or

not to approve the application according to the following due diligence criteria.

### **III. Due Diligence Criteria**

For those applicant TVEs who meet the basic requirements and have passed the preliminary test, Hongyuan can go to the next step and perform due diligence. The due diligence should be performed from the following five aspects:

- A. Industrial and Market Due Diligence
- B. Technical Due Diligence
- C. Managerial Due Diligence
- D. Financial Due Diligence
- E. Legal Due Diligence

Of the five aspects of due diligence, the first four could be performed by a scoring method, that is, to give a score for each applicant TVE on its performances of various items. The final score could be calculated by the weighted average method. However, the legal due diligence can only give supportive opinion in making the final decision and is not appropriate for scoring.

All the five aspects of due diligence can be extended to details. The following gives one possible detailed due diligence criteria.

#### **A. Industrial and Market Due Diligence**

- (1) The extent of the consistence of the applicant TVE's industrial sector with the national industrial development plan
- (2) Growth rate of the target market
- (3) The applicant TVE's competitive advantages in its sector
- (4) The applicant TVE's bargaining power in its raw material purchasing
- (5) The applicant TVE's control of price in its sales

(6) The growth rate and growth potential of substitute product market

#### B. Technical Due Diligence

(1) The applicant TVE's general technical level in domestic competitors after completion of technical improvement

(2) The applicant TVE's general technical level in international competitors after completion of technical improvement

(3) Energy saving potential in three years after the completion of technical improvement

(4) GHG emission reduction potential in three years after the completion of technical improvement

(5) The technology and/or equipment supplier's ability in after-sale service and technical support

(6) The cost of the technology and/or equipment's further update

(7) The stableness of the technology and/or equipment

(8) The threat of substitute technology

(9) The quality of the feasibility study

#### C. Managerial Due Diligence

(1) Educational background of key managers

(2) Industrial background of key managers

(3) Passion of key managers

(4) The soundness of the structure of the management team

(5) The efficiency of communications between management team members

(6) The frequency of the change of management team members in the past three years

(7) The history of management team members been suit in court in the past three years

(8) The soundness of the applicant's incentive system

(9) The quality of the applicant's internal control system

(10) Whether or not the applicant has passed any managerial or quality control

certificates

(11) Whether or not the applicant has gotten any rewards or punishments from government authorities

#### D. Financial Due Diligence

- (1) The soundness of the applicant's financial and accounting system
- (2) The applicant's credit rating
- (3) The average profit-total assets ratio in the past three years
- (4) The average profit-sales ratio in the past three years
- (5) The average liquid ratio in the past three years
- (6) The average quick ratio in the past three years
- (7) The average asset-liability ratio in the past three years
- (8) The average accounts receivable turnover in the past three years
- (9) The average sales-production ratio in the past three years
- (10) The average sales growth rate in the past three years
- (11) The average owner's equity growth rate in the past three years
- (12) The cost saving potential or revenue addition potential after completion of technical improvement
- (13) The percentage of self-funded capital in total capital budget for the technical improvement
- (14) Whether or not the financial information from financial statements is in accordance with the applicant's taxation record

#### E. Legal Due Diligence

- (1) Whether or not the applicant is an independent legal entity
- (2) Whether or not the applicant has the necessary legal proofs for those tangible and intangible assets it declared
- (3) Whether or not the applicant has any unfinished law suits which might affect its loan repayment ability
- (4) Whether or not the applicant has any significant contracts with any third parties

which might affect its loan repayment ability

(5) Whether or not the security interests provided by the applicant is in compliance with related law and regulations

#### **IV. Final Decision**

The due diligence gives fundamental supports to the final conclusion. However Hongyuan still needs to consider the following factors to make its final decision.

- (1) The opinions from other joining parties, including PIC and ABC; and
- (2) The status of the applicant's loan application to the ABC branch. Only after local ABC branch approves the applicant's commercial loan application can Hongyuan make entrustment loan.

If Hongyuan decides to approve the application after considering all the factors, it needs to determine the key terms and conditions of the TVE entrustment loan:

- (1) size of the loan,
- (2) duration of the loan,
- (3) timetable for money transfer,
- (4) security of the loan,
- (5) method of repayment, and
- (6) management fee rate.

In determine the above key terms and conditions, Hongyuan may refer to the following criteria:

- (1) The size of the loans can not exceed 200,000 US dollars, and it should not exceed 70 percent of the total capital budget.
- (2) The duration of the TVE entrustment loan should not exceed three years, at most five years.
- (3) The money transfer schedule should be in accordance with the progress of the technical improvement project.

- (4) Generally the loan size can not exceed 70 percent of the valuation of the mortgage.
- (5) Usually the borrower should repay the loan after it takes all the loan. However, Hongyuan could consider to give the borrower some grace period with no longer than one and half years.
- (6) The management fee rate should be determined by the loan size, the service fee rate charged by ABC local branch and Hongyuan's management cost. However, the rate should not exceed 50 percent of the compound interest rate charged by commercial banks over the same period.

## **V. Management of the TVE Entrustment Loan**

Hongyuan should enhance the management of the TVE Entrustment Loan after making them and effectively control the risks.

During the construction period of the loan project, the management should focus on:

- (1) Check whether the project has been approved by concerned government agencies according to the laws and regulations;
- (2) Check whether the borrower has signed a construction contract with the construction company and a purchasing contract with the equipment supplier;
- (3) Check whether the progress of the construction is in compliance with the feasibility study and whether the construction quality can pass related standards;
- (4) Check whether the self-funded capital for the project has been ready;
- (5) Check whether the construction cost exceeds the capital budget in the feasibility study;

(6) Check whether there are some important issues including changes of project location, project layout, key equipments, or key leaders of the project;

(7) Check whether the construction period ends in time and whether the completion of the construction has been approved by related government authorities.

After the loan project has been put into operations, the management should focus on:

(1) Check the changes of production and cash flows;

(2) Check the situation of the repayment of the TVE Entrustment Loan;

(3) Check the liquid ratio and quick ratio;

(4) Check the accounts receivable turnover and production/sales ratio;

(5) Check the asset-liability ratio;

(6) Check the ROA ratio and profit-sales ratio.

Hongyuan should conduct the routine checks once every three months and conduct temporary checks when necessary. Hongyuan needs to make post-loan management report and analysis the results of its checks.

Hongyuan could ask the related ABC local branches for their assistance in its post-loan management.

