



Financial Inclusion in the People's Republic of China

An analysis of existing research and public data

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and the Working Group on Inclusive Finance in China

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List of Abbreviations

ABC	Agricultural Bank of China	MSME	Micro-, Small- and Medium-sized Enterprise
ADB	Asian Development Bank	NBFI	Nonbank Financial Institution
ADBC	Agricultural Development Bank of China	NBS	National Bureau of Statistics
AFI	Alliance for Financial Inclusion	NPL	Nonperforming Loan
ATM	Automated Teller Machine	NRCMS	New Rural Cooperative Medical Scheme
CAM	China Association of Microfinance	NTFI	New-type Financial Institution
CAR	Capital Adequacy Ratio	P2P	Peer-to-Peer
CBRC	China Banking Regulatory Commission	PA MFI	Poverty Alleviation Microfinance Institution
CCB	City Commercial Bank	PB	Policy Bank
CDB	China Development Bank	PBC	People's Bank of China
CFPA	China Foundation for Poverty Alleviation	POS	Point of Sales
CGAP	Consultative Group to Assist the Poor	PRC	People's Republic of China
CPC	Communist Party of China	PSBC	Postal Savings Bank of China
FFB	Foreign-Funded Bank	PSRB	Postal Savings and Remittance Bureau
G2P	Government-to-Person	RCC	Rural Credit Cooperative
GIZ	German Agency for International Cooperation	RCF	Rural Cooperative Foundation
GNI	Gross National Income	RCOMB	Rural Commercial Bank
GPMI	Global Partnership for Financial Inclusion	RCOOPB	Rural Cooperative Bank
ID	Identity Document	RMB	Renminbi
IFC	International Finance Corporation	RMCC	Rural Mutual Credit Cooperative
IMF	International Monetary Fund	ROE	Return on Equity
IPO	Initial Public Offering	ROSCA	Rotating Savings and Credit Association
JSCB	Joint Stock Commercial Bank	SBU	Small-Business Unit
KYC	Know Your Customer	SME	Small- and Medium-sized Enterprise
LC	Lending Company	SOE	State-owned Enterprise
LCB	Large Commercial Bank	TVE	Township and Village Enterprise
MCC	Microcredit Company	UCC	Urban Credit Cooperative
MFI	Microfinance Institution	VTB	Village and Township Bank
MIA	Microfinance Institution Association	WMFG	World Microfinance Forum Geneva
MIX	Microfinance Information Exchange		

Exchange rate end 2010: 1 US\$ = 6.62 RMB and 1 Euro = 8.81 RMB.

Executive Summary

The beginning of the 21st century represents a watershed in the promotion of financial inclusion in the People's Republic of China (PRC).

The transformation from a centrally planned to a partially market-oriented economy since the end of the 1970s had made access to financial services increasingly difficult for rural households, low-wage workers, small- and medium-sized enterprises (SMEs), and the unemployed. Directed lending and fiscal and interest rate policies had created a banking system that channeled savings from rural, western areas toward urban and eastern areas. The system had become inefficient and burdened with very high levels of nonperforming loans. The subsequent commercialization of the country's state-owned banks and the reform of rural credit cooperatives (RCCs) had resulted in the closure of tens of thousands of rural branches and entities. These reforms had cut off people's access to basic banking products. Subsidized rural poverty lending programs that were intended to compensate for increasing disparities had not achieved their goals and were unsustainable. Calls for more lending to small and private enterprises had contradicted the system's inherent incentives for banks to serve mostly large state-owned enterprises. By the end of the 20th century, rural households, low-wage workers, SMEs, and the unemployed largely depended on nonbank financial service providers. This exposed them to the risk of losing their deposits, paying very high interest rates, and being exposed to informal and occasionally unethical methods of loan recovery.

New policies and regulations, particularly those introduced since 2005, have reversed this trend. First, policies to clean up and commercialize the banking sector have resulted in a much stronger system, with financial regulators reporting healthy levels of bank profitability and capital adequacy, even if some vulnerabilities remain. A more welcoming environment has also attracted a large number of foreign banks to invest in the country.

Second, policies to promote social harmony have widely increased banking service coverage and sustainable bank lending to rural households and SMEs.

- A massive increase in government-to-person transfers has been a major factor in expanding ownership of bank accounts in rural areas.
- Policies to increase institutional diversity and competition have been a major factor in reducing rural households' dependence on the remaining RCCs.
- Political pressure, incentives, and knowledge transfer have been major factors in breaking the banks' habits of lending mostly to large, state-owned enterprises.

Third, policies to prevent contagion from the international financial crisis have resulted in the development of new risks to the stability of the country's economic and financial system, but have not destroyed its fundamentally stronger nature. Stress tests conducted by the International Monetary Fund and the China Banking Regulatory Commission (CBRC) indicate that the system could withstand considerable shocks and is therefore essentially more sustainable.

Experts agree that ownership of bank accounts and bank cards has become much more widespread. Unfortunately, this cannot be confirmed from information produced by financial institutions, which tend not to report their numbers of accounts and clients. However, a World Bank survey found 64 percent of adults with a bank account in 2011, and the People's Bank of China reports a bank card penetration rate of 35 percent at the end of 2010.

There has also been a significant increase in the diversity of the banking sector and the variety of appropriate, commercially viable loan products. A review of a wide range of data sources conducted in 2011 shows that the RCC system probably still serves the largest number of rural clients with credit, but the Agricultural Bank of China, the Postal Savings Bank, and city commercial banks are starting to become serious competitors. Scores of existing large, medium, and small commercial banks have established small business units offering SME loans, and the newly incorporated Postal Savings Bank has become a market leader in this segment. Policies to support the establishment of new types of financial institutions, such as village and township banks and rural mutual credit cooperatives, are likely to increase their role.

However, experts also agree that basic banking services are not yet accessible to all, and there is still a sizeable gap between demand for and supply of loans to rural households and SMEs. Many RCCs are not viable and, therefore, do not constitute a sustainable source of rural household loans. While SME credit is increasing, banks still face a variety of obstacles to increasing their exposure to private entities.

Besides, despite the frequent use of the word "microcredit," banks provide very few loans that are small compared to average income (no greater than 250 percent of gross national income per capita). According to a recent World Bank report, in 2011, only 39 percent of the poorest quintile of adults owned a bank account in a formal institution compared with a national average of 64 percent. This is of particular concern given the wide gap between the rich and the poor in China, and between urban and rural areas. While many banks have developed products for "microenterprises," in the PRC microenterprises are defined very widely and include enterprises that would be considered SMEs in many other countries.



Photographer: Shi Tian'an

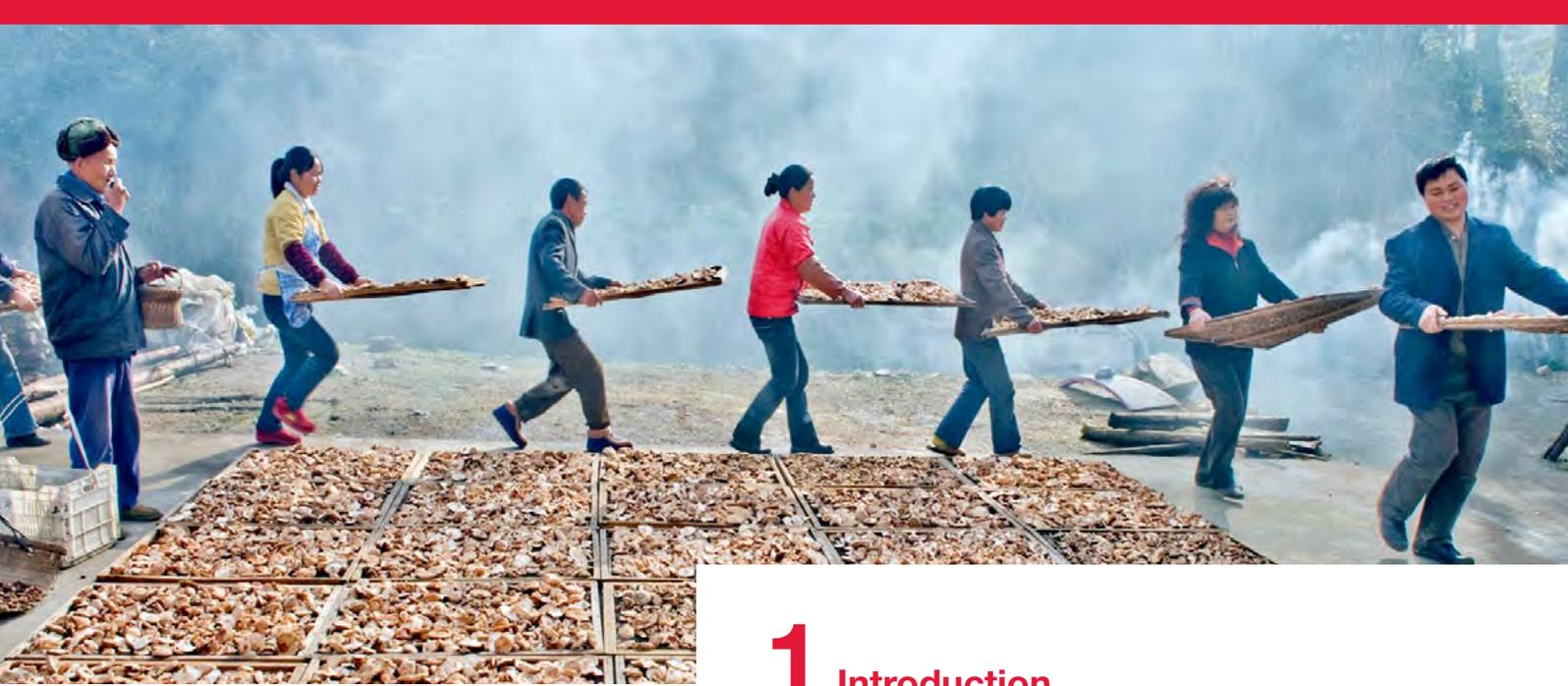
The groups that are excluded from banking services rely largely on nonbank sources of finance. The recent monetary tightening has resulted in strong growth of this so-called shadow banking sector. Morgan Stanley estimates that guarantee companies, microcredit companies, and pawnshops are the principal providers of nonbank financial services to SMEs and rural clients. Poverty alleviation microfinance institutions have much smaller loan portfolios but are particularly good at reaching out to the poor. Some peer-to-peer lending platforms also manage to achieve considerable depth of outreach. While these nonbank providers play an important role in satisfying the need for financial services, they also expose the most vulnerable to considerable risks.

There is considerable potential for increasing and improving the commercial provision of financial services to the previously excluded in the PRC. Regular policy statements confirm the government's commitment to ensuring sustainable outreach to the excluded through innovation and investment in new technologies. The size of the PRC's market offers opportunities for economies of scale that are not available in many countries; its comprehensive and sophisticated identification system greatly helps banks to meet know-your-customer requirements. The excellent mobile telephone infrastructure and wide network of branchless access points offer opportunities for reaching large numbers of clients at low costs. Work on financial infrastructure, such as deposit insurance, credit

bureaus, and payment systems, has started to contribute to the expansion of opportunities.

To take full advantage of this potential, policy makers, financial institutions, and investors need comprehensive, high-quality market information. Currently, stakeholders need to consult a wide range of sources to get a picture of the financial inclusion landscape. And information from these sources is not always comparable, consistent, and complete. There is a great need for better data and more research. Greater financial inclusion can be achieved only when the needs of different market segments are understood. Stakeholders also need a thorough comprehension of the nature, efficiency, and effectiveness of financial service providers that target the previously excluded. More in-depth analysis of policies, regulations, and supervision would help to enhance financial inclusion, for example, in the area of branchless banking.

Finally, both Chinese stakeholders and the international community would greatly benefit from a more extensive exchange of knowledge on financial inclusion. Global partnerships, such as the Inclusive Finance in China Working Group, the Global Partnership for Financial Inclusion, the Alliance for Financial Inclusion, the World Microfinance Forum Geneva, and CGAP offer opportunities for studying global best practices and lessons learned in other countries, and for sharing the PRC's unique experience in improving financial access with the rest of the world.



Photographer: Li Suren

1 Introduction

1.1 Global Context

People need reliable access to a broad variety of financial services, such as savings, credit, payments, transfers, and insurance, to manage their lives, take advantage of business opportunities, and prepare themselves for major expenses and difficult times. While financial inclusion¹ has been a concern of governments for several centuries throughout the world, in the past 20 years or so, financial access for the poor and the unbanked has rapidly evolved with microfinance. Thousands of new institutions have emerged to serve those at the bottom of the pyramid and microenterprises, and many of them have become financially sustainable while fulfilling a social mission.

Many governments have adopted and continue to adopt national strategies for financial inclusion. The emergence from the G-20 of the Global Partnership for Financial Inclusion shows that financial inclusion has become a major concern for leading countries worldwide. New technologies have also created hopes that one can expand financial access at lower costs through “branchless banking.”² And yet there are still 2.7 billion people worldwide who do not have access to formal financial services (CGAP 2010). A recent World Bank survey shows that only 22 percent of adults report that they have saved in a formal financial institution in the past 12 months (Demirgüç-Kunt and Klapper 2012). While policy makers, banks, international donors, investors, and mobile network operators are working to reduce this gap and find new solutions to solve the problem of financial exclusion, there is still a significant task ahead. Part of the solution will come from better understanding each individual country’s financial inclusion landscape, so that possible solutions to close the financial exclusion gap rapidly can be identified.

1. CGAP (2011) defines financial inclusion as “a state in which all working age adults, including those currently excluded or underserved by the financial system have effective access to the following financial services provided by formal institutions: credit, savings, payments and transfers, and insurance.”

2. CGAP defines branchless banking as the delivery of financial services outside conventional bank branches using information and communications technologies and nonbank retail agents, for example, over card-based networks or with mobile phones (McKay and Pickens 2010).

1.2 Background and Objectives

With 1.3 billion inhabitants in 2010, the People's Republic of China (PRC) constitutes the largest single market for financial services (NBSC 2011a). The annual income per capita has increased considerably over the past 30 years (NBSC 2011b), with urban disposable income in 2010 estimated at RMB 19,109 (US\$2,885³) and rural net income estimated at RMB 5,919 (US\$894) per person.^{4,5} Yet, international investors and donors who consider funding financial institutions that seek to serve this large and growing market often seek in vain for information on demand and supply.

This paper aims to be a first step in providing a picture of the extent and nature of financial inclusion in the PRC and the size and characteristics of the unbanked and underbanked market. It analyzes the effect of policy changes since 2005 on the inclusiveness of the PRC's formal financial system. The authors hope that it will provide a useful basis for forthcoming research and diagnostics on financial inclusion in the PRC. The report describes the overall landscape, while the annexes provide more detail on a number of key financial retailers.

This paper covers a limited number of financial services. The focus is on the three key aspects of financial inclusion that the China Banking Regulatory Commission (CBRC) has been promoting since 2005:

1. Universal access to basic banking services (i.e., bank accounts, payment services)
2. Productive bank credit for rural households
3. Bank credit for micro-, small-, and medium-sized enterprises (MSMEs)

3. According to the People's Bank of China's Annual Report 2010, the end of 2010 exchange rate was 6.62 RMB per US dollar and 8.81 RMB per euro.

4. The National Bureau of Statistics of China (NBSC) defines disposable income of urban residents as the actual income at the disposal of residents that can be used for final consumption, other noncompulsory expenditures, and savings. This equals to the sum of income from wages and salaries, cash income from household operations, income from properties, and income from transfers, minus income tax, personal contribution to social security, and subsidy for keeping diaries in being a sample household. Currently, disposable income of urban residents includes cash income received only.

5. NBSC defines net income of rural residents as the total income of rural residents from all sources minus all corresponding expenses. It is classified as the sum of income from wages and salaries, income from household operations, income from properties, and income from transfers, minus household operation expenses, depreciation of fixed assets for production, taxes, and fees paid, and gifts to nonrural relatives.

Clearly, financial exclusion goes beyond these services and includes products such as consumer credit, payments, money transfers, and microinsurance products. Further research in these areas and others is recommended.

The analysis in this report is largely based on research conducted in 2011, and therefore describes the situation at the end of 2010. It is important to be aware that the PRC Government and financial authorities are issuing new policies and regulations on an almost monthly basis. At the same time, several types of institutions have been experiencing double digit growth rates in the numbers of their clients. This report should therefore be considered a snapshot of a situation that is in a state of considerable flux.

1.3 Caveat on Data Quality

Availability of reliable information is a significant issue in the PRC. Not only should one carefully verify every piece of data, one should be aware that important information is often simply not available. For example, data published by NBSC is often not comparable to data from other countries because of methodological discrepancies; recent information on portfolio quality of financial institutions is not always available from CBRC. These and other issues regarding data on financial inclusion in the PRC have been extensively documented.

Language barriers are another important challenge. International researchers often need to rely on native Mandarin speakers to locate and interpret important sources of information.

The authors recommend that readers use this report to supplement their own research. The authors and contributors have made every effort to collect data from credible sources, and where possible to verify these data through triangulation. Despite this effort, they cannot guarantee that all the information presented here is accurate.



