POLICYMAKING IN THE DIGITAL AGE

Mobile Banking in China

An opportunity for financial inclusion?

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INTRODUCTION

The development of China's financial system ran parallel to its larger market-oriented economic reforms launched in the late 1970s. Many experts argue that this has contributed to the financial inclusion of vulnerable groups on the margins of society. In 2005, China entered the fourth phase in the development of its financial system – 'increasing economic and social inclusion' – whereby the government has particularly focused on expanding financial services to sang nong (i.e. rural areas, agriculture and farmers) (ADBI, 2015).[1] However, China's financial sector, led by state controlled commercial banks, has primarily provided financial services to SOEs (State Owned Enterprises) and large corporations. The absence of consumer credit history and ratings adds to banks' reluctance to lend to individuals. Therefore, China's financial system still faces difficulty in financing MSMEs, rural households, low-wage workers (especially migrant workers), and the unemployed (e.g. laid-off workers from restructured SOEs and job seekers in urban areas) (CGAP, 2012). For instance, MSMEs and micro-entrepreneurs take up less than 30% of total bank credit (CAFI, 2016). Even when owning a bank account, these segments of the population may not access full range of financial services. Therefore, they often rely on informal networks and strategies to achieve financial sustainability.

1. The three previous phases were: Economic inclusion but stagnation and poverty (1949-1978), inclusive growth but increasing inequalities (1978-1993), slower growth but increasing exclusion (1993-2005) (ADBI, 2015, p. 9)

A study computing data from the World Bank and China's Ministry of Industry and Information Technology found that only 24.8% of rural residents use the Internet and only 6.14% of rural households transact via mobile technologies (Xiong and Turvey, 2013). However, in a separate and more recent study conducted in 2016 in Hubei and Guizhou provinces, Xiong and Turvey found out that 75% of rural households claim to be using Internet for less than five years, which corresponds to the rise of China's leading non-bank Internet payment companies, such as WeChat and Alipay (Xiong and Turvey, 2016). China, thus, makes a good fit for financial inclusion through mobile banking.

Drawing on primary research and secondary sources, this paper highlights key areas where the Chinese government could undertake initiatives to ensure that mobile finance foster financial inclusion instead of further marginalising underserved groups. This study finds out that despite a significant rate in the adoption of Internet and mobile banking, disparities between different socio-economic groups in using financial services through mobile banking still exists due to low levels of financial and digital literacy among the most disadvantaged groups. Moreover, mobile finance in China still remains largely unregulated and puts consumers at risk regarding data protection.

THE RISE OF MOBILE FINANCE IN CHINA: AN OVERVIEW

Since 2010, China has experienced a rise in the sector of mobile finance, primarily led by the two competitors that are Tencent and Alibaba. In 2011 Tencent, China's biggest gaming firm, launched WeChat, an instant messaging application. WeChat entered the financial realm in 2013, when Tencent created WeChat Pay, a virtual wallet connected to users' WeChat account. The new function has offered the possibility to make peer-to-peer

(P2P) money transfers, mobile payments, tax bills, etc. Likewise, Alipay is Alibaba's payment service created in 2004. Alibaba's digital payment capabilities have grown alongside its microlending activities. In June 2013, Alibaba addded to Alipay, 'Yu'e Bao', a market mutual fund pledging 8% return rates. WeChat then launched its own consumer investment fund in January 2014, 'Licaitong', offering an annualised return of about 7.34%. Both funds accept very small savings, while providing users with the possibility to make micro-loans, a service they have usually been denied by traditional banking institutions. To use WeChat and Alipay, however, users are required to link their bankcard to their WeChat/Alipay account. WeChat and Alipay currently have 846 million and 400 million monthly active users respectively.

RISKS AND OPPORTUNITIES OF MOBILE FINANCE

Mobile finance holds great promise in bringing financial service to the unbanked poor who are not profitable for commercial banks (Aron, 2017; Allen et al., 2016; Kendall and Voorhies, 2014). In China, mobile finance has primarily benefited individuals already enrolled in the formal financial system who are looking to open informal businesses. Through the establishment of mutual funds, WeChat and Alipay have expanded possibilities for entrepreneurs running informal businesses to take loans and accumulate personal savings. With regards to other segments of the informal economy, WeChat and Alipay have expanded the set of financial services available to them and created impetus for people to switch from informal saving options (storage of cash in the household, informal saving groups) to formal ones. Whilst the terms of inclusion are set by the formal sector and big high-tech companies (e.g. requirement to hold a formal bank account), mobile finance innovations in China has provided its users better terms compared to those using traditional banking system: higher interest rate on saving accounts, lower cost of financial services.