For those loan risks discovered in the post-loan management, Hongyuan should take appropriate measures according to the agreements and contracts and China's laws and regulations to best control the risks by ceasing the extension of the TVE Entrustment

Loan, collecting the loan in advance, selling of collaterals, asking the guarantor to repay the loan, or lawsuits.

## **VI. Supervision and Reports**

Hongyuan should accept the supervision of the UNDP, the UNIDO and the MOA in doing the TVE Entrustment Loan business. The supervisory bodies can read the business documents and archives of Hongyuan and may make inquiries for Hongyuan.

Hongyuan should provide quarterly reports to the UNIDO and the MOA and report its TVE Entrustment Loan business, possible problems and proposed solutions in a timely and precise manner.

## UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

Project Title: Energy Conservation and Greenhouse Gas Emissions Reduction  
in Chinese Township and Village Enterprises – Phase II  
Project Number: EG/CPR/99/G31  
Subcontract Title: Transfer and Management of the Entrustment Loan Facility

### TERMS OF REFERENCE

#### A. Background Information

The Entrustment Loan Facility is one of the three integral components of the Revolving Capital Fund (RCF) financing mechanism under the project entitled “Energy Conservation and GHG Emissions Reduction in Chinese TVEs” funded by the Global Environment Facility (GEF). The project is executed by the United Nations Industrial Development Organization (UNIDO) in cooperation with the Chinese Ministry of Agriculture (MOA). The Entrustment Loan Facility aims to help Chinese TVEs remove financial barriers in their efforts to adopt advanced technologies to improve energy efficiency. The Entrustment Loan Facility is a pioneering and innovative approach in financing technology upgrading for energy efficiency in small and medium scale industries in China.

According to the Memorandum of Understanding on the Establishment and Operation of the RCF (Annex One), the project document, and relevant Chinese laws and regulations, the concerned parties have agreed that the Hongyuan Energy and Environmental Protection Company (hereafter Hongyuan) be selected to manage the Entrustment Loan Facility. Hongyuan will entrust the Agricultural Bank of China (ABC) to make loans from the Entrustment Loan Facility to qualified TVE borrowers.

#### B. Scope of Work

The overall scope of work for Hongyuan is to manage the Entrustment Loan Facility of the RCF. The following is a list of tasks to be undertaken:

1. Sign the Memorandum of Understanding on the Operation of the TVE Entrustment Loan Facility with ABC and MOA.

Detailed working procedures will be defined and carried out by Hongyuan and the ABC branches. These procedures should be endorsed by ABC

headquarters and MOA. See Annex Two for the draft MOU between ABC, MOA, and Hongyuan.

The contractor will ensure that ABC headquarters will issue a code of practice to its local branches regarding the operation of the Entrustment Loan Facility.

2. Set up an Entrustment Loan Management Committee.

In order to ensure the proper functioning of the Entrustment Loan Facility, Hongyuan will establish a committee (hereafter the Committee) responsible for the management of the Entrustment Loan Facility.

The Committee will consist of the president, the general manager, and the financial manager of Hongyuan. The UNIDO Chief Technical Advisor will sit on the Committee in an advisory capacity. Hongyuan may invite one or more external experts to participate in Committee deliberations without voting rights.

The functions of the Committee will include:

- Reviewing and approving or rejecting applications to the Entrustment Loan Facility;
- Managing the entrustment loans after they are made;
- Handling non-performing loans;
- Dealing with other issues related to the Entrustment Loan Facility.

The contractor will set up the Committee within two weeks of contract acceptance.

3. Review applications to the Entrustment Loan Facility.

Hongyuan will review applications received from ABC to the Entrustment Loan Facility and decide through the Committee whether to accept or reject the loan application.

See Annex Three for the Entrustment Loan Assessment and Management Criteria and Procedures. These criteria and procedures should be revised and updated as and when required.

4. Conduct due diligence and decide on the loan terms and conditions.

Hongyuan will conduct due diligence on the applications from the industrial and market, technical, managerial, financial, and legal perspectives.

Once the application is accepted, Hongyuan will submit it to the National Policy Implementation Committee (PIC) for its clearance regarding compliance with environmental and industrial policies.

Subsequently, Hongyuan will establish detailed terms and conditions for the entrustment loan of the accepted application and issue an Entrustment Loan Notification Form to the relevant ABC branch indicating the applicant's name, loan type and size, usage, duration, the drawing and repayment methods, the security interests, and the rate of management fee.

The terms and conditions established by Hongyuan will be in accordance with the Entrustment Loan Assessment and Management Criteria and Procedures (Annex Three).

5. Authorize disbursement of the entrustment loan.

Hongyuan will forward the Entrustment Loan Notification Form to the relevant ABC branch and authorize it to transfer the specified amount to the borrower's bank account in conformity with the Entrustment Loan Notification Form and the entrustment agreement (see Annex Four).

6. Manage and monitor the approved entrustment loan.

Hongyuan will obtain periodic notification from the borrower ensuring that the loan is used for its intended purpose and is in compliance with the Entrustment Loan Assessment and Management Criteria and Procedures and the entrustment agreement.

### **C. Deliverables and Reporting Requirements**

Deliverables will include the following:

1. Progress reports. Hongyuan should submit quarterly reports covering the activities carried out during the period under consideration, listing the reviewed and approved loans.
2. Bankable proposals. Hongyuan should submit bankable proposals approved by them, ABC, and PIC.
3. Account statements. Hongyuan should forward the statement of the Entrustment Loan Facility account at ABC headquarters on a quarterly basis.

## **Annexes**

- Annex One      Memorandum of Understanding on the Establishment and Operation of the Revolving Capital Fund
- Annex Two      Memorandum of Understanding on the Operation of the Entrustment Loan Facility
- Annex Three    Entrustment Loan Assessment and Management Criteria and Procedures
- Annex Four     Entrustment Agreement (Template)

**MEMORANDUM OF UNDERSTANDING**  
**ON THE ESTABLISHMENT AND OPERATION OF**  
**THE REVOLVING CAPITAL FUND**

“Energy Conservation and Greenhouse Gas (GHG) Emissions Reduction in Chinese Township and Village Enterprises (TVEs) – Phase II” is a project funded by the Global Environment Facility (GEF). The United Nations Development Programme (UNDP) is the implementing agency for the project. The project is executed by the United Nations Industrial Development Organization (UNIDO) in cooperation with the Chinese Ministry of Agriculture (MOA). The project aims to promote Chinese TVEs to adopt advanced technologies to improve their energy efficiency and reduce GHG emissions. According to the project document, all parties agree to establish a Revolving Capital Fund (RCF) to help the Chinese TVEs remove financial barriers in their efforts to implement technical improvement. In order to make the RCF function well according to the project document and relevant Chinese laws and regulations, the concerned parties agree to establish the RCF as a financing mechanism and have reached the following understanding.