Photographer: Wu Guoqun

2 The Origin and Nature of Financial Exclusion

The year 2005 constitutes a turning point in the government's approach toward financial inclusion in the PRC. This chapter describes the historical developments between 1949 and 2005 that led to the government's decision for a much stronger focus on access to banking. Section 2.1 analyses why the transformation from a centrally planned to a more market-oriented economy gradually excluded more and more people from the financial services they needed. Section 2.2 explains that in 2005 it was not just the rural poor who had difficulty accessing formal financial services; the tens of millions of migrant workers and private small- and medium-sized enterprises (SMEs) constituted a significant part of the unbanked or underbanked.

2.1 Historical Background

To understand the evolution in the government's approach to financial inclusion, it is useful to go back to the creation of the PRC in 1949, and to follow its transformation from a state-controlled society to one in which resource allocation is left partly to the market. Between 1949 and 2005, economic transformation was accompanied by three distinct phases in the development of the banking system, which eventually made it very difficult for certain groups to access the financial services they needed.

Figure 1. Development Phases in the PRC's Financial System



Figure 1 illustrates the three principal phases in the development of the PRC's financial system between 1949 and 2005. These phases are further described below.

This section draws heavily on a study on rural finance commissioned by the Asian Development Bank (Zhang, Xu, Shen and Cheng 2010) and on two papers by Kellee Tsai (2004 and 2006).

2.1.1 1949–1979: Creation of a State-owned Monobanking System

Having established the PRC in 1949, the Communist Party of China (CPC) quickly developed a centrally led “command” economy. In an attempt to create a unified, prosperous, and nonexploitative society, the government nationalized all property and outlawed all private enterprise. It created specialized monopolistic state-owned enterprises (SOEs) to produce necessary goods and services. The rural population was gradually organized into people's communes, with output targets to achieve. The government ordered the closure of all types of private finance and banned popular forms of “informal finance,” including pawn brokerage and “loan sharking” (Tsai 2004).

The People's Bank of China (PBC) was gradually turned into the sole provider in rural finance. In 1951 it ordered the creation of rural credit cooperatives (RCCs) in every township to provide savings and credit services to the 80 percent of China's population living in rural areas. As their numbers grew into the hundreds of thousands, in 1955 the government created the Agricultural Bank of China (ABC) to supervise and manage them. In 1957 PBC took ownership of both ABC and RCCs and integrated them into its structure (Zhang, Xu, Shen, and Cheng 2010). While these RCCs were originally set up as independent entities owned and controlled by their members, the centralization of management and ownership made them lose their cooperative nature (Li and Xuchu 2011).

During this period, the state took responsibility for allocating resources. Surplus income from economic activities were deposited in PBC, which then used part of this income to provide investment funds to SOEs directly and to the communes via RCCs according to the central plan.

The transformation of the economy led to increased equality, but the country remained poor. Intended production and welfare gains were partly undone by a series of political campaigns and natural disasters, and partly by the well-documented efficiency and incentive issues associated with command economies.

2.1.2 1979–1993: Creation of a State-led Multibanking System

The introduction of market pricing and profit incentives into the real economy and the opening up of the economy resulted in significant growth. Upon Mao's death in 1976, CPC leadership launched a series of changes, including instituting the household land responsibility system, creating collectively owned township and village enterprises (TVEs)⁶ run by local authorities, and partially commercializing SOEs. This greatly boosted worker productivity, resulting in a significant rise in both agricultural and industrial production, and unprecedented rates of annual growth (Zhang, Xu, Shen, and Cheng 2010).

To support economic transformation, the government created a more diverse banking system of large national banks with sectoral mandates and smaller banking institutions with local mandates. Four state-owned banks were carved out of PBC, and PBC assumed the role of banking regulator and supervisor. ABC remained in charge of RCCs.⁷ Although several reforms were implemented to restore the

6. There is controversy over the proportion of TVEs that were truly collective.

7. For the purposes of this paper RCCs are considered to be part of the banking system. Like banks, they are allowed to mobilize deposits, and they are overseen by the PRC's banking sector supervisory authority.

RCCs' original cooperative nature, in the end ABC effectively ran the RCCs as its branches and offices (Zhang, Xu, Shen, and Cheng 2010). In this same period, the government started authorizing the establishment of smaller banks, by first permitting urban governments to set up urban credit cooperatives (UCCs) (Girardin and Xie 1997) and later letting regional authorities establish joint stock commercial banks (JSCBs) (China Merchants Bank 2012).

In parallel, the government permitted the emergence or re-emergence of a set of nonbank financial service providers. Most notably, from 1984 it allowed the Ministry of Agriculture to establish a network of rural cooperative foundations (RCFs), which were effectively mutually owned. It also allowed various branches of government agencies as well as state banks to establish “nonexploitative” pawnshops, and even allowed some pawnshops to register as ordinary private businesses. By the early 1990s RCFs were offering savings and credit services in a third of all townships, and over 3,000 documented pawnshops were offering credit. Other types of nonbank financial service providers, known as “underground banks,” remained strongly suppressed (Tsai 2004).

The government strongly encouraged deposits in the prudentially supervised banks and RCCs. RCCs were expected to deposit part of the savings they collected in the central bank. In 1986 the government also created the Postal Savings and Remittances Bureau (PSRB). PSRB had to deposit all client funds in the central bank, which paid a high interest rate on these deposits (Zhang, Xu, Shen, and Cheng 2010). In the virtual absence of social security provisions, insurance, wealth management, and other investment products, the country achieved household savings rates that were very high by international standards.

During this period, banks were given “priority sector guidance” on where to invest these deposits. Large and small institutions were given lending quota or portfolio growth targets, mostly for infrastructure and industrial development projects.

A significant part of fiscal income was distributed to the state-owned banks for on-lending in the form of so-called policy loans. In the more market-based system introduced at the end of the 1970s, the country's income and savings no longer flowed to the central government, and it could no longer fully control the allocation of resources. The government, therefore, introduced a system of taxes and fees on enterprise and household income and profits. Policy lending consisted of channeling fiscal income to particular priority projects, sectors, or target groups in the form of low-interest loans.

Fiscal decentralization and the Communist Party cadre evaluation system encouraged local governments to steer bank lending toward state-run companies. From the beginning of the 1980s the central government gradually

allowed local governments to keep a portion of tax income for local investments and expenditures. In addition, whether a Communist Party cadre working in a local government or SOE was promoted depended on his or her success in increasing fiscal income. Local governments therefore used their influence in local RCCs to direct credit toward local government-run TVEs (Ong 2012).

Priority sector guidance, policy loans, and directed lending resulted in high volumes of nonperforming loans (NPLs). As in other countries at the time, government's involvement in managing banks and credit cooperatives resulted in high inefficiencies, credit rationing, capture of subsidized loans by state-backed or wealthier clients, and high default rates. Since fiscal income was insufficient to cover losses, state banks were left severely weakened, and many RCCs became technically insolvent (Zhang, Xu, Shen, and Cheng 2010).

Market pricing, fiscal, and interest rate policies caused savings from agricultural areas to be converted into loans to industrial areas, thus increasing rural–urban and west–east disparities. Policies to pay positive interest rates on savings and charge low interest rates on loans made it impossible for banks to cover the costs of small and risky rural loans in resource-constrained, remote inland areas. At the same time, the opening to the outside world offered banks many attractive investment opportunities in the coastal areas. This resulted in the “water pump” phenomenon of savings being transferred on a large scale from rural to urban areas, and from western and central to eastern China. In addition, fiscal decentralization allowed the better endowed coastal provinces to collect and spend more tax income. Partly as a consequence of much better access to credit and government investments, urban and eastern areas grew much faster, and inequality increased. The government started to fear social instability (Ong 2012).

A strict residential registration system prevented increasing flows of rural–urban migrants from settling in the cities and benefiting from services available to urban residents. Increasing numbers of people grew frustrated by the household registration or “hukou” system in which people with rural hukou were allowed to go to cities to work but could not take their families and had to return to their rural homes.

A large subsidized lending scheme for poverty alleviation was not very effective in reducing inequality, repayment was poor, and it was unsustainable. Policy lending in the 1980s was targeted at particular sectors and not aimed at poverty alleviation. The poverty alleviation lending program introduced in 1986 targeted TVEs rather than individual households. As is the case with most subsidized credit schemes, many loans were distributed to politically important enterprises and higher income households, and repayment rates were only about 50 percent (Tsai 2004).

2.1.3 1993–2005: Market-oriented Banking System Reform

Inefficiencies in the real economy prompted the cautious and partial reintroduction of private property into the real economy. The government decided to sell part of SOE and TVE share capital to private investors, and promote SMEs of combined public and private or fully private ownership.

In the regulated banking sector, unsustainable NPL ratios prompted market-oriented bank reform. From 1993 onward the government undertook a series of reforms aimed at improving the efficiency of financial intermediaries. ABC was instructed to let its investments be guided by profitability considerations, to transfer its policy loan portfolio to the newly created Agricultural Development Bank of China (ADBC), and to transfer the management of RCCs to PBC (Zhang, Xu, Shen, and Cheng 2010). At the same time, UCCs were demutualized, partly privatized, and consolidated into so-called city commercial banks (CCBs) (KPMG 2007).

Accumulated NPLs in RCCs also prompted a series of reforms aimed at improving their governance and viability. In the early 2000s the government combined a massive capital investment with the transformation of relatively strong

RCCs into cooperative or commercial rural banks, the consolidation of promising RCCs into county and provincial cooperatives with shareholders as members, and the elimination of the weakest RCCs (Zhang, Xu, Shen, and Cheng 2010).

In an effort to increase its control over monetary flows and to protect depositors, the government cracked down on nonbank financial service providers. In 1996 it closed more than half of all pawnshops because of illegal deposit mobilization, and reorganized their supervision. In 1999 it announced the closure of rural credit foundations that had been taking excessive risks with their members' capital contributions, and the take-over of the better performing ones by the newly mutualized RCCs (Tsai 2004). These measures made it more difficult for people to get access to the financial services they needed.

Unfortunately, the market-oriented bank reforms led to the closure of large numbers of rural bank outlets, which greatly reduced access to basic banking services. ABC moved away from agriculture to refocus its business on low-risk urban and industrial projects. Between 2000 and 2005, it closed more than 13,000 outlets in central and western regions (Zhang, Xu, Shen, and Cheng 2010).

Photographer: Jian Changjiang



RCC reforms not only failed to resolve the problems of governance and NPLs, but also further reduced rural access to their services. Reform resulted in the closure of more than 10,000 of the weakest RCCs. For the remaining RCCs, the centralized administration by PBC contradicted efforts aimed at transforming them back into member-owned entities. The withdrawal of the banks turned RCCs into virtual monopolists in their markets, which made it very difficult to increase their efficiency. As a consequence, the majority of the remaining RCCs continued to be weak and ineffective. However, in the absence of a prudentially supervised alternative for the rural poor it was politically impossible to close them all. Overall, between 2000 and 2005, the number of depository institution outlets at or below the county level fell from 166,000 to 126,000, resulting in a situation where there was only one outlet for every 20 villages (Zhang, Xu, Shen, and Cheng 2010).

The market-oriented reform of the banking sector did not significantly increase private companies' access to banking services. Banks continued to concentrate on lending to SOEs and government guaranteed infrastructure projects. This is blamed on a combination of banks' inability to assess a project's commercial viability, the absence of clear property rights, political pressure to focus on state priorities, and a fear of change. In 2005–2006, less than 1 percent of bank loans went to private enterprises (Tsai 2006).

In parallel to the banking reform described above, the national government, local governments, and international donors developed subsidized loan programs targeted at the several groups that have difficulty accessing banking services. Box A describes the principal initiatives.

2.2 The Unmet Need for Financial Services

2.2.1 Situation Before the Policy Changes Initiated in 2005

By the beginning of the 21st century, the banking sector had largely withdrawn from markets that were considered too risky or too costly to be commercially viable. In urban areas, a variety of commercially oriented financial institutions focused on services to national and local SOEs and salaried employees. In rural areas, only RCCs and the postal system maintained a network of outlets, yet RCCs failed to meet the credit needs of rural households and the postal system offered only savings and remittances services.

Households and businesses largely relied on family and friends, informal savings and credit associations, and the suppressed nonbank institutions that provided financial services. A 2001 IFAD study estimates that farmers obtained four times more credit from the informal market than from formal financial institutions, and a 2002 study of small-business owners found that nonbanking sources of finance accounted for up to three-quarters of private sector financing during the first two decades of reform (Tsai 2004). This meant that the government did not have full control

Box A. Subsidized Lending Programs and Projects Targeted at the Financially Excluded

From 1992, the government encouraged and partly funded the development of guarantee companies to take on the risk of bank lending to disadvantaged groups, in particular SMEs. At the time of the SOE restructuring, the government asked banks to cooperate with guarantee companies to offer laid-off workers business start-up loans. The project later expanded to cover college students, returning soldiers, landless farmers, and low-income entrepreneurs. Credit guarantee companies have not managed to leverage large volumes of bank loans to disadvantaged groups because banks, faced with a multitude of attractive investment opportunities, were unwilling to assume any risks.

Starting in 1993 the government began to allow international donors, local governments, and other agencies to co-finance poverty-oriented loan programs that were mostly based on the Grameen Bank model. At one point there were over 300 such programs, and they were mostly registered as societal organizations, foundations, and privately run nonprofit enterprises and institutions. Lack of recognition by financial authorities made it difficult for these poverty alleviation microfinance institutions (MFIs) to raise funds locally after donor funding ended. Programs that bowed for local government pressure to adopt lending rates close to those of RCCs mostly faded, but those that managed to charge interest rates closer to cost-recovery survive until today. Most reach fewer than 2,000 clients. For more information on poverty alleviation MFIs, see Annex A7.

A few years later the government introduced poverty-oriented loans that were distributed through the banking system in collaboration with local government offices. In 1997 ABC and ADBC were instructed to channel poverty alleviation funds from the 8-7 Poverty Alleviation Plan to poor people in the form of microloans. In 1999 PBC started extending "agriculture loans" to RCCs for on-lending in the form of microcredit; the program was rolled out nationally in 2002. While both program adopted aspects of the Grameen Bank system, their success was hindered by excessive involvement of local governments in client selection, the imposition of outreach quotas, and interest rates that were too low to cover program costs. The subsidized loan programs suffered the usual problems of loan deviation, inefficiencies, high NPL ratios, and lack of sustainability (Tsai 2006).

The subsidized microcredit programs had limited outreach and were largely unsustainable. They failed to compensate for the reduced access to financial services as a result of banking reform.

Sources: Situ (2011), Sun (2008), and Du (2008).

over the total volume of credit, and therefore of monetary policy, and it also exposed individuals and enterprises to the risk of losing their savings, being charged usurious interest rates, and having to endure inappropriate and occasionally unethical methods of debt collection.

2.2.2 Groups with Difficult Access to Banking Services

Four groups found it particularly difficult to access banking services at the beginning of the 21st century. Of course some members of these groups did manage to open bank accounts and get bank loans, but many faced obstacles ranging from problems reaching branches to being offered unattractive or inappropriate products.

- The largest group was rural households, in particular those of small-scale farmers, livestock raisers, and fishermen.** These rural households had difficulties because they lived at large distances from each other, had limited assets and low productivity, and operated in a risky environment.

2. **The second largest group was low-wage workers, especially migrant workers.** Low-wage workers had difficulties accessing banking services because they had little income and almost no collateral. Migrant workers in particular could not open a bank account or get a loan because they had no residence status in towns.
3. **The third group was MSMEs, particularly private enterprises.** MSMEs found it difficult to access banking services because financial institutions preferred lending to large, state-owned companies with implicit guarantees.
4. **The fourth group was the unemployed, particularly laid-off workers from SOEs and rural job seekers in urban areas.** They had difficulties because previously there were no unemployed people and because lending to them to start up a business was very risky.

Within these groups, the poorest households and the smallest enterprises had the most difficulties. However, note that not all poor people and microenterprises were excluded from banking services, and some nonpoor people and medium-sized enterprises also experienced problems accessing banking services.

Subsidized loan programs failed to substitute for the banking services the groups needed. As indicated in Box A, a range of government-supported loan programs failed to reach their target groups, depended heavily on fiscal resources, and were unable to give people and enterprises permanent access to credit. They also did not offer other much needed financial services.

2.2.3 Financial Services Needed by These Groups

The four groups described constitute distinct market segments for different financial products. Table 1 illustrates the groups' multiple financial service needs.

Since 2005, CBRC has been introducing guidelines and regulations affecting the availability of financial services to what it calls "the weak sectors." It has been giving priority to:

- Basic financial services (such as household current and savings accounts) for those who currently have difficult access (especially rural households and low-wage workers)
- Credit for enterprise investment purposes for those who currently have difficult access (in particular, rural households and MSMEs)

The remainder of this report is structured around the financial authorities' efforts to improve the availability of basic financial services for all, rural household credit, and MSME credit.

It should be noted that the PRC government has also made policy changes affecting the availability of other financial services for other target groups. Most notably, in 2003 it introduced the New Rural Cooperative Medical Scheme, a basic health social security system that combines insurance and social assistance, which at the end of 2010 is reported to cover 97 percent of all farmers and rural residents (ILO 2012). These important policy changes and accomplishments are not covered in the report.

