Country Focus Note:

China

The objective of this note is to provide readers with an overview of financial inclusion in China. The note begins with an examination of the current state of financial inclusion in the country. It moves on to recent trends that have been driving usage in the financial sector. The note concludes by a view of the challenges that limit financial inclusion, and the opportunities that exist to unlock the potential of fintechs.

1,378.7 Million
Population

78.6 Million
Population with income <USD 2 per day

983 Million
Population with income <USD 10 per day

45.9%
Rural population

96.4%
Adult literacy level

94.2%
Mobile penetration

79%
Banked population

5%
Gender gap in ownership of bank accounts

Key Trends: Savings	Key Trends: Credit
• 71.6% of the population save money, of which 41% save at a formal financial institution. • Large distances from financial institutions and regulatory limitation on micro credit companies (MCCs) to take deposits are some of the key barriers for low-income customers.	• Ranked at 84 globally in terms of ease of access to loans • 36.3% of the population avails credit, of which less than a fourth avails credit from formal financial institutions. • High interest rate, collateral risk, and bureaucratic loan process at formal financial institutions propagate the poor towards informal sources of credit.

General Business Environment

#78
Ranked on ease of doing business index

#10
Ranked on availability of venture capital

100%
of the population has access to electricity

54.47%
of the population has access to the Internet

USD 786.12 Billion
Total value of digital payments in 2017

USD 647.57 Million
Total value of digital commerce transactions in 2017

Key Trends: SME Sector				
60% Contribution to GDP	**80%** Contribution to employment	**17%** SME claim access to finance as major barrier	**USD 62.7 Bn** Total credit gap in SME sector	**USD 16,615** Average credit gap per SME

Status of Financial Inclusion in China[1]

The 2017 World Economic Forum Global Competitiveness Report states that out of 137 countries, China ranks 54th based on the availability and 30th on the affordability of financial services. China has made significant progress towards financial inclusion in the recent past, owing to conducive regulations, innovation, and strengthening of the banking sector. In the three years from 2011 to 2014, China saw a 15% increase in the adult population with access to a bank account. In 2014, 78.9% of all adults owned a bank account in the country as compared to 69% of adults in East Asia and Pacific. However, we expect that a significantly larger number of people remain under-banked.[2] At the last count, 234 million Chinese adults are still unbanked. Of these, 55% are women, 71% live in rural areas, and 54% live in the poorest 40% of households. Internal migrants, usually low income, are at a particular disadvantage due to the strict residential registration system in China that prevents them from settling in cities and accessing financial services.

Key Trends in Financial Sector Usage[1]

We can summarise the current use of the key financial products in Bangladesh as follows.

1 Strong Savings Culture

Rural and poor people constitute many of the 'newly banked adults' with 66% of the poorest quintile and 74% of the rural adults being formally banked. Village and township banks (VTBs) and other providers in remote regions have taken up agency-banking initiatives to enable access for rural low-income customers. They have set up mobile units or banks-on-wheels, automated teller machines (ATMs), and placed point-of-sale devices with retailers and other non-banking institutions to provide access. While 52% of the accounts in China fall in the 'high use' category with at least one instance of savings in the past 12 months, 72.1% of the population saved money in some form in 2014. .

2 Large Credit-gap

Access to formal credit remains a problem in China, with only 9.6% of adults borrowing in 2014. The State Council and People's Bank of China (PBoC) have rolled out specific policy guidelines to address the credit-gap in the agriculture and small and medium enterprises (SMEs) sectors. Guided by China Banking Regulatory Commission (CBRC) and PBoC, financial institutions have made efforts to develop commercially viable and client-oriented loan products for farmers and MSMEs. These efforts resulted in an annual growth rate of 24.3% for agro-related loans between 2007 and 2012. Peer-to-peer (P2P) platforms have emerged as the avenue of choice for SMEs. A deeply embedded practice of informal lending between friends, relatives, and business partners exists within the local business culture in China. In this regard, P2P platforms offer the promise of a more transparent alternative. Regulators have been closely watching this space and have issued new regulations in the past year amid instances of fraud, such as Ezubao's SD 7.6 billion scam.

3 Private Sector Innovations

WeChat and Alipay hold 92% of the digital payments market share in China, which includes 502 million unique mobile payment users. Presently, 40% of consumers use new payment methods, such as NFC and QR code-enabled e-wallets. These now account for a 58% share of the mobile payment market.

1. This document contains a few hyperlinks and readers are advised to read the document in conjunction with them.
2. The *MicroSave* report, titled Leveraging Technology for Meaningful Financial Inclusion in Asia, provides a detailed status on financial inclusion and usage of financial services in China.

Even in the five provinces with the lowest incomes at the national level, mobile phones account for almost 60% of payments. The key enabling factor has been low costs for both merchants and users – digital payment through Alipay or Tencent costs on average 40% less than typical credit card fees.

4 Insurance Product Uptake is Steady

China's total insurance premium scale reached RMB 3.1 trillion (~USD 493 billion) in 2016, growing at 18.9% CAGR during 2012-16. Enabling policies have encouraged the development of products relevant to lower-income customers, such as those targeting agriculture risks. Currently, more than 600 agro-related insurance products covering 90 crop varieties are available. However, perception studies of potential customers, even from the more affluent segments, indicate a sense of dissatisfaction. Among potential buyers, 33% do not find a suitable product and are dissatisfied with the coverage offered.