**1. Funding Sources for the RCF**

The RCF financing mechanism consists of one million US dollars from GEF/UNDP through UNIDO, two million US dollars (in Chinese RMB equivalent) from the Agricultural Bank of China (ABC), and one million US dollars (in Chinese RMB equivalent) from the Chinese MOA.

All parties agree that in future the RCF financing mechanism can receive funds from sources other than the founding parties.

**2. The Entrustment Loan Facility**

UNIDO will transfer the one million US dollars from GEF/UNDP to Hongyuan Energy and Environmental Protection Company, Ltd. (formerly PTPMC). In turn, Hongyuan will entrust the funds to ABC to make loans to the qualified TVEs.

**3. The Commercial Loan Facility**

ABC will make no less than two million US dollars (in Chinese RMB equivalent) commercial loans to TVEs in support of technical improvement for the purpose of

energy conservation and GHG emissions reduction. The commercial loan appraisal, disbursement, and management procedures will be solely decided by ABC according to relevant laws and regulations.

#### **4. The Capacity Building Facility**

MOA will provide no less than one million US dollars (in Chinese RMB equivalent) to help TVEs in capacity building with regard to removing financial barriers. MOA will act by itself or through its local agencies to provide capacity building. This will include training, equipment, and technology support.

#### **5. Other Business**

Detailed procedures regarding the operation of the RCF will be agreed to by the parties concerned.

MOA

Authorized Representative:

Signature:

Date:

ABC

Authorized Representative:

Signature:

Date:

UNIDO

Authorized Representative:

Signature:

Date:

UNDP

Authorized Representative:

Signature:

Date:

## **MEMORANDUM OF UNDERSTANDING ON THE OPERATION OF THE ENTRUSTMENT LOAN FACILITY**

The TVE entrustment loan is an important part of the project entitled “Energy Conservation and GHG Emissions Reduction in Chinese TVEs” sponsored by UNDP/GEF. It aims to help to eliminate financial barriers for Chinese TVEs in their efforts to improve their technology and thus improve their energy efficiencies. According to the project documents and related Chinese law and regulations, the Chinese government has agreed that Beijing Hongyuan Energy and Environmental Protection Co., Ltd (the former PTPMC) is designated as the managing body and principal of the TVE entrustment loan and the Agricultural Bank of China (ABC) provides the banking services. In order to better implement the business, all the related parties have reached the following common understanding.

### **1. Fund Sources of the TVE Entrustment Loan**

The TVE entrustment loan program has a fund of equivalent with one million US dollars. Hongyuan is responsible for supplying the fund.

### **2. Several Basic Principles in the TVE Entrustment Loan Business**

Hongyuan and the ABC agree that both parties will comply with the following principles in the TVE entrustment loan business.

(1) According to the commercial banking act of China and Chinese banking regulation, the ABC as an agency and services provider can only deliver services of making, supervising and assisting drawing back the entrustment loan. The ABC will not assume any kind of loan risks.

(2) Any single TVE entrustment loan shall not exceed 200,000 US dollars.

(3) Hongyuan agrees that it will not charge any interests for the TVE entrustment loan, but only charge some management fees, and the fee rate will not exceed 50 percent of the interest rate charged by commercial banks during the same period.

(4) The Ministry of Agriculture will act as the supervisory body of the operation of the TVE entrustment loan business.

### 3. The Management of TVE Entrustment Loan Business

The local branches of the ABC will be responsible for providing banking services to the TVE entrustment loan program. In order to better manage the operation of the program, the ABC headquarter will issue a code of practice in doing the TVE entrustment loan business to guide its local branches. And the ABC headquarter will also be responsible for coordinating the relationship between Hongyuan and its local branches.

According to a regulation issued by the People's Bank of China, currently Hongyuan needs to sign entrustment agreements with the ABC branches respectively. The ABC headquarter and Hongyuan will work together for a template agreement. The rate of the service fee charged by the ABC local branches will be set in the entrustment agreements.

### 4. The Fund Management of the TVE Entrustment Loan

Hongyuan will open a special account with the ABC headquarter and deposit the fund of one million US dollars into the account.

After the loan application is approved by Hongyuan, Hongyuan shall arrange the fund transfer from the special account to the borrower through the ABC local branches.

The local branches of the ABC will transfer the management fee paid by the borrowers less the service fee to the current account of Hongyuan. And the principal repaid by the borrowers will be transferred directly back to the special account.

### 5. Other Matters

In case the related regulation changes in the future, the operation and management of the TVE entrustment loan program might need to change as well. However, any such change must be approved by the MOA, Hongyuan and the ABC.

Other issues concerning the TVE entrustment loan program will be resolved by all three parties through mutual consultation.

MOA	Hongyuan	ABC
Name	Name	Name
Signature	Signature	Signature
Date	Date	Date

## **THE ENTRUSTMENT LOAN ASSESSMENT AND MANAGEMENT CRITERIA AND PROCEDURES**

The loan assessment procedures should be followed by the Hongyuan Energy and Environmental Protection Co., Ltd (formerly PTPMC). In conducting the assessment, Hongyuan needs to first clarify whether or not the applicant TVE meets the basic requirements for the TVE entrustment loan. And then, Hongyuan needs to complete the preliminary test. There are several removal standards, and if the applicant TVE meets any one of the standards, Hongyuan can just reject its application. For those who passes the preliminary test, Hongyuan needs to conduct detailed due diligence, to evaluate the applicant TVE from its industrial, market, technological, managerial, financial and legal aspects. The conclusion from the due diligence is of great importance for Hongyuan to make its final decision. However, Hongyuan still needs to consider the opinions of PIC and ABC to finally decide whether or not to make the loan and terms and conditions of the loan.

### **I. Basic Requirements to Qualify the Application of the TVE Entrustment Loan**

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- (1) The applicant's businesses must comply with Chinese law and regulation, and are in accordance with the national industrial development plan.
- (2) The applicant has steady revenue and good credit record, and have the capability to repay the loan in time.
- (3) The applicant should have opened an account with the Agricultural Bank of China, and is willing to accept ABC's monitoring.
- (4) The applicant has the Loan Card issued by People's Bank of China and an Organizational Code issued by the Quality and Technical Supervision authority.
- (5) The applicant has a valid business license issued by local SAIC.