Table 1. Important Financial Service Needs of Groups with Difficult Banking Access

	Current and savings accounts, bank cards	Credit for enterprise investment purposes	Credit for consumption, including education, housing, etc.	Payment and transfer services	Insurance services
Rural households, especially small-scale farmers, livestock raisers, and fishermen					
Low-wage workers, especially rural migrant workers					
Micro-, small-, and medium-sized enterprises, especially private MSMEs					
Unemployed, including low-income workers from SOEs and rural job seekers in urban areas					



Photographer: Miao Hualong

3 Policy Changes and the Evolution of Financial Inclusion

Since the beginning of the 21st century, three changes in the PRC government's goals have strongly affected financial inclusion:

- The desire to clean up the banking system
- The aspiration to improve social harmony
- The wish to prevent contagion by the global financial crisis

Section 3.1 describes these changes in government goals and some of the key policies under each of these goals. Then, Section 3.2 describes how the banking sector has undergone a considerable transformation and greatly increased its overall health and profitability. Section 3.3 describes how financial access to banks has improved over the past couple of years, thanks in part to the government's new goals and policies. It also describes how these same policies and economic developments have contributed to a parallel increase in the use of nonbank financial services.

Figure 3 summarizes the PRC government's parallel goals and objectives since 2005, which are further described below.

This chapter does not seek to provide a full diagnostic of prudential and nonprudential financial regulation and supervision in the PRC. Rather, it offers insight into the effects of recent policies and changes in the economy on financial inclusion. The chapter notes positive achievements but also points to some remaining vulnerabilities that put these achievements at risk.

Annex A provides detailed descriptions of some of the most significant providers of financial services to the previously excluded.

Figure 2. Parallel Government Goals and Objectives

GOALS	Stable and healthy banking sector	Social harmony through financial inclusion	No contagion with world financial crisis
OBJECTIVES	<ul style="list-style-type: none"> • Partial bank privatization • Increased foreign investment • Enhanced banking supervision • Partial interest rate liberalization 	<ul style="list-style-type: none"> • Promotion of universal banking coverage • Promotion of rural finance • Promotion of SME finance 	<ul style="list-style-type: none"> • Rein in inflation • Manage growth of shadow banks • Avoid property price crash • Control bank asset quality

3.1 Changes in Policy Goals and Objectives

3.1.1 A Stable and Healthy Banking Sector Through Clean-up and Commercialization

Persistent NPLs and the impossibility of covering all the banks' losses forced the government to pursue a thorough clean-up of the banking sector. In 2001, when NPLs were estimated to compose 27–44 percent of the financial sector's portfolio (Pistor 2009), the government created asset management companies to buy NPLs. In 2003 it created the CBRC to take over PBC's task of banking regulation and supervision, and make it more modern, professional, and efficient. CBRC was charged with creating and maintaining a healthy banking sector that focuses on protecting the interests of depositors and consumers. PBC was to focus on monetary policy.⁸

CBRC was to ensure that the banking system met the standards set by the Basel Committee and the World Trade Organization. To achieve this, CBRC's steps included the following, among others:⁹

- Partial privatization of most banks, to bring in a certain level of market discipline
- Increased admission of foreign investors, to increase competition and obtain knowledge
- Increased and enhanced supervision of the banking sector, to ensure its stability
- Partial liberalization of lending rates, to allow banks a degree of risk pricing

8. Although the supervisory functions of financial institutions have been transferred to CBRC, PBC remains a very influential institution with considerable regulatory power. In theory, PBC will concentrate on regulations concerning monetary conditions and financial system liquidity with the objective of promoting economic growth and price stability. CBRC, on the other hand, will focus on the strength of financial institutions, capital adequacy issues, and the restructuring of the banking sector. In practice, however, there is no clear division between the functions of PBC and those of CBRC. It is not uncommon for their functions to overlap in some areas (China Knowledge 2012).

9. Based on CBRC's annual reports from 2006 to 2009 (<http://www.cbrc.gov.cn/showannual.do>). Because annual reports before 2006 are not available on CBRC's Web site, it is not always clear when each of these steps was initiated.

3.1.2 Social Harmony Through Financial Inclusion

Rising disparities and labor migration policies have caused the population considerable frustration, and the risk of social instability pushed the government to change direction. In early 2005 PRC President Hu Jintao instructed the country's leading officials and Party cadres to move away from gross domestic product growth as the central policy goal, by placing "building a harmonious society" on the top of their work agenda (People's Daily 2005). Subsequent policy documents issued by the State Council required the banking sector to find ways to support the drive toward social harmony by enhancing social and economic inclusion through increased access to finance.

Based on an analysis of the gaps in the market, the State Council instructed CBRC to put particular emphasis on what it calls "the weak sectors" through the following:

- Achievement of full banking service coverage¹⁰
- Promotion of *san nong*, the three rural issues (rural areas, agriculture, and farmers)¹¹
- Promotion of SMEs (which under government definitions included microenterprises)¹²

10. In July 2007 CBRC launched the China Banking Services Distribution Map on its Web site. The map contains detailed information about the banking service coverage and competition status in rural areas and serves as a reference when licensing new-type rural financial institutions.

11. "During the 11th five-year period from 2006 to 2010, CBRC has, in line with the instructions and arrangements of the State Council, earnestly performed its supervisory duties and attached great importance to strengthening and improving the provision of financial services to agriculture, farmers and rural areas" (CBRC 2011a).

12. "CBRC has always attached great importance to the promotion of small enterprise finance. As early as 2005 CBRC made it clear that alleviation of the funding difficulty of small enterprises was a long-term strategic task for banking institutions, who should regard it as a part of their social responsibility as well as an effective means of contributing to economic development and social harmony" (CBRC 2011b).

Table 2. Banking Institutions by Total Assets

(Trillion RMBs)	Assets 2009	Percentage	Assets 2010	Percentage
Large commercial banks (LCBs)	40.8	51%	46.9	49%
Joint-stock commercial banks (JSCBs)	11.8	15%	14.9	16%
CDB and policy banks (PBs)	6.9	9%	7.6	8%
City commercial banks (CCBs)	5.7	7%	7.9	8%
Rural credit cooperatives (RCCs)	5.5	7%	6.4	7%
Postal savings bank (PSBC) and new-type financial institutions	2.7	3%	3.5	4%
Rural commercial banks (RCOMBs)	1.9	2%	2.8	3%
Nonbank financial institutions (NBFIs)	1.6	2%	2.1	2%
Rural cooperative banks (RCOOPBs)	1.3	2%	1.5	2%
Foreign-funded banks (FFBs)	1.3	2%	1.7	2%
Total	79.5	100%	95.3	100%

Source: CBRC Annual Report 2010.

3.1.3 Crisis Prevention Through a Temporary Increase in Credit Supply

Fearing that the financial crisis that originated in the United States would lead to global contagion and an ensuing decline in China's robust export-led economy, the country's leaders decided on drastic interventions. In November 2008 the government announced a 4 trillion RMB stimulus program. Local governments were to provide 70 percent of the funds (Wong 2012). Since local governments could not directly issue bonds, they created local investment companies that could borrow from banks. In addition to being expected to lend indirectly to local governments, banks received instructions to increase their lending to companies and households.

The economy was unable to effectively absorb the national stimulus program. In 2009 commercial bank loans grew by 32.5 percent in real terms (Monus 2012). Local governments and banks invested part of the funds in unviable undertakings, resulting in NPLs. A significant part of the funds was used by local companies to purchase stocks at the stock exchange and make real estate investments, resulting in a sharp rise in the prices of these assets. The stimulus package also resulted in a sharp increase in inflation, which caused returns on deposits to become negative. This encouraged people and companies with excess funds to look for alternative ways to place or invest their money.

Financial regulators needed to bring the risks arising from the stimulus program back under control, by doing the following:

- Minimizing the effect of local government debt and speculation on banks' asset quality
- Avoiding a sudden crash in the prices of property and stocks
- Reining in inflation
- Managing the growth of nonbank financial services

3.2 Effects of Recent Changes on the Health and Stability of the Banking Sector

3.2.1 Composition and Nature of the Banking Sector

Commercially oriented banks now make up the brunt of the banking sector in terms of assets. According to CBRC (2011b), at the end of 2010 the formal banking system comprised 3,769 banking institutions with assets totaling 95.3 trillion RMB. More than 80 percent of these assets belonged to institutions classified as commercial banks. Table 2 shows that 49 percent of total banking sector assets¹³ were held by China's "big five": Bank of China, Industrial and Commercial Bank of China, China Construction Bank, Agricultural Bank of China (ABC), and Communication Bank of China. They were followed by JSCBs, policy banks (PBs), and CCBs.

A large majority of commercial banks have been "equitized." All large, state-owned commercial banks have sold part of their capital to nonstate investors through initial public offerings (IPOs), although the government has maintained control in four out of five. Private ownership in JSCBs and CCBs has increased, with local government holdings now a minority. Besides, the country has made great progress in transforming viable urban and rural cooperatives into small and medium-sized commercial banks, also partly privately owned. This has increased the chances of the banking sector's continued commercial orientation.

Foreign investment in the banking sector has increased considerably. At the end of 2010, 37 wholly foreign-owned banks had incorporated in the PRC, with a combined total of 260 branches or subsidiaries. In addition, 90 foreign banks had chosen to open branches of their home bank in China (Martin 2012).

13. While CBRC uses "banking institutions" in the title of the table on which Table 2 is based, it actually also includes information on some nonbank financial institutions that are under its supervision. These include insurance companies, trust companies, financial leasing companies, and consumer finance companies.

3.2.2 Performance of the Banking Sector

According to official statements, the stability and profitability of the banks has improved substantially. Over the last few years, the banking sector has gone through a process of significant structural reform. According to CBRC's 2010 Annual Report, at the end of 2010 the NPL ratio of all banking institutions registered at 2.44 percent, and that of commercial banks only was down to 1.13 percent.¹⁴ The weighted average capital adequacy ratio (CAR) of commercial banks reached 12.2 percent at year end, and the weighted average core CAR rose to 10.1 percent. By the end of 2010, CAR of all commercial banks exceeded the minimum requirement of 8 percent. In 2010, China's banking industry realized a return on equity (ROE) of 17.5 percent, while the return on assets (ROA) was 1.03 percent during the same period.

Figures 4 and 5 show recent developments in the banking sector's NPL and capital adequacy ratios.

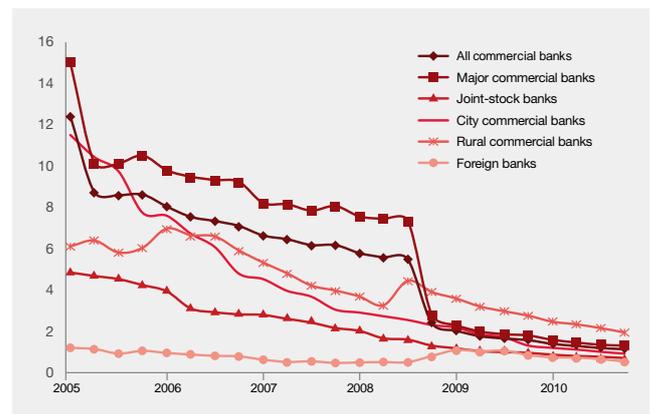
3.2.3 Vulnerabilities of the Banking Sector

While considerable progress has been made in improving the health of the financial sector, vulnerabilities remain (IMF 2011 and World Bank 2011). For example, while banks are expected to make decisions based on commercial considerations, they are still under pressure to allocate resources according to "guidelines" issued by the financial authorities, and to favor state-preferred enterprises. Whereas banks are gradually starting to introduce risk pricing for loans, in practice, they appear to have limited ability or willingness to differentiate interest rates or to set interest rates much beyond the official benchmark rate. Besides, while banks are in principle free to price loans, they are still limited in their ability to attract deposits because PBC continues to fix interest rates banks can pay. These vulnerabilities limit the banking sector's ability to contribute to financial inclusion.

However, there is no doubt that in 2010 the PRC's banking system was in much better shape than at the beginning of the decade.

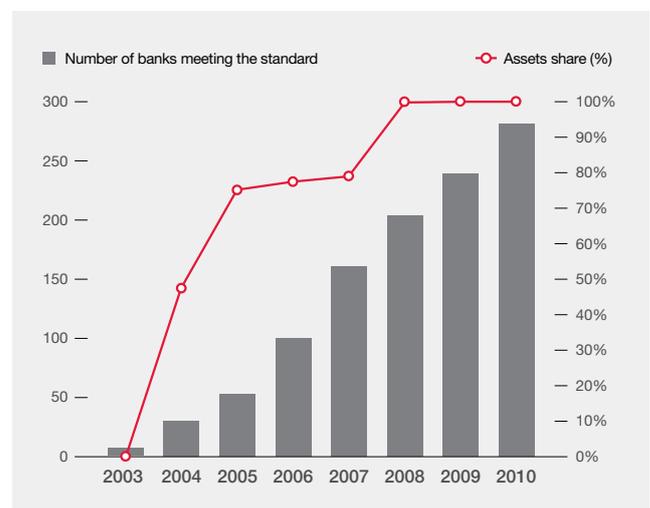
14. It should be noted that the reduction in NPLs is largely due to the transfer of NPLs into four state-owned asset management companies.

Figure 3. China: Nonperforming Loans to Total Loans (%)



Source: World Bank (2011).

Figure 4. Number and Percentage of Banks Meeting the CAR Requirement (2003–2010)



Source: CBRC (2010).

Photographer: Zhou Qing



3.3 Effects of Recent Changes on Financial Access to Banks and Nonbank Providers

In this section we look in more detail at the government's goals of achieving full banking service coverage (Section 3.3.1), increasing rural household credit (Section 3.3.2), and growing SME credit (Section 3.3.3). In each section we first describe the way financial authorities have translated the goals into concrete guidelines and regulations. We then present an overview of the principal banking sector providers of financial services in each category that have emerged from the changes in regulations and the overall economy over the past few years. Section 3.3.4 concludes with an analysis of the effects that recent policies and economic developments have had on the use of nonbank financial service providers.

3.3.1 Full Banking Service Coverage

Policies

The massive closure of commercial bank outlets and unviable RCCs created a need for alternative ways of reaching people in western and central, rural, and remote areas with basic banking services. Some of the main policies related to meeting that need are as follows:

- Since 2005 financial authorities have been pushing the banking sector to ensure the availability of minimal financial services in all townships and villages, by increasing the number of branches and exploring innovative alternatives to physical facilities (CBRC 2011b).
- In 2006 CBRC issued a policy document that lowered the requirements for setting up rural financial institutions, by encouraging the establishment of three new-type rural financial institutions (Giehler 2012). Village and township banks (VTBs) can offer bank accounts and other banking services to all people and businesses in the county where they are registered; rural mutual credit cooperatives (RMCCs) can offer such services only to members.
- In the mean time, the government has continued to consolidate RCCs, to transform viable RCCs into rural commercial banks and rural cooperative banks, and to close down highly unviable ones (CBRC 2011b).

- The government has also been promoting the ownership and use of bank accounts and bank cards, by requiring bank accounts for government-to-person (G2P) transfers and recommending the use of bank cards for person-to-government (P2G) payments (PBC 2009).

Access to basic banking services: Banking outlets and service points

Since 2005 the number of banking outlets has increased significantly. While in 2005 the number of financial institution outlets had arrived at a historic low (Zhang, Xu, Shen, and Cheng 2010), in 2010 only 2,312 towns and townships had no physical outlet (CBRC 2011). However, in many townships and villages banks had found cost-effective ways of creating branchless access points by setting up mobile units and automated teller machines (ATMs), or placing point-of-sales (POS) devices with retailers and other nonbanking institutions.

The number of bank card access points has multiplied.

Table 3 shows PBC's estimate of the number of establishments, POS terminals, and ATMs that had established a connection to the Bankcard Interbank Payment System by the end of 2010. For clients, the presence of physical outlets and branchless access points reduces the costs and increases the convenience of access to basic banking services, such as bank accounts and money transfers.

Even though experts believe official reports overstate access in remote western villages, and point out that the reports say little about the quality of the services on offer, they agree that significant progress has been made in improving access to service points.

Table 3. Number of Bank Card Access Points

	National (in thousands)	Rural (in thousands)
Establishments/merchants	2,183	87
ATMs	271	11
POS devices	3,334	265

Source: PBC Annual Report 2010.

Photographer: Lu Jia



3.3.2 Rural Household Bank Credit

Policies

By the beginning of the 21st century it had become clear that RCC reform was not going to be enough to improve the rural population's access to bank credit and that it would be necessary to create competition in the market for rural loans. Following are some of the key policies introduced since 2005 that were intended to improve rural access to productive bank credit:

- In 2005 PBC designed and pilot-tested MicroCredit Companies (MCC), a new type of small, privately funded, credit-only institution to compete with RCCs in rural areas. In 2006 it issued guidelines for investors to create MCCs. However, while in 2008 CBRC accepted MCCs as nondeposit taking companies, it ruled that they were to be supervised by the provinces' financial offices (Giehler 2012). However, since CBRC does not supervise MCCs it does not include them in its statistics on banks and nonbank financial institutions.¹⁵
- Two of the new-type finance institutions created in 2006, bank-initiated VTBs and member-owned RMCCs, were encouraged to develop loan products for rural enterprises and households (Giehler 2012).
- In 2007 the government transformed PSRB into the Postal Savings Bank of China (PSBC), with the mandate to develop commercially viable loan products for rural enterprises, migrant workers, and farmers (Giehler 2012).
- In the same year, the government issued a guideline that lifted earlier restrictions on the type of banking institutions permitted to provide small rural loans, thus allowing CCBs and other types of banks to enter rural areas (He, Du, Bai, and Li 2009).

