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中国普惠金融发展报告(2015)

GREEN PAPER OF FINANCIAL INCLUSION IN CHINA(2015)

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经济管理出版社
ECONOMY & MANAGEMENT PUBLISHING HOUSE

Preface

The stock market has been suffering from shock recently, leaving many people in doubt about finance. Whether finance is driving the economy or a drag on the economy? Will the financial crisis lead to an economic crisis? Has the stock market created value for the economy or constantly eliminates the value, so that the economy and even the whole society have to pay a huge price to rescue the market? Indeed, the pros and cons of finance for economy are once again presented clearly in front of people to look at. Interestingly, our team has been thinking about these issues since last year. On the social and financial aspects, we are increasingly convinced that the society are classified to good and evil, and there are good and bad finance.

After more than 30 years of efforts, China's economy ranks No. 2 in the world. In China's finance, the complicated structure and operation rules have already been formed. Broadly speaking, China's financial structure evaluates from the single banking system to diversified financial market system. For example, the leading banks have been listed on the capital market, the economy is increasingly sensitive to the stock market and various kinds of non-banking financial institutions are striving in their own fields, let alone the surging internet finance, which directly challenges the existing supervision framework under the flag of marketization. It is undeniable that finance has made great contributions to the economic miracle in China.

However, the facts on the other side clearly remind us that some chronic illnesses in economic structure and even in society as a whole are closely related to the financial structure. The divide between poverty and wealth co-occurred with the market economy. In the early days of reform and opening up, some people were encouraged to get rich first because the great driving force for social development of the market economy existed. Every individual has a different risk tolerance and capacity for productivity, generating the difference between poverty and wealth. In fact, such difference is the inevitable product of market economy development. Whereas a moderate difference between poverty and wealth may accelerate economic growth, a serious difference or extreme disparity between the rich and the poor can lead to the prevalence of unhealthy ways and customs, hindering social development and even causing social turmoil. The root of economic structure is the financial structure. Why? Because it is easier for rich people to obtain financial resources, while the poor find it difficult or even impossible. Whoever the financial resources tilt towards will have more opportunities to climb higher in the social economic structure. Without financial resources, middle and lower class enterprises and households are limited to the middle and lower class or even the bottom of the structure. While the rich are satiated with existing resources, but the poor turn their hair grey in efforts to get resources. The rich should care about the situation the poor are in, for the extreme disparity between the rich and the poor will cause social turmoil, which in turn will cause the rich to suffer losses. Thus, it is clear that finance is not just about financing, value assessment, and asset management and risk control. The reasonable allocation of financial resources should be and will be the driving force for sound operation of society and for reducing the gap between the rich and the poor. To this end, finance can drive society to better develop by being beneficial for effective resource allocation, economic structure adjustment, driving economic growth and social equity, reducing the three major financial differences, helping lower-class people climb higher, transforming the pyramid society into an olive-shaped society and avoiding falling into the "middle income trap" . These are the possibilities of good finance. In general, good finance is a system of finance with full of positive energy.

The construction of finance and assist the poor the construction of good finance is not necessarily a process to rob the rich for the poor or reinvents the wheel. Instead, good finance aims to let more people share the achievements of modern financial services via greater market innovation and technical innovation. It aims to keep adding increments and elements to the existing system in order to drive society forward. In the existing financial system, the human nature of greed and fear should be taken into account and financial fluctuation should be solved so as to reduce its negative effect on finance and improve supervision; this is already an initiative for the improved development of finance.

Good finance doesn't reject such high-end finance as private banks and wealth management, but it has the characteristic of letting every citizen enjoy financial services. In this light, Inclusive Finance is one of key aspects of good finance. Inclusive Finance emphasizes the fairness and inclusiveness of financial services, specifically in providing financial services to the middle and lower classes, including micro-enterprises and individuals. In fact, both developing countries and developed countries are not satisfactory in this regard. China's finance has made great progress in the past 30 years, leaving a long shadow in the field of inclusive finance. The difficulty and costly of financing for micro and small enterprises has become a commonplace talk of an old scholar in news of media, and what is more, low-incomes household often can't afford what they want to buy. To be straightforward, the present under-consumption facing the macro economy is closely related to the lack of consuming power of the larger part of the people. As experts point out, while helping the poor to earn more, it's more effective to help them improve their purchasing power.

Well, it isn't easy to give an accurate definition for "Inclusive Finance". Some say that "Inclusive" means popularizing and favoring, but this is a misunderstanding. "Inclusive" simply refers to popularizing and benefiting, not favoring. As theories and practices have proven, subsidized favor might distort the market, and thereby prove less than effective. "Inclusive Finance" is more like a concept; everyone has the right to access basic financial services. Who has no such right? Is it obtained easily in theory but difficult in reality? Absolutely, micro and small enterprises are entitled, as well as middle and low-income people. As such, Inclusive Finance stresses the coverage of middle and lower-level financial services, service quality and other related issues including fund availability, fund cost, consumer protection, education, regulatory framework and so on. Inclusive Finance is a dynamic concept that must keep pace with the times. Presently, deposit, loan and remittance are listed in the basic services of Inclusive Finance. However, we should consider what changes could occur to these basic services as time goes by; for example, insurance products, leasing products and even the increasingly expensive financing products would become the basic needs of the middle and lower income group. When the internet is popularized in rural areas and mobile banking becomes the essential software of every mobile phone user, Can you say that stocks are the luxury products that only few people could play?