### **II. Preliminary Test Criteria**

During the preliminary test, if the applicant is found to meet ANY of the following removal standards, Hongyuan can just simply reject its loan application. The removal standards are:

- (1) The applicant is not a township and village enterprise.
- (2) The applicant does not belong to any one sector of brick manufacture, cement

production, metal casting and coking.

(3) The purpose of the loan application is not for a technical improvement for energy conservation and GHG emission reduction.

(4) The applicant does not have a feasibility study report for its technical improvement project.

(5) The management of the applicant is disordered, and the applicant does not have a financial record or taxation record.

(6) The applicant's average asset-liability ratio in the last three years is higher than 85%, and the net owner's equity is negative.

(7) The applicant's credit rating is lower than BBB.

The Hongyuan Company should finish the preliminary evaluation within five working days since it receives the loan application, and decide whether or not it accepts the loan application according to the above basic requirements and preliminary test criteria. Hongyuan needs to notify its decision to the applicants and related ABC local branches.

For those applications accepted by Hongyuan, it should conduct due diligence within twenty-five working days upon its receive of the applications, and decide whether or not to approve the application according to the following due diligence criteria.

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A. Industrial and Market Due Diligence

B. Technical Due Diligence

C. Managerial Due Diligence

D. Financial Due Diligence

E. Legal Due Diligence

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All the five aspects of due diligence can be extended to details. The following gives one possible detailed due diligence criteria.

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(1) The extent of the consistence of the applicant TVE's industrial sector with the

national industrial development plan

- (2) Growth rate of the target market
- (3) The applicant TVE's competitive advantages in its sector
- (4) The applicant TVE's bargaining power in its raw material purchasing
- (5) The applicant TVE's control of price in its sales
- (6) The growth rate and growth potential of substitute product market

#### B. Technical Due Diligence

- (1) The applicant TVE's general technical level in domestic competitors after completion of technical improvement
- (2) The applicant TVE's general technical level in international competitors after completion of technical improvement
- (3) Energy saving potential in three years after the completion of technical improvement
- (4) GHG emission reduction potential in three years after the completion of technical improvement
- (5) The technology and/or equipment supplier's ability in after-sale service and technical support
- (6) The cost of the technology and/or equipment's further update
- (7) The stableness of the technology and/or equipment
- (8) The threat of substitute technology
- (9) The quality of the feasibility study

#### C. Managerial Due Diligence

- (1) Educational background of key managers
- (2) Industrial background of key managers
- (3) Passion of key managers
- (4) The soundness of the structure of the management team
- (5) The efficiency of communications between management team members
- (6) The frequency of the change of management team members in the past three years
- (7) The history of management team members been suit in court in the past three years
- (8) The soundness of the applicant's incentive system
- (9) The quality of the applicant's internal control system
- (10) Whether or not the applicant has passed any managerial or quality control certificates
- (11) Whether or not the applicant has gotten any rewards or punishments from government authorities

#### D. Financial Due Diligence

- (1) The soundness of the applicant's financial and accounting system
- (2) The applicant's credit rating
- (3) The average profit-total assets ratio in the past three years
- (4) The average profit-sales ratio in the past three years

- (5) The average liquid ratio in the past three years
- (6) The average quick ratio in the past three years
- (7) The average asset-liability ratio in the past three years
- (8) The average accounts receivable turnover in the past three years
- (9) The average sales-production ratio in the past three years
- (10) The average sales growth rate in the past three years
- (11) The average owner's equity growth rate in the past three years
- (12) The cost saving potential or revenue addition potential after completion of technical improvement
- (13) The percentage of self-funded capital in total capital budget for the technical improvement
- (14) Whether or not the financial information from financial statements is in accordance with the applicant's taxation record

#### E. Legal Due Diligence

- (1) Whether or not the applicant is an independent legal entity
- (2) Whether or not the applicant has the necessary legal proofs for those tangible and intangible assets it declared
- (3) Whether or not the applicant has any unfinished law suits which might affect its loan repayment ability
- (4) Whether or not the applicant has any significant contracts with any third parties which might affect its loan repayment ability
- (5) Whether or not the security interests provided by the applicant is in compliance with related law and regulations

#### IV. Final Decision

The due diligence gives fundamental supports to the final conclusion. However Hongyuan still needs to consider the following factors to make its final decision.

- (1) The opinions from other joining parties, including PIC and ABC; and
- (2) The status of the applicant's loan application to the ABC branch. Only after local ABC branch approves the applicant's commercial loan application can Hongyuan make entrustment loan.

If Hongyuan decides to approve the application after considering all the factors, it needs to determine the key terms and conditions of the TVE entrustment loan:

- (1) size of the loan,
- (2) duration of the loan,
- (3) timetable for money transfer,
- (4) security of the loan,
- (5) method of repayment, and
- (6) management fee rate.

In determine the above key terms and conditions, Hongyuan may refer to the

following criteria:

- (1) The size of the loans can not exceed 200,000 US dollars, and it should not exceed 70 percent of the total capital budget.
- (2) The duration of the TVE entrustment loan should not exceed three years, at most five years.
- (3) The money transfer schedule should be in accordance with the progress of the technical improvement project.
- (4) Generally the loan size can not exceed 70 percent of the valuation of the mortgage.
- (5) Usually the borrower should repay the loan after it takes all the loan. However, Hongyuan could consider to give the borrower some grace period with no longer than one and half years.
- (6) The management fee rate should be determined by the loan size, the service fee rate charged by ABC local branch and Hongyuan's management cost. However, the rate should not exceed 50 percent of the compound interest rate charged by commercial banks over the same period.

#### **V. Management of the TVE Entrustment Loan**

Hongyuan should enhance the management of the TVE Entrustment Loan after making them and effectively control the risks.

During the construction period of the loan project, the management should focus on:

- (1) Check whether the project has been approved by concerned government agencies according to the laws and regulations;
- (2) Check whether the borrower has signed a construction contract with the construction company and a purchasing contract with the equipment supplier;
- (3) Check whether the progress of the construction is in compliance with the feasibility study and whether the construction quality can pass related standards;
- (4) Check whether the self-funded capital for the project has been ready;
- (5) Check whether the construction cost exceeds the capital budget in the feasibility study;
- (6) Check whether there are some important issues including changes of project location, project layout, key equipments, or key leaders of the project;
- (7) Check whether the construction period ends in time and whether the completion of the construction has been approved by related government authorities.