15. PBC collects statistics on MCCs and reports them on its Web site, see http://www.pbc.gov.cn/publish/diaochatongjisi/3172/2012/20120510160014154597736/20120510160014154597736_.html.

- Also in 2007, it instructed ABC to return to its original mandate of serving rural areas, but this time with the instruction to pursue this mandate on a commercial basis (Yuk-Shing 2009).
- In 2010, it instructed banks to ensure that the overall tightening of credit did not affect rural lending, by making sure that rural loan growth remained at or above overall loan growth.

RCCs and all banking institutions mentioned above are described in more detail in Annex A.

Use of rural household bank credit: Providers and products

According to CBRC, the banks' value outstanding of both agro-related loans and loans to farmers doubled between 2007 and 2010 (CBRC 2010a).¹⁶ In 2010, the regulator categorized 2.6 trillion RMB or about 5 percent of banking sector RMB loans as farmer loans. Note that overall RMB bank credit to the entire economy also doubled over this period, thanks largely to the stimulus package introduced in 2008.

Data on the breadth and depth of outreach of rural financial institutions are scarce. Table 4 aims to provide some insight by showing the main categories of providers of bank loan products to rural household-run enterprises.¹⁷

It is important to note the following:

- Table 4 contains information on loans to rural households for productive investment in the household's business. It is not always clear whether the loans are restricted to agricultural investments only or may also be used for non-agricultural purposes.

16. For CBRC, agro-related loans are all loans issued by banking institutions categorized as rural, whereas loans to farmers are loans to rural households for the purpose of investment in agriculture.

17. It is not always clear whether these loans can be used only for agriculture or whether investment in nonagricultural enterprises is permitted.

Table 4. Principal Types of Banks that Provide Rural Household Productive Loans

	Year started	Number of institutions*	Published product name in English	Date of data	Number of borrowers (in thousands) [†]	Total volume of loans outstanding (in billions RMB)	Average outstanding balance (in thousands RMB)
Rural Credit Cooperatives (RCCs) ^a	1950s	2,646	Trust loans and group guarantee loans	2005	73,000	314	4
Large Commercial Banks ^b	various	5	NA	Dec 2010	NA	NA	NA
– Agricultural Bank of China ^c	1951	1	Ag. loans through rural benefits card	Dec 2010	5,800	99	17
Postal Savings Bank of China ^d	2007	1	Microloans to farmers	Mar 2010	1,310	62	47
New-Type Rural Financial Institutions ^{‡b}	2006	395	Rural household loans	Dec 2010	237	21	89
City Commercial Banks ^b	1995	147	NA	Dec 2010	NA	NA	NA
– Harbin Bank ^e	1997	1	Just for You Farmer Loans	Dec 2010	226	8	36

*All numbers of institutions are from CBRC (2011b).

[†]Where no figure on number of borrowers is available, the data in this column represents number of loans.

[‡]New-type rural financial institutions consist of village and township banks, rural mutual credit cooperatives, and lending companies.

Sources: a. Planet Finance (2008); b. CBRC (2011b); c. ABC (2011a); d. Chen (2011); e. Harbin Bank (2011)



Photographer: Liu Yinhu

- For some categories of institutions, for example, CCBs, no aggregate information is available. In such cases, the table presents data for a selected institution in that category that is widely considered to be a leader with respect to rural household loans. So, in the case of CCBs, the table presents specific data on Harbin Bank.
- Since MCCs are not banking institutions and, therefore, have not increased access to bank loans, they are not included in Table 4. MCCs are discussed further in Section 3.3.4.

Table 4 shows that government policies have contributed to a significant increase in the number and diversity of banking institutions involved in rural finance. At the end of 2010 RCCs were probably still the main banking sector lenders in terms of the number of rural households and household-run enterprises they reached.¹⁸ However, a diversity of banks was quickly increasing their role:

- According to the most recent data available, in 2005 RCCs had “credit loans” (collateral-free loans) and group loans outstanding to 73 million households.¹⁹ Although some

RCCs offer innovative products in line with international good practices, the absence of comprehensive information makes it difficult to judge the overall appropriateness of RCCs’ loan products. Since CBRC does not publish information on RCCs’ financial health, it is unclear to what extent they are a sustainable source of finance for rural households (Zhang, Xu, Shen, and Cheng 2010).

- Large commercial banks, such as ABC²⁰ and PSBC, have developed commercially oriented loan products for farmers and rural entrepreneurs. Together they serve about 8 million clients. Product design is innovative and based on international good practices. The extensive branch/branchless networks of these banks mean that these products have great scope for expansion.
- An unknown number of small and medium-sized banks have recognized the opportunity at the low end of the rural loan market and invested in the development of appropriate and profitable products. These banks have the advantage of being able to tailor loans to the needs in their area of operation. Harbin Bank—a CCB turned joint stock commercial bank—reports that its credit product for farmers reached 230,000 clients in 2010. The importance of the other 158 JSCBs and CCBs in rural household loans is unknown.
- New-type financial institutions have also been developing commercial products targeted at rural households; because they are small and their operations are restricted to a limited geographical area, they are in a good position to tailor products to local needs. However, by the end of 2010 the 395 institutions together served barely more rural households than Harbin Bank on its own.²¹

3.3.3 SME Bank Credit

By the beginning of the 21st century the government realized that SMEs were an important engine of growth, and that private SMEs in particular were facing major obstacles to borrow from banks. It was therefore necessary to remove institutional barriers to SME lending and to encourage a market-based approach at the same time.

It is important to note that in the PRC the term SME is commonly used to refer to MSMEs, too. For a long time, policy makers and banks did not distinguish between micro and small enterprises, and considered all enterprises under a certain size to be small (China SME Online 2004). In the middle of 2011 the government issued a new regulation on the classification of SMEs that did include a separate category of “microenterprises” (China Briefing 2011). However, regulations and press statements continue to consider the term SME to include microenterprises. In keeping with this practice, this report uses the term SME to also include MSMEs.

18. In keeping with CBRC’s categorization, in this paper we treat RCCs as part of the banking sector.

19. As far as the authors have been able to ascertain, the government and regulatory authorities have not issued any more recent figures on the number of RCC household loans. Experts concur with Du Xiaoshan (2008) that reliable data on RCCs are very difficult to obtain, and data from different sources vary greatly.

20. It is unknown to what extent the ABC figures include poverty alleviation loans that carry government interest rate subsidies.

21. Note that according to Luo Ping from CBRC (2012) the number of approved new-type financial institutions had doubled to 786 by the end of 2011.

Table 5. Maximum Number of Employees for Different Sizes of Enterprise

	Micro	Small	Medium
Agriculture, forestry, livestock, farming, fishing	NA	NA	NA
Heavy industry	20	300	1000
Retail industry	10	50	200
Transportation	20	300	1000
Restaurant and catering	10	100	300

Table 6. Maximum Revenue for Different Sizes of Enterprise (million RMB)

	Micro	Small	Medium
Agriculture, forestry, livestock, farming, fishing	0.5	5	200
Heavy industry	3	20	400
Retail industry	1	5	200
Transportation	2	30	300
Restaurant and catering	1	20	100

Source: *China Briefing* (2011)

Tables 5 and 6 present a selection of current criteria for classifying SMEs. As can be seen, the criteria for classification as an MSME differ by sector. The tables show the criteria for five out of 16 sectors. Note that in many countries, the companies that are classified as microenterprises in the PRC would be considered small- or medium-sized. Also, many enterprises considered medium-sized in the PRC would be considered large elsewhere.

Photographer: Zhao Jianming

Policies

In recent years, the government has put in place several policies to increase SMEs' access to finance.

- In 2005 the government issued guidelines encouraging large, medium, and small banks to set up small business units.
- A number of subsequent guidelines, policies, rules, and opinions issued between 2005 and 2010 encouraged banks to support SMEs.
- In 2011, CBRC issued a new regulation designed to provide greater incentives to Chinese banks to offer loans to small enterprises.
- Finally, over the past few years, the government has tolerated the emergence of a range of nonbank financial service providers targeting SMEs, as long as they did not mobilize deposits or charge usurious interest rates.

Use of SME bank credit: Providers and products

SMEs' access to bank credit has improved. According to CBRC (2010a) the SME part of banks' portfolio grew faster than any other part of their portfolio in 2010. At the end of the year its value amounted to 7.27 trillion RMB, which constitutes about 14 percent of banking institutions' total portfolio of loans and advanced accounts.

As is the case for rural household loans, comprehensive information on banks' breadth and depth of outreach with SME loans is difficult to obtain. Table 7 shows the categories of financial institutions that are the most significant SME loan providers. Where no consolidated information is available the table shows detailed data for one or two examples.

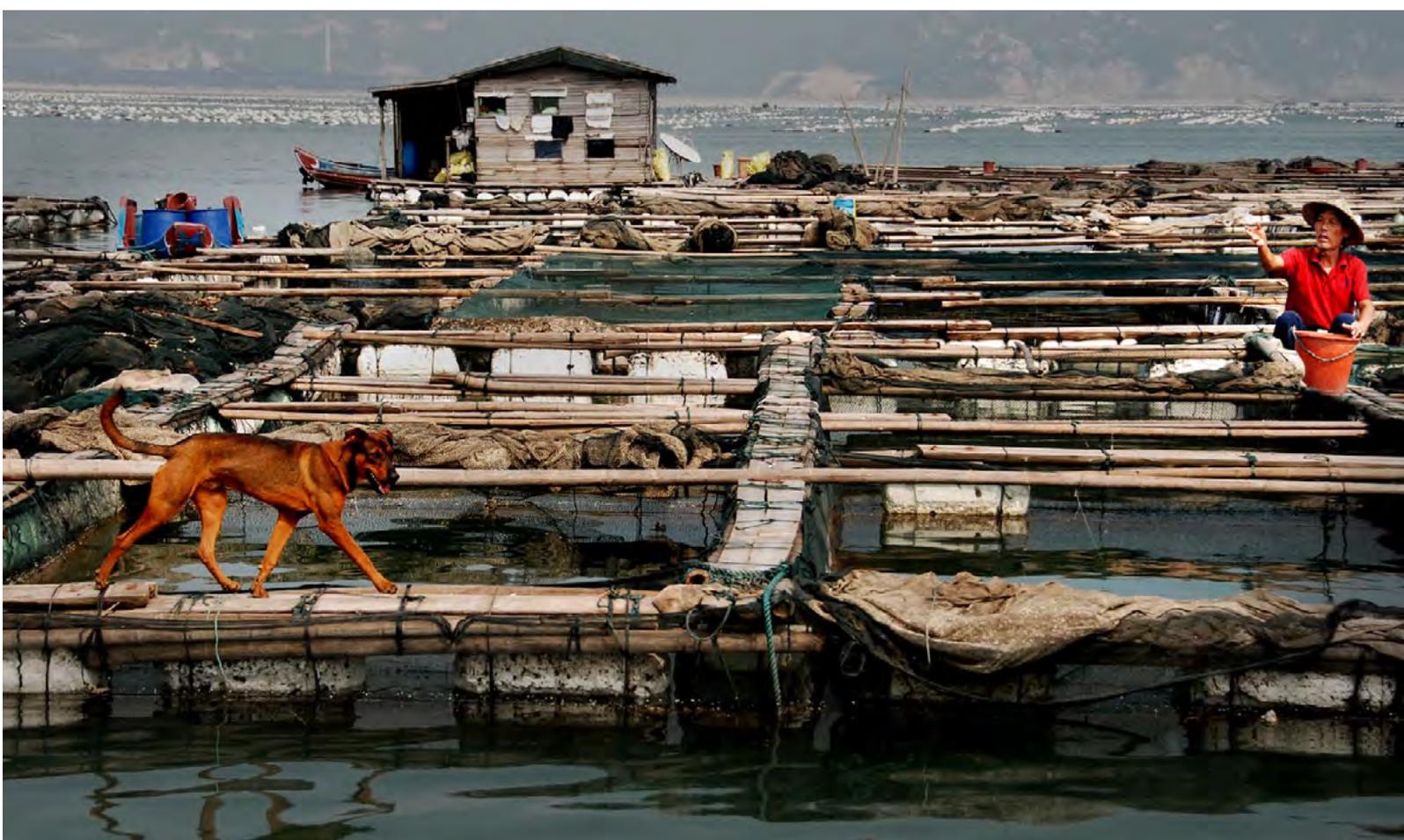


Table 7. Principal Types of Banks that Provide SME Loans (including microenterprise loans)

	Year started	Number of institutions*	Published product name in English	Date of data	Number of borrowers (in thousands)†	Total volume of loans outstanding (in billions RMB)	Average outstanding balance (in thousands RMB)
Large Commercial Banks ^b	various	5	NA	Dec 2010	NA	NA	NA
– Agricultural Bank of China ^c	1951	1	Small loans SME loans	Dec 2010 Dec 2010	40 63	461 1,900	11,525 30,159
– Bank of China ^c	1912	1	SME loans	Dec 2010	36	1,000	27,778
Postal Savings Bank of China ^d	2007	1	Microloans to small enterprises	Mar 2010	910	43	47
Joint Stock Commercial Banks ^a	1987	12	NA	Dec 2010	NA	NA	NA
– China Minsheng Banking Corp. ^e	1996	1	Shang Dai Tong loans	Dec 2010	110	159	1,445
City Commercial Banks ^f	1995	147	Micro and small loans	Dec 2009	NA	716	NA
– Baoshang Bank ^g	2002	1	NA	Dec 2010	30	4	147
New-Type Rural Financial Institutions ^{2a}	2006	395	SME loans	Dec 2010	31	31	1,000

*All numbers of institutions are from CBRC (2011b).

†Where no figure on number of borrowers is available, the data in this column represents number of loans.

^aNew-type rural financial institutions consist of village and township banks, rural mutual credit cooperatives, and lending companies.

Sources: a. CBRC (2011b); b. ABC (2011b); c. Bank of China (2011); d. Chen (2011); e. China Minsheng Banking Corp. (2011); f. CBRC (2010); g. CAM (2011).

As Table 7 indicates, government policies have contributed to a significant increase in the number and diversity of institutions involved in SME finance. At the end of 2010, the 147 CCBs together had probably become the main providers of what the government considers SME loans, in terms of number of clients. However, a large number of other banks played an important role:

- By the end of 2010, the Postal Savings Bank, with 500,000 microloans to small enterprises, was probably the largest single supplier of SME bank loans in terms of number of clients.
- 109 large, medium, and small commercial banks had established small business units (SBUs), which were typically serving several tens of thousands of clients each.²²
- All 395 new-type financial institutions together were serving only 31,000 SMEs, i.e., the approximate number of SMEs served by a single bank SBU.

Annex A provides more details on the banking categories with the deepest outreach.

3.3.4 Nonbank Providers of Financial Services

Policies

While CBRC has had some success in helping to increase access to bank services and the availability of bank loans for SMEs and rural households, experts agree that the past few years have also seen a significant increase in “shadow banking services” (J.P. Morgan 2011). This term is widely used to cover financial services that do not come from banks or RCCS but from nonbank financial service providers.

It is generally believed that the growth in nonbank financial service provision is a consequence of a number of developments in the national and international economy, combined with a set of government policies intended to manage the economy (J.P. Morgan 2011). These include a continued cap on bank deposit rates, an increase in the minimum lending rate and banks’ reserve requirements, and “guidelines” to banks to reduce lending.

Since 2005, financial authorities have issued a large number of regulations and guidelines regarding nonbank financial service providers. For example, the regulation and supervision of banks’ off-balance sheet activities have been tightened, and leasing and guarantee companies have come under closer scrutiny. Most notable among the new regulations have been guidelines for investors to set up MCCs, which offer opportunities for private actors to engage in legalized microcredit activities. These actors include people and companies formerly engaged in illegal lending.

Use of nonbank credit: Providers and products

Recent estimates of the size of the shadow-banking or nonbank financial sector vary widely—4–18 trillion RMB, depending on which activities are included or excluded (Borst 2011). Table 8 shows Morgan Stanley’s (2012) estimate of the volume of outstanding loans in the shadow banking market. This volume is the equivalent of 20 percent of banking institutions’ total loan portfolio at the end of 2010.²³ It is interesting to compare this to banks’ farmer credit portfolio (5 percent of the banks’ total loan portfolio) and banks’ SME credit portfolio (14 percent of the banks’ total portfolio).

22. While the authors have made every effort to include in the table the total number of SME borrowers per featured bank, it is possible that the sources used did not include information on all loan products used by SMEs.

23. According to CBRC’s 2010 Annual Report, at the end of 2010, banking institutions had 47.6 trillion RMB outstanding in short-, medium-, and long-term loans.