Mobile finance has had a limited impact on people who lack financial and digital literacy. Xiong and Turvey have skilfully demonstrated that mobile banking facilitates financial inclusion in rural China with regards to purchases, point of sales, and investment but not for borrowing and loans due to lack of financial literacy. In their study only 10.4% of surveyed households in rural areas had an understanding of financial matters, only 49% understand financial information such as 'loan interest rate' and 29% have no prior knowledge of financial products (Xiong and Turvey, 2016). These findings reveal that level of financial literacy remains low in rural areas. Further insights into the digital divide feature in a study on Chinese migrants conducted by Yu et al. The study found that Chinese migrant workers are partially "e-included" due to their lack of "motivational, intellectual, and social access". According to the authors, lack of information and communication technology (ICT), including mobile, education would be responsible for digital divide in China (Yu et al., 2016).

Further risks emerge with the new set of financial services offered by dominating tech companies, such as Tencent and Alibaba. First, it increases surveillance of customers and state's ability to control its population. WeChat and Alipay's database are gold mines for social control. China's Internet giants are collaborating with the government to build an encompassing Social Credit System by 2020. Second, it increases the likelihood of commercial capture. The amount of data produced by WeChat and Alipay consumers can be used from targeted advertising to product development. Third, as much as they satisfy customers' convenience, monopolies are a threat to consumers' agency. Their reliance on a single application opens door to manipulation and exploitation. The beginnings of this evolution can be seen in the recent introduction of fees for P2P transactions by Tencent. WeChat now charges users when they transfer money from their WeChat wallet to their bank account, thus incentivizing them to retain funds in their WeChat wallet.

POLICY IMPLICATIONS AND RECOMMENDATIONS

Mobile finance has facilitated financial inclusion in terms of access and quality. However, it has not benefited the different segments of the society evenly in terms of usage. Mobile finance has primarily created economic benefits for the upper tier as it improves micro-entrepreneurs financing channels. Therefore, mobile finance in China has reinforced existing fractures between various economic groups due to unequal levels of financial and digital literacy. This would ultimately make the already marginalised groups harder to reach and will lead to a fragmentation within the economy – those having sufficient financial and digital knowledge to enjoy financial services offered by non-bank commercial actors, while ill-informed groups remain excluded.

1. Develop educative policies to strengthen financial and digital literacy to support the adoption of mobile finance.

The fast adoption of mobile finance in China brings about challenges for people to acquire financial and digital knowledge. Further inclusion can be achieved in China if access to financial services is accompanied by educational policies on financial matters. The government could for instance set up a financial education curriculum for elementary, junior and high schools. Achieving a good understanding in financial services and management is a long-term objective, as it requires a change in public behaviour. Therefore, to measure the achievement of these policies, provincial or local governments could undertake regular financial literacy survey. The results of which would inform governments on the level of knowledge and utilisation of financial products and services.

2. Take advantage of the significant growth in mobile finance to extend formal financial system to unreachable groups.

Data from mobile banking could be used by the financial system to establish the financial identity for MSMEs and individuals and assess their creditworthiness. It would bridge the information gaps between financial services providers and small businesses. This development is already taking place as the Chinese government has granted the right, since 2015, to leading tech companies, such as Alibaba and Tencent to create their own credit rating system (premises of the Social Credit System). Yet, concerns about conflict of interest and uncertainty about the misuse of data by these digital disruptors has led the Chinese government to delay its licenses for these companies to run credit scoring systems. To facilitate the smooth expansion of financial services, the Chinese government should maintain/strengthen its intermediary role, i.e. to better supervise non-banking transactions and to ensure that non-banking actors and the incumbents in banking sector work together in a compliant and transparent way.

3. Develop a supportive regulatory framework to safeguard users' data protection and avoid commercial and political capture.

The exploitation of financial data should also be embedded in the set-up of supportive regulations. International experiences have demonstrated that mobile banking regulations are challenging traditional banking regulations. The regulatory framework should also focus on the protection of consumers' data. Since 2016 the government has initiated gradual measures to strengthen data protection. In 2016, the country's National Information Security Standardisation Technical Committee presented its draft national standards for the protection of personal information. The Cyber Law, which entered into force in June 2017, makes some provisions for the protection of personal data (Art. 22, 64). However, the law remains primarily concerned with censorship and the control of information as a means of social control. To fully achieve the digital transformation of the country, the Chinese government should introduce a comprehensive legal regime to effectively protect personal information and to enable citizens to hold both Internet companies and government authorities accountable.

4. Raise public awareness in prudential aspects of financial transactions and the risks posed by mobile finance, and ensure preparedness of good financial behaviour in the community.

The Chinese government has to enhance user education to foster security awareness over financial issues. In a survey conducted by the Boston Consulting Group (BCG) in 2013, only 63% of Chinese people considered their credit card data as "moderately or extremely private" against 83% in the UK, while only 50% of surveyed consumers regarded their financial data as "moderately or extremely private" against 87% in the UK. If financial inclusion through mobile finance is to be successful, China will have to ensure that all segments of its highly diversified population are aware of the financial risks of mobile banking, the rights and obligations of consumers, and the availability of complaints and dispute settlement mechanisms. Users vulnerability could be reduced through the delivery of security awareness training and the establishment of an independent authority that would monitor the activities of mobile banking providers, set up guidelines for Internet companies, and impose that required information is disclosed properly to the public. The presence of consumer groups in the auditing committee of this new authority would guarantee its independence.

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