After the loan project has been put into operations, the management should focus on:

- (1) Check the changes of production and cash flows;
- (2) Check the situation of the repayment of the TVE Entrustment Loan;
- (3) Check the liquid ratio and quick ratio;
- (4) Check the accounts receivable turnover and production/sales ratio;
- (5) Check the asset-liability ratio;
- (6) Check the ROA ratio and profit-sales ratio.

Hongyuan should conduct the routine checks once every three months and conduct temporary checks when necessary. Hongyuan needs to make post-loan management report and analysis the results of its checks.

Hongyuan could ask the related ABC local branches for their assistance in its post-loan management.

For those loan risks discovered in the post-loan management, Hongyuan should take appropriate measures according to the agreements and contracts and China's laws and regulations to best control the risks by ceasing the extension of the TVE Entrustment Loan, collecting the loan in advance, selling of collaterals, asking the guarantor to repay the loan, or lawsuits.

## **VI. Supervision and Reports**

Hongyuan should accept the supervision of the UNDP, the UNIDO and the MOA in doing the TVE Entrustment Loan business. The supervisory bodies can read the business documents and archives of Hongyuan and may make inquiries for Hongyuan.

Hongyuan should provide quarterly reports to the UNIDO and the MOA and report its TVE Entrustment Loan business, possible problems and proposed solutions in a timely and precise manner.

## ENTRUSTMENT AGREEMENT

(Template)

This agreement is signed between  
Beijing Hongyuan Energy and Environmental Protection Co., Ltd (hereinafter referred to as "Hongyuan")  
and  
The \_\_\_\_\_ Branch of Agricultural Bank of China (hereinafter referred to as "the ABC")

Hongyuan entrusts the ABC to make loans to the borrowers designated by Hongyuan, and the ABC agrees to do the business. According to related law and regulation of People's Republic of China, both parties have reached the following agreements on the business of TVE entrustment loan.

Article One Hongyuan entrusts the ABC to make loan of RMB \_\_\_\_\_ yuan and helps to collect the loans back according to the procedures of the entrustment loan.

Article Two Hongyuan should open a special account with the ABC headquarter and deposit funds of RMB \_\_\_\_\_ yuan within \_\_\_ days since this agreement comes into effect. The entrustment loan can not exceed the amount deposited by Hongyuan.

Article Three The borrower qualification, the amounts, the types of loans, the duration, the interest rates, and grace period and the repayment methods of the entrustment loans should all be decided by Hongyuan. And Hongyuan should fill in an Entrustment Loan Notification Form.

Article Four After this agreement comes into effect, when Hongyuan decides to make an entrustment loan to a borrower, it should deliver the Entrustment Loan Notification Form to the ABC. The ABC should check the items listed in the Entrustment Loan Notification Form for their compliance with this agreement and then make the entrustment loan according to the Entrustment Loan Notification Form.

Article Five The ABC should sign an Entrustment Loan Contract with the borrow before making the loan and should send a copy of the contract to Hongyuan within \_\_\_ working days since the Entrustment Loan Contract comes into effect.

Article Six If the borrower can not repay the entrustment loan, Hongyuan can not ask the ABC to pay any part or full of the entrustment loan. If the entrustment loan

suffers a loss, the ABC will not assume any responsibility of reimbursement.

Article Seven Hongyuan can ask the borrowers to supply with security interest against the entrustment loans. The method of the security interest should be checked by Hongyuan and should be made clear in the Entrustment Loan Notification Form.

Article Eight If the borrower can not repay the entrustment loan according to the Entrustment Loan Contract, the ABC could charge the borrower with an interest fine. The ABC could reserve 50 percent of the interest fine and transfer the remaining to Hongyuan's account.

Article Nine The ABC should pay interests at a monthly rate of \_\_\_ percent for the balance of the special account of Hongyuan. The ABC should transfer the interests or management fees paid by the borrowers to Hongyuan's account within \_\_\_ working days.

Hongyuan shall pay a service fee which is 0.3 percent of the entrustment loan to the ABC. The charge of the service fee will be according to the following:

Article Ten Within \_\_\_ working days after the ABC collects the entrustment loan back from the borrower, it should remit the money to the special account of PTPMC with the headquarter of the ABC.

Article Eleven Any changes to the repayment of the entrustment loans should be agreed in written by Hongyuan, the ABC and the borrower.

Article Twelve After the entrustment loan is collected, Hongyuan can use it on another new entrustment loan project.

Article Thirteen This agreement can not be changed without written agreement of both Hongyuan and the ABC.

Article Fourteen Defaults

1. If Hongyuan fails to deposit the fund to the special account with the headquarter of the ABC according to Article Two of this agreement, or fails to supply with necessary materials according to Articles Three and Four of this agreement, the ABC can refuse to make the entrustment loan.
2. If the ABC fails to make the entrustment loan according to the Entrustment Loan Notification Form, Hongyuan can draw part of full fund from the special account and the ABC should compensate any losses caused by its default.
3. If the ABC agrees the borrower to change the repayment method without written permission of Hongyuan, Hongyuan can ask the ABC to collect the entrustment loan according to the original repayment method.

Article Fifteen Other Issues

Article Sixteen Disputes Resolution

Any dispute with regard to the execution of this agreement should be resolved through mutual consultation. Failure of mutual consultation can lead to a lawsuit on the court.

Article Seventeen For any issues that are not specified in this agreement, both parties agree to act according to the laws and regulations of the People's Republic of China.

Article Eighteen This agreement will come into effect upon signatures of legal representatives or their authorized representatives of both Hongyuan and the ABC.

Article Nineteen The Entrustment Loan Notification Form and the materials provided by Hongyuan should be regarded as appendixes of this agreement.

Article Twenty This agreement has two formal copies, and each party shall have one copy.

Hongyuan

ABC

Name

Name

Signature

Signature

Date

Date

## RCF TRAINING PLAN

### I. TRAINING AGENDA

The RCF training will be held at Beijing Xiangshan hotel on August 10 to 12, 2003. The trainees are representatives from the pilot TVEs and local ABC branches. The employees of the PTPMC will also attend the training. There will be approximately 40 trainees.