Table 8. Nonbank Providers of Financial Services by Total Loan Volume Outstanding

	Date	Number of institutions	Total volume of loans outstanding (billion RMB)	Regulators
Enterprises: entrusted loans*	Sep 11	NA	4,571	CBRC, PBC
Trust companies: trust loans	Sep 11	65	1,674	CBRC, PBC
Credit guarantee companies*	Dec 11	6,500	780	CBRC, PBC
Noncredit guarantee companies*	Dec 11	13,000	840	NA
Licensed financial leasing companies	Sep 11	17	377	CBRC, PBC
Nonlicensed financial leasing companies*	Sep 11	242	750	MOFCOM
Pawnshops*	Dec 11	5,000	55	MOFCOM
Microcredit companies (MCCs)	Sep 11	3,791	336	Local governments' financial service department, CBRC, PBC
Other private lending*	Dec 11	NA	850	NA
Total			10,233	

*Estimate.

Sources: Morgan Stanley (2012).

Box B provides a short description of what Morgan Stanley considers the most significant shadow banking providers and activities, all of which can operate legally. The different providers pose different risks to clients and the financial system. Off-balance sheet activities, such as trust loans and entrusted loans, financial leasing, and credit guarantee companies, have become highly regulated and strictly supervised

Box B. Significant Nonbank Financial Service Providers

Trust Companies Extend Trust Loans. As they are not authorized to absorb deposits, the loans are mainly financed through various financial products, such as wealth management products, issued to enterprises and individuals. Banks and trust companies act as intermediaries only to earn fees, and usually do not undertake risks should borrowers default.

Enterprises Provide Entrusted Loans. Enterprises that wish to lend significant sums to other enterprises are prohibited from doing so directly; however, they can provide Entrusted Loans with banks or other financial institutions as intermediaries. In the same vein as trust loans, banks and other financial institutions play only an intermediary role to earn fees, and it is very rare to assume default risks.

Licensed Financial Leasing Companies Offer Leasing Services. These are regulated by CBRC and PBC because they can engage in some kind of banking business, such as financing from the interbank market. Many are subsidiaries of banks. Nonlicensed financial leasing companies are mainly regulated by the Ministry of Commerce, and they usually conduct traditional leasing business.

Credit Guarantee Companies Offer Bank Loan Guarantees. Since 1992 the government has permitted the establishment of credit guarantee companies. Licensed credit guarantee companies provide guarantees for bank loans, and their credit volume represents bank lending that would not have taken place without their involvement. So-called noncredit guarantee companies are illegal. An unknown proportion of credit and noncredit guarantee companies have been illegally involved in direct lending and taking deposits from the public.

Pawnshops Offer Collateral-Based Loans. Pawnshops were abolished in 1949 but reappeared in the 1980s. After a review in the 1990s, they are now regulated and supervised by the Ministry of Commerce. While not intended for enterprise loans, in a situation of tight bank credit, they have become an important source of short-term business lending, taking real estate and vehicles as collateral. Some have also illegally started taking deposits.

MicroCredit Companies Offer Cashflow-Based Loans. In 2005 PBC designed and pilot-tested the MicroCredit Company (MCC)—a new type of small, rural focused, and privately funded, credit-only—intended to offer nonbank credit providers a vehicle for legalizing their businesses. In 2006 it issued guidelines for investors to create MCCs. The 2008 guidelines for MCCs issued by CBRC in conjunction with PBC marked their official acceptance as nondeposit-taking companies. MCCs were to be supervised by the provinces' financial offices. While MCC lending is technically legal, regulatory support has not been unambiguous. CBRC is concerned about MCCs illegally taking deposits.

Sources: Morgan Stanley (2012), Situ (2010), Tsai (2004 and 2006), and Giehler (2012).

by CBRC and PBC²⁴ over the past few years. The other providers are not supervised by central financial authorities.

Other sources of private lending include a variety of legal as well as illegal operators. Illegal practices, such as direct intercompany lending and informal note discounting, often go unregistered and are unsupervised. So-called underground banks, such as private money houses, illegally mobilize deposits and pay deposit rates above PBC's deposit rate ceiling. These as well as professional moneylenders often charge very high lending interest rates. In fact, MCCs were designed as a way for underground lenders to legalize their business.

Morgan Stanley does not specify what is included in its estimate of other sources of private lending. We do not know whether it includes informal but legal practices, such as interpersonal lending, loans from friends and family, and rotating savings and credit associations. It is also unclear whether the estimate includes two important types of institutions that explicitly target those with difficult access to banks and other formal financial institutions:

- **Poverty alleviation microfinance institutions (MFIs).** Poverty alleviation MFIs were started in the early 1990s and tend to target the rural poor. Nowadays they tend to be legally registered as societal organizations, foundations, privately run nonprofit enterprises, and institutions (Sun Tongquan 2008).
- **Peer-to-peer (P2P) platform managers.** P2P platforms are a more recent phenomenon, started in 2006. P2P platform managers intermediate between individual investors and borrowers in urban as well as rural areas. They tend to be registered as nonfinancial companies, such as consultancies (Caixin 2011).

While these two types of providers constitute less than 1 percent of the nonbank sector in terms of the volume of loans they provide, they may be some of the most relevant nonbank providers of financial services for microenterprises and the poor. This is discussed further in Chapter 4.

24. The different roles of CBRC and PBC in banking regulation and supervision were described in Section 3.1.1.



Photographer: Li Xiangju

4 Gap Assessment

Recent government policies to improve financial inclusion in the PRC have focused on access to basic banking services and productive bank loans for rural households and SMEs. This chapter analyzes the degree to which banks meet the potential demand from groups that previously found it difficult to access such services. Section 4.1 looks at banks' breadth of outreach (as measured by the number of clients) and their depth of outreach (as measured by the degree to which the poor are reached); it also analyzes selected nonbank financial service providers. Section 4.2 considers some of the reasons behind banks' and nonbanks' current roles in financial inclusion. Based on the limited data that are publicly available, we conclude that while the results of policy changes have largely been positive, considerable work remains to be done before the PRC's financial system can be considered fully inclusive.

4.1 Breadth and Depth of Outreach of Banks and Nonbank Providers

4.1.1 Full Banking Service Coverage

Breadth of outreach: Bank account and card ownership

The number of adults with bank accounts has increased significantly. Most banks do not report how many clients they have.²⁵ However, from a recent World Bank study reporting on a survey of more than 4,000 nationally representative and randomly selected individuals, we know that, in 2011, 64 percent of Chinese adults owned an account with a formal financial institution, compared to a 50 percent global average (Demirgüç-Kunt and Klapper 2012). We also know that PSBC had 475 million individual clients at the end of 2010, which is a third of the population. Many Chinese experts believe that most households (not individuals) now have access to formal banking in China.

25. While some publish the number of accounts, this is not a good proxy for number of clients as many people have more than one account.

Bank cards have become widely available. According to PBC (2011), by the end of 2010 banks had issued over 2.4 billion bank cards—more than 90 percent of which were debit cards. ABC alone had issued 96 million Kins Farmers Benefit Cards.²⁶ With a national population of more than 1.3 billion, this means that the number of bank cards per capita exceeded 1.8. Even in rural areas, the number of bank cards per capita was 1.07. However this does not mean that all rural people had a debit card. In fact, PBC (2011) reports a bank card penetration rate of only 35 percent. Only 8 percent of adults hold a credit card according to the recent World Bank Findex report (Demirgüç-Kunt and Klapper 2012).

Even if many of these bank accounts and cards are not actively used,²⁷ the ownership of accounts and cards is an important step in improving financial inclusion.

Depth of outreach: Use of basic banking services by the poor

Bank account ownership among the poor is still low. Banks do not generally have information on the income level of their clients. The most reliable up-to-date demand side study that gives insight into depth of outreach is the Findex study. According to this study, 39 percent of the poorest quintile in the sample had a bank account (Demirgüç-Kunt and Klapper 2012). This is considerably lower than for the total adult population in China of which 64 percent has access.

PBC's recent commitment to ensuring that all social transfers are made through bank accounts and bank cards is likely to have a significant impact on the number of poor with access to basic banking services.

26. For more information on ABC see Annex A2.

27. The World Bank's Findex study (Demirgüç-Kunt and Klapper 2012) found that only 32 percent of the sample had made savings in their account over the past year, compared to 45 percent in high-income countries. It is well known that, in many cases, transactions on accounts and cards are limited to the reception and withdrawal of the G2P transfer, and the accounts are dormant for the remainder of the time.

4.1.2 Rural Household Bank Credit

Breadth of outreach: Number of rural households with productive credit

To be able to judge the proportion of rural households reached with productive credit, it is important to first obtain an estimate of demand for rural household bank loans. The latest population census, which was conducted in 2010, counted 674 million rural residents living in slightly over **200 million rural households**. According to the latest national Agricultural Census (NBS 2008), in 2006, 71 percent of the total rural employed population of 478 million (i.e., 373 million) worked in the primary sector.²⁸ Syngenta Foundation (Yuan 2011) calculated that 190 million of these were smallholder farmers, with the remainder working in state, local government, and collective enterprises, or being unemployed.

The number of rural households is not an accurate proxy for demand; rather, the number indicates an order of magnitude. Only a certain percentage of households *want* to supplement their own funds with bank loans, and not all have a viable business and *are able* to repay a loan.

To obtain an estimate of the supply in the sense of the number of bank loan clients, we extrapolated the data on financial service providers presented in Table 4 in Chapter 3. See Annex B1 for the detailed calculations. We estimate that in 2010 all banks and RCCs together had **a maximum of 119 million rural household loans outstanding**. This constitutes 58 percent of the number of rural households.

It should be noted that these extrapolations constitute an overly optimistic estimate, and in actual fact, the number of bank loan clients is significantly lower. The calculations make the very generous assumption that all banks

28. This includes individuals belonging to households engaged in farming, forestry, animal husbandry, and fishery.

Table 9. Relative Loan Size of Rural Household Loans

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Institutions by average outstanding balance	Product name	Average outstanding balance per loan (2010) (thousand RMB) ^a	Average rural annual net income per capita (2010) (thousand RMB) ^{a,b}	Average loan balance/ average rural net income (%)	National rural poverty line (2011) (thousand RMB) ^c	Average loan balance/rural poverty line
				Column 3 ÷ Column 4		Column 3 ÷ Column 6
RCCs	Trust loans and group guarantee loans	4	5.9	68%	2.3	174%
ABC	Ag. loans through rural benefits card	17	5.9	288%	2.3	739%
Harbin Bank	Just for You Farmer Loans	36	5.9	610%	2.3	1,565%
PSBC	Microloans to farmers	47	5.9	797%	2.3	2,043%
NTFIs	Rural household loans	89	5.9	1,508%	2.3	3,870%

Sources: a. See Table 4; b. National Bureau of Statistics of China (2011b); c. Xinhuanet (2011).

in a particular category have a portfolio comparable to the sample institution in that category.²⁹ This is certainly not the case. However, in the absence of complete data, it is not possible to determine the real magnitude of the number of clients.

Depth of outreach: Relative value of rural household loans

A frequently used indicator for the depth of outreach of loan products is the relative value of the average outstanding loan balance. Table 8 compares this loan balance first to average rural annual net income per capita³⁰ (in column 5) and then to the poverty line³¹ (in column 7).

Table 9 shows that the average rural household loan balance of most banks is many multiples of average rural annual net income per capita.³² Of all the rural household loans presented in Table 9, only RCCs' collateral-free loans and group guarantee loans have an average outstanding balance that is below rural annual net income per capita (4,000 RMB is 68 percent of 5,900 RMB).³³ The average outstanding balance of agricultural household loans extended by the institution with the next deepest outreach, ABC, is 17,000 RMB, or 288 percent of rural annual net income per capita.

The average loan balance of most banks is also much higher than the rural poverty line. The average outstanding loan balance of RCCs, the banking sector institutions with the deepest outreach, is 174 percent of the rural poverty line, and that of ABC's agricultural household loans is 739 percent of the rural poverty line.

Compared to other countries, a majority of the PRC's banking institutions do not reach out very deeply with their loans. This is further explained in Box C.

Box C. The PRC's Banks' Depth of Outreach Compared to Other Countries

The Microfinance Information Exchange (MIX) contains information on about 2,000 MFIs worldwide. For an institution to be included in MIX, its average outstanding loan balance has to be less than 250 percent of gross national income (GNI) per capita. Based on this guideline, none of the banking sector institutions in the PRC except RCCs are eligible to be included in MIX. However some nonbank providers, such as MCCs and poverty alleviation MFIs, are included in MIX.

Source: MIX (2011).

Note that Table 9 shows only averages. Each institution's portfolio contains loans with a balance above and below this average. For example, a certain proportion of PSBCs' microloans to farmers is certainly reaching people with the average rural net income. In addition, not all institutions within the same category have the same average loan balance. Since we do not have data on all CCBs, it would be inappropriate to draw far reaching conclusions on their depth of outreach based on the data of Harbin Bank alone.

4.1.3 SME Bank Credit

Breadth of outreach: Number of SMEs with credit

To obtain an estimate of demand for SME and rural household bank loans, in the sense of the number of people needing bank loans, we obtained national statistics on the number of SMEs. The latest Economic Census (NBS 2009) held in 2008 counted 45 million legal units, establishments, and self-employed individuals who were engaged in secondary and tertiary industries within the territory of China. This number includes large, state-owned enterprises, but a large majority are public and private SMEs, including microenterprises. The closest estimate for the number of legal private SMEs and microenterprises is the number of self-employed

29. For example, it assumes that each CCB has the same number of rural loan clients as Harbin Bank.

30. The definition of rural net income is given in the footnotes to the introduction of this report.

31. Column 6 mentions the new rural poverty line introduced in 2011, which is 80 percent higher than the one used previously.

32. Note that the table contains the average outstanding balance for PSBC's entire microloan portfolio (which includes both farmer loans and SME loans) because this is the only figure available. In fact, farmer loans are only half the size of SME loans, so in reality the average outstanding balance for farmer loans is smaller than 47,000 RMB.

33. RCC household loan balance figures are 2005; the income figures are for 2010.

Table 10. Relative Loan Size of SME Loans

Actual average loan size of different types of institutions			Government criteria for defining different types of SMEs			
Institutions by average outstanding loan balance	Product name	Average outstanding balance per loan (2010) (thousand RMB) ^a	Sector	Enterprise size ^b	Minimum average revenue ^b	Maximum average revenue ^b
PSBC	Microloans to small enterprises	47	Primary	Micro	0	500
Taizhou Bank	Micro and SME loans	450	Retail	Micro	0	1,000
NTFIs	SME loans	1,000	Transportation	Micro	0	2,000
China Minsheng Banking Corp	Shang Dai Tong loans	1,450	Heavy industry	Micro	0	3,000
ABC	Small loans	11,500	Heavy industry	Small	3,000	20,000
BoC	SME loans	28,000	Wholesale trade	Small	10,000	50,000
ABC	SME loans	30,000	Real estate development	Small	20,000	50,000

Sources: a. See Table 7; b. China Briefing (2011).

individuals with licenses, at 29 million.³⁴ In general only legal, registered SMEs are eligible for bank loans.

It should be noted that the number of SMEs is not an accurate proxy for demand; rather, the number indicates an order of magnitude. For example, only a certain percentage of SMEs *want* to supplement their own funds with bank loans, and not all have a viable business and *are able* to repay a loan.³⁵

To obtain an estimate of the supply in the sense of the number of bank loan clients, we extrapolated the data on financial service providers presented in Table 8 in Chapter 3. Annex B2 shows the detailed calculations. We estimate that in 2010 banks had **at most 6.6 million SME loans outstanding**. This constitutes 16 percent of the number of all registered SMEs.

As was the case for rural household loans, this extrapolation for SMEs constitutes an overly optimistic estimate, and in fact, the number of bank loan clients is significantly lower. The calculations make the very generous assumption that all banks in a particular category have a portfolio comparable to the sample institution in that category.³⁶ This is certainly not the case. However, in the absence of complete data it is not possible to determine the real magnitude of the number of clients.

34. NBS defines these as economic units except rural households where the means of production is owned by individuals, individual work constitutes the basic form of operation, and the results of the operation are owned by or at the disposal of the individuals concerned.

35. Many SMEs are not viable and, therefore, cannot pay back a loan. Enterprise survival rates constitute an indication of the percentage of unviable SMEs. For example, in Switzerland where competition is considered to be tough, only 66 percent of new SMEs in the secondary and tertiary sector survive after their third year.

36. For example, it assumes that each CCB has the same number of SME loan clients as Baoshang Bank.

Note that both SMEs that do and those that do not have access to bank credit often use a range of nonbank sources of finance. A recent survey of 2,400 SMEs in the PRC found that on average they had financed only 20 percent of new investments with bank loans. For the smaller companies, banks were an even less significant source of finance (Ayyagari, Demirgüç-Kunt and Maksimovic 2010).

Depth of outreach: Relative value of SME loans

Again we use average outstanding loan balance as an indicator for the depth of outreach. To see to what extent SME lenders reach out to the smallest types of enterprises, Table 10 compares their average loan balance with the government's newly issued revenue criteria for defining microenterprises.