As mentioned above, the Inclusive Finance system is not a new system running aside the existing one. The existing financial system has already provided or been able to provide lots of inclusive financial services. Existing financial institutions are unable to or have not provided inclusive services due to their business model, which leaves the new players in the field development space. The new players include institutions focusing on micro-credit to households in rural areas, consumption loans to low-income people in cities, crowd funding, and third-party payment in internet finance and all kinds of financial services on mobile phone platforms. These new inclusive financial services providers could be included in formal financial system. The cause of developing Inclusive Finance involves those new institutions and new services, and formal finance and Inclusive Finance will eventually overlap.

Inclusive Finance is an international consensus. The UN has made a 2020 plan for it. Even so, China's Inclusive Finance may yet have its own unique characteristics, such as all kinds of innovative financial services provided by medium and small technological enterprises including the consumption loans currently active in large cities and small towns in China. Although they are not in the formal finance, they are designed to increase the consumption power of low-income groups. Another example is the microloan for supporting undergraduates to start businesses. Thus, it's clear that Inclusive Finance is very inclusive, and that's why it is called as such.

China's Inclusive Finance is in the ascendant. To write the Development of Financial Inclusion in China is to reflect the real advancement and problems of China's Inclusive Finance. The work of our teams is based on facts and data, which can be found in the cases and analyses of this book. We fully aware that due to time constraints and weak fundamental work, this year's Report is just the tentative start, so the improvement and concretion work are still needed to make with more efforts in the future. Nonetheless, we are proud of putting forward and elaborating the concepts of *Good Finance and Good Society*. If more and more people become aware of good finance and strive for it that is just the hope of our team's efforts. As the Report is about to be printed, I would like to express my gratitude to Mrs. Li Yan, Director of our Center for Microfinance Initiatives & Networks of Ruc, and Professor of School of Business, the Renmin University of China, and her research team. Their great efforts and hard work from morning until night will be the beautiful memory of our research center. I would also like to express appreciation for the strong financial support of China Minsheng Bank. Our confidence was greatly increased by the personal attention of Chairman Hong Qi and the guidance from Mr. Xu Jie, Vice General Manager of the Micro and Small Loan Department. Finally, I would like to thank all the board members of our Research Center, especially to Mr. Chen Yulu, President of RUC who holds Co-Chair of our board, for their earnest hope expressed upon the establishment of the center last December. That hope is our action plan.

Bei Duoguang
Houshayu, Beijing
August 29th, 2015

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Summary

The Good Finance, *Good Society—Development of Financial Inclusion in China 2015* is the first systemic research achievement published by the Center for Microfinance Initiatives & Networks of RUC. In the first development report, we intend to refine the connotations and denotations of Inclusive Finance from social value and moral value and include them in the framework of concepts of "Good Finance and Good Society". To this end, we clearly put forward the definition of "Good Finance" and point out that Inclusive Finance is good finance and conducive to the realization of a good society.

Focusing on good finance and good society, this report basically discusses and summarizes the definition of Inclusive Finance and its development in China, and specially discusses the development of Inclusive Finance and market-oriented adjustment to the financial resource allocation mechanism, credit risk control in the Inclusive Finance system, the significance of big-data credit reporting to the development of Inclusive Finance, and other problems on that basis. In the last part of this report, we specifically discuss the boundaries of microfinance, credit risk control in the small and micro finance that traditional big banks engage in, the balance mechanism for dual goals in microfinance, the role of third-party mutual aid unions in solving financing difficulties for small and medium-sized enterprises, the development and

challenges of China's online P2P lending platforms, and credit support of big-data credit reporting for microfinance with six cases. We hope that discussions on these issues may draw attention from all sectors of the society to good finance, Inclusive Finance and pertinent questions in the development of Inclusive Finance, and promote industrial circles, theorists and government departments to make their own contributions to the development of Inclusive Finance and good finance.

The whole report is consists of three parts. Part 1 is the Fundamentals, in which, firstly, we propose the concepts of good finance and good society, and include Inclusive Finance in these deeper and broader concepts; secondly, we completely discuss the concept of Inclusive Finance and put forward an explicit definition of Inclusive Finance; finally, we summarize the development practice of Inclusive Finance in the world and in China and make comprehensive data statistics. Part 2 is the Special Topic, respectively discussing financial resource allocation and the development of Inclusive Finance, credit risk control in small and micro finance, the credit reporting system based on big-data credit reporting, and the development of small and micro finance. Part 3 is the Case Studies, discussing relevant problems in the development of Inclusive Finance with six cases we have investigated and researched.