The training will be delivered through lecturing and discussion. The teachers are mainly from the sub-contractor FRC/VCChina, and an expert from the ABC will be invited to give a lecture on bank loans.

The detailed training agenda is available.

### II. CONTENTS OF TRAINING

Considering the trainees' education and occupation backgrounds, the RCF training will focus on practical issues. However, the sub-contractor will print some related material which is a little bit theoretical and give to the trainees as complementary reading materials.

The main purpose of this RCF training is to help employees from pilot TVEs and local ABC branches be more familiar with the RCF mechanism and its operation, understand China's current financial and banking system, discuss the financial obstacles that the TVE sector faces, and understand the process and criteria of the TVE entrustment loan and ABC commercial loan. It is expected to help promote the RCF subproject and the whole TVE project through this training.

The RCF training will cover the following contents: China's financial and banking system, practical corporate financing, operation of the RCF (including TVE entrustment loan and ABC commercial loan), practical corporate accounting, taxation, and corporate management.

#### **China's Financial and Banking System**

This part aims to provide the trainees a framework knowledge of China's financial system and a closer look of China's banking sector. This should be the basic background knowledge for any enterprise who is looking for funding. Detailed contents include:

(1) Organizational structure of China's financial industry: the central bank, CBRC, CSRC, CIRC, commercial banks, policy banks, security companies, insurance companies, investment banks, and other non-banking financial institutions.

(2) China's financial markets: money market, capital market, and related international financial markets.

(3) Legal framework for China's financial industry: central bank act, commercial bank act, securities act, insurance act, and loan regulations

(4) Business framework of commercial banks: asset businesses, liability businesses, intermediary businesses

### **Practical Corporate Financing**

This part is based on the real situation of Chinese TVEs and provides guidance on how to get financing for the TVEs' technical improvement projects.

(1) Various financing channels: self financing, banking loans, bonds financing, public offering, private equity, etc. Comparison of these channels.

(2) Feasible financing resources for Chinese TVEs: banking loans, private equity.

(3) Banking loan financing and capital structure.

(4) Private equity and venture capital.

### **Operation of the RCF**

This part aims to help the trainees to understand the RCF mechanism and to know how to apply for the entrustment loan and the commercial loan facilities. It will help the RCF function more efficiently. Detailed contents include:

(1) Framework of the RCF structure and its role and function in the whole TVE Project.

(2) How to apply for the TVE entrustment loan: procedure and criteria of the entrustment loan

(3) How to apply for the commercial loan provided by the ABC.

(4) How to apply for the capacity building support from the MOA

### **Practical Corporate Accounting**

Whether a TVE has a sound accounting system with high quality financial statements will have great influence on its credit rating. The RCF training will focus on basic practical accounting issues:

- (1) Functions of a sound accounting system.
- (2) Financial statements: balance sheet, income statement and statement of cash flows.
- (3) Preliminary analysis of financial statements: financial ratio analysis

### **Taxation**

To pay taxes according to the law is not only a liability of every enterprise, but also an important factor in business decision making. The tax cost should be considered in investments, financing, and operations decision. This part of training will focus on the most important taxes for the TVEs: value added tax, income tax and business tax. The trainees will learn how to calculate the taxes and how to take the tax costs into consideration when making business decisions. Detailed contents include:

- (1) Implication of taxes
- (2) Value-added tax
- (3) Income tax
- (4) Business tax

the sub-contractor will reprint related tax laws for the trainees as a complementary reading material.

### **Corporate Management**

This part aims to introduce some modern management philosophy to the trainees:

- (1) Sound enterprise organizational structure
- (2) Modern human resources management philosophy
- (3) Quality control and 6  $\sigma$
- (4) Incentive system and ESOP

## **Discussions**

There will be two sessions of discussions during the training.

(1) Discussion between representatives from the TVEs and local ABC branches. After the training of the operations of financing and loan procedures, the TVEs can communicate with the banks and discuss any practical issues related to the application of TVE entrustment loan or commercial loan. This will help the pilot TVEs better understand the loan procedures and criteria and provide them with an opportunity to get guidance from the commercial banks.

(2) Panel discussion at the end of the training. It will help the trainees to review the whole training session and propose possible questions for discussion. Besides, some TVEs or local ABC branches with good experiences can share their successful experiences with all of the trainees.

## RCF TRAINING AGENDA

Date: August 10 – 12, 2003

Place: Fragrant Hill Hotel, Beijing

Date	Time	Topic	Speaker	Content
August 10	8:00—17:00	Registration		
August 11	8:00—9:30	China's Financial and Banking System	Yulu Chen	Introduce China's financial and banking systems, especially rural financial system
	9:40—11:10	Practical Corporate Financing	Bo Hu	Analyze financing obstacles for Chinese TVEs, esp. small and median sized TVEs, and propose possible suggestions
	13:30—15:10	Operation of the RCF	Yunbo Li	Introduce the RCF mechanism and its current construction progress
	15:20—16:30	The TVE Entrustment Loan Business	Bo Hu	Introduce how to apply the entrustment loan, and how the application will be processed
August 12	8:00—11:00	Practical Corporate Management	Bo Hu	Organization structure, HR management, quality control, ESOP
	13:30—15:00	Practical Accounting	Xiaoke Cheng	Accounting system, financial statements and their analysis
	15:10—16:40	Taxation	Xiaoke Cheng	Value-added tax, income tax and business tax

## **RCF TRAINING MINUTE**

In order to help the demonstrating TVEs and local ABC branches to better understand the RCF, especially the application and approval procedures of the TVE entrustment loan, and to facilitate the operation of the RCF, the RCF subcontractor FRC/VCChina held the RCF training and forum from August 10, 2003 to August 12, 2003 at Beijing Fragrant Hill Hotel.

### **I. Participants**

The participants included representatives from the eight demonstrating TVEs, local governments, ABC branches at the county and provincial levels, the PMO, the PTPMC, GEF China Office and the CTA.

### **II. Activities**

During the conference, the subcontractor combined training and discussion together. Professor Yulu Chen and lawyer Yunbo Li from FRC, Bo Hu from VCChina, and Dr. Xiaoke Cheng from Renmin Business School made speeches to the participants. The contents of the training covered a wide range, including the operation structure of the RCF, application and approval procedures of the TVE entrustment loan, the code of practice in the operation of the TVE entrustment loan (only staffs from the ABC attended this part of training), China's financial and banking system and selected current hot financial issues, practical accounting, practical taxation, practical financing, practical corporate management, and etc.