Table 10 shows that different categories of banks probably target different market segments:

- PSBC and Baoshang Bank, a CCB, have products of a size comparable with the average revenue for a primary sector or retail microenterprise, as defined by the government.
- New-type financial institutions and China Minsheng Banking Corporation, a joint stock commercial bank, offer SME products of a size that would be suitable for microenterprises in the transportation sector and heavy industries.³⁷
- The average size of SME products of ABC and the Bank of China is above the criteria for microenterprises in all sectors.

Of course, not all institutions within the same category have the same average loan balance, and each institution's portfolio contains loans with a balance above and below this average.

37. As far as the authors have been able to discern, there is no separate criteria for manufacturing. It seems plausible that "heavy industries" covers manufacturing.

We already saw that most rural loan products in the PRC do not meet the informal international standard for being considered “microcredit”; the same is the case for SME loans. Institutions are generally considered to be providing microcredit only if their loans are under MIX’s cut-off rate. Official English translations of Chinese documents on rural household and SME loans and the English-speaking press frequently refer to these loans as “microcredit.” This practice is cause for much international miscommunication. Box D explains this in more detail.

4.1.4 Credit from Selected Nonbank Providers

Breadth and depth of outreach

Information on the outreach of nonbanks is rather scarce. As a consequence, it is difficult to estimate the degree to which they meet demand, and the extent to which they reach out to the poor. Table 11 provides information on some types of nonbank financial services providers for which data on outreach are available.

MCCs are starting to become a significant group of actors in terms of breadth of outreach, but despite their name they do not tend to reach out to the poor. In 2010, the 2,614 MCCs³⁸ altogether served almost 500,000 clients. However, at 400,000 RMB, average outstanding loan balances were 65 times rural net income per capita. Experts believe that the majority of MCC loans do not go to farmers but to rural and peri-urban entrepreneurs in the secondary and tertiary sector.

Poverty alleviation MFIs have average outstanding loan balances around rural net income per capita; however, with the exception of the China Foundation for Poverty Alleviation, their outreach is very low. The 42 MFIs that report to the China Association of Microfinance (CAM) have fewer than 2,000 clients each. Of those that do not report to CAM, the China Foundation for Poverty Alleviation with over 100,000 clients is by far the largest. The majority operates in an incomplete legal framework, and it is unclear whether the government is going to support their continuation in their current form.

38. The number of MCCs is growing extremely fast. In 2011, the total number of MCCs increased by 64 percent, according to data released by PBC (Zhang 2012).

Box D. Microcredit versus SME and Rural Loans: Confusion in Terminology

The PRC’s English-speaking press and official English translations of Chinese documents often describe banks offering rural and SME loans as providing “microcredit.” However, banks do not strictly disburse many microloans as defined internationally. The average balance outstanding of rural and microenterprise loans tends to exceed the informal international norm of less than 250 percent of GNI per capita.

Occasional miscommunication on this issue between the government and the international community arises from two sources:

1. Translation—The Chinese word for “MicroCredit Company” can be translated into English as “microcredit company” or as “small credit company.”

Chinese	Pinyin	English
微型企业	Weixing qiye	Microenterprise
小企业	Xiao qiye	Small enterprise
小额贷款公司	Xiao edaikuan gongsi	Micro/small credit company

2. Distinction—For a long time, Chinese regulations have not distinguished between micro and small enterprises. Although a new regulation is now in place, the government and banks continue to consider microenterprises simply to be very small SMEs.

The international community believes it is important to distinguish between SMEs and microenterprises for two main reasons:

1. Products—Microenterprises require products that explicitly recognize their unregistered, asset-poor, and informal nature.
2. Models—Microcredit requires a business model that involves different mechanisms for risk control and cost recovery.

Sources: China Working Group on Inclusive Finance (2011b) and IFC (2009).

P2P platforms are a new type of nonbank with a lot of potential for breadth and depth of outreach. Very little is known about P2P platform managers as they do not publish their results. According to press reports (Shen 2011), CreditEase is the largest of approximately 30 P2P platform managers. It has developed relatively low-value commercial loan products, with which it reaches 70,000 clients. According to personal communications, CreditEase’s rural clients typically borrow 6,000 RMB and urban clients borrow 60,000 RMB. It is likely that most P2P platform managers mainly provide loans for rural and urban nonagricultural microenterprises. It is unclear whether the government will accept P2P providers as an alternative model and provide a regulatory framework for their operation and expansion.

Table 11. Outreach of Selected Nonbank Providers of Financial Services

	Year started	Number of institutions	Published product name in English	Date of data	Number of borrowers (in thousands)	Total volume of loans outstanding (in billions RMB)	Average outstanding balance (in thousands RMB)
Microcredit Companies ^a	2005	2,614	Loans	Dec 2010	493	197	400
Poverty Alleviation MFIs ^b	1993	100	NA	2008	NA	NA	NA
– Members of China Association of Microfinance ^c	1993	42	Loans	2009, 2010	73	0.36	5
– China Foundation for Poverty Alleviation ^d	1996	1	Loans	Dec 2011	106	0.66	6
P2P Providers ^e	2006	30	NA	Nov 2011	NA	NA	NA
– CreditEase ^e	2006	1	Loans	Nov 2011	70	1	14

Sources: a. Giehler (2012); b. Du (2008); c. He, Du, Bai, and Li (2009); d. CFPA Microfinance (2010); e. Lanhee Lee (2011).

4.2 Considerations on the Role of Banks and Nonbanks in Financial Inclusion

While considerable progress has been made in expanding access to basic banking services, such as bank accounts and bank cards, bank loans appear to reach only a part of rural households and SMEs, and they do not reach out very deeply. This apparently limited breadth and depth of loan outreach to previously excluded market segments is due to a complex set of issues on both the demand and the supply side, combined with some issues on the macro level. The following are some examples.

On the demand side:

- **Not all people in the selected sectors and occupations need or want a loan.** For example, many of the PRC's poor operate unviable smallholdings or enterprises and do not need productive loans but they need government income support or jobs. A considerable number of rural households receive domestic transfers from relatives who are working in towns. Others who do have a viable piece of land or a promising enterprise prefer to draw on their own savings. Past policies have ensured that Chinese households hold relatively high bank savings balances.
- **Of those who do need or want a loan, many prefer to use nonbanking sources.** The one-child policy means that a young couple can often borrow some money from their parents as well as from up to four sets of grandparents. Informal loans from family and friends are usually interest free. In addition, a large variety of nonbanks offer loans against terms and conditions that compete with those offered by banks. Easier access often outweighs the higher interest rates charged.
- **However, in poverty-stricken areas people often do not have access to sufficient nonbanking sources of loans.** In these areas, extended families and nonbank financial service providers often cannot offer the amount of money that people need at the time that they need it.

On the supply side:

- **Different types of banking institutions face different challenges.** Annex A provides a detailed description of the principal categories of financial institutions that offer small rural and SME loans, and describes some of the bottlenecks for achieving higher growth and deeper penetration into the market. Box E summarizes some of the issues they face.

- **It takes time for banks to change their way of doing business.** We saw in the section on the history of the PRC's financial sector that, for a long time, banks based their decisions on sectoral quotas and focused their lending on large, state-owned companies that carried an implicit government guarantee; loans to rural households carried a low interest rate and were subsidized. Unsubsidized lending to smaller private companies or households requires banks to not only build the capacity to assess companies on the basis of their cash flow and to develop the ability to work with a variety of collateral. It also requires them to change their internal culture and break habits long ingrained during the time of the command economy. In particular, after many years of being told that rural inhabitants can pay only very low interest rates, banks find it hard to accept the idea that the costs of many rural household loans can actually be covered from interest income.

Box E. Examples of Challenges Faced by Banks in Increasing Outreach

- **Size and structure make it difficult for large regulated financial institutions to adapt products to local circumstances and changes in the market.** For example, as Giehler (2012) notes, in large institutions, product development, management, and marketing decisions are centralized. This means they can apply only an industrialized approach and offer standardized products. A multi-layer hierarchical structure makes management and supervision more complicated. Product features also lack flexibility as a result of long decision-making chains.
- **Regulations governing small financial institutions, such as VTBs, discourage them from serving large numbers of the poor and microenterprises.** For example, funding source and leverage restrictions on different types of institutions severely limit growth. Geographical restrictions mean that economies of scale from expansion are limited. While they are officially free to price loans according to risk (within bands), many are reluctant to do so for fear of prosecution (IMF 2011).

On the macro level:

- **The government needs to balance its wish to increase lending to those who previously had difficulty accessing banking services with the need to conduct monetary policy.** Growth in rural and SME lending is necessarily limited by PBC's measures to reduce the growth in overall credit supply.
- **The role of the government and the various financial authorities is not always clear.** The IMF (2011) mentions contradictions between CBRC's safety and soundness mandate and the government's continued effort to use the financial system to attain development goals. While banks are expected to operate on commercial principles, they continue to be "encouraged" to allocate their resources to priority sectors.



Photographer: Liao Guowei

5 Conclusions

Major policy changes have taken place in recent years

The beginning of the 21st century represents a watershed in the promotion of financial inclusion in the PRC. During the previous two decades government policies had favored large, industrial, government-owned companies located in urban areas and on the coast, at the expense of rural households, low-wage workers, SMEs, and the unemployed. Rising social inequalities prompted the realization that new policies were required. With social harmony and sustainable development as its new central policy goals, the central government embarked on a concerted effort to ensure more widespread access to banking services. Furthermore, while thus far the government had tried to increase access through lending quotas and subsidized loan programs, limited success motivated a push toward commercially viable, investable institutions offering products to clients perceived as too costly or too risky to serve. These changes in goals and emphasis have had a major impact on the PRC's financial landscape.

New policies and regulations, particularly those introduced since 2005, have reversed the previous trend by increasing the accessibility of banking services. There has been an increase in the number of banks with a mandate to provide banking services to the hitherto excluded—in particular, rural people and SMEs. Banks have expanded their outreach by establishing large numbers of virtual access points, such as mobile units, ATMs, banking agents, and POS devices. CBRC reports that banks' branch and branchless networks now cover all townships and villages.

The policies have also increased the sustainability of access to financial services. The overall health and, therefore, the stability of the banking sector have greatly improved. Banks and legal credit-only financial service providers are experimenting widely with methods for serving account and card holders in a more efficient manner by using the latest developments in mobile technology. They have expanded their loan portfolios more cost-effectively by building on international and national experience with lending methodologies. As a result, many of the previously excluded can be served without the need for long-term subsidies.

In addition, a more welcoming policy environment has attracted a diverse base of investors. There has been an increase in private and foreign investment in banking and credit-only institutions, with a mandate to serve the previously excluded. New regulations have enabled domestic investors to turn the underground banks they supported into formal institutions. They have also allowed international microfinance investors, such as IFC, Standard Chartered, Accion International, and Planet Finance, to enter the market.

Financial inclusion has improved, but not sufficiently

While ownership of bank accounts and bank cards is now much more widespread, work remains to be done to give the poorest access to these basic banking services. Increased G2P social transfers have had the important side effect of significantly increasing the number of people with a bank account and access to basic banking services. According to the 2012 World Bank Findex study, 64 percent of adults have a bank account, and PBC reports a bank card penetration rate of 35 percent. Savings services are widely developed. However, the same Findex study shows that only 39 percent of the poorest quintile has a bank account.

Also, despite the growth in rural household and SME loans in recent years, the market is still far from satisfied. A lack of aggregate and consistent data makes it difficult to estimate the exact size of the gap between demand and supply. If all banks offered the same number of loans as the market leaders in their category, 58 percent of rural households and 16 percent of SMEs would currently have a bank loan. However, experts agree that this is an overly optimistic estimate of supply. Frequent reports in the press about the volume and growth in illegal lending point to large numbers of households and enterprises that cannot or do not want to use banking services.

In addition, very few types of banking institutions serve the rural poor with loans. An analysis of average outstanding loan balances shows that despite frequent use of the word “microcredit” to designate their products, all categories of banks tend to provide loans above 250 percent of GNI per capita, which is often used internationally to define microcredit. RCCs are the only banking sector institutions that offer a product whose average outstanding loan balance approximates average rural net income and that are affordable to the poor. This is of particular concern given the wide gap between rich and poor in China, and between urban and rural areas.

Some banking institutions do serve what the PRC government defines as microenterprises. For example, PSBC and some CCBs have developed appropriate products for microenterprises. It should be noted, however, that enterprises that are considered micro in the PRC would be considered SMEs in many other countries.

The groups that have difficulties accessing banks and RCCs rely largely on nonbank providers. Guarantee companies, pawnshops, and MCCs play an important role in serving those who have no access to banks. Nonbank providers of financial services that have a deeper reach than most banks include poverty alleviation MFIs and P2P platforms. Unfortunately, with a couple of exceptions, the outreach of these two types of institutions is limited.

Most nonbank financial service providers are less strictly regulated and supervised than banks, and can therefore expose people to considerable costs and risks. Some illegal providers charge loan interest rates that are higher than those of formal institutions. Others use inappropriate loan collection methods or run away with people’s savings; in these cases, people have no recourse to the legal system.

Conditions are right for accelerating progress toward a fully inclusive banking sector

There is considerable potential for increasing the commercial provision of financial services to the previously excluded. Regular policy statements confirm the central government’s commitment to ensuring commercial and sustainable outreach to the excluded, and the promotion of innovation (see Box F). The size of the PRC’s market offers opportunities for economies of scale that are not available in many countries; its comprehensive identification system greatly helps banks to meet know-your-customer (KYC) requirements³⁹ and to recover loans. The excellent mobile telephone infrastructure and wide network of branchless access points offers opportunities for reaching large numbers of clients at low costs. Work on financial infrastructure, such as deposit insurance, credit bureaus, and payment systems, has started to contribute to the expansion of opportunities (IMF 2011).

Box F. Government Commitment

During the 11th 5-year period, the CBRC has, in line with the instructions and arrangements of the State Council, earnestly performed its supervisory duties and attached great importance to strengthening and improving the provision of financial services to Agriculture, Farmers and Rural Areas. Efforts have been made to...encourage and facilitate the innovation of rural financial products and service...The CBRC has urged banking institutions to increase the extension of agro-loans according to market principles.

During the 12th 5-year period the CBRC will continue to work hard to advance the development of a modern rural financial regime, actively press ahead with the reform of the rural financial system and ensure effective financial support for the development of a new countryside.

Excerpts from CBRC (2011a).

39. For more information on KYC requirements and their link to financial inclusion, see CGAP (2011).

There is a need for more research and exchange

To take full advantage of this potential, the government, financial institutions, and investors need comprehensive, high-quality information on the market. Currently, obtaining a picture of the landscape requires these stakeholders to consult a wide range of sources; information from these sources is not always comparable and complete. This paper has highlighted the need for better data and more research in the following areas:

1. **Demand. Greater financial inclusion can be achieved only when the needs of different market segments are understood.** In the past, PBC and the China Bureau of Statistics have conducted surveys on the use of formal and informal financial services by rural people and SMEs. The 2012 World Bank Findex study (Demirgüç-Kunt and Klapper 2012) provides up-to-date figures on use of formal financial services and barriers to use of formal accounts. The regular execution of surveys on use and needs among groups that have difficulty accessing financial services, based on the latest insights in demand survey methodologies, would be very useful.
2. **Supply. Stakeholders need a thorough comprehension of the nature, efficiency, and effectiveness of formal financial service providers that target the previously excluded.** It would save a lot of time and effort if a single agency were to take responsibility for the systematic collection and national compilation of data from all types of institutions that claim to be engaged in financial inclusion. This should include the numbers of savings accounts and outstanding loans, as well as their average balances. Information on the volume and number of domestic and international transfers would also be useful. MIX Market⁴⁰ offers an interesting international model, although data should include all kind of institutions providing financial access, such as RCCs, PSBC, MCCs, etc.
3. **Specific research and case studies could help answer some of the questions raised in this paper. Examples of these include the following:**
 - How do the formal financial institution business models compare with international best practices, in particular in terms of their efficiency, sustainability, and the quality of their products?
 - How successful are subsidized loan programs in increasing financial inclusion? What is the potential for substituting their services with commercially viable products?
 - To what extent do nonbank financial service providers meet the needs of those with difficult access to banks and RCCs?
 - How could more nonbank providers be transformed into formal, regulated financial service providers that serve a large number of people?

- What is the extent of the supply of financial services through branchless banking? What are the conditions to make it a viable business model in China? What are clients' specific needs? What is the level of client acceptance of such innovative models?

4. **Financial infrastructure. More research is needed on the role and effectiveness of a variety of other meso-level actors that influence financial inclusion.** Stakeholders who wish to advance financial inclusion in China would benefit from a series of studies that provide a systematic overview and in-depth analysis of different categories of meso-level service providers and financial partners. These include actors such as existing microfinance networks, consultancy companies, research organizations, rating agencies, payment system actors, deposit insurance providers, credit reference centers and credit bureaus, wholesale lenders, and guarantee companies.
5. **Government and financial authorities. More in-depth analysis of policies, regulations, and supervision would help to enhance financial inclusion.** Questions that merit more research include the following:
 - How do national and provincial policies and regulations governing banks and nonbanks compare with international standards?
 - How well do regulations support branchless banking?
 - To what extent does improved access to banks and legal credit-only financial service providers result in improved client protection?
 - How are regulations implemented on the ground, and what can be done to enhance supervisory effectiveness?
 - How have government policies on social transfers (G2P payments) contributed to the rapid expansion of financial inclusion?