The value of finance is to improve the economic efficiency, but finance does not always play a good role

The value of financial activities lies in enhancing the efficiency of economic activities, thus carrying forward social development and progress. However, practice has proved that finance does not always live up to its positive potential. Since the 20th century, financial crises, recurring like a nightmare, remind people that finance may also exert impact or even devastate the economy. From 1929, when a financial crisis caused a global economic crisis, to 2008, when the American Financial Crisis spread around the world in a fierce manner and triggered global, economic recession, various financial crises have shown the negative role of finance in the economy and society. What's more, finance may also facilitate the uneven distribution of social wealth and inequality, etc. . Joseph Stiglitz, winner of the Nobel Prize in Economics, said that "Before the financial crisis (2008), 40% of all corporate profits flowed to financial sectors... The financial system is leading to social loss and private profitability... The economy is distorted"① . In 2013, Thomas Piketty, a French economist, published *Capital in the Twenty-first Century*, further associating the great industrial society marked by large capital and big finance with the ever-increasing gap between the rich and the poor in society. According to Piketty's study, since the Industrial Revolution, the increase in global capital income has been greater than that in labor income, and the rise of rentier wealth was greater than that of laborers wealth, thus resulting in more uneven distribution of social wealth and increasingly drastic polarization between the rich and the poor. Objectively, financial activities with the main function of helping rentiers realize the return on investment play an important role in the concentration of social wealth in the hands of a few.

In China, the financial industry also grabs the real economy

The situation in which the financial industry obtains huge profits seems to occur not only in capitalist countries but also in China. From 2010 to 2015, China's GDP growth rate has been declining. Meanwhile, the growth rate of net profits of China's major commercial banks has been falling, but always higher than that of GDP; and the proportion of profits of the financial industry to that of the whole society has been increasing by years, reaching one third in 2014, while profits in the financial industry have reached 96%, almost equal to that of

① Joseph Stiglitz. *The Price of Inequality* (*Chinese Version*) [M] . Beijing: China Machine Press, 2013.

industrial enterprises. From the data of China's listed companies in non-financial industries, from 2010 to 2014, except 2013, the total return on assets based on average earnings before interest and tax was essentially close to or even less than the one-year loan interest rate of banks, which suggests that it is not enough, even though all corporate profits are contributed to banks.

History and reality tell us that there is not a simple, positive correlation between financial development and stable economic growth with social harmonious development. So, what finance may be conducive to the harmonious and stable development of the society and economy? What finance will bring negative influence thereon? This is the issue we must address.

Enlightenment from *Finance and Good Society*— "Good Finance" and "Good Society"

Robert J. Shiller, winner of the Nobel Prize in Economics in 2013, published *Finance and Good Society*, which has inspired us to further think about the role of finance in the economy and society. In essence, financial activities convert the responsibility and obligation of mutual help between human beings into debts, which are naked cash relations. While regulating the surplus and deficiency in resources, financial activities that enable "money to beget money" also create positive feedback on wealth accumulation and make income distribution more uneven. Professor Shiller linked financial activities "pursuing money" with a good society and elevated finance to a moral height. He gave us an important revelation: Is there such a kind of finance that can contribute to the achievement of harmonious, stable development of the economy and society and the reduction of the polarization between the rich and the poor? Is such a kind of finance good finance? If finance appears in such a form, realizing a good society with the help of finance is not merely a dream.

Despite the different definitions, "Good Society" is subject to a common understanding that, in a good society, everyone who lives earnestly shall enjoy equal treatment and everyone who works hard shall have the opportunity to survive, develop and succeed. Therefore, the equity in a good society refers to not only fair results but also fair process, and is embodied not only in wealth distribution but also in the acquisition of self-development opportunities. "Harmony" and "development" are two key words in a good society, while "stagnation" and "polarization between the rich and the poor" are incompatible with a good society.

Good finance shall be conducive to the achievement of a good society. Since the core content of a good society is equity, especially the fair access to self-development opportunities, then good finance means that it is able to provide each competent person with the capital and financial services necessary to start a business, innovate and develop, and to give them fair development opportunities. Under good finance, financial services can benefit all entitled (qualified) individuals and enterprises on an equal basis, without any financial discrimination. Good finance may promote the harmonious development of society while offering fair financial services.

Good finance means that it is able to provide each competent person with the capital and financial services necessary for starting a business, innovate and develop, and to give them fair development opportunities

Finance is the lubricant of economic activities in nature. Through the reasonable allocation of resources, financial activities may help society create social wealth with maximum efficiency and achieve economic development; provide each competent person with the capital and financial services necessary to start a business, innovate and develop and give them fair development opportunities. Therefore, finance is borne with the innate gene for contributing to the realization of a good society. However, the gene cannot be realized until in an appropriate environment, which refers to a fully competitive market with highly symmetric information. A fully competitive market guides resources to flow to places where resources are scarce by virtue of prices, while highly symmetric information enables all individuals and enterprises eligible for social resources to get the needed social resources at reasonable prices, without any financial discrimination. Unfortunately, the above environment cannot be fully realized due to economic systems, technical levels and other factors. Hence, the allocation of social resources will be distorted on account of wrong pricing or information asymmetry, and the unfair distribution of financial rights will take shape, thus influencing people's access to the financial resources required for making a living and developing, and the development of the society. For this reason, it is not good finance. Under bad finance, relative to the financial needs of economic activities, financial services are excessive or insufficient in total amount and structure, which manifests as an imbalance between financial supply and demand.

In the language of economics, "good finance" will be interpreted as finance that can meet the needs of social and economic development in terms of the total amount and structure of financial services. Therefore, in economics, "good finance" shall ensure the balance between the supply and demand of financial services

So, we may, with the language of the "supply and demand" of financial services, interpret "good finance" as that: the finance can meet the needs of social and economic development in terms of the total amount and structure of financial services. "Meet" means that, with the proper system design, the supply of financial services rightly matches the demand thereof, without imbalance between supply and demand with regard to the total amount and structure. In this case, all individuals and departments can obtain deserved financial resources at reasonable prices, without financial discrimination. Following this logic, in economics, "good finance" shall ensure the balance between the supply and demand of financial services.