Challenges to Financial Inclusion

Sectoral Challenges

- Business Model Sustainability: MFIs, particularly those that serve rural and remote areas, face a higher cost to serve customers. Coupled with limited access to capital, this curbs their ability to offer favourable interest rates, which currently average 24%.
- Broadening Customer Segments: There is market potential for P2P lending in the middle-income segment, where many parents send their kids to the US for higher education. Lenders may tap this market through loans issued using a marketplace or P2P platform. The SME segment also offers opportunities, as it is possible to collaborate to offer credit to original equipment manufacturers (OEMs), which often struggle with access to loans due to insufficient collateral.
- Diversification in Markets and Customisation of Products: Leading fintechs have a range of tested products. However, these products still require some level of customisation in terms of:
    - Attracting users by building on existing e-commerce platforms or social networks;
    - Making platform tools openly available to innovators for seamless integration;
    - Enabling universal access for users or businesses by developing ecosystems that function across various platforms.

For example, Tencent was able to build a widespread digital payment product within an existing service, which helped it gain rapid acceptance.

Challenges Related to the Design and Delivery of Financial Services

Product	Outstanding Constraints
Payments and Transfers	• Limited youth population, low levels of trust and limited meaningful awareness restrict the growth of mobile financial services (MFS) in the rural areas of the country. • While SIM toolkit (STK) technology has enabled digital payments to work on feature phones as well, low literacy levels in some rural segments limit its application across a broader suite of products. • The security of digital transactions remains a concern. A recent spate of scams involving fake quick response (QR) codes and leaks involving payment data held by third-party platforms point to a need for improvement in the security measures for digital transactions.

Product	Outstanding Constraints
Credit	• Microcredit companies (MCCs) are not financial intermediaries and can only provide loans to a limited number of clients. They face constraints in growth due to limited access to finance. • For the SME sector, there is a lack of an effective credit-rating system. As a result, loans to commercial players are expensive. In the retail market, this issue remains – the People's Bank of China had data on 880 million people, but only maintained credit history on 380 million people. This is less than one-third of the adult population of the country.
Savings	• Following the new regulations in 2008, MCCs have emerged as a major player particularly in remote parts of the country – for instance, in mountainous or very rural areas. • However, unlike village and township banks (VTBs) or rural cooperative financial institutions, MCCs are unable to take deposits under current regulatory guidelines. This limits their ability to grow and expand their customer base, and increase formal savings further for such communities.
Insurance	• Despite the growth in premiums for life and agro-related insurance products, there is still considerable unmet demand for traditional and micro-insurance products. China's insurance penetration rate at 4.2% is still below the global average of 6.2%. • Low-income customers, especially, poor farmers and migrant labourers, lack awareness of insurance products. • Current insurance product offerings are not necessarily suited to low incomes. In addition, providers do not market small ticket-size transactions and the traditional bundling of insurance with other financial products to the low-income populations, which makes reaching this segment difficult.

Opportunities to Unlock the Potential of Fintech

China is home to four of the world's largest fintech 'unicorns': Ant Financial, Lufax, JD Finance, and Qufenqi. Fintech activity is on the rise in the four key areas below, where players are fast overtaking traditional banking channels:

a) Online lending (Yirendai, Lufax, Dianrong, etc.);

b) Digital payments (AliPay, Tenpay, 99bill, etc.);

c) Insurance (Ping An, Zhong An, PICC, etc.);

d) Personal wealth management (JD Finance, Tongbanjie, etc.).

The fintech players in China have a huge potential to address most of the constraints highlighted before. Outlined in the following section are some ways in which fintechs can address product-specific challenges.

Understanding of Demand-side Behaviour of Rural Customers

According to a recent ADB study, there is a significant unmet demand for credit in the rural customer segment. However, it is challenging to access the data required for credit risk assessment of this customer segment, which does not have an extensive digital footprint. Support for rural-customer focused research and product development could therefore be an important driver that may enable and encourage fintechs to serve this customer segment.

Extending Rural Partnerships

Unless fintechs have a specific financial inclusion objective (such as the case with Creditease), serving rural customers often requires partnerships with rural organisations. This necessitates investments of staff-time to build partnerships as well as to refine and market potential products. Most earlier-stage fintechs either cannot afford these investments or, when they run into impediments, tend to reprioritise efforts away from rural areas. Similarly, rural MFIs also have a limited ability to network and explore potential partnerships with fintechs, which are typically located in major cities like Shanghai or Beijing.

Financial and Digital Literacy of Customers

The rise in smartphone ownership in China, from 39% in 2013 to 71% in 2016, has catalysed the growth of digital payment solutions such as WeChat and Alipay. While many rural customers have smartphones and are familiar with apps such as WeChat, they are often illiterate and are uncomfortable with using technology. These challenges limit the use of digital interfaces. Furthermore, given that most MFIs and rural financial organisations primarily serve women, fintechs need to be sensitive to traditional gender roles in their marketing and product development efforts. The more affluent middle-income customer segment offers a high potential for asset-building investment products. This segment could benefit from the rise of internet-based wealth-management platforms. However, their limited understanding of these products will need marketing efforts to both inform customers and ensure consumer protection.

Looking Ahead

Aided by conducive government policies, China has made significant progress towards financial inclusion in the recent past. Private sector innovations continue to drive a noticeable shift towards digital financial services in China. A supportive regulatory environment for fintechs that strikes a balance between encouraging innovation and managing risk enables much of the innovation seen in China. The government's "wait and see" approach allows innovation by industry participants within informal limits, under careful supervision by the relevant regulators. The banking sector is undergoing significant reforms to accelerate the access to and use of formal financial services, particularly for the under-banked population. Technology-driven and innovative solutions are expected to emerge which will further augment meaningful financial inclusion in the country and facilitate the integration of underserved segments into the formal financial services sector.

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This note is part of a series highlighting the findings of a ***MicroSave*** study supported by MetLife Foundation. The study focused on understanding how technology could be meaningfully leveraged to advance financial inclusion across six markets in Asia – Bangladesh, China, Malaysia, Myanmar, Nepal, and Vietnam.