It would also be useful to have a clearer idea of current regulations and policies in important areas, such as consumer protection and branchless banking, which are two important elements for the rapid development of a responsible financial inclusion sector in the PRC.

Finally, Chinese stakeholders and the international community would both greatly benefit from a more extensive exchange of knowledge on financial inclusion. Global partnerships, such as the Inclusive Finance in China Working Group, the World Microfinance Forum Geneva, the Global Partnership for Financial Inclusion, the Alliance for Financial Inclusion, and CGAP offer opportunities for studying global best practices and lessons learned in other countries and for sharing the PRC's unique experience in improving financial access with the rest of the world. ■

40. See <http://www.mixmarket.org/mfi/country/China,%20People%27s%20Republic%20of>.



Photographer: Wu Shaoping

Annex A: Important Providers of Financial Services to Rural Households and SMEs

This annex contains detailed descriptions of some of the PRC's principal providers of financial services to rural households and microenterprises. In the interest of comparability, all figures mentioned refer to 2010, unless otherwise mentioned.

Regulated/ Unregulated	Type of Institution	Short Description
Banks and RCCs	Rural Credit Cooperatives (RCCs)	Small rural-based providers of multiple financial services including savings, loans, and money transfer services; originally mutually owned and managed
	Agricultural Bank of China (ABC)	One of the country's original five large commercial banks; formerly state-owned and now partly privatized
	City Commercial Banks (CCBs)	Small, urban-based providers of multiple financial services
	Postal Savings Bank of China (PSBC)	New large commercial bank, originally the postal savings and remittances bureau, now also offering credit and insurance products
	Village and Township Banks (VTBs)	One of three "new-type" small rural financial institutions, initiated by commercial banks, offering a wide range of banking products
	Rural Mutual Credit Cooperatives (RMCCs)	One of three "new-type" small rural financial institutions, initiated by rural communities, offering savings and credit services*
Nonbanks	Poverty Alleviation MFIs (PAMs)	Credit-only institutions that are mostly registered as social welfare organizations
	MicroCredit Companies (MCCs)	Recent, small, credit-only institutions that are registered as companies
	Peer-to-Peer (P2P) Platform Managers	Financial advisers that link individual investors with individuals needing a loan

*The third "new-type" financial institution—lending company—is not presented here because it does not target microenterprises.

A1. Rural Credit Cooperatives (RCCs)⁴¹

The PRC's rural cooperative system consists of a large and diverse set of small-scale, locally based rural financial institutions, including 85 rural commercial banks, 223 rural cooperative banks, and 2,646 RCCs (CBRC 2010). Their clients constitute a significant proportion of the rural population, both poor and better off. They offer a variety of products, including savings, loans, and money transfer services.

The rural cooperative system originates in the early 1950s, when the state ordered the creation of an RCC in every township and encouraged the establishment of service outlets or agents in villages. RCCs were originally independent entities owned and controlled by members. However, they were soon placed under the management of ABC, and then integrated into PBC. After the collectivization movement, they were turned into the state's instruments for funneling credit to the communes (Li and Xuchu 2011). In this process they effectively lost their cooperative nature.

With the dismantling of the communes in the early 1980s and direction to lend to newly established TVEs, RCCs accumulated high levels of NPLs. Since the government failed to pay promised subsidies, many RCCs became insolvent. ABC remained in charge of RCCs. Even though several reforms were implemented to resume their original cooperative nature, in the end ABC effectively ran them as its branches and offices.

In 1996 the government launched a series of reforms aimed at, among others, restoring their commercial viability and their cooperative nature. RCCs were separated from ABC in this process. However, these reforms did not resolve the problem of high NPLs and accumulated losses. Besides, the administration of RCCs was taken over by PBC, and from 2003 by CBRC. This not only failed to increase members' voice in management, but also the combination of administration and supervision in a single institution created a conflict of interest.

In the early 2000s, the government launched another round of reforms. Some of the solvability issues were resolved by injecting funds into RCCs with potential and eliminating those that could not be rescued. Corporate governance issues were tackled by consolidating and transforming RCCs into different types of more or less commercial entities, according to their strengths. Some RCCs were merged into rural cooperative unions, others were transformed into rural commercial banks and rural cooperative banks, and unviable RCCs were closed down. Part of the conflict of interest inherent in combining administrative and supervisory functions was handled by transferring RCCs' administration to provincial authorities.

PBC launched a nationwide microcredit program in 2000. Microloans varied between 1,000 and 30,000 RMB and were made available on the basis of a variety of guarantees. In 2002, all RCCs began promoting microcredit at full scale. By the end of 2003, microcredit operations were being managed by 90 percent of RCCs across the country, and half of RCCs had provided group loans. In 2006, Mme Wu Xiaoling stated that the value of RCCs' collateral-free and group guarantee loans outstanding was 314 billion RMB to 73 million clients (Planet Finance 2008).

Questions for further research

Aggregate up-to-date information on RCCs is extremely scarce. Many experts claim that despite all the reforms, RCCs' strength and performance continue to vary considerably across the different entities. Local authorities continue to play an important role in RCCs' management, and members do not necessarily have a say.

The following are examples of several research questions that deserve to be addressed:

- How strong and how profitable is the rural cooperative finance system?
- What share do microloans constitute in RCCs lending compared with state-owned agribusinesses?
- What will be the effect of the planned further commercialization of the rural cooperative system on its incentives to serve the needs of the poor?
- What is the potential for RCCs to remain or become a significant player in making the PRC's financial system more inclusive?

41. Unless otherwise mentioned, this Annex draws largely on Zhang, Xu, Shen, and Cheng (2010).

A2. Agricultural Bank of China (ABC)

ABC is one of China's big five commercial banks. It has branches and sub-branches in every province and offers a wide range of services, including savings, loans, and money transfer services.

With several older predecessors, ABC was established in 1979 as a policy bank, with the mandate to manage all fiscal funds and bank credits for supporting rural development. As described in Section A1, it used RCCs as its lending extensions (Zhang, Xu, Shen, and Cheng 2010).

From 1986, ABC operated the subsidized Poverty Alleviation program, under which small loans were provided to TVEs. As is often the case with subsidized credit programs, many loans were diverted to enterprises outside the target group. The program incurred heavy losses (Tsai 2004).

With China's gradual introduction of a competitive banking system in the mid 1990s, ABC was restructured into a state-owned commercial bank, operating according to economic principles. The restructuring involved transferring its subsidized credit portfolio to the newly created ADBC and transferring the administration of RCCs to PBC (Zhang, Xu, Shen, and Cheng 2010).

Despite the restructuring, in 1997 the government asked ABC and ADBC to implement the "Eight-seven poverty alleviation project," another effort at providing subsidized credit to the poor. Predictably, outreach and performance were poor. Starting from 2000, ABC decidedly phased out of rural lending and microcredit, and reoriented its activities toward the more profitable industrial and urban market. In this process, it closed more than 13,000 branches in the central and western regions (Zhang, Xu, Shen, and Cheng 2010).

With China's realization that the unbalanced development of urban and rural areas was causing risks to social stability, in 2007 the government made an about-turn. It instructed ABC to be the leading financial institution in implementing *San Nong*, the government's three-pronged policy of serving agricultural industry, rural communities, and farmers. However, contrary to past efforts, products had to be commercially viable (Yuk-Shing 2009). This required innovation.

ABC acted quickly on the call to innovate by introducing a more efficient way of interacting with farmers through the Kins Farmers Benefit Card. Using this debit card, rural households could make cash deposits and withdrawals, conduct transfers, obtain loans, and receive subsidies. It could be accessed via telephone, Internet, and ATMs, as well as through POS devices at local shops and companies. To deepen its penetration into areas where it had no outlets, ABC developed partnerships with companies, cooperatives, service providers, and villages to help select and manage clients and recover loans (Chang 2009).

Several personal loan products and overdraft facilities are now available to farmers based on their personal credit scoring and on a wide range of traditional and alternative types of collateral. They include guarantees offered by public servants, leading agricultural enterprise, cooperatives, and guarantee companies, as well as guarantees from fellow farmers. ABC further manages the risks of the loans collaborating with insurance companies and risk compensation funds (Chang 2009).

In 2010 ABC was the last of the big five banks to sell part of its shares through an IPO (CBRC 2010). It is unclear what this will mean for its commitment to the rural poor.

Questions for further research

By the end of 2010, ABC had issued 96 million Kins Farmers Benefit Cards (ABC 2011a).

- ABC reports more than 5.8 million rural households with small loans outstanding of 99 billion RMB through the benefit card (ABC 2011a), suggesting an average outstanding value of 17,000 RMB.
- In addition, ABC (2011b) reports 1.9 trillion RMB in small loans outstanding with 40,000 clients, suggesting an average loan balance of slightly over 11.5 million RMB, and 461 billion RMB SME loans outstanding with 63,000 clients, suggesting an average loan balance of 30.2 million RMB.
- Through the benefit card, in 2010 ABC (2011a) reports providing farmers in 484 counties with a new farmers' insurance fund and in 313 counties with new rural cooperative medical fund collection, management, and distribution services.

Questions for further research include the following:

- To what extent do ABC's products meet the needs of specific sectors or locations?
- How does ABC overcome the problems that a limited local presence poses to the development of appropriate products?
- How does ABC overcome the challenges posed by its size and hierarchical structure in offering flexible and efficient products?
- Will ABC be able to compete with newly established, small, and agile institutions offering similar products?

A3. City Commercial Banks (CCBs)

In 2010 there were 147 CCBs in China (CBRC 2010). The first CCB was created in 1995; many followed in the second half of the 1990s. They were the result of city governments undertaking the active merger and restructuring of the 5,000 or more UCCs to resolve a number of issues that developed within the sector. At the time most CCBs were wholly or majority state owned (KPMG 2007). The transformation of UCCs into CCBs is ongoing (CBRC 2010).

In 2005, CCBs started inviting Chinese and international private companies to take shares, and by the end of 2010, 43 percent of their equity belonged to private nonfinancial institutional investors (CBRC 2010).

CCBs traditionally have been focused on financing local infrastructure and other government projects as well as state-owned companies (KPMG 2007). In 2002, PBC encouraged CCBs to cooperate with guarantee companies for the provision of microloans to workers laid off from SOEs in urban areas (Du Xiaoshan 2008). Since 2005, CBRC has been coming out with guidelines for small enterprise lending every year. This has helped China Development Bank (CDB) take on a catalytic role in the development of commercially viable SME and microfinance, by providing banks with technical assistance, loan funds, and where necessary equity (CDB 2012).

In 2005, CDB, with funding from KfW and the World Bank, contracted IPC to provide technical assistance to 12 CCBs for developing and pilot testing a microcredit product based on international best practices. The piloted product had a loan value ranging from 100 to 500,000 RMB, according to CDB. In parallel, Harbin Bank contracted Planet Finance for the same purpose.⁴² The pilots were successful and were soon rolled out. The experience gained in the pilot banks is being used to expand small lending in other CCBs as well as in other types of banks.

More recently, IFC, through the China Secured Transactions Project, has worked with the government and PBC to develop a system and reforms that enable financial institutions to increase financing to these businesses by using movable assets (such as equipment, accounts receivable, inventory) as collateral (IFC 2012).

There is reason to believe that CCBs play a significant role in small and microenterprise finance. The following are some examples:

- In 2010, CDB funds to banks financed an outstanding SME loan balance of 1.2 trillion Yuan to 1.6 million enterprises (CDB 2011), which points to an average outstanding loan value of 750,000 Yuan. A considerable proportion of these funds were lent to CCBs.
- By the end of 2010, Baoshang Bank (formerly Baotou Bank), one of the first CCBs supported by CDB, had more than 30,000 active loan clients with an average loan balance of 144,000 RMB (CAM 2011). The proportion of microenterprise loans within this portfolio is not known.
- By the end of 2010, Harbin Bank management tells us that it had 226,000 clients for its Just for You group loan product targeted at rural microenterprises with an average loan balance of 36,000 RMB.⁴³

Questions for further research

Official figures for 2010 show that CCBs, when taken together, are profitable and financially healthy (CBRC 2010). By the end of 2009, CCBs' balance of loans to small- and micro-sized businesses reached RMB 715.5 billion (CBRC 2010), about 13 percent of the total portfolio.

Unfortunately, very little additional information is available on CCBs' national role in offering inclusive savings accounts, credit, insurance, and money transfer services.

- What proportion of CCBs offers dedicated products to groups that have found it historically difficult to access banking services, including rural inhabitants and SMEs?
- How many clients do they reach?
- To what extent do CCB products meet the needs of these groups?

42. The Planet Finance China case study on its support to Harbin Bank is available on World Bank and Finance (2012) blog.

43. Harbin Bank was founded as a CCB in 1997 but converted into a Joint Stock Commercial Bank in 2007.

A4. Postal Savings Bank of China (PSBC)⁴⁴

Postal savings were removed from China Post in 1953. From 1986 China Post resumed the postal savings business by taking deposits and placing these in PBC. It facilitated remittances, but did not extend loans. This resulted in an outflow of funds from rural areas (Zhang, Xu, Shen, and Cheng 2010).

In 2001, the government started studying the possibility of countering the outflow of savings from rural areas through the creation of a postal savings bank, with a mandate to provide comprehensive financial services to all. On 31 December 2006, CBRC approved the incorporation of the PSBC, with China Post as its sole investor (Giehler 2012).

At the end of 2010, PSBC had 36,000 service outlets,⁴⁵ of which two-thirds were at the county level and below. Approximately 84 percent were run by agents.⁴⁶ The bank had more than 893 million accounts, 475 million individual clients (one in three Chinese was a client with PSBC), and over 300,000 corporate accounts. It had issued over 400 million debit cards. Clients were mostly students, self-employed entrepreneurs, migrant workers, and pension receivers (Cheng 2011).

The newly created PSBC was expected to offer microloans to farmers and entrepreneurs. It was well-positioned to do this because of its extensive branch network, its stable source of funds, and the long-term relationships it had built with local clients through its savings and remittances business. Therefore, in 2007 PSBC launched, with German technical assistance, a microcredit pilot targeted at farmers and microentrepreneurs without collateral. It designed a three-day application process to compete in quick access. In 2008, the bank trained 20,000 credit officers and rolled out the product nationwide. PSBC has since positioned microcredit as a strategic core product (Giehler 2012).

By March 2011, microcredit was being offered by 319 city branches, 2,105 county-level sub-branches, and 4,676 outlets; 3,080 were in rural areas. The number of microloans outstanding was 2.22 million RMB, and the average balance outstanding was 47,000 RMB. Of the total microloan portfolio, 41 percent was to entrepreneurs (average loan size 86,100 RMB) and 59 percent to farmers (average loan size 42,500 RMB). Seventy-three percent of microloans were disbursed in rural areas. The NPL rate was 1.6 percent. By the end of 2010, the interest income from the retail credit business with microcredit as its core was the branches' and outlets' biggest source of income (Chen 2011).

PSBC has also developed other products targeted at the poor. In 2008 it launched a banking card service specifically tailored to rural migrant workers in China. With this banking card, migrant workers have greater geographical flexibility in depositing and withdrawing cash and in remittance transactions. In 2009 PSBC assumed an important role in promoting the New Rural Cooperative Medical Scheme. Because all of its outlets are connected electronically, it can offer an efficient system for insurance premium payment and medical expense reimbursement. A considerable proportion of local government subsidies and social payments to the rural population also pass through PSBC.

Questions for further research

When the Postal Savings and Remittance Bureau (PSRB) was converted into a bank, staff from headquarters down to those in outlets had little to no lending experience.

- How successful has PSBC been in changing the institution's culture toward one revolving around the management of credit risk?
- Has it been able to build sufficient capacity in the credit business?

PSBC's predecessor, PSRB, was highly hierarchical with a centralized structure and long decision-making chains.

- To what extent has PSBC been able to implement the necessary changes in management and supervision?
- How do PSBC's relatively standardized products compare with those of the new smaller institutions in terms of attractiveness and flexibility?
- What future role can PSBC play in reaching the bottom of the pyramid using branchless banking, including mobile phone technology?

44. Unless otherwise mentioned, this Annex draws on Chen (2011) and Giehler (2012).

45. Whereas the Postal Savings Bank describes these as its outlets, experts say the figure also includes all the post office outlets that do not offer banking services.

46. Agents can offer savings deposit and withdrawal services as well as insurance, mutual fund, and wealth management products.

A5. Village and Township Banks (VTBs)⁴⁷

In 2006, CBRC released its “Opinion regarding easing market access for banking financial institutions in rural areas in order to better support the construction of a new socialist countryside.” This new policy called for the creation of three different types of rural financial institutions: VTBs, RMCCs, and lending companies. According to a CBRC three-year work plan (2008–2011), new-type rural financial institutions should preferably be established in the key counties of the national poverty alleviation program in central and western regions (Li and Xuchu 2011).