An unavoidable fact is that China is faced with serious structural imbalance in finance. Private enterprises, especially small and medium-sized private enterprises, which create 60% of GDP and account for 80% of urban employment, only enjoy 30% of the total bank credit, while medium and large-sized enterprises mainly engaging in state-owned economy occupy 60% of the total credit. If self-employed groups, farmers and consumers are also included in objects of financial services, the imbalance between the supply and demand existing in China's financial structure will be more serious, which is shown as medium and large-sized enterprises and the wealthy at the top of the pyramid receiving the best and excess financial services, while micro, small and medium-sized enterprises and the salaried class at the middle only share gravely inadequate financial services, and poor and vulnerable groups (including farmers) at the bottom of the pyramid are confronted with a serious lack of financial services. With overabundant financial resources for one side and insufficient financial resources for the other side, the pyramid of China's financial supply and demand is completely inverted, forming serious structural imbalance; as a result, the most dynamic and innovative micro, small and medium-sized enterprises lack financial services. If things continue this way, finance will have a serious, negative impact on economic development.

As defined by the World Bank, Inclusive Finance refers to a system providing financial services for all social groups, especially those rejected by the traditional financial system, via various channels. At present, the groups ignored (excluded) by the traditional financial system in China mainly include micro, small and medium-sized enterprises, groups of agriculture, rural areas and farmers, individual businesses, low-income groups in society, groups starting a business and the unemployed, and special groups (such as the disabled). At the present stage, China's Inclusive Finance refers to the system offering timely, convenient and differential financial services in an effective, comprehensive and continuous man-

Inclusive Finance refers to the system providing financial services for all social groups, especially those repelled by the formal financial system ner and at reasonable prices so as to service objects, including the above groups in need of financial services, based on the principle of equal opportunity and commercial sustainability and on the premise of affordable costs.

Inclusive Finance is good finance and needs every strength to be developed

It can be seen from the definition of Inclusive Finance that Inclusive Finance is good finance, because its social thought is to help the vulnerable groups, enable all social groups needing financial needs to get financial services that match abilities, and assist all individuals and groups in enjoying fair access to business resources and the fair opportunity for creating wealth. The economic results of Inclusive Finance are to guide financial resources to flow into the demand gap arising from the structural imbalance between financial supply and demand, thus adjusting the imbalance between the supply and demand of financial resources. Therefore, Inclusive Finance promotes the achievement of good finance and for this reason, great efforts shall be made to develop Inclusive Finance.

Inclusive Finance is featured with the equity of financial rights, the inclusiveness of service objects, the variability of service groups, the comprehensiveness and diversity of service products, the innovativeness of service means, the universality of participants, and sustainable development. In addition to the equity and inclusiveness mentioned, the so-called variability of service groups refers to the objects for which Inclusive Finance provides key assistance varying with the changes in objects ignored by mainstream finance. As the financial structure changes along with the economic structure, service objects that mainstream finance focuses on and ignores will also change accordingly; therefore, the groups that mainstream finance "discriminates against" may vary from countries at different stages of economic development and at different stages in the same country. Currently, such groups in China include not only low-income people and special groups, but also micro, small and medium-sized enterprises. The so-called comprehensiveness of service products refers to service products including fully-functional and multi-level financial services covering savings, insurance, transfer and remittance, agency, lease, mortgage and pensions, with a service scope far greater than the loan business of traditional microcredit. The so-called innovativeness of service means refers to Inclusive Finance fully embodying the innovation in systems, institutions, technologies, products, services and in other aspects, especially technological innovation. As embodied in China, the innovative application of Internet/Mobile Internet and big data technology in the field of Inclusive Finance facilitates the leap in the coverage and penetration rate of Inclusive Finance services, making convenient financial services with commercial sustainability available to everyone. The so-called universality of participants refers to, in the era of "Internet Plus", Inclusive Finance participants including not only financial institutions but also the public who directly take part in activities of small and micro finance through various convenient trading platforms, such as online P2P lending and crowd funding. The so-called sustainable development refers to Inclusive Finance not being the same as government funding, but operating in accordance with financial business principles, and with the requirement of repaying capital and interest. This may not only inspire customers' internal impetus for self-development but also realize the commercial sustainability of finance.

The development of international Inclusive Finance has undergone: (1) the infancy stage (from the 15th century to the 1970s), in which microcredit took initial shape; (2) the development stage (from 1970s to 1990s), in which microcredit developed steadily and healthily; (3) the growth stage (from 1990s to the early 21st century), in which microfinance was formed preliminarily; and (4) the developing stage (from the early 21st century to now), in which small and micro finance has been developing rapidly with Internet finance. The main modes of Inclusive Finance in developing countries are summed up as the Grameen Bank (hereinafter referred to as "GB") mode, Unit Desa (hereinafter referred to as "UD") mode of the Bank Rakyat Indonesia (hereinafter referred to as "BRI"), the BancoSol mode, the correspondent bank mode in Brazil, the mobile banking mode in Kenya, and the COLUMNA micro insurance plan in Guatemala, etc., and in developed countries: the American community bank mode, and the online P2P credit mode, etc.. The successful and typical practice of Inclusive Finance plays an important, enlightening role in the development of China's Inclusive Finance.