The subcontractor also arranged a forum on the RCF. On the forum, the participating TVEs, the ABC, the subcontractor and the PMO discussed the operation structure and procedures of the RCF into very details, and proposed with valuable suggestions. The subcontractor, the PMO and the CTA made explanations on some questions raised by the participants.

During the conference, the headquarter of the ABC also held a forum and asked its local branches from the county and provincial levels to discuss the code of practice in conducting the TVE entrustment loan business. The representatives from local ABC branches also proposed some constructive suggestions.

### **III. Outcomes**

During the conference, the participants thought highly of the RCF structure. Most of the suggestions proposed by the participants were related with the TVE entrustment loan.

1. Regarding the definition of the technical improvement, some representatives from the TVEs argued that technical improvement should cover not only improvements of original equipments and technologies, but also update of whole product line, because currently different provinces have different regulations on the environmental effects of selected production technologies.

2. Regarding the commercial loans made by the ABC, in order to ensure the safety of the TVE entrustment loan, the subcontractor suggested to make the TVE entrustment loan and the commercial loan at the same time and with the same duration, usage, security interests and repayment method. The subcontractor also proposed that the commercial loan should be one of the pre-conditions of the TVE entrustment loan. Some representatives from local ABC branches argued that according to current code of practices issued by the ABC headquarter, the county level branch has no qualification to make loans for technical improvement. Such loan applications should be reported to provincial level branch and even the headquarter for approval. As a matter of fact, many local commercial bank branches usually do not accept small technical improvement loan applications. Instead, they could make operational loans to the applicants and asked the applicants to use their original operational capital to purchase equipment or technologies. Therefore, some representatives from local ABC branches suggested that the ABC make operational capital loan and the PTPMC make technical improvement loan. However, the PTPMC argued that should this be the case, then it would be hard to match these two kinds of loans together. The duration of operational capital loan is usually less than one year, but the duration of technical improvement loan is typically longer than one year. Therefore, it will be difficult to combine them together and the safety of the TVE entrustment loan will not be secured.

3. Some specific problems were also discussed. The ABC Beijing branch said that the demonstrating TVE Beijing Yancun Brick Plant applied for technical improvement loan several months ago and now its application had been approved. The bank will make the loan in the coming weeks. Therefore, if the TVE entrustment loan can not be put into operation soon, then it will be hard to make the TVE entrustment loan and the commercial loan together.

Mr. Hao Xu, director of the agribusiness credit department of the headquarter of the ABC, asked the representatives from local branches to report to their governors after the conference ended, to contact the demonstrating TVEs, and to evaluate the capital requirement of the TVEs. Mr. Xu asked the local branches to report to the ABC headquarter within one month about the evaluation of the demonstrating TVEs and possible suggestions. Mr. Xu also requested the local branches to assign special persons to be in charge of the TVE entrustment loan business.

According to the suggestions proposed in the conference, the subcontractor will

propose an updated operational structure of the TVE entrustment loan in consultation with the ABC and the PTPMC.

# OUTLINE FOR FURTHER TRAINING

## PART ONE: CORPORATE FINANCE

### 1.1 Portfolio Management

- 1.1.1 Capital Market Theory
- 1.1.2 Asset Pricing
- 1.1.3 International Portfolio Investment

### 1.2 Financial Statement Analysis

- 1.2.1 Compiling of Financial Statements
- 1.2.2 Financial Ratio Analysis
- 1.2.3 Off-balance Sheet Items

### 1.3 Corporate Financing and Investing

- 1.3.1 Risk Analysis and the Optimal Capital Budget
- 1.3.2 Capital Structure and Leverage
- 1.3.3 Discounted Cash Flow Applications

### 1.4 Securities Markets

- 1.4.1 Types of Securities Markets
- 1.4.2 Stock Market
- 1.4.3 Bond Market
- 1.4.3 Derivative Securities
- 1.4.4 Alternative Investments

### 1.5 International Finance

- 1.5.1 Foreign Exchange
- 1.5.2 International Project Finance
- 1.5.3 Foreign Exchange Risk Management

## PART TWO: CORPORATE TAXATION

### 2.1 Overview of Taxation

- 2.1.1 Taxation as a tool for macro-economic adjustment
- 2.1.2 Taxation and government budgeting
- 2.1.3 Implications for enterprises

### 2.2 Enterprise Income Tax

- 2.2.1 Definition
- 2.2.2 Calculation
- 2.2.3 Pre-tax deductions

2.2.4 Preferential income tax

### **2.3 Business Tax**

2.3.1 Definition

2.3.2 Tax rates and calculations

### **2.4 Procedures of Taxation Management**

## **PART THREE: MANAGEMENT**

### **3.1 Business Analysis**

3.1.1 Business Plan Writing

3.1.2 Business Plan Analysis

3.1.3 Feasibility Study

### **3.2 Quality Control**

3.2.1 Enterprise Resources Planning (ERP)

3.2.2 Introduction to Six Sigma ( $6\sigma$ ) Management

### **3.3 Marketing**

3.3.1 Market Fractionize

3.3.2 Pricing Strategy

3.3.3 Competition

3.3.4 Brand Strategy

### **3.4 Human Resources**

3.4.1 Recruiting Talented Personnel

3.4.2 Internal Training System

3.4.3 Performance Evaluation

3.4.4 Salary and Bonus Policy

### **3.5 Incentives**

3.5.1 Annual Salary

3.5.2 Employee Stock Option Plan (ESOP)

3.5.3 Employee Retirement Plan

## **RCF FURTHER DEVELOPMENT PLAN**

RCF is designed as a flexible mechanism through which the fund suppliers support Chinese TVEs in their efforts to finance for their technical improvement in order to save energy and reduce GHG emissions. The participating TVEs will be able to improve their energy efficiency and save production costs at the same time, which will make such technical improvement projects high quality credit lending projects.

The future development of the RCF relies on continuous fund suppliers and fund demands, and it should make the RCF mechanism a win-win vehicle to obtain both social welfare and economic benefits.

The near-term development aim of the RCF is: upon the ending of the second phase of the Project, there will be no less than eight Chinese TVEs who have been supported by the entrustment loan, commercial loan and/or capacity building facilities. And the total sum of the loans will be no less than 2.3 million US dollars, of which the commercial loan will be no less than 1.5 million US dollars and the TVE entrustment loan will be no less than 0.8 million US dollars. And there will be more than three companies or other institutions who have intended to invest or participate in the RCF.