The required registered capital for a new VTB is 3 million RMB at the county or municipality level, and 1 million RMB at the town or township level. This is much lower than the required capital for a rural commercial bank. A Chinese or foreign banking institution must be the controlling or sole shareholder, holding at least 20 percent of the VTB's equity. Chinese natural persons, nonbank financial institutions, and nonfinancial enterprises can hold no more than 10 percent of total equity each.

VTBs can provide a wide range of banking services, including current and deposit accounts, loans, money transfer services, insurance intermediation, and wealth management. However, they can serve only customers in the county in which they are registered.

In the interest of depositors, CBRC requires VTBs to meet a large number of banking requirements, such as standards for the safety of the premises, minimum qualifications for management, and capital and savings ratios. VTBs are subject to the same taxes as commercial banks. For the protection of borrowers, they must also respect a maximum loan interest rate.

47. Unless otherwise mentioned, this Annex draws largely on Giehler (2012).

Questions for further research

At the end of 2010 there were 349 VTBs (CBRC 2010), considerably fewer than the government's target. According to a recent study of VTBs commissioned by the China Working Group on Inclusive Finance (2011a), banks owned 52 percent of VTB equity and were thus the dominating investors.

- What are banks' and nonbanks' incentives to invest in VTBs?

VTB regional development was unbalanced, with average registered capital, assets, and deposits in western and central region VTBs lagging far behind those of the eastern region (China Inclusive Finance Working Group 2011a).

- What are initiators' incentives to establish VTBs in remote and poverty-stricken areas?

In addition, most VTBs offered little support to rural areas, agriculture, and farmers (China Inclusive Finance Working Group 2011a).

- What are VTBs' incentives to serve rural and small customers?
- What is the role of banking ratios, interest rate restrictions, geographical limitations, and tax policies in encouraging an increased role for VTBs in financial inclusion?

A6. Rural Mutual Credit Cooperatives (RMCCs)⁴⁸

RMCCs, created in conjunction with VTBs and lending companies in 2006, are community-based, member-owned banking institutions. Like VTBs, they must be established within the scope of a town or village in poor, rural areas. However, unlike VTBs they can offer only deposit, loan, and settlement services, and their business is restricted to members.

A minimum of 10 farmers or rural entrepreneurs is needed to establish an RMCC. Ideally they should come from the same community and have a strong degree of social connectedness. Contrary to RCCs, RMCCs are designed to operate like true cooperatives. Corporate governance is participatory, with many RMCCs operating on the basis of “one member, one vote.” Surpluses are partly distributed to members.

The registered capital is one-tenth of that for a VTB: 300,000 Yuan at the county/town level and 100,000 Yuan at the administrative village level. Members are the principal source of share capital, and the biggest shareholder may hold no more than 10 percent of total equity. In addition, RMCCs are allowed to attract bank financing and donations. However, unlike RCCs, they are not entitled to any government subsidies. Also, foreign investments are not allowed in RMCCs.

Since 2009, the government has encouraged members of farmers' specialized cooperatives to set up their own RMCCs. This is to overcome the problem that members of these cooperatives have in accessing loans because they do not individually own land, buildings, and machinery. Because of their strong community rooting, RMCCs are able to provide loans on the basis of personal creditworthiness. Their design also allows them to develop flexible services and streamlined loan application and approval procedures.

RMCCs are fully licensed financial institutions, and fall squarely under the jurisdiction of CBRC. They pay the same taxes as VTBs and have to meet the same savings reserves requirements. Like VTBs, they face stringent regulations on business premises and safety precautions, they must recruit and remunerate qualified directors, and they must pay for the costs of professional accountants. As a result, both start-up and operational costs are high relative to the income of their members. Unlike RCCs, RMCCs do not receive an operating subsidy.

Questions for further research

There were only 37 RMCCs by the end of 2010—considerably fewer than the government's target for 2011.

- To what extent is the slow growth in the number of RMCCs due to the high start-up and operational costs compared to the income of the target group?

At the end of 2010, 98 percent of RMCC capital consisted of member deposits. It is difficult to increase deposits, because RMCCs need official approval to enlarge their membership, and deposit mobilization from nonmembers is prohibited. While in theory RMCCs can obtain bank financing and social donations, in practice this has turned out to be quite difficult.

- What are the obstacles RMCCs face to external resource mobilization?

48. This Annex draws largely on Li and Xuchu (2011).

A7. Poverty Alleviation MFIs

In the beginning of the 1990s, a number of foreign donors started supporting microcredit projects based on the Green Bank group lending methodology in the PRC's rural areas (Du 2008). The legal basis for their operations was often an agreement between an international donor and a ministry or local government office. At one point, there were 300 such projects in the country. However, many of these projects were unable to cover their costs from income when donor funding ended, and they were closed down. Of the approximately 100 projects that survived, most are registered as societal organizations, foundations, privately run nonprofit enterprises, and institutions (Sun 2008).

The programs are often referred to collectively as NGO MFIs, which is a bit of a misnomer: many rely wholly or in part on local governments for both funding and management. We prefer to use the term poverty alleviation MFIs.

The largest poverty alleviation MFIs include the fast-growing China Foundation for Poverty Alleviation (loans outstanding of 660 million RMB and 106,000 active clients in 2011)⁴⁹ and the Funding the Poor Cooperative (loans outstanding of 39 million RMB and over 16,000 active clients in 2010) (CAM 2011). Most other poverty alleviation MFIs are quite small. The 42 institutions that reported their loan portfolio and number of clients to CAM in 2011 had an average loan portfolio outstanding of 8.6 million RMB and an average of number of clients of 1,700 clients each (CAM 2011).⁵⁰ According to Du (2008), in 2008 only about 10 organizations were operationally self-sufficient.

Poverty alleviation MFIs are not regulated or supervised by CBRC or PBC. An advantage of this situation is that contrary to VTBs and RMCCs, poverty alleviation MFIs do not necessarily face security requirements, restrictions on geographical outreach, etc. A disadvantage is that the organizations are not allowed to mobilize deposits, borrow from banks, or attract commercial investments. In the absence of donor money, this constrains their ability to grow and to become sustainable.

Since 2008 poverty alleviation MFIs can convert into MCCs (described in Section A8). In that same year, the first such conversion resulted in the creation of Ningxia Huimin MCC. At the end of 2010, Ningxia Huimin says it had more than 6,000 clients. For many poverty alleviation MFIs conversion is difficult; obstacles include the difficulty of splitting assets as local government supported them with offices and salaries for many years.

49. At the end of 2008, CFPA founded a subsidiary, CFPA Microfinance Management Co., Ltd., which specialized in the management and implementation of microfinance projects (CFPA 2011).

50. Together, the 42 institutions had 73,000 active loan clients and an outstanding loan portfolio of 360 million RMB. Four of these institutions are local chapters of the Funding the Poor Cooperative (FPC) mentioned earlier; in others words, data for FPC are included in the figures for CAM.

Questions for further research

- How many poverty alleviation MFIs have the potential to cover their costs from operational income and become sustainable?
- What can poverty alleviation MFIs learn from organizations that have achieved considerable scale, such as CFPA?
- How feasible and desirable is transformation of poverty alleviation MFIs into MCCs, following Ningxia Huimin's recent example?
- What has been the result of the recent increase in partnerships between poverty alleviation MFIs and banks, such as ABC, that wish to gain access to lower market segments?

A8. MicroCredit Companies (MCCs)⁵¹

In 2005, PBC started a pilot of a new type of institution called MCC that was to be predominantly invested by private capital and that was to provide competition for RCCs, whose long-lasting reform was failing to have the desired effect. An important additional goal was the creation of a vehicle that allowed underground lenders, until then difficult to control, to formalize their activities. In 2006, PBC issued guidelines and encouraged private investors to start MCCs. In 2007 MCCs were recognized and regulated by CBRC (Jiao and Liang 2010), and in that same year the first foreign investments took place.

MCCs were designed as credit-only institutions, so as to limit the risks to the financial system and minimize the supervisory burden. They are not banking institutions; they are limited liability or joint stock companies. The capital and shareholding requirements provide a stable basis and a clear ownership structure. MCCs can also accept donations or bank loans, but they cannot leverage their equity by more than 50 percent. This restricts their growth.

MCCs have the right to issue loans to anyone they think fit, provided that such issuance is in line with the principle to serve farmers, agriculture, and rural economic development (Jiao and Liang 2010). The balance of loans issued by a MCC to the same customer must not exceed 5 percent of its net capital. As is the case for VTBs, microcredit services can be offered to clients only within the administrative jurisdiction in which the institution is registered.

In 2009, CBRC issued procedures for converting MCCs into VTBs. In 2010, PBC issued tax incentives to encourage loans under 50,000 RMB. In 2011, PBC launched the China Micro-finance Institutions Association (CMIA), which serves as a national platform for MCCs.⁵²

Based on national guidelines, provincial governments are expected to issue specific regulations. This allows for the adaptation of rules to local circumstances. The provincial financial offices have been tasked with the supervision of MCCs, and most of them have delegated surveillance functions to newly created provincial MCC associations.

While MCCs have not reached a large number of low-income clients, they have had significant success in SME financing, and they have played an important role in bringing a more commercial approach to the financial inclusion industry in China.

51. Unless otherwise mentioned, this Annex draws largely on Giehler (2012).

52. CMIA should be distinguished from CAM; the former principally unites MCCs, whereas the latter consist mostly of poverty alleviation MFIs.

Questions for further research

At the end of 2010, there were 2,614 MCCs covering every province of China (Giehler 2012).⁵³ This explosive growth may create problems for the financial offices of provincial authorities, which have limited, if any, experience or qualified staff to supervise credit institutions.

- What needs to happen to ensure adequate supervision?

Estimates of average loan size vary from 400,000 to 600,000 RMB. It is likely that the restrictions on the number of equity sources, the level and sources of leverage, and geographical outreach limit MCCs' ability to achieve economies of scale and, therefore, discourage outreach to the poor.

- How can MCCs play a greater role in serving low-income segments?

Despite the fact that MCCs are allowed to borrow from banks, at the end of 2010, approximately 95 percent of their portfolio was financed by equity. No MCC has converted into a VTB so far. It is likely that MCCs are not interested to do so because private investors would lose their influence by introducing the formal banking partner needed to become a VTB.

- How can MCCs overcome their funding problems?

53. In 2011, the total number of microcredit companies increased by 64 percent, according to data released by PBC (Zhang 2012).

A9. Peer-to-Peer (P2P) Lending Platforms⁵⁴

P2P lending platforms bring individuals with surplus funds in contact with individuals seeking a loan. While credit intermediation between individuals has existed in China for a long time, the tight bank credit environment that started in 2010 has helped the platforms take off. It is believed that at least 30 P2P platform managers are currently operating in the market, including Credit Ease, Wokai, 51Give, and PPDai. No exact data on number of clients and average loan sizes are available, but it is generally assumed that numbers of clients are significant and growing, and a certain proportion of the loans provided are small or microloans.

P2P lending platforms bring clients into contact via the Internet: Individuals wanting to lend and those who wish to borrow self-match transactions online. Most P2P companies operate as investment advisers or e-commerce processors. The companies generally earn their income from a transaction fee, which because of the lean structure required for the intermediation is often as low as 2–4 percent. Borrowers pay interest to lenders, and even after taking into account the transaction costs, returns to lenders can be as high as 10–12 percent. This is much higher than the returns offered by most wealth management products at commercial banks.

Contrary to traditional individual credit intermediaries most P2P platform managers in the PRC offer investors a guarantee that their loans will be repaid. They set aside part of the transaction fee they charge to create a reserve against risk. In the event of a default, the platform pays the investor a prearranged amount.

A growing number of P2P lending platform managers have been expanding their business to include so-called offline clients. They offer loans to specialized credit providers, such as poverty alleviation MFIs, which then are responsible for selecting and managing borrowers and recovering loans. This is, in fact, the P2P lending model that is most common outside China: while lenders are shown profiles of borrowers online, in reality their loans are passed on to specialized MFIs, and the repayments received may not come from the selected borrower.

P2P loan providers base their business on the fact that intermediation between individual borrowers and lenders is a legal activity. However, they are not covered by any specific regulations, nor are they supervised by financial authorities. In 2011 CBRC issued a notice detailing seven risks tied to P2P lending platforms and ordered banks to watch them carefully. But the notice did not say how P2P platforms might reduce those risks, nor did it mention possible regulations to control their growth.

Questions for further research

P2P platform managers are not required to publish their accounts; as a consequence very little information is available.

- What is the PRC's P2P platform managers' real outreach and performance?

Platforms that select borrowers and that promise repayment are assuming a large responsibility. When they get into difficulties or go bankrupt, as has recently happened to one of them, they cannot deliver on their promise. However, contrary to those who deposit their money in a bank, investors in the platforms cannot appeal or get recourse from the government.

- What needs to happen to ensure P2P platform investors are adequately protected?

54. This Annex draws largely on Shen (2011). Information was cross-checked in Lanhee Lee (2011).

Annex B: Productive Loan Supply— an Optimistic Estimate

An important measure of financial inclusion is the proportion of a population using particular financial services. This annex explains the method used to obtain an optimistic estimate of the proportion of Chinese SMEs and rural households that have a loan for productive purposes. The calculation is based on an extrapolation of the data presented in Chapter 3.

B1. Rural Household Loans

The rural household loan calculation is shown in Table B1-1.

Table B1-1. Optimistic Estimate of the Number of Rural Household Loans Outstanding.

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6
	Number of institutions presented in Chapter 3	Average number of loans outstanding per institution presented in Chapter 3 (in thousands)	Minimum number of loans outstanding (in thousands) Column 2 × Column 3	Total number of institutions in PRC	Maximum number of loans outstanding (in thousands) Column 5 × Column 3
Rural Credit Cooperatives ^a	2,646	28	73,000	2,646	73,000
Agricultural Bank of China ^{a*}	1	5,800	5,800	1	5,800
Postal Savings Bank of China ^a	1	1,310	1,310	1	1,310
New-type rural financial institution ^a	395	0.60	237	395	237
City commercial banks ^a	1	226	226	159	35,934
Total supply (min and max)			80,573		116,281
Number of rural households ^b			200,000		200,000
% of rural households with loans			40%		58%

**It is assumed that ABC is the only large commercial bank offering rural household loan. Sources: a. See Table 4; b. National Bureau of Statistics of China (2011a).*

- Columns 2, 3, 4, and 5 take information from Table 4 in Chapter 3 on the seven institutional categories that offer rural household loans. For the categories where aggregate information was readily available (e.g., RCCs, ABC, PSBC, new-type rural financial institutions), Table 4 presented comprehensive data. For the categories where we did not have aggregate data (CCBs), Table 4 presented data on a market leader—for example, for P2P providers it presented data on CreditEase.
- Column 6 constitutes an extrapolation from the data in Chapter 3. It shows how many rural households would have loans if all institutions of a particular category provided the same number of loans as the market leader we presented. So for example, if all 147 CCBs had, like Harbin Bank, a portfolio of 226,000 rural household clients, then together they would be serving more than 36 million clients. Since most institutions that were not individually presented in Chapter 3 are not market leaders in their category, the 119 million figure is clearly an overestimate of the number of rural household loans outstanding.
- The bottom section of the table shows a proxy for the demand for rural household loans: the number of rural households SMEs. The optimistic estimate of supply represents 58 percent of the total number of registered SMEs.

B2. SME Loans

The SME calculation is shown in Table B2-1.

Table B2-1. Optimistic Estimate of the Number of SME Loans Outstanding

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6
	Number of institutions presented in Chapter 3	Average number of loans outstanding per institution presented in Chapter 3 (in thousands)	Minimum number of loans outstanding (in thousands) Column 2 × Column 3	Total number of institutions in PRC	Maximum number of loans outstanding (in thousands) Column 5 × Column 3
Large Commercial Banks ^a	2	70	140	5	350
Postal Savings Bank ^a	1	910	910	1	910
Joint Stock Commercial Banks ^a	1	110	110	12	1,320
City Commercial Banks ^a	1	30	30	147	4,410
New-Type Rural Financial Institutions ^a	395	0.08	31	395	31
Total supply (min and max)			1,221		7,021
Number of registered SMEs ^b			45,000		45,000
% of registered SMEs with loans			3%		16%

Sources: a. See Table 7; b. National Bureau of Statistics of China (2009).

Columns 2, 3, 4 and 5 retake information from Table 7 in Chapter 3 on the five institutional categories that offer SME loans. For the categories where aggregate information was readily available (e.g., new-type rural financial institutions), Table 7 presented comprehensive data. For the categories where we did not have aggregate data (large commercial banks, JSCBs, and CCBs), Table 7 presented data on a market leader—for example, for CCBs, it presented data on Baoshang Bank.

- Column 6 constitutes an extrapolation from the data in Chapter 3. It shows how many SMEs would have loans if all institutions of a particular category provided the same number of loans as the market leader we presented. So, for example, if all 147 CCBs had, like Baoshang Bank, a portfolio of 30,000 SME clients, then together they would be serving more than 4.4 million clients. Since most institutions that were not individually presented in Chapter 3 are not market leaders in their category, the 6.6 million figure is clearly an overestimate of the number of SME loans outstanding with banks, RCCs, and MCCs.
- The bottom section of the table shows a proxy for the demand for SME loans: the number of registered SMEs. The optimistic estimate of supply represents 15 percent of the total number of registered SMEs.

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