The development of China's Inclusive Finance is on the fast track

China's Inclusive Finance in the true sense began in the 1990s, starting from finance against poverty. With the help of the World Bank, the United Nations Development Programme (UNDP) and other international financial organizations, microcredit for poverty alleviation has been carried out, with the first batch of microcredit demonstration projects launched. From 2000 to 2005, China entered the developing stage of microfinance, in which China's Inclusive Finance was still focused in rural areas but had begun to pay attention to cities. Rural credit cooperatives, city commercial banks and other formal financial institutions began to enter the field of microcredit. The business scope was expanded from "poverty alleviation" to "serving general farmers and small and micro enterprises". Since 2005, China's Inclusive Finance gradually entered the stage of rapid growth. Along with the participation of small loan companies, village banks, Internet banks, online P2P lending platforms and other new financial organizations, service objects of Inclusive Finance have been extended from rural areas to cities and to micro, small and medium-sized enterprises rapidly.

In contrast to the rapid development of China's Inclusive Finance, "financial repression" and the infrastructure construction lagging behind become the two main obstacles affecting the development of Inclusive Finance.

"Financial repression" is the "intestinal obstruction" to the reasonable allocation of financial resources and the development of Inclusive Finance

One obstacle is financial repression. China's planned economic system, lasting for 30 years before 1979, and market-oriented transformation over 30 years thereafter constitute China's current financial system, featured with the monopoly of large banks in financial institutions and financial resources primarily subject to government adjustment. It is very difficult for the existing financial system to adapt to the development needs of Inclusive Finance that shall be inclusive, diversified, dynamic and innovative. This maladaptation is first embodied in the allocation of financial resources. Traditional finance, with more than 90% of social capital resources and financial human resources, provides services for large-sized enterprises and state-owned economy accounting for approximately 40% of all the enterprises in society. Due to serious mismatch of financial resources, Inclusive Finance must contend with more serious problems such as less capital, expensive capital, scarcity of talent and backward management during the development. The second embodiment is the "intestinal obstruction" to resource flow in financial repression. The first characteristic of financial repression is the interest rate control. Although, in 2013, China lifted the control over loan interest rates, the situation that the long-term interest rate control restricts the flow of financial resources to sectors with scarce financial resources will not be improved soon. The second characteristic of financial repression is the strict access system. Even though, in 2006, the China Banking Regulatory Commission (CBRC) began to encourage eligible private capital to participate in the banking industry, and in July 2013, the State Council issued the *Guiding Opinions*, proposing the establishment of private banks sponsored by private capital, approval is still very strict and, so far, only five private banks have been approved and established in China. This strict access system limits competition and protects monopoly so that traditional financial institutions that can easily obtain monopoly profits naturally have no intention of entering the field of Inclusive Finance. Financial repression hinders the adjustment to the mismatch of financial resources.

Infrastructure lagging behind results in the lack of market order in the activities of Inclusive Finance

The other obstacle is infrastructure construction lagging behind. The main problems in the infrastructure construction of the Inclusive Finance system include dated laws and supervision, and lagging construction of the social credit reporting system. Dated laws and supervision are mainly reflected in the lack of supervision laws and regulations on and supervision of new financial institutions, such as supervision of the issue that small loan companies that "only conduct the loan business without the deposit business" enjoy the legal status of non-bank financial institutions, and of Internet finance and other financial organizations, which may lead to more serious market disorder. The lagging construction of the social credit reporting system is manifested in the absence of credit reporting laws related to the social credit reporting system, such as the law on protection of personal privacy, which may affect the development of the social credit reporting system, especially the application of big data technology in the credit reporting system. Without the services of the third-party credit reporting agencies that have social credibility, government-led construction of the credit reporting system is extremely inefficient. Because of its characteristics, Inclusive Finance relies greatly on the social credit reporting system; accordingly, lagging construction of the credit reporting system may increase the risks in activities of Inclusive Finance and industrial costs.

Information asymmetry and asset mortgage of customer groups that Inclusive Finance serves determine the particularity of the credit risk control of small and micro loans

Like traditional finance, credit risk control in small and micro finance is the core of risk control, and the business characteristics of the customer groups of small and micro finance determine the particularity of credit risk control in small and micro loans. Compared with traditional finance, the customer groups of small and micro finance, first of all, face more serious information asymmetry. Due to small operation scale, low popularity, own big business risks, and the lack of verifiable and complete, standardized, financial information, they must adopt special credit risk identification methods, including paying frequent visits to customers, replacing financial information with a large number of non-financial information, emphasizing the collection of personal credit information of business owners, and paying attention to the dynamic information of borrowers. Secondly, in the absence of asset mortgage, loan security depends more on other means, including carrying out post-loan, real-time monitoring, requiring all kinds of guarantees (guarantees of professional guarantee companies, other individuals or enterprises, and joint guarantees of borrowers), a large amount of small-amount diversified investment made by financial institutions, and increasing loan interest rates to cover risks.

Small and micro finance requires the “real-time holographic image” of customers' behaviors, effective loan guarantee, small-amount diversified investment, and higher interest rates to cover risks

Therefore, compared with traditional financial loans, in terms of the identification and measurement of credit risks, small and micro finance lays more emphasis on the ability to collect and identify “soft” information and on the capacity of real-time monitoring on all information, which is called the capacity for a “real-time holographic image”. For management and control over credit risks, small and micro finance stresses the function of guarantees, especially the function of collective guarantees. In addition, small and micro finance emphasizes small-amount diversified investment in terms of investment decision-making, and interest rates covering risks in terms of pricing strategies. The small and micro finance's demand for a "real-time holographic image" determines its dependence on "ground forces" and on big-data credit reporting technology. The demand of small and micro finance for guarantees, especially joint guarantees, requires the improvement of guarantee ability and settlement of the principal-agency problem in joint guarantees of borrowers. The demand of small and micro finance for interest rates covering risks decides the intrinsic rationality of higher interest rates in Inclusive Finance.

Regional characteristics of small and micro financial institutions affect their selection of risk control modes

In practice, different financial institutions engaged in small and micro financial business form respective distinctive risk control modes according to their business regions. Large-sized financial institutions that conduct cross-regional operations tend to adopt the patterning, routing and modular credit factory risk-control mode to overcome the disadvantages, namely high labor costs and lack of ground forces. Regional financial institutions are apt to use the risk control mode of short-distance visits and the "four methods of diagnosis of traditional Chinese medicine science" to give full play to advantages of ground forces. Internet finance makes full use of the advantages of the real-time collection and analysis of network information, forming the risk control mode mainly relying on big data.

Risk control in small and micro finance greatly relies on the social credit reporting system

Why does risk control in small and micro finance depend greatly on the social credit reporting system? There are three reasons: firstly, considering the credit information characteristics of micro, small and medium-sized enterprises and individuals, if the identification of their credit risks is required, more emphasis shall be laid on non-financial information, dynamic information and personal information. By virtue of loan officers' short-distance visits, acquaintance circles and networks, borrowing groups, Internet big data and information, with other methods, small and micro financial institutions can solve the problems about information collection and identification to a certain extent. However, if powerful third-party credit reporting agencies with rich contents provide services for small and micro financial institutions, their own credit reporting costs may be greatly reduced and the social cost saved. Secondly, professional credit reporting agencies collect a large amount of information, including not only static verifiable information (hard information) from judicial organs, banks and personal resumes, but also dynamic soft information from life, friends, consumption and other aspects, and can better meet the demand of small and micro loan lending institutions for the "real-time holographic image" of borrowers' credit information. Thirdly, compared with customer groups of big finance, customer groups of small and micro finance have low popularity and high geographic mobility; in the case of an imperfect social credit reporting system, their reputation may suffer small damages arising from breach of contract (no one knows what bad things they have done), and bear low costs for malicious breach of contract. A social credit reporting system covering the whole country can significantly improve the damage to reputation and the cost for breach of contract, so as to reduce credit risks resulting from malicious breach of contract.

Big-data credit reporting, which meets the credit demands of small and micro loans, is of fundamental significance to the development of Inclusive Finance in China

Big-data credit reporting is the application of information technology in the credit reporting field. Obtaining real-time and dynamic information to supplement the lack of historic and static information, and perfecting a small amount of single-dimension information with a large amount of multi-dimension information are the main characteristics of big-data credit reporting. Given that it takes a real-time picture, complete with information of an object under credit reporting, using the breadth, accuracy and real-time nature of the volume of information, big-data credit reporting completely meets the small and micro finance demand for identifying the borrower's credit risks, and helps restrain the credit risks arising from malicious default for its social coverage. Therefore, speeding up the development of big-data credit reporting is of fundamental significance to Inclusive Finance which is materially featured by small and micro loans.

Big-data credit reporting will help quickly improve the backward situation of the credit reporting system in China and produce the effect of "overtaking on the bend", provided that there are perfect legal supervision systems

At present, the main problems concerning the lagging development of China's credit reporting system are concentrated in four aspects: narrow coverage of people in the credit reporting system; lagging legislation; inefficient government-led credit mode; lack of an information sharing mechanism and existence of serious information island problems. Entities in China currently engaged in big-data credit reporting are private enterprises engaged in e-commerce, Internet banking, social networking, data mining and other business activities based on Internet/Mobile Internet. These enterprises, operating in accordance with the market mechanism, and compensating for the low efficiency of the government-led credit model, bring vitality to the development of China's social credit industry. In addition, the coverage of people under big-data credit reporting rapidly increases with the rapid growth of network terminal users and in a period as short as one to two years, an even larger coverage than that obtained by the credit reporters that have been established by the government for more than ten years is witnessed. Furthermore, big-data credit reporting can take advantage of its multi-dimensional data sources and data cleaning, processing and matching technologies as well as the dynamic modeling technology to resolve the lack of information brought by the "information island" that has long affected the development of new undertakings in China.

Therefore, big-data credit reporting will help resolve the main problems currently existing in the credit reporting system in China, rapidly improve the backward situation of the social credit reporting industry in China, and produce the effect of "overtaking on the bend", provided that industry laws and regulations as well as supervision shall be perfected as soon as possible. Our times are distinctively characterized by technological, innovation-driven, institutional reforms. They are the challenges that legal and regulatory authorities must meet.

In this research report, we, in combination with six cases, specifically discuss the boundaries of microfinance, credit risk control in the small and micro finance engaged in by traditional banks, the balance mechanism for the dual goals of Inclusive Finance, the role of third-party mutual aid unions in solving financing difficulties of small and medium-sized enterprises, the development and problems of China's online P2P lending platforms, and credit support from big-data credit reporting for small and micro finance.

Microfinance, as an important part of Inclusive Finance, refers to financial activities mainly concerning loans of RMB 10,000 to RMB 100,000 (less than RMB 500,000). Plenty of practical experience has been accumulated internationally, and rich research achievements have been made in microfinance. At present, both microfinance and small and medium finance are the main components of Inclusive Finance in China. CFPA Microfinance is a non-profit organization engaged in microfinance.

Microfinance's upper boundary is a boundary between microfinance and traditional finance

Microfinance is a downward extension of the traditional financial client, and its upper boundary determines the essential differences between microfinance and mainstream finance in terms of customer orientation, credit lines, credit products, and risk control ways. For example, in terms of customer orientation, farmers form the main component of CFPA Microfinance's customer base; in terms of credit lines, a single credit line is mainly RMB 10, 000 to RMB 20, 000; credit products are primarily group lendings; risk control methods mainly include visits by loan officers in the case of close distances and mutual supervision within groups of group lending. CFPA Microfinance's loan officers giving priority to local farmers greatly reduces operating costs.

Microfinance's lower boundary is a boundary between microfinance and charity

Inclusive Finance is about benefits rather than favors. Inclusive Finance provides financial services for groups excluded by mainstream finance, thus achieving the effect of teaching one to fish rather than giving them a fish. This determines that Inclusive Finance is not for charity purposes. As an important part of Inclusive Finance, there is a lower boundary between microfinance and charity, which is the profit level to ensure the sustainable development of microfinance and the lowest loan rate of microfinance mainly engaged in loan activities. According to the research by the Consultative Group to Assist the Poor (CGAP) of the World Bank and MIX-Microfinance Information Exchange (CGAP, 2003), the average loan rate for microfinance institutions to achieve financial sustainability is 26%. In this case, researchers calculated the loan rate that must be offered by CFPA Microfinance to maintain a low margin of 1% based on the relevant data of CFPA Microfinance and, using the Rosenberg Model and the cost-plus pricing method, the result is almost equal to the actual loan rate of 20.64% of CFPA Microfinance. This demonstrates that CFPA Microfinance is basically in a state of financial self-sufficiency and that its loan rate is lower than the medium value of the world.

Generally, in China, small and micro finance refers to financial activities including microfinance and small and medium finance, or including loan programs of not more than RMB5 million in terms of credit lines. In China, small and micro finance is also an important part of Inclusive Finance. From the perspective of an upper boundary of microfinance, mainstream finance institutions must change their risk control modes if engaging in small and micro financial activities, otherwise they will make no headway. Given the large scale, multiple management levels and cross-regional operation of our traditional large commercial banks, the major obstacles for them to engage in small and micro finance are the higher costs of human resources and fewer teams in local outlets. This limitation requires Minsheng Bank and other financial institutions of its kind to choose an appropriate risk control mode by fostering strengths and circumventing weaknesses when engaging in the Inclusive Finance sector. Minsheng bank's advantages are having enough financial strengths and research ability and having the ability to make cross-regional investments aimed at risk diversification.

Minsheng Bank's 2. 0 version of small and micro finance weakens the pervious mode mainly featuring experience-based control and manual monitoring, and adopts data analysis models

After nearly four years of exploration, and with the popularization of the Internet/Mobile Internet and the development of big-data credit reporting technologies, Minsheng Bank is gradually transforming its risk control mode into a similar credit factory mode, emphasizing patterning, streamlining and standard risk control. As this kind of risk control mode is more dependent on data information, Minsheng Bank is enhancing its ability to expand the dimensions of data acquisition and to analyze and integrate data. Along with the transformation of the risk control mode, Minsheng Bank is making organizational structure adjustments by transferring the authority of grass roots sub-branches to branches and giving play to the role of branches as the brain and decision-making center under the credit factory mode. The transformation of

Minsheng Bank's risk control mode provides the experience for traditional banks to engage in small and micro finance.

How will microfinance realize the dual goals of social performance and financial performance

It is often difficult to balance Inclusive Finance's social goal of serving vulnerable groups and its goal of making financial profit. This becomes a major problem affecting the development of small and micro finance institutions. China's first wholly foreign-owned small loan company, MICROCRED, implements social performance management aimed at the social goal. At the same time, under the condition of resource constraints, through balancing the depth and breadth of services and balancing production efficiency and management efficiency, and on the premise of the effective control of operating costs, MICROCRED obtains financial profits by leveraging interest rates to achieve the financial goal, and thus builds an internal mechanism balancing both goals. MICROCRED's successful operation provides valuable experience for small and micro finance institutions to achieve both goals.

Third-party mutual aid union's innovation in solving the financing difficulties of small and medium-sized enterprises (SMEs)

Small and medium-sized enterprises are a special group of enterprises of neither large nor micro size. Being in a turning point of expansion and high-class management, this group is exposed to more risks as compared to micro-sized enterprises and medium and large-sized enterprises; meanwhile, due to fewer assets that can be mortgaged and lower information transparency, banks lack the means of resisting loan losses; due to low profits, banks have difficulty covering risks by high rates. Therefore, as compared to medium and large-sized enterprises and micro-sized enterprises, small and medium-sized enterprises are less popular with banks and other financial institutions and it is more difficult for them to get financed. The key to solving the financing difficulties of small and medium-sized enterprises is credit risk control. At present, China's financial institutions mainly offer small and medium-sized enterprises loans guaranteed mainly by specialized guarantee companies or other enterprises/individuals, or jointly guaranteed by borrowers.

However, there are different problems in all the existing guarantee methods. For example, guarantees by private guarantee companies are unstable; joint guarantees by borrowers (mutual guarantee) appointed by the lender involves a moral hazard in the self-management of trustees and risk contagion. The Zhengzhou "3+1" integrity union, guided by the idea of "being good and honest", realizes post-loan risk control by means of good faith points and risk evaluation, and through giving guidance to member enterprises on "self-organizing" management. At present, a financial services organization with functions of supervision, control, slow release, and transfer of credit risks in small and medium-sized enterprises has been initially formed.

Guarantees by private guarantee companies are unstable, and agents shall be involved in joint guarantee by borrowers

The "3+1" integrity union provides valuable experience for small and medium-sized enterprises in solving financing difficulties. Moreover, the "3+1" integrity union reflects the idea of good finance by its guiding ideology of "being good to help people" and the positive incentives that give priority to assistance rather than punishment.

The "3+1" integrity union reflects the idea of good finance by "being good to help people"

Online P2P lending (direct lending between individuals relying on the Internet) has created a new mode of lending transactions in the data age. Online P2P lending bypasses banks and other professional intermediaries and enables ultimate borrowers and ultimate lenders to directly meet with each other, thus reducing transaction costs and greatly increasing the utilization efficiency of funds. It creates a mass of modes of direct investment and financing between individuals in the field of lending, and is an important innovation in the Inclusive Finance sector.

P2P lending is an important innovation in the Inclusive Finance sector. Online P2P lending was introduced into China in

2007, and has been booming since 2013. The total loans offered through online P2P lending platforms in China amount to the largest in the world, and the number of such platforms is also the largest in the world, which are, however, accompanied by constant shutdowns or the escape of money and market disorder.

Original P2P lending platforms are platforms where transactions between borrowers and lenders are procured. But, this mode has been mutating constantly since its entry into China, which is reflected by the platforms being changed from simple information intermediaries aimed at procuring transactions into credit intermediaries aimed at ensuring the security and the compulsory exchange of funds, and from engaging in pure online transactions to engaging in both online and offline transactions, stepping on the red line of policy. Our research finds that the main reason leading to the Chinese-type variation of online P2P lending platforms is the critically lagging social credit reporting system, which affects the quality of information provided by the platforms and forces the platforms to provide security by way of exchange guarantee for attracting customers, and to develop customers and verify information via offline ways.

PPDAI has paid the price of low growth and high cost for its insistence on the original P2P business model of making no advances and engaging in pure online transactions

PPDAI was the first online P2P lending platform in China. It has stuck to the initial business model, acting as an information intermediary instead of a credit intermediary, in the eight years since its establishment. Persisting in neither providing users with principal security nor engaging in offline transactions, PPDAI has developed its own big-data credit reporting system in order to solve the problem of inadequate information. PPDAI has paid the price of low growth and high costs for its persistence.

Fortunately, regulatory policies followed PPDAI's persistence. The Guiding Opinions, signed in 2015 by ten ministries and commissions under the Central Government, affirm that online P2P lending platforms are information intermediaries for procuring direct lendings between individuals. PPDAI finally met the spring of development.

The regulatory blank is an important reason for disorder in the online P2P lending industry

During the eight years from 2007, when China's first online P2P lending platform appeared, to July 2015, there was no legal and regulatory supervision in the industry. The legal and regulatory vacuum led to the following: (1) the law abiding had no laws to rely on and could only practice on their own, thus constantly encroaching on the red line of financial regulation; (2) there were fraudsters disrupting the reputation and order of the industry; (3) it was more difficult for those who persisted to survive, causing the situation of "bad money driving out the good". On the contrary, in the USA, within less than two years of the USA's P2P lending market starting to work, in 2006, clear regulations and supervision came into force, in 2008.

The role of big-data credit reporting in promoting the social credit reporting system

On the one hand, the financial sector, especially small and micro finance, has great demand for third-party credit reporting services with credibility, and on the other hand, China's social credit reporting system is lagging far behind. The Internet, e-commerce, big data and other technologies provide opportunities for fast development of the credit reporting industry. Bairongzhixin forms effective risk assessment by relying on its own big data technology and retail, social networking, media, aviation, education, operators, brand owners and other online and offline multi-dimensional data sources.

The practice of Bairongzhixin has proved that big-data credit reporting technology can collect plenty of online and offline multi-dimensional information, use advanced data analysis technology to improve the effect of traditional credit reporting and risk assessment, and form credit reporting and credit assessment results with better quality, including anti-fraud technology services against malicious default risk. By its unique "dynamic information" mechanism, big-data credit reporting rapidly expands the coverage and alleviates the degree of information asymmetry in financial activities.