The mid-term development aim of the RCF is: till December 31, 2006, there will be no less than twenty Chinese TVEs who have been supported by the entrustment loan, commercial loan and/or capacity building facilities. The accumulative loans made through the RCF mechanism are more than 6 million US dollars.

The long-term development aim of the RCF is: till December 31, 2012, there will be over three hundred Chinese TVEs who have undertaken the technical improvement aiming to improve energy efficiency and reduce GHG emissions. The accumulative loans made through the RCF mechanism are more than 40 million US dollars.

This development plan is designed to assure the RCF development aim can be realized.

### **I. Take Full Use of the Initial Funds**

The initial funds of the RCF are supplied by GEF/UNDP, the ABC and the MOA with the total fund size of four million US dollars. The GEF/UNDP funds will be used as an entrustment loan facility, the ABC funds will be used as a commercial loan facility, and the MOA funds will be used as a capacity building facility.

The use of the initial funds will be of great importance for the future development of

the RCF, therefore, during the Project Period, all related parties should pay attention to the following aspects.

(1) Choose the WRITE participating TVEs. In choosing the participating TVEs, the concerned parties need to take both social welfare and economic benefits into consideration. If the technical improvement project is not bankable, it will be difficult for the RCF to be revolving.

(2) Enhance the risk management. Both Hongyuan Company and the ABC should take full use of the risk management tools and measures. Before the loan is made, the loan size, duration, usage, security interests, etc should be properly decided. And after the loan is made, various kinds of checks and supervision are important for risk management.

(3) Adjust the RCF mechanism in time. As China's financial and banking system reform is further carried out, the current RCF mechanism may be inappropriate with the legal and regulation environment. Therefore, the related parties need to review the RCF mechanism from time to time and make necessary adjustments.

## **II. Locate Potential Future Funds Suppliers**

The potential future funds suppliers include commercial banks, equipment and technology suppliers, governments and international energy and development organizations.

(1) Commercial banks. In the foreseeable future, China's financial market will continue to be dominated by indirect financing through the intermediary of commercial banks. In such a market, many commercial banks are looking for high quality lending clients and projects. However, for various of reasons, now the commercial banks are a little bit reluctant to make loans to Chinese TVEs. If the RCF can succeed in the first phase, its demonstrating effects will absorb many commercial banks to be its new funds suppliers.

(2) Equipment and technology suppliers. In equipment and technology trades, it is a conventional practice that the supplier give buyer's credit to the purchaser. However, because of the information asymmetry, the suppliers are not very familiar with the buyers' credit rating and thus their ability of repayment. Therefore, the current buyer's credit will result costs increase to both the suppliers and the buyers. RCF will provide the equipment and technology suppliers a new and more effective way to identify buyers with high credit rating and strong repayment ability. And through the RCF mechanism, the suppliers can arrange their credit to the buyers in a lost and safe mechanism.

(3) Governments and international organizations. For the sake of social welfare,

governments and various of international energy and development organizations often have some plans to give TVEs financial supports. The RCF mechanism can create for them an efficient and quick way to reach the right TVEs.

### **III. Attract More TVEs to Participate**

To attract more TVEs to take technical improvement projects in order to save energy and reduce GHG emissions is one of the aims of the RCF, and it is also a necessity for the RCF to get further development.

In order to better attract the TVEs to participate the RCF mechanism, the current RCF design has taken into consideration of several important factors, and these factors need to be strengthened in the operation of the RCF.

(1) Facilitate the TVEs financing activities. With the RCF, some financing which was difficult or even impossible now becomes probable. For example, the TVE entrustment loan facility and the matching commercial loan facility provided by the ABC are actually new financing sources for Chinese TVEs to complete their technical improvement projects. And in the operation of the RCF to provide financing services to the TVEs, it is designed to simplify the procedure and reduce the burden of the TVEs.

(2) Bring real economic benefits to the TVEs. On the one hand, in providing the services to the TVEs, the RCF is trying to reduce the financing costs of the TVEs. For example, the entrustment loan will not charge any interests. On the other hand, in helping the TVEs get financing, Hongyuan will take full use of its technical and information advantages to help the TVEs make a scientific plan and choose high quality equipments and technologies with comparatively low prices.

### **IV. Promotion**

The future development of the RCF relies on absorbing new financial resources to a great extent. Whether the RCF can attract new funds depends on whether it can take good use of the initial funds and how it can let potential funds suppliers know its successful experiences.

Therefore, the RCF should promote itself through various channels.

(1) Industrial and public media. Through the media, people will be familiar with the mechanism and track records of the RCF. The RCF could cooperate with the media in various ways, such as co-sponsoring a TV program, interviewing, and demonstrating.

(2) Conferences and forums. To sponsor industrial conferences and forums from time to time can effectively increase the popularity of the RCF and will be much helpful to

reach the potential funds suppliers.

(3) Training. RCF could supply training services to Chinese TVEs and commercial banks. Through the training activities, potential funds suppliers and demanders will be more familiar with the mechanism of the RCF.

#### V. Activity Plan in the Near Term

Activity	Responsibility	Time
Complete the establishment of the RCF mechanism	UNIDO, MOA, ABC	Year 1
Receive and accept loan applications by the TVEs, and start to work on the applications	ABC, HONGYUAN	Year 1
Complete loan and capacity building for at least three TVEs	ABC, HONGYUAN, MOA	Year 2
Work out a booklet for the RCF	HONGYUAN, ABC, MOA	Year 2
Launch the RCF website	HONGYUAN	Years 2-3
Contact equipment and service providers, commercial banks and international organizations, and sign intentional agreements or MOUs with them	HONGYUAN, MOA	Years 2-3
Complete loan and capacity building for at least eight TVEs	ABC, HONGYUAN, MOA	Year 3
Study experiences and lessons from operations of the RCF, and make necessary adjustments to the RCF mechanism	UNIDO, MOA, ABC, HONGYUAN	Year 3
Sponsor an industrial forum	ABC, HONGYUAN, MOA	Year 3
Sponsor an investor's conference and demonstrate the successful participating TVEs	ABC, HONGYUAN, MOA	Year 3
Negotiate with potential funds suppliers, and get financing for the RCF	HONGYUAN	Years 3-5
Train Hongyuan employees	HONGYUAN	Every Year
Train the employees of the TVEs and local branches of the ABC	MOA, HONGYUAN	